LOCKHEED MARTIN CORPORATION » » »

2005 Annual Report

2005 Financial Highlights[1]

(In millions, except per share data and ratios)	**2005**	2004	2003
Net sales	**$37,213**	$35,526	$31,824
Operating profit from business segments	**3,432**	2,976	2,468
Consolidated operating profit	**2,986**	2,089	2,019
Net earnings	**1,825**	1,266	1,053
Earnings per diluted share	**4.10**	2.83	2.34
Average diluted common shares outstanding	**445.7**	447.1	450.0
Net cash provided by operating activities	**$ 3,194**	$ 2,924	$ 1,809
Cash dividends per common share	**1.05**	0.91	0.58
Cash, cash equivalents and short-term investments	**2,673**	1,456	1,250
Total assets	**27,744**	25,554	26,175
Total debt	**4,986**	5,119	6,208
Stockholders' equity	**$ 7,867**	$ 7,021	$ 6,756
Common shares outstanding at year-end	**432**	438	446
Debt-to-total-capital ratio	**39%**	42%	48%
Return on invested capital[2]	**14.5%**	10.8%	9.6%

NOTES:

[1]*For a discussion of matters affecting the comparability of the information presented above, refer to Management's Discussion and Analysis of Financial Condition and Results of Operations on pages 17 through 40 of this Annual Report.*

[2]*For additional information concerning return on invested capital, including its definition, use and revised method of calculation, see Note (f) to the Consolidated Financial Data—Five Year Summary on page 74 of this Annual Report.*

On the Cover: Lockheed Martin's Center for Innovation: Defining the Networked World, Delivering the Future

We Never Forget Who We're Working For » » »

Lockheed Martin's capabilities are aligned with the highest priorities of our customers in defense, homeland security and civil government agencies. As one company and one team, the 135,000 men and women of Lockheed Martin take pride in delivering the advanced technologies that protect liberty and promote progress for people worldwide.

LOCKHEED MARTIN

Dear Fellow Stockholders,

The solid execution of our business strategy in 2005 has yielded the strong financial results our stockholders expect from Lockheed Martin. We have in place a comprehensive strategy of disciplined growth as well as a culture of operational excellence, the ability to flex with dynamic market conditions and a leadership team that is focused squarely on making Lockheed Martin the preeminent global security enterprise.

In 2005, we achieved sales of $37.2 billion, a five percent increase over the previous year. Significantly, we can report earnings per share (EPS) of $4.10. In fact, our EPS has grown at a double-digit rate over the past four years. We also generated $3.2 billion in operating cash in 2005, providing this company with financial flexibility. Rounding out the picture, our balance sheet is healthy, demonstrated by a 39 percent debt-to-total-capital ratio.

Our revised calculation of Return on Invested Capital (ROIC), an important barometer of our financial performance and a key metric for evaluating executive incentive compensation, showed a 34 percent increase over 2004 to 14.5 percent in 2005.

We continue to execute a balanced cash deployment strategy by which a majority of our free cash flow will be returned to stockholders in the form of share repurchases and dividends. In 2005, we repurchased 19.7 million shares of our common stock, bringing the total stock repurchase to 46.1 million shares since 2002. We also increased the dividend by 20 percent, reflecting our commitment to pay an attractive, competitive dividend.

As we enter 2006, this management team is keenly aware that the world around us is changing at a rapid pace. Sitting still is never an option in our business, so we are solidifying our leadership position in traditional markets as well as gaining ground in new higher-growth areas. We know that to take advantage of the opportunities in the marketplace today, customer commitments must be a priority, and that means focusing on execution across the portfolio.

Our Systems and Information Technology (IT) businesses demonstrated particular momentum this year. With 50 percent of total sales coming from our Systems and IT group, we are pleased to report that we have achieved an impressive record. Lockheed Martin is the number one provider of Systems and IT to both defense and civil government agencies, and that leadership was strengthened last year as the National Archives and Records Administration selected Lockheed Martin to preserve and manage all its electronic records.

In the defense arena, Lockheed Martin continues to lead the way in building net-centric battlespace operations by delivering the tools that process and share information. The defense side of our business is also distinguished by the production of the world's only 5th Generation aircraft, as well as advanced space and missile systems that help our forces and allies maintain a military advantage on the front lines. We also provide a wide range of technologies and systems that extend beyond combat power—missions that include peacekeeping and humanitarian relief.

It is increasingly important to envision applications of these game-changing technologies for critical homeland security and civil government IT requirements. In one example of this forward thinking, we

Facing Page: Robert J. Stevens, *Chairman, President and Chief Executive Officer*

successfully leveraged the Systems and IT expertise resident across the enterprise to offer the New York Metropolitan Transit Authority the best design for a critical infrastructure protection system. This project will integrate command, control and communications capabilities throughout the entire New York City and suburban transit system.

Winning and delivering on this vital domestic security contract, as well as other complex systems efforts, requires that we adhere to our strategy of Horizontal Integration, in which we align ourselves internally and apply our resources to provide the best solutions for our customers' challenges. Horizontal Integration also means teaming effectively across the global supply chain—to remain the industry partner of choice in the United States and more than 50 other countries.

Organizing the right teams and resources was the rationale behind establishing our Maritime Surveillance Enterprise in 2005. This corporate-wide effort to support the Navy's maritime patrol and reconnaissance mission mobilizes the expertise we need to perform at our peak on existing programs and to capture new business.

As we continue to transform Lockheed Martin into a fully networked global security enterprise, we can point with great pride to the opening of our Center for Innovation in April 2005.

Located in Suffolk, Virginia, the Center for Innovation is an advanced laboratory dedicated to experimentation, simulation and analysis. The Center for Innovation is backed by a nationwide network of our best labs and brightest minds, burnishing Lockheed Martin's credentials as a technology and business innovator; it is a position that we must not cede to any of our competitors. In the long run, we believe the Center for Innovation will support our goal to add new business orders and grow our backlog.

In a time of vigorous competition, the advantage goes to the company with foresight and creative thinking. Although we are not a helicopter manufacturer, we were selected in 2005 to lead the VH-71 Presidential Helicopter program. Our team also laid the keel for the U.S. Navy's first advanced Littoral Combat Ship in 2005, although we are not a shipbuilder. These accomplishments are indicative of our people—their brainpower and unyielding passion to invent, perfect, perform and team with partners to create best value solutions.

Significant milestones in 2005 also included:

- We are on track for the first flight of the F-35 Joint Strike Fighter later this year, as the majority of this aircraft's structural assembly was completed in 2005.
- The F-22 Raptor reached Initial Operational Capability in 2005. Together, the F-22 and the F-35 will ensure air dominance for the U.S. military and joint forces against threats for the next 40 years.
- The Federal Aviation Administration began use of our Advanced Technologies and Oceanic Procedures (ATOP) system, which will increase the capacity and efficiency of international air travel. Sixty percent of the world's air traffic is controlled by our air traffic management systems.
- We received the first international orders for the combat-proven Patriot Advanced Capability-3 (PAC-3) missile from The Netherlands and Japan.
- Lockheed Martin was selected to process information gathered for the Year 2010 U.S. Census, building on our success on the Year 2000 U.S. Census and the 2001 U.K. Census.
- The venerable Titan IV celebrated 50 years of success with its historic final launch on October 19. We also celebrated 50 years of unmatched performance of the U-2 which continues to provide high-altitude reconnaissance for our national security.
- The C-130J transport aircraft, being deployed in southwest Asia, achieved a major performance milestone by completing operational testing. It is a significant step to finalizing the U.S. Air Force's Operational Test & Evaluation.

In 2005, we also announced a joint venture with The Boeing Company to combine our respective production and launch operations associated with U.S. government launches. Structured as a 50-50 joint venture, the United Launch Alliance will provide our national security and NASA launch customers with assured access to space at a lower cost to the taxpayers. Recognizing budgetary pressures and the need for greater efficiencies, the United Launch Alliance will eliminate duplicate infrastructure and enhance reliability. As of this writing, we are awaiting government approval of the joint venture.

Portfolio shaping in 2005 included selective acquisitions designed to bolster our presence in the important arena of net-centric and IT technologies, both for defense and civil government applications.

We acquired The SYTEX Group, Inc. which provides information technology and technical support services to the Department of Defense and other federal agencies. SYTEX, which specializes in information warfare, network security solutions and integrated logistics, offers access to new customers and should provide appropriate financial returns to the shareholders.

We acquired two companies in the United Kingdom, expanding Lockheed Martin's commitment to a critical ally and the world's second largest defense market. STASYS Ltd. specializes in network communications, defense interoperability, simulation and air traffic management consulting. INSYS Group Ltd. is a diversified supplier of military communications systems, weapons systems and advanced analysis services.

In addition, we acquired Coherent Technologies Inc., a Colorado-based developer of high-performance laser-based remote sensing systems, and announced our intention to acquire Aspen Systems Corp., an information management company with experience in delivering IT products to the federal government.

The financial and operational muscularity of this Corporation is a testament to the full-spectrum leadership that our 135,000 employees bring to the table. Anticipating future opportunities demands leaders who drive operational excellence. These are men and women who set the course, energize their teams and lead them toward their goal.

Full spectrum leaders operate as one team, and they take the high road distinguished by a dedication to ethics, superlative corporate governance, integrity and accountability. We conduct consistent ethics training for every Lockheed Martin employee, embedding these rigorous standards deep into the fabric of the Corporation.

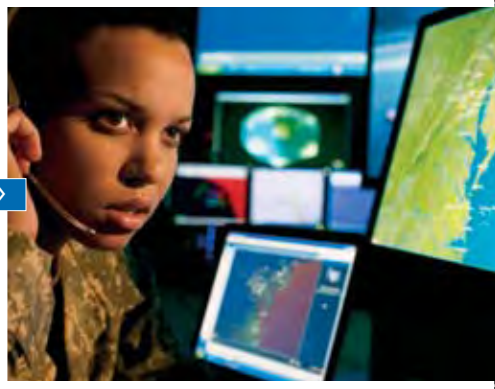
We are an enterprise that embraces the diversity of its workforce and a commitment to hiring the best talent. As the employer of choice, Lockheed Martin is a company of more than 65,000 scientists and engineers.

I was particularly gratified to witness the generosity and compassion of the men and women of Lockheed Martin as they responded to the tragic events of the past year. Lockheed Martin and its employees contributed well over $5 million for relief to victims of the tsunami, earthquake in Pakistan and in the aftermath of hurricanes Katrina and Rita. Lockheed Martin people also lent their support to our troops overseas through our partnership with Operation USO Care Package.

In closing, we at Lockheed Martin are confident that we can continue to build on the progress we have made in the interest of our customers, partners, employees, stockholders and our country. Tremendous possibilities lie ahead for all of us and we will work tirelessly to bring them to fruition.

March 1, 2006

Robert J. Stevens
Chairman, President and Chief Executive Officer



F-35 Simulator:
The Virtual Battlespace.

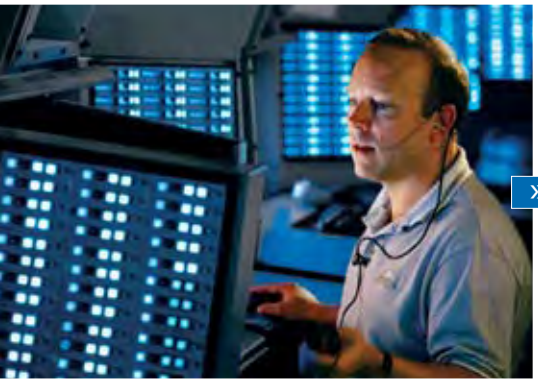
Partners in
Homeland Security.

Joint Force Protection:
Achieving Information Superiority.

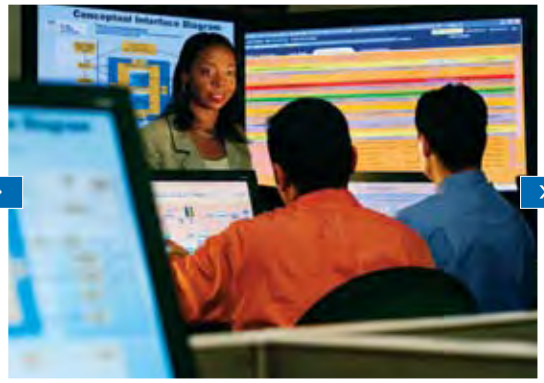
Powered by Innovation

» » » The men and women of Lockheed Martin are driven by a passion for invention in both technology and business. In April 2005, we opened the Center for Innovation, an advanced laboratory dedicated to experimentation, information integration and analysis. At the Center for Innovation, we are collaborating with our customers in testing potential solutions in a fully net-centric environment in order to address today's critical defense and homeland security challenges.

Backed by a nationwide network of our best labs and brightest minds, the Center for Innovation is a beacon for inventive thinking and cutting-edge technology.



Clear Skies: The FAA's Automated Flight Services Station.



Digital Speed: IT Services for the Social Security Administration.

Preserving Our Heritage: National Archives and Records Administration.

Forward Thinking

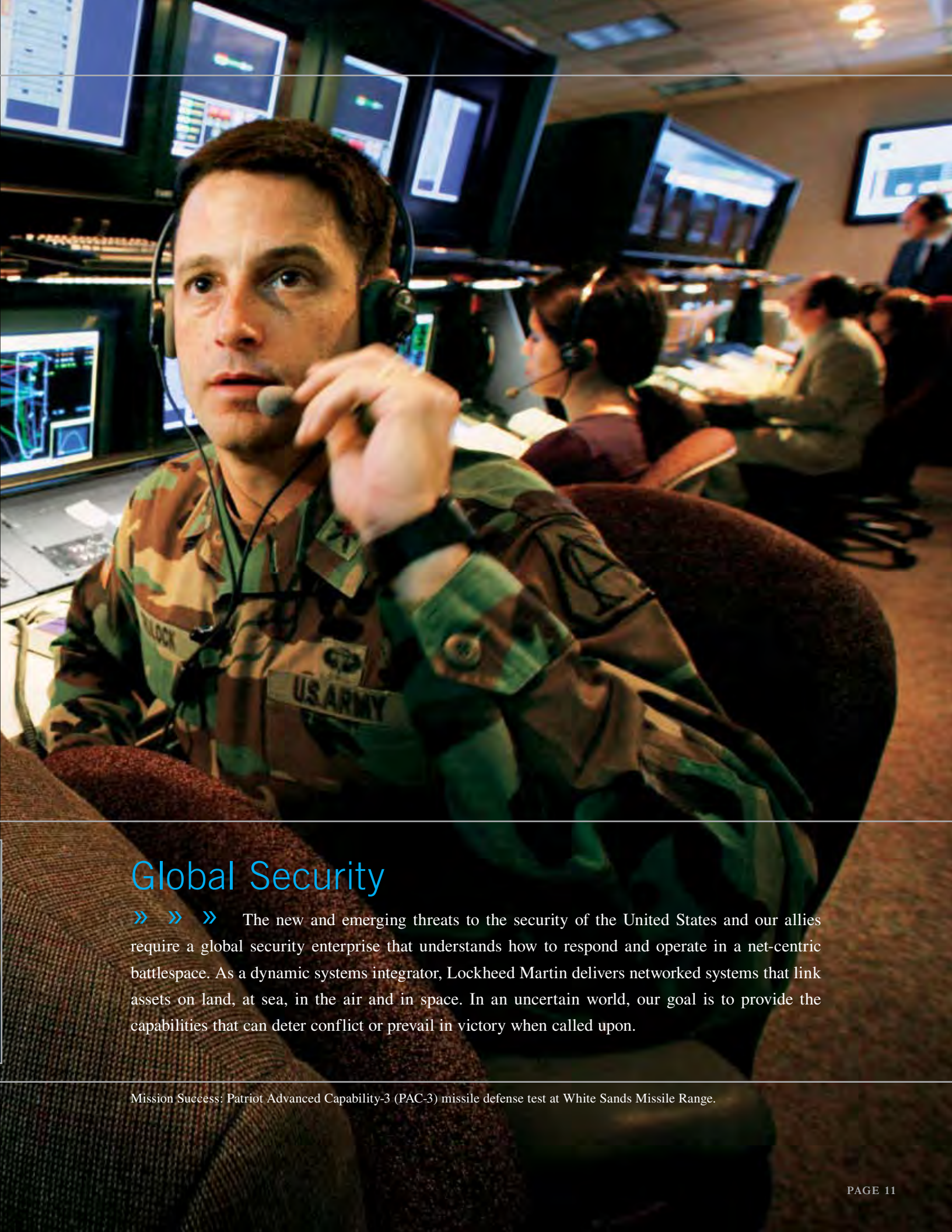
» » » With extensive Systems & Information Technology capabilities, Lockheed Martin has earned a reputation as the number one provider of IT solutions to the Federal Government. At Lockheed Martin, we apply this expertise to the pressing demands of our customers in defense, homeland security and civil government. As a result, we require people committed to forward thinking who can mobilize resources and talent resident throughout the Corporation.

In a significant domestic security initiative, the New York Metropolitan Transit Authority selected Lockheed Martin to design and build its infrastructure protection system.

The High Ground:
The Mobile User Objective System (MUOS) satellite will transmit vital data to mobile forces worldwide.

London Police:
Utilizing networks to protect the public.

Sniper XR: Providing pilots with the most capable and maintainable targeting system in the world.



Global Security

» » » The new and emerging threats to the security of the United States and our allies require a global security enterprise that understands how to respond and operate in a net-centric battlespace. As a dynamic systems integrator, Lockheed Martin delivers networked systems that link assets on land, at sea, in the air and in space. In an uncertain world, our goal is to provide the capabilities that can deter conflict or prevail in victory when called upon.

Mission Success: Patriot Advanced Capability-3 (PAC-3) missile defense test at White Sands Missile Range.

VH-71 Helicopter:
Lockheed Martin leads the team to build and integrate the new fleet of Marine One helicopters for the President of the United States.

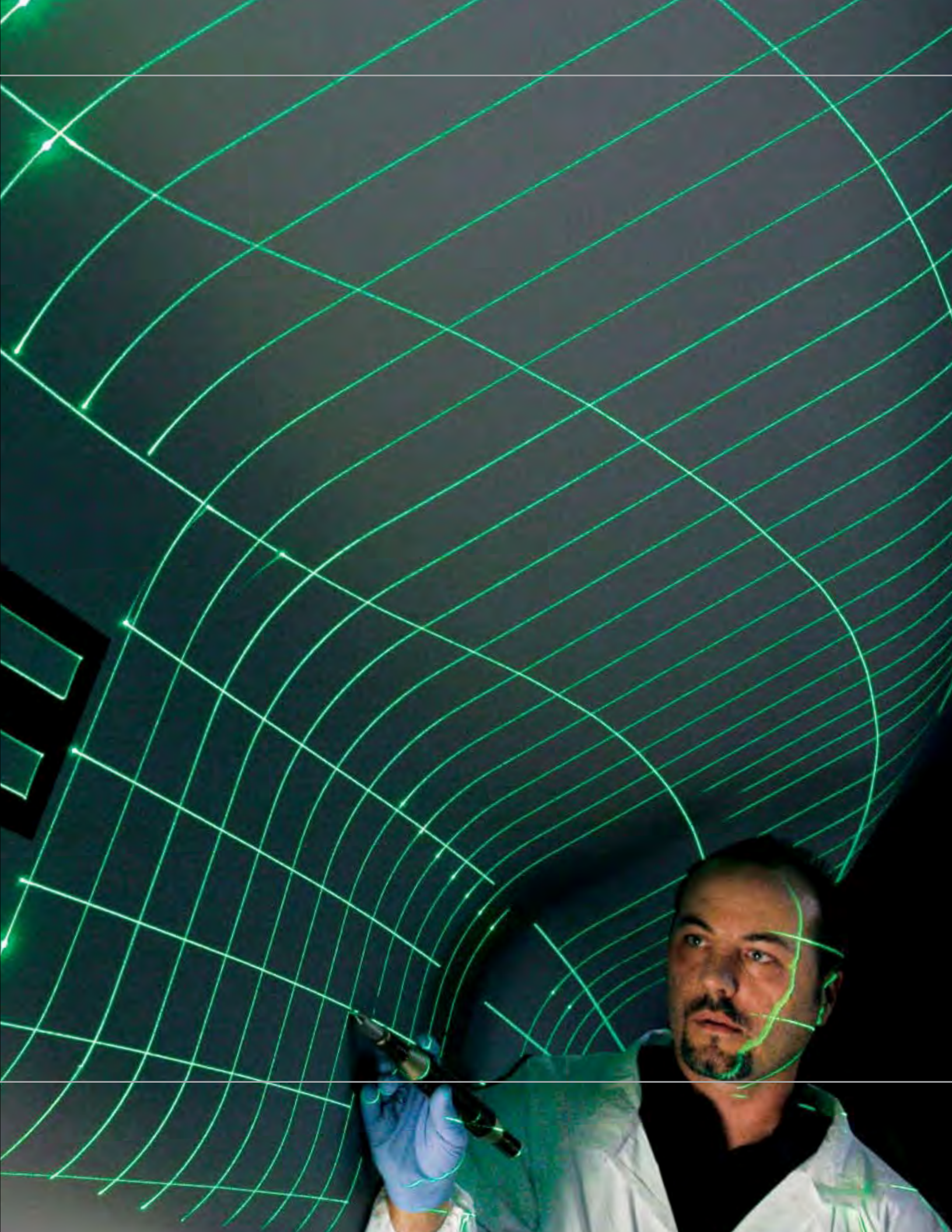
Redefining customer service for the U.K. Royal Mail.

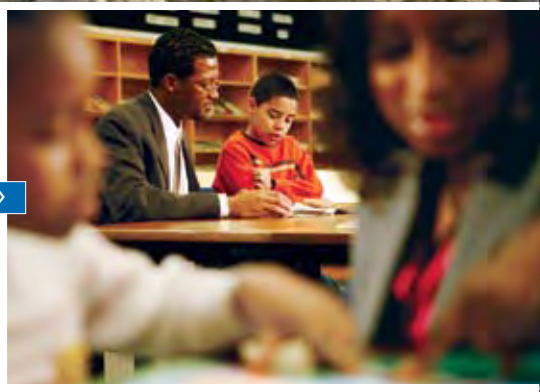
F-22 Support Center: Building a net-centric platform for air dominance in the 21st century.

Horizontal Integration

» » » As a company that takes Horizontal Integration seriously, we combine talented people across the breadth of Lockheed Martin to invent, perfect and perform. In addition to promoting internal collaboration, Horizontal Integration means organizing across the industrial base, to remain the industry partner of choice in the United States and in more than 50 countries. Whatever the challenge, our approach is straightforward: One Company, One Team.

The F-35 is a truly transformational aircraft with variants that will satisfy future requirements of the U.S. Air Force, Navy and Marine Corps as well as the U.K. Royal Air Force and Royal Navy. Aside from the United Kingdom, international participants on this combat aircraft program include Italy, The Netherlands, Turkey, Canada, Australia, Denmark and Norway. Here lasers are used in F-35 advanced manufacturing.





In partnership with the USO, Lockheed Martin employees prepare much appreciated care packages for our troops overseas.

We bring our skills back to the communities in which we live and work through mentoring and other educational initiatives. We support local math, science, engineering and computer sciences programs from elementary education through the university level with grants.

Guided by Integrity

» » » At Lockheed Martin we are motivated by a commitment to ethical business conduct and superlative corporate governance at every level of the organization. There also is a steadfast belief at Lockheed Martin that we are a company of 135,000 individuals working to build a better world through support for education, our communities, and our military men and women. Whether partnering with the USO or assisting those in need after natural disasters, Lockheed Martin people respond with generosity and compassion.

Lockheed Martin employees pitched in with their time and their money to help those communities affected by the tsunami as well as hurricanes Katrina and Rita. These employee volunteers made a difference in the aftermath of hurricane Katrina.

Financial Section

Lockheed Martin Corporation, 2005 Annual Report

2005 Financial Highlights	Inside Front Cover
Management's Discussion and Analysis of Financial Condition and Results of Operations	17
Management's Report on the Financial Statements and Internal Control Over Financial Reporting	41
Report of Ernst & Young LLP, Independent Registered Public Accounting Firm, Regarding Internal Control Over Financial Reporting	42
Report of Ernst & Young LLP, Independent Registered Public Accounting Firm, on the Audited Consolidated Financial Statements	43
Audited Consolidated Financial Statements:	
Consolidated Statement of Earnings	44
Consolidated Balance Sheet	45
Consolidated Statement of Cash Flows	46
Consolidated Statement of Stockholders' Equity	47
Notes to Consolidated Financial Statements	48
Consolidated Financial Data—Five Year Summary	73
Corporate Directory	75
General Information	77
Forward-Looking Statements—Safe Harbor Provisions	78

FINANCIAL SECTION ROADMAP

The financial section of our Annual Report includes management's discussion and analysis, our consolidated financial statements, notes to those financial statements and a five-year summary of financial information. We have prepared the following summary, or "roadmap," to assist in your review of the financial section. It is designed to give you an overview of our company and focus your review by directing you to some of the more important activities and events that occurred this year.

Lockheed Martin's Business

Lockheed Martin Corporation principally researches, designs, develops, manufactures, integrates, operates and sustains advanced technology systems, products and services. We mainly serve customers in domestic and international defense, civil agencies, and homeland security. Our sales to agencies of the U.S. Government represented 85% of our sales in 2005. Of the remaining 15% of sales, approximately 13% related to sales to international customers, with the remainder attributable to commercial customers. In 2004 and 2003, sales to agencies of the U.S. Government represented 80% and 78% of our total sales, respectively. Our main areas of focus are in defense, space, intelligence/homeland security, and government information technology.

We operate in five principal business segments: Aeronautics, Electronic Systems, Space Systems, Integrated Systems & Solutions (IS&S), and Information & Technology Services (I&TS). As a lead systems integrator, our products and services range from electronics and information systems, including integrated net-centric solutions, to missiles, aircraft, spacecraft and launch services.

Financial Section Overview

The financial section includes the following:

Management's discussion and analysis, or MD&A *(pages 17 through 40)*—provides management's view about industry trends, risks and uncertainties relating to Lockheed Martin, accounting policies that we view as critical in light of our business, our results of operations, including discussions about the key performance drivers of each of our business segments, our financial position and cash flows, commitments and contingencies, important events or transactions that have occurred over the last three years, and forward-looking information, as appropriate.

Reports related to the financial statements and internal control over financial reporting *(pages 41 through 43)*—include the following:

- A report from management, indicating our responsibility for financial reporting, the financial statements, and the system of internal control over financial reporting and an assessment of the effectiveness of those controls;
- A report from Ernst & Young LLP, an independent registered public accounting firm, including their opinions on management's assessment of internal control over financial reporting and the effectiveness of internal control over financial reporting; and
- A report from Ernst & Young LLP, including their opinion on the fair presentation of our financial statements based on their audits.

Financial statements *(pages 44 through 47)*—include our consolidated statements of earnings, cash flows and stockholders' equity for each of the last three years, and our balance sheet as of the end of the last two years. Our financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP).

Notes to the financial statements *(pages 48 through 72)*—provide insight into and are an integral part of our financial statements. The notes contain explanations of our significant accounting policies, details about certain of the captions on the financial statements, information about significant events or transactions that have occurred, discussions about legal proceedings, commitments and contingencies, and selected financial information relating to our business segments. The notes to the financial statements also are prepared in accordance with GAAP.

Highlights

The financial section of our Annual Report describes our ongoing operations, including discussions about particular lines of business or programs, our ability to finance our operating activities, and trends and uncertainties in our industry and how they might affect our future operations. We also discuss those items affecting our results that were not considered in senior management's assessment of the operating performance of our business segments. We separately disclose these items to assist in your evaluation of our overall operating performance and financial condition of the consolidated company. We would like to draw your attention to the following items disclosed in this financial section and where you will find them:

Topic	Location(s)
Critical accounting policies:	
Contract accounting/ revenue recognition	Page 22 and page 50
Postretirement benefit plans	Page 24 and page 61
Environmental matters	Page 26, page 50 and page 68
Discussion of business segments	Page 28 and page 69
Liquidity and cash flows	Page 34 and page 46
Capital structure and resources	Page 35, page 45, page 47 and page 59
Legal proceedings, commitments and contingencies	Page 37 and page 66
Stock-based compensation	Page 38, page 51 and page 60

INDUSTRY CONSIDERATIONS

Department of Defense Business

Customer requirements for defense and related advanced technology systems for 2006 and beyond will continue to be affected by the global war on terrorism through the continued need for military missions and reconstruction efforts in Iraq and Afghanistan and the related fiscal consequences of war. The war on terrorism has focused greater attention on the security of our homeland and better communication and interoperability between law enforcement, civil government agencies, intelligence agencies and our military services. At the same time, our nation's overall defense posture continues to move toward a more joint-capabilities-based structure, which creates the ability for a more flexible response with greater force mobility, stronger space capabilities, enhanced missile defense and improved information systems capabilities and security.

The U.S. Department of Defense (DoD) recently completed the Congressionally mandated 2006 Quadrennial Defense Review (QDR). The QDR continues and accelerates the DoD's prior commitment to a transformation of the military to focus more on the needs of its combatant commanders and to develop portfolios of joint capabilities rather than stove-piped programs. This movement towards horizontally-integrated structures is expected to become an organizing principle for the DoD in making investment decisions for future systems. We formed the Integrated Systems & Solutions business segment in 2003 to help us better focus our integrated solutions capabilities across the Corporation and enhance our ability to serve as a lead partner with the DoD. In 2005, we opened our Center for Innovation, a state-of-the-art facility for modeling and simulating our net-centric solutions for our customers.

The President's budget proposal for fiscal year 2007 and beyond presents a framework to reduce the federal budget deficit while prosecuting the global war on terrorism. The DoD budget is growing, but at lower levels than in the past few years, in order to continue the modernization and recapitalization that began earlier this decade. The budget for the Department of Homeland Security is increasing, while spending across other non-defense federal agencies is anticipated to decline through 2011. These changes in the President's budget plan reflect a commitment to a 50% reduction in the federal budget deficit by 2009, and the sentiment expressed by the Federal Reserve that sustained federal deficits could hamper economic growth.

The President's budget proposal includes $439 billion for the DoD, including $84 billion for procurement of systems and $73 billion for research and development. Transformation of the DoD enterprise and accompanying budget pressures also may create additional opportunities for supply chain logistics, business process management and outsourcing of service functions by the military services, expanding the scope of private sector contracting opportunities at the DoD.

The Fiscal Year 2007-2011 Future Years Defense Plan (FYDP) projects sustained growth in the DoD's top line budget, rising from $439 billion in 2007 to $502 billion in 2011. These estimates do not include any allowance to fund ongoing military operations in Iraq, Afghanistan and the global war on terrorism, which are expected to be addressed through annual supplemental appropriations as required. The DoD's continued emphasis on systems modernization is reflected in the proposed growth in the FYDP for Procurement, which is

estimated to increase from $84 billion in 2007 to $118 billion in 2011. Research, Development, Test and Engineering (RDT&E) spending will remain roughly the same during this period, ranging from $73 billion in 2007 to $75 billion in 2009, declining then to $71 billion in 2011.

While subject to change in future specific budget submissions and annual appropriation by Congress, these estimates continue the Administration's long stated intent to modernize the Armed Forces while prosecuting the war on terrorism. The differing trends in Procurement and RDT&E budgets reflect the maturation of programs emerging from RDT&E funding into procurement, such as the F-35 program.

In the past two years, Congress provided for supplemental appropriations to defray costs for Operation Iraqi Freedom and Operation Enduring Freedom in Afghanistan. Approximately $50 billion has already been provided relative to 2006 and another $70 billion has been requested. These supplemental appropriations have enabled the DoD to proceed on critical modernization and acquisition programs, versus using amounts available for those programs to pay for the Iraq and Afghanistan missions. While there is no assurance that additional supplemental appropriations will be approved by Congress, we do not believe that sustained operations in Iraq and Afghanistan will materially impact the procurement and research and development budget in the near term.

We believe that our broad mix of programs and capabilities positions us favorably to support the future needs of the various agencies of the U.S. Government in defense and information technology. Our major programs and capabilities include: missile defense; space intelligence; command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR); air mobility aircraft; and air-power projection/precision-strike capability. In terms of size and long-term potential impact, two of our more significant programs are the F-22 Raptor and the F-35 Joint Strike Fighter. The Air Force approved the F-22 for full rate production, declared initial operational capability and rated the F-22 "mission capable" based on successful completion of operational testing. The DoD plans to continue production of the F-22 through 2011 to coincide with the anticipated production of the F-35 to avoid a gap in 5TH Generation fighter stealth and advanced avionics capabilities. While the ultimate number of F-35s to be produced will continue to be subject to debate, the QDR and budget indicate support for the program.

We are also represented in almost every aspect of land, sea, air and space-based missile defense, including the AEGIS Weapon System program, the Medium Extended Air Defense System (MEADS), the Patriot Advanced Capability (PAC-3) missile program, the Terminal High Altitude Area Defense (THAAD) system, and the Multiple Kill Vehicle program. In the areas of space intelligence and information superiority, we have leadership positions on programs such as the TSAT Mission Operations System (TMOS), Mobile User Objective System (MUOS), the Advanced Extremely High Frequency (AEHF) system, and the Space-Based Infrared System-High (SBIRS-H), and in classified programs and battle management command and control capabilities. In airlift, we have the C-130J program and are under contract to upgrade the C-5 strategic airlift aircraft. Many of the aforementioned programs require funding over several budget cycles. There is always an inherent risk that these and other large, highly visible programs which are subject to annual appropriation by Congress could become potential targets for future reductions or elimination of funding to pay for other programs.

We continually explore opportunities to expand into adjacent product lines utilizing our existing advanced technology products and services, and have been successful in doing so through such programs as the Littoral Combat Ship and Marine One U.S. Presidential Helicopter programs. We also are continuing to pursue opportunities to expand our sustainment and logistical support activities to enhance the longevity of the systems procured by our customers. In addition, we have focused our efforts on select acquisitions, cost savings and improving efficiency. Through these activities, we have been able to pass along savings to our customers, mainly the U.S. Government.

Non-Department of Defense Business

We provide products and services to a number of government agencies other than the DoD, including the Departments of Homeland Security, Justice, Commerce, Health and Human Services and Energy, the U.S. Postal Service, the Social Security Administration, the Federal Aviation Administration, the National Aeronautics and Space Administration (NASA), the Environmental Protection Agency (EPA) and the Library of Congress. Although our lines of business addressing civil government needs are not dependent on defense budgets, they share many of the same risks as our defense businesses, as well as other risks unique to the particular programs.

For example, although indemnification by the U.S. Government to cover potential claims or liabilities resulting from a failure of technologies developed and deployed may be available in some instances for our defense businesses, U.S. Government indemnification may not be available for homeland security purposes. While we maintain insurance for some business risks, it is not possible to obtain coverage to protect against all operational risks and liabilities. We do plan to seek, and in certain cases have obtained, limitation of such potential liabilities related to the sale and use of our homeland security products and services through qualification by the Department of Homeland Security under the "SAFETY Act" provisions of the Homeland Security Act of 2002. In the event we were to provide homeland security-related products and services to a customer without such qualification, we would not be afforded the benefit of the SAFETY Act's cap on tort liability or U.S. Government indemnification. In addition, our information technology products and services related to Homeland Security may raise potential liabilities associated with privacy issues for which neither indemnification nor SAFETY Act coverage is available. Other risks unique to civil government programs may include development of competing products, technological feasibility and product obsolescence.

We have continued to expand our capabilities in critical intelligence, knowledge management and E-Government solutions for our customers, including the Social Security Administration and the EPA, as well for the DoD. We also provide program management, business strategy and consulting, complex systems development and maintenance, complete lifecycle software support, information assurance and enterprise solutions. Consistent with the President's agenda, the expected growth in business process outsourcing has been enabled by rule changes for public/private competitions. Such a competition led to the selection in 2005 of Lockheed Martin to operate the Federal Aviation Administration's Automated Flight Services Station Network. In addition, recent trends continue to indicate an increase in demand by federal and civil government agencies for upgrading and investing in new information technology systems and solutions. As a result, we continue to focus our resources in support of infrastructure modernization that allows for interoperability and communication across agencies.

In addition, the increase in emphasis on homeland security may increase demand for our capabilities in areas such as air traffic management, ports and waterways security, biohazard detection systems for postal equipment, information systems security and other global security systems solutions.

We provide products and services to NASA, including the Space Shuttle program, mainly through our Space Systems and Information & Technology Services business segments. We also have a 50% equity interest in United Space Alliance, LLC which provides ground processing and other operational services to the Space Shuttle program. We expect to compete for NASA programs related to the next generation manned space exploration program.

Non-U.S. defense budgets have generally been flat or declining over the past decade. As a result, consolidation has been occurring in the European aerospace industry, resulting in fewer but larger and more capable competitors.

Space Business

Sales of commercial launch vehicles and satellites continues to be very competitive due mainly to low demand for new satellites as a result of excess capacity in the telecommunications industry. The reduction in demand has resulted in pricing pressures for both launch vehicles and satellites. Despite this environment, we did receive new orders for commercial satellites and launch vehicles in both 2004 and 2005. For a discussion of the results of operations of our Space Systems segment, see the "Discussion of Business Segments" section.

The above factors have impacted orders for the Evolved Expendable Launch Vehicle (EELV or Atlas V), our next generation launch vehicle program in which we have made significant investments over the past few years. The Atlas V is available for both commercial and U.S. Government use. This program has required investment of funds for research and development, start-up and other nonrecurring costs, and launch facilities. Some of these expenditures have been funded under an agreement with the U.S. Government.

We have received a total of 19 launch assignments from the U.S. Government, nine of which are under contract and in backlog. The 19 launch assignments include seven that were reassigned in 2003 from the original EELV competition (referred to as "Buy 1") as a result of our competitor's violation of the Procurement Integrity Act. Two of the seven launch reassignments were for West Coast launches and, since then, the Air Force has assigned us four additional West Coast launches. To prepare for these, we upgraded our West Coast launch facilities, which required further investment in the EELV program (see Note 5 to the financial statements). We expect to recover the investment through the pricing of the West Coast launches.

The U.S. Government has been awarding launch missions incrementally as it continues to develop its acquisition strategy for future national missions. The U.S. Government plans to maintain assured access to space to the maximum extent possible and has recognized the need to fund additional EELV infrastructure costs created by the weaker-than-originally-anticipated commercial demand for launch services. We had three Atlas launches in 2005, including our fifth Atlas V commercial launch. As of year end 2005, the Atlas family of launch vehicles had a record of 77 consecutive successful launches. Commercial orders and prices for the Atlas V launch vehicle to date have been lower than we originally expected during the development phase of the vehicle.

In 2005, we entered into an agreement with Boeing to create a joint venture that would combine the production, engineering, test and launch operations associated with U.S. Government launches of our Atlas launch vehicles and Boeing's Delta launch vehicles. The joint venture, named United Launch Alliance, LLC (ULA), is structured as a 50-50 joint venture and would be accounted for as an equity investment. Under the terms of the joint venture, Atlas and Delta expendable launch vehicles would continue to be available as alternatives on individual launch missions. The agreement also stipulates that, upon closing of the transaction, Lockheed Martin and Boeing will dismiss all claims against each other in the pending civil litigation related to a previous competition for launches under the Air Force EELV program (see Note 15 for a discussion of that litigation).

The closing of the ULA transaction is subject to conditions to closing, including government and regulatory approvals and agreements in the United States and internationally. On August 9, 2005, the European Commission determined that ULA was compatible with European Union merger control regulation. On October 24, 2005, the Federal Trade Commission (FTC) requested additional information from Lockheed Martin and Boeing related to ULA in response to the pre-merger notice under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR) submitted by the parties. The FTC's "second request" extends the period that the FTC is permitted to review the transaction under the HSR Act. We currently plan to close the ULA transaction as soon as practicable following satisfaction of all the closing conditions. We do not expect that its formation will have a significant impact on our results of operations or financial position for 2006. If the conditions to closing are not satisfied and the ULA transaction is not consummated by March 31, 2006, either Boeing or Lockheed Martin may terminate the joint venture agreement.

Lockheed-Khrunichev-Energia International, Inc. (LKEI), a joint venture we have with two Russian government-owned space firms, has exclusive rights to market launches of commercial, non-Russian-origin space payloads on the Proton family of rockets from a launch site in Kazakhstan. One of the joint venture partners, Khrunichev State Research and Production Space Center (Khrunichev), is the manufacturer of the Proton launch vehicle and provider of the related launch services in Russia. Commercial Atlas and Proton launch services are marketed around the world through International Launch Services (ILS), a joint venture between Lockheed Martin and LKEI. We consolidate the results of operations of LKEI and ILS into our financial statements based on our controlling financial interest. We received four new awards for launches on Proton vehicles in 2005. Contracts for launch services usually require substantial advances from the customer prior to launch. At the end of 2005, $315 million of advances received from customers for Proton launch services not yet provided was included as a liability in our balance sheet in customer advances and amounts in excess of costs incurred.

A sizeable percentage of the advances we receive from customers for Proton launch services are sent to Khrunichev. If a contracted launch service is not provided, a sizeable percentage of the related advance would have to be refunded to our customer. At year-end 2005, payments to Khrunichev included in inventories for launches under contract totaled $190 million. Our ability to recover these advances may be affected by Khrunichev's ability to provide the launch services, as well as economic conditions and the political environment in Russia. Through the end of 2005, launch services through LKEI and ILS have been provided according to contract terms.

The Corporation has entered into an agreement with RD AMROSS, a joint venture of the Pratt & Whitney division of United Technologies Corporation and the Russian firm NPO Energomash, for the purchase, subject to certain conditions, of RD-180 booster engines for use in the Corporation's Atlas launch vehicles. Terms of the agreement call for payments to be made to RD AMROSS upon the achievement of certain milestones in the manufacturing process. Payments of $70 million made under this agreement for engines not yet delivered were included in the Corporation's inventories at December 31, 2005.

As discussed above, commercial satellite sales have continued to experience pricing pressures due to excess capacity. However, in the past two years, we have received six commercial satellite orders and are in active discussions for additional satellite orders. In addition to commercial activity, we also received new orders for government satellites in 2004 and 2005, including those under the MUOS program and certain classified activities.

Other Business Considerations

As a government contractor, we are subject to U.S. Government oversight. The government may ask about and investigate our business practices and audit our compliance with applicable rules and regulations. Depending on the results of those audits and investigations, the government could make claims against us. Under government procurement regulations and practices, an indictment of a government contractor could result in that contractor being fined and suspended from being able to bid on, or be awarded, new government contracts for a period of time. A conviction could result in debarment for a specific period of time. Similar government oversight exists in most other countries where we conduct business. Although we cannot predict the outcome of these types of investigations and inquiries with certainty, based on current facts, we do not believe that any of the claims, audits or investigations pending against us are likely to have a material adverse effect on our business or our results of operations, cash flows or financial position.

We are exposed to risks associated with U.S. Government contracting, including technological uncertainties, dependence on fewer manufacturing suppliers and obsolescence, as well as Congressional appropriation and allotment of funds each year. Many of our programs involve the development and application of state-of-the-art technologies aimed at achieving challenging goals. As a result, setbacks, delays, cost growth and product failures can occur.

We have entered into various joint venture, teaming and other business arrangements to help support our portfolio of products and services in many of our lines of business. Some of these business arrangements include foreign partners. The conduct of international business introduces other risks into our operations, including changing economic conditions, fluctuations in relative currency values, regulation by foreign countries and the potential for unanticipated cost increases resulting from the possible deterioration of political relations.

The nature of our international business also makes us subject to the export control regulations of the U.S. Department of State and the Department of Commerce. If these regulations are violated, it could result in monetary penalties and denial of export privileges. We are currently unaware of any violations of export control regulations which are reasonably likely to have a material adverse effect on our business or our results of operations, cash flows or financial position.

CRITICAL ACCOUNTING POLICIES

Contract Accounting/Revenue Recognition

A large part of our business is derived from long-term contracts for design, development and production activities which we account for consistent with the American Institute of Certified Public Accountants' (AICPA) audit and accounting guide, *Audits of Federal Government Contractors,* and the AICPA's Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts.* We also enter into contracts to provide other services that are not associated with design, development or production activities. We account for those contracts in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition,* and other relevant revenue recognition accounting literature. We consider the nature of these contracts and the types of products and services provided when we determine the proper accounting method for a particular contract.

Accounting for Design, Development and Production Contracts

Generally, we record long-term, fixed-price design, development and production contracts on a percentage of completion basis using units-of-delivery as the basis to measure progress toward completing the contract and recognizing sales. For example, we use this method of revenue recognition on our C-130J tactical transport aircraft program, Atlas and Proton launch vehicle programs, and Multiple Launch Rocket System program. For certain other long-term, fixed-price development and production contracts that, along with other factors, require us to deliver minimal quantities over a longer period of time or to perform a substantial level of development effort in comparison to the total value of the contract, sales are recorded when we achieve performance milestones or using the cost-to-cost

method to measure progress toward completion. Under the cost-to-cost method of accounting, we recognize sales based on the ratio of costs incurred to our estimate of total costs at completion. As examples, we use this methodology for our F-22 Raptor program and the AEGIS Weapon System program. In some instances, long-term production programs may require a significant level of development and/or a low level of initial production units in their early phases, but will ultimately require delivery of increased quantities in later, full rate production stages. In those cases, the revenue recognition methodology may change from the cost-to-cost method to the units-of-delivery method after considering, among other factors, program and production stability. As we incur costs under cost-reimbursement-type contracts, we record sales. Cost-reimbursement-type contracts include time and materials and other level-of-effort-type contracts. Examples of this type of revenue recognition include the F-35 Joint Strike Fighter system development and demonstration (SDD) program and the THAAD missile defense program. Most of our long-term contracts are denominated in U.S. dollars, including contracts for sales of military products and services to foreign governments conducted through the U.S. Government (*i.e.*, foreign military sales).

As a general rule, we recognize sales and profits earlier in a production cycle when we use the cost-to-cost and milestone methods of percentage of completion accounting than when we use the units-of-delivery method. In addition, our profits and margins may vary materially depending on the types of long-term contracts undertaken, the costs incurred in their performance, the achievement of other performance objectives, and the stage of performance at which the right to receive fees, particularly under incentive and award fee contracts, is finally determined.

Incentives and award fees related to performance on design, development and production contracts, which are generally awarded at the discretion of the customer, as well as penalties related to contract performance, are considered in estimating sales and profit rates. Estimates of award fees are based on actual awards and anticipated performance. Incentive provisions which increase or decrease earnings based solely on a single significant event are generally not recognized until the event occurs. Such incentives and penalties are recorded when there is sufficient information for us to assess anticipated performance.

Accounting for design, development and production contracts requires judgment relative to assessing risks, estimating contract revenues and costs, and making assumptions for schedule and technical issues. Due to the size and nature of the work required to be performed on many of our contracts, the estimation of total revenue and cost at completion is complicated and subject to many variables. Contract costs include material, labor and subcontracting costs, as well as an allocation of indirect costs. Assumptions have to be made regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the contract (to estimate increases in wages and prices for materials), and the availability and timing of funding from the customer. For contract change orders, claims or similar items, we apply judgment in estimating the amounts and assessing the potential for realization. These amounts are only included in contract value when they can be reliably estimated and realization is considered probable. We have accounting policies in place to address these as well as other contractual and business arrangements to properly account for long-term contracts.

Products and services provided under long-term design, development and production contracts make up the majority of our business. Therefore, the amounts we record in our financial statements using contract accounting methods and cost accounting standards are material. Because of the significance of the judgments and estimation processes, it is likely that materially different amounts could be recorded if we used different assumptions or if the underlying circumstances were to change. For example, if underlying assumptions were to change such that our estimated profit at completion for all design, development and production contracts was higher or lower by 1%, our net earnings would increase or decrease by approximately $190 million. When adjustments in estimated contract revenues or costs are required, any changes from prior estimates are included in earnings in the current period.

Accounting for Other Services Contracts

Revenue under contracts for services other than those associated with design, development or production activities is generally recognized either as services are performed or when earned, depending on the contract. This methodology is mainly used by our Information & Technology Services segment.

Services contracts primarily include operations and maintenance contracts, and outsourcing-type arrangements. Revenue under such contracts is generally recognized on a straight-line basis over the period of contract performance, unless evidence suggests that the revenue is earned or the obligations are fulfilled in a different pattern. Costs incurred under these services contracts are expensed as incurred, except that initial "set-up" costs are capitalized and recognized over the life of the agreement. Operating profit related to such services contracts may fluctuate from period to period, particularly in the earlier phases of the contract. Incentives and award fees related to performance on services contracts are recognized when they are fixed and determinable, generally at the date of award.

Other Contract Accounting Considerations

The majority of our sales are driven by pricing based on costs incurred to produce products or perform services under contracts with the U.S. Government. Cost-based pricing is determined under the Federal Acquisition Regulations (FAR). The FAR provides guidance on the types of costs that are allowable in establishing prices for goods and services under U.S. Government contracts. For example, costs such as those related to charitable contributions, advertising, interest expense, and public relations are unallowable, and therefore not recoverable through sales. In addition, we may enter into agreements with the U.S. Government that address the subjects of allowability and allocability of costs to contracts for specific matters. For example, most of the amounts we spend for groundwater treatment and soil remediation related to discontinued operations and sites operated in prior years are allocated to our current operations as general and administrative costs under agreements reached with the U.S. Government.

We closely monitor compliance with and the consistent application of our critical accounting policies related to contract accounting. Business segment personnel assess the status of contracts through periodic contract status and performance reviews. Also, regular and recurring evaluations of contract cost, scheduling and technical matters are performed by management personnel independent from the business segment performing work under the contract. Costs incurred and allocated to contracts with the U.S. Government are reviewed for compliance with regulatory standards by our personnel, and are subject to audit by the Defense Contract Audit Agency. For other information on accounting policies we have in place for recognizing sales and profits, see our discussion under "Sales and earnings" in Note 1 to the financial statements.

Postretirement Benefit Plans

Most employees are covered by defined benefit pension plans (pension plans), and we provide health care and life insurance benefits to eligible retirees. Our earnings may be negatively or positively impacted by the amount of expense or income we record for our employee benefit plans. This is particularly true with expense or income for pension plans because those calculations are sensitive to changes in several key economic assumptions and workforce demographics. Effective January 1, 2006, new non-union represented employees that we hire are not being covered by defined benefit pension plans, but are eligible to participate in defined contribution plans. We currently plan to offer those employees the ability to participate in our retiree medical plans, but will not subsidize the cost of their participation effective January 1, 2006.

We account for our pension plans using Statement of Financial Accounting Standards (FAS) 87, *Employers' Accounting for Pensions*. Those rules require that the amounts we record, including the expense or income for the plans, be computed using actuarial valuations. These valuations include many assumptions, including assumptions we make relating to financial market and other economic conditions. Changes in key economic indicators can result in changes in the assumptions we use. The key year-end assumptions used to estimate pension expense or income for the following calendar year are the discount rate, the expected long-term rate of return on plan assets and the rates of increase in future compensation levels.

We use judgment in reassessing these assumptions each year because we have to consider current market conditions and, in the case of the expected long-term rate of return on plan assets, past investment experience, judgments about future market trends, changes in interest rates and equity market performance. We also have to consider factors like the timing and amounts of expected contributions to the plans and benefit payments to plan participants.

An example of how changes in these assumptions can affect our financial statements occurred in 2005. We reassess our pension plan assumptions each year. Based on our review of interest rates at the end of the year, we lowered our discount rate assumption to 5.625% at December 31, 2005, compared to 5.75% used at the end of 2004. Before the end of 2005, we also performed a study of the rates of increase in future compensation levels. The results of that study indicated that it would be appropriate to reduce that rate from 5.50% to 5.0% at the end of 2005. These changes, together with other factors such as the

effects of the actual return on plan assets over the past few years, resulted in our projecting that the amount of pension expense for 2006 will decrease by approximately 15% to 20% as compared to 2005 expense. The primary drivers of this projected decrease were the change in the rate of future compensation increases as well as the growth in plan assets over the past year, including contributions we made to the pension trust. The decrease of 50 basis points in the compensation rate decreased the estimated 2006 expense by approximately $100 million. In addition, the higher asset base at the beginning of 2006 drove a higher expected return on assets for 2006, which was the main component of the remaining decrease in the expense. This decrease was partially offset by an increase of approximately $50 million in the estimated 2006 pension expense, resulting from the 12.5 basis point decrease in the discount rate assumption. The annual review of our pension plan assumptions also affects the pension liability recorded in our balance sheet.

At the end of each of the last few years, we have recorded noncash after-tax adjustments in the stockholders' equity section of our balance sheet to reflect a minimum pension liability for many of our pension plans. These adjustments were calculated on a plan-by-plan basis, and were determined by comparing the accumulated benefit obligation (ABO) for each plan to the fair value of that plan's assets. The amount by which the ABO exceeds the fair value of the plan assets, after adjusting for previously recorded accrued or prepaid pension cost for the plan, must be recorded as a minimum pension liability, with a corresponding increase in an intangible asset, if appropriate, and a reduction to stockholders' equity. In 2005, the minimum pension liability adjustment we recorded reduced stockholders' equity by $105 million primarily due to minimum pension liabilities associated with nonqualified benefit plans and the changes in assumptions. At the end of 2004, the adjustment reduced stockholders' equity by $285 million, mainly driven by the change in the discount rate. These adjustments did not impact earnings. The accumulated minimum pension liability balances in stockholders' equity at the end of 2005 and 2004 were $(1,629) million and $(1,524) million, respectively. The amount of the minimum pension liability is computed at each year-end and could decrease or increase depending on changes in interest rates and other factors.

U.S. Government Cost Accounting Standards (CAS) are a major factor in determining our pension funding requirements and govern the extent to which our pension costs are allocable to and recoverable under contracts with the U.S. Government. Funded amounts are recovered over time through the pricing of our products and services on U.S. Government contracts, and therefore are recognized in our net sales. The total funding requirement for pension plans under CAS in 2005 was $498 million. For 2006, we expect our funding requirements under CAS to increase. Also in 2006, funding in addition to the amount calculated under CAS will likely be required under Internal Revenue Code rules. Any additional amounts computed under those rules are considered to be prepayments under the CAS rules, and are recorded on our balance sheet and recovered in future periods. In 2005 and 2004, we made discretionary prepayments of $980 million and $485 million, respectively, to the pension trust. Prepayments reduce the amount of future cash funding that will be required. Accordingly, although our CAS funding requirements are expected to increase over the $498 million required in 2005, we expect our cash contributions to the pension plans to be $100 million to $110 million, primarily reflecting the additional funding required under Internal Revenue Code rules.

The FAS/CAS pension adjustment represents the difference between pension expense calculated in accordance with FAS 87 and pension costs calculated and funded in accordance with CAS. Since the CAS expense is recovered through the pricing of our products and services on U.S. Government contracts, and therefore recognized in a particular segment's net sales, the results of operations of our segments only include pension expense as determined and funded in accordance with CAS rules. Accordingly, the FAS/CAS adjustment is an amount included in the reconciliation of total segment operating profit to consolidated operating profit under GAAP. See the discussion of "Net Unallocated Corporate (Expense) Income" under "Discussion of Business Segments."

In response to the public's concern over the adequacy of pension plan funding, Congress has been drafting legislation to address the amount of annual contributions that companies are required to pay into their pension funds. Both the Senate and the House of Representatives have passed their own versions of a pension funding bill and those bills are expected to go to conference during the latter part of the first quarter of 2006. It is expected that the conference process will produce compromises and changes in the Senate and House bills, and ultimate passage of a bill is uncertain. This uncertainty makes it difficult to quantify the potential impact to our pension funding. Generally, the Senate and House bills, as drafted, would accelerate the required amount of our annual pension plan contributions, which may have a material impact on our cash

flows for a few years beginning in 2007. Absent other changes, the subsequent annual funding requirements would be expected to decline in recognition of the accelerated contributions.

Environmental Matters

We are a party to various agreements, proceedings and potential proceedings for environmental cleanup issues, including matters at various sites where we have been designated a potentially responsible party (PRP) by the EPA or by a state agency. We record financial statement accruals for environmental matters in the period that it becomes probable that a liability has been incurred and the amounts can be reasonably estimated (see the discussion under "Environmental matters" in Note 1 to the financial statements). Judgment is required when we develop assumptions and estimate costs expected to be incurred for environmental remediation activities due to, along with other factors, difficulties in assessing the extent of environmental remediation to be performed, complex environmental regulations and remediation technologies, cost allowability issues and agreements between PRPs to share in the cost of remediation as discussed below.

We enter into agreements (*e.g.*, administrative orders, consent decrees) which document the extent and timing of our obligation. We are also involved in remediation activities at environmental sites where formal agreements exist but do not quantify the extent and timing of our obligation. Environmental cleanup activities usually cover several years, which makes estimating the costs more judgmental due to, for example, changing remediation technologies. To determine the costs related to cleanup sites, we have to assess the extent of contamination, the appropriate technology to be used to accomplish the remediation and continually evolving regulatory environmental standards. We consider these factors in our estimates of the timing and amount of any future costs that may be required for remediation actions. In cases where a date to complete activities at a particular environmental site cannot be estimated by reference to agreements or otherwise, we project costs over an appropriate time frame not to exceed 20 years. Given the level of judgment and estimation which has to occur, it is likely that materially different amounts could be recorded if different assumptions were used or if circumstances were to change (*e.g.*, a change in environmental standards).

If we are ultimately found to have liability at those sites where we have been designated a PRP, we expect that the actual costs of remediation will be shared with other liable PRPs. Generally, PRPs that are ultimately determined to be responsible parties are strictly liable for site cleanup and usually agree among themselves to share, on an allocated basis, the costs and expenses for investigation and remediation of hazardous materials. Under existing environmental laws, responsible parties are jointly and severally liable and, therefore, we are potentially liable for the full cost of funding such remediation. In the unlikely event that we were required to fund the entire cost of such remediation, the statutory framework provides that we may pursue rights of contribution from the other PRPs. The amounts we record do not reflect the fact that we may recover some of the environmental costs we have incurred through insurance or from other PRPs, which we are required to pursue by agreement and U.S. Government regulation.

Under agreements reached with the U.S. Government, some of the amounts we spend for groundwater treatment and soil remediation are allocated to our operations as general and administrative costs. Under existing government regulations, these and other environmental expenditures relating to our U.S. Government business, after deducting any recoveries received from insurance or other PRPs, are allowable in establishing prices of our products and services. As a result, a substantial amount of the expenditures we incur are being included in our sales and cost of sales according to U.S. Government agreement or regulation.

At the end of 2005, the total amount of liabilities recorded on our balance sheet for environmental matters was $464 million. About 60% of the liability relates to sites in Redlands, Burbank and Glendale, California, and in Great Neck, New York, mainly for remediation of soil and groundwater contamination. The remainder of the liability relates to other properties (including current operating facilities and certain facilities operated in prior years) for which our obligation is probable and the financial exposure can be estimated. We have recorded assets totaling $353 million at December 31, 2005 for the portion of environmental costs that are probable of future recovery in pricing of our products and services for U.S. Government businesses. The amount that is expected to be allocated to our commercial businesses has been expensed through cost of sales. Any recoveries we receive from other PRPs or insurance would reduce the allocated amounts included in our future U.S. Government sales and cost of sales.

ACQUISITION AND DIVESTITURE ACTIVITIES

We continuously strive to strengthen our portfolio of products and services to meet the current and future needs of our customers. We accomplish this not only internally, through our independent research and development activities, but also through acquisitions. We selectively pursue the acquisition of businesses and investments that complement our current portfolio and allow expansion into adjacent product lines or access to new technologies. We have made a number of such niche acquisitions of businesses during the past several years. Over the last five years, we have completed 10 such acquisitions for an aggregate purchase price of approximately $1.5 billion. Conversely, we may also explore the sale of businesses, investments and surplus real estate. If we were to decide to sell any such businesses or real estate, the resulting gains, if any, would be recorded when the transactions are consummated and losses, if any, would be recorded when the value of the related asset is determined to be impaired.

Acquisitions

In 2005, we completed the purchase of The SYTEX Group, Inc. (SYTEX). The total purchase price, including transaction-related costs, was approximately $480 million. Approximately $380 million of the purchase price was paid in cash at closing, with most of the remainder payable in 2006. The acquisition was accounted for under the purchase method of accounting. Purchase accounting adjustments were recorded by allocating the purchase price to the assets acquired and liabilities assumed based on their estimated fair values, and included recording goodwill of $395 million, of which $360 million will be amortized for tax purposes. The acquisition expands the Corporation's information technology solutions and technical support services businesses with the DoD and other federal agencies. The operations of SYTEX are included in the Information & Technology Services business segment.

In 2005, we also completed the acquisitions of STASYS Limited, a U.K.-based technology and consulting firm specializing in network communications and defense interoperability; INSYS Group Limited, a U.K.-based diversified supplier of military communications systems, weapons systems and advanced analysis services; and Coherent Technologies, Inc., a U.S.-based supplier of high-performance, laser-based remote sensing systems. The aggregate cash purchase price for these three acquisitions was $180 million. Purchase accounting adjustments included recording combined goodwill of $164 million. These acquisitions were not material to our consolidated results of operations for 2005. In January 2006, we acquired Aspen Systems Corporation, a U.S.-based company that provides a range of business process and technology solutions primarily to civil agencies of the U.S. Government. This acquisition is not expected to have a material impact on consolidated results of operations, financial position or cash flows.

Divestitures

During 2005 and 2004, we continued to execute the strategy to monetize certain of our equity investments, as follows:

In January 2005, we completed the sale of our 25% interest in Intelsat, Ltd. to a private equity firm for $18.75 per share, or $752 million in total proceeds. The transaction resulted in the recording of a gain, net of state income taxes, of $47 million in other income and expenses, and an increase in net earnings of $31 million ($0.07 per share).

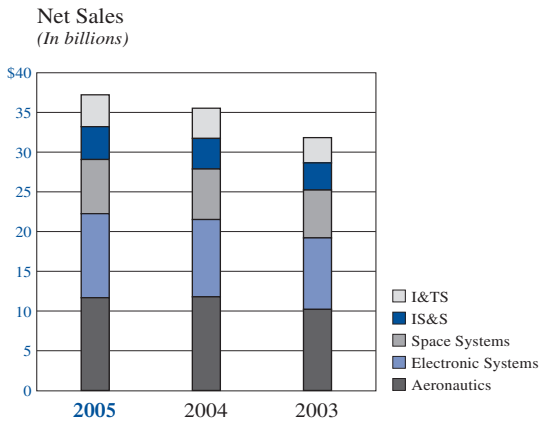
In June 2005, Inmarsat plc (Inmarsat), a company in which we held a 14% interest, completed an initial public offering (IPO) of 150 million of its ordinary shares on the London Stock Exchange. The IPO had the effect of diluting our ownership to 8.9% and was the primary driver for our recognition of a $42 million deferred gain that was recorded in 2003 related to this investment. In October 2005, we sold approximately 16 million of our Inmarsat shares for $89 million, further reducing our ownership percentage to 5.3%. These transactions resulted in the recording of gains, net of state income taxes, totaling $126 million in other income and expenses, and an increase in net earnings of $82 million ($0.18 per share). At December 31, 2005, we held 24 million shares of Inmarsat with a total market value of $146 million. In January 2006, we sold an additional 12 million shares of Inmarsat for $75 million. The gain is expected to increase 2006 net earnings by $47 million ($0.11 per share).

In the fourth quarter of 2005, we completed the sale of our interest in NeuStar, Inc. The transaction resulted in the recording of a gain, net of state income taxes, of $30 million in other income and expenses, and an increase in net earnings of $19 million ($0.04 per share).

In November 2004, a private equity firm purchased the outstanding shares of New Skies Satellites, N.V. (New Skies). We sold our shares for $148 million. The transaction resulted in the recording of a gain, net of state income taxes, of $91 million in other income and expenses, and an increase in net earnings of $59 million ($0.13 per share). The carrying value of our investment in New Skies was marked to market through other comprehensive income prior to the sale.

RESULTS OF OPERATIONS

Since our operating cycle is long-term and involves many types of development and production contracts with varying production delivery schedules, the results of operations of a particular year, or year-to-year comparisons of recorded sales and profits, may not be indicative of future operating results. The following discussions of comparative results among periods should be viewed in this context. All per share amounts cited in this discussion are presented on a "per diluted share" basis.



The following discussion of net sales and operating results provides an overview of our operations by focusing on key elements set forth in our statement of earnings. The "Discussion of Business Segments" which follows describes the contributions of each of our business segments to our consolidated sales and operating profit for 2005, 2004 and 2003. We follow an integrated approach for managing the performance of our businesses and generally focus the discussion of our results of operations around major lines of business, versus distinguishing between products and services. As mentioned previously, most of our services revenues are generated in our Information & Technology Services segment.

For 2005, net sales were $37.2 billion, a 5% increase over 2004 sales. Sales for 2004 were $35.5 billion, an increase of 12% compared to 2003. Sales, as compared to the prior year, increased in all segments except Aeronautics in 2005, where there was a slight decline due to an anticipated reduction in combat aircraft deliveries. The U.S. Government is our largest customer, accounting for about 85% of our sales for 2005, compared to 80% in 2004 and 78% in 2003.

Other income and expenses, net was $449 million for 2005 compared to $121 million in 2004. This was due to an increase in investment income, gains from the sale of investments (primarily Intelsat and Inmarsat) and charges in 2004 for the early retirement of debt. Other income and expenses, net increased $78 million from 2003 to 2004 due to gains from the sale of the COMSAT General business and the investment in New Skies.

Our operating profit for 2005 was $3.0 billion, an increase of 43% compared to 2004. Our operating profit for 2004 was $2.1 billion, an increase of 3% compared to 2003.

Interest expense for 2005 was $370 million, $55 million lower than in 2004. Interest expense for 2004 was $425 million, $62 million lower than the amount for 2003. The decrease in interest expense was due to reductions in our debt outstanding.

Our effective tax rates were 30.2% for 2005, 23.9% for 2004 and 31.3% for 2003. For each of the three years, our tax rate was reduced from the statutory rate by the tax benefits related to export sales and tax deductible dividends. For 2005, our tax rate was reduced by the new tax deduction for sales of products manufactured in the U.S. For 2004, our tax rate reflected a $144 million reduction in our income tax expense primarily resulting from the closure of an Internal Revenue Service (IRS) examination.

Net earnings increased as compared to the prior year for the fourth straight year. We reported net earnings of $1.8 billion ($4.10 per share) in 2005, compared to net earnings of $1.3 billion ($2.83 per share) in 2004 and earnings of $1.1 billion ($2.34 per share) in 2003.

DISCUSSION OF BUSINESS SEGMENTS

We operate in five business segments: Aeronautics, Electronic Systems, Space Systems, Integrated Systems & Solutions (IS&S) and Information & Technology Services (I&TS).

In the Aeronautics business segment, sales have leveled compared to the growth that had been experienced the last few years. This is largely due to lower sales on Combat Aircraft programs driven by declines in F-16 volume, completion of initial ramp-up activities associated with F-35 development and F-22 production, and the completion of the F-22 Engineering and Manufacturing Development (EMD) phase of the program. The number of F-16 deliveries is expected to

continue to decline over the next few years; however, with the Greek Government's contract authorization for 30 aircraft, firm production is currently planned through 2009. During 2005, 23 F-22s were delivered and the program achieved initial operational capability, indicating its readiness for service. The Lot 5 contract for the production of 24 aircraft is expected to continue production of the F-22 into 2008, and we received advanced procurement contracts for production of Lots 6 and 7 associated with long lead activities. The initial F-35 test aircraft is being readied for its first flight and significant progress is being made on the carrier-based and short takeoff variants as well. Activity on the C-130J program included 15 aircraft deliveries in 2005. Through 2005, we have delivered 16 of the 60 aircraft under the multi-year award, and production and delivery of the remaining multi-year aircraft are expected to continue into 2009.

The Electronic Systems business segment has a broad portfolio of products and services. Many of its activities involve a combination of both development and production contracts with varying delivery schedules. This business segment has continued to expand its core competencies as a leading systems integrator, as demonstrated with its role as the prime contractor on the Presidential Helicopter and Littoral Combat Ship programs.

The Space Systems business segment is a key supplier of space solutions, primarily to our U.S. Government customers. Growth will depend on our government satellite business and our ability to capture market share. The commercial satellite and launch vehicle industries continue to be very competitive, with resulting pricing pressures. During 2005, the final Titan IV was launched and we now plan to continue to provide launch services to our U.S. Government customers with our Atlas V vehicle through the EELV program.

The IS&S and I&TS business segments continue to focus their capabilities in providing information technology services to defense, intelligence and other government customers. We expect continued strong growth in providing information technology solutions to government agencies.

In the following table of financial data, total operating profit of the business segments is reconciled to the corresponding consolidated amount. The reconciling item "Net unallocated Corporate expense" includes the FAS/CAS pension adjustment (see discussion below), earnings and losses from equity investments, interest income, costs for certain stock-based compensation programs, the effects of items not considered part of management's evaluation of segment operating performance, and Corporate costs not allocated to the operating segments, as well as other miscellaneous Corporate activities.

The FAS/CAS pension adjustment represents the difference between pension expense or income calculated for financial reporting purposes in accordance with FAS 87, and pension costs calculated and funded in accordance with U.S. Government CAS, which are reflected in the business segment results. CAS is a major factor in determining our pension funding requirements, and governs the extent of allocability and recoverability of pension costs on government contracts. The CAS expense is recovered through the pricing of our products and services on U.S. Government contracts, and therefore recognized in segment net sales. The results of operations of the segments only include pension expense as determined and funded in accordance with CAS rules.

This table shows net sales and operating profit of the business segments and reconciles to the consolidated total.

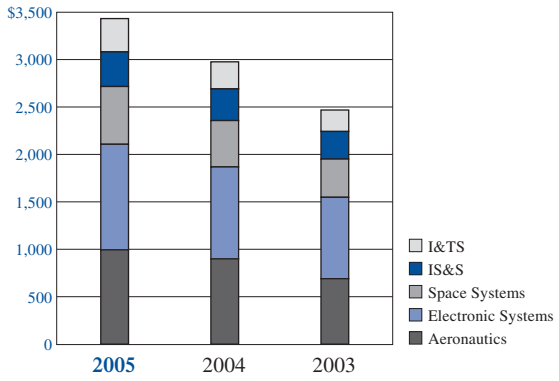
(In millions)	**2005**	2004	2003
NET SALES			
Aeronautics	**$11,672**	$11,785	$10,206
Electronic Systems	**10,580**	9,729	8,996
Space Systems	**6,820**	6,359	6,024
Integrated Systems & Solutions	**4,131**	3,851	3,422
Information & Technology Services	**4,010**	3,802	3,176
	$37,213	$35,526	$31,824
OPERATING PROFIT			
Aeronautics	**$ 994**	$ 899	$ 690
Electronic Systems	**1,113**	969	858
Space Systems	**609**	489	403
Integrated Systems & Solutions	**365**	334	291
Information & Technology Services	**351**	285	226
Total business segments	**3,432**	2,976	2,468
Net unallocated Corporate expense	**(446)**	(887)	(449)
	$ 2,986	$ 2,089	$ 2,019

The following segment discussions also include information relating to negotiated backlog for each segment. Total negotiated backlog was approximately $75 billion and $74 billion at December 31, 2005 and 2004, respectively. This amount included both funded backlog (unfilled firm orders for which funding has been both authorized and appropriated by the customer–Congress in the case of U.S. Government agencies) and unfunded backlog (firm orders for which funding has not yet been appropriated). Negotiated backlog does

not include unexercised options or task orders to be issued under indefinite-delivery/indefinite-quantity (IDIQ) contracts. Funded backlog was approximately $35 billion at December 31, 2005.

The Aeronautics segment generally includes fewer programs that have much larger sales and operating results than programs included in the other segments. Therefore, due to the large number of comparatively smaller programs in the remaining segments, the discussions of the results of operations of these business segments generally focus on lines of business within the segments rather than on specific programs. The following tables of financial information and related discussions of the results of operations of our business segments are consistent with the presentation of segment information in Note 16 to the financial statements.

Segment Operating Profit
(In millions)



Aeronautics

Aeronautics' operating results included the following:

(In millions)	**2005**	2004	2003
Net sales	**$11,672**	$11,785	$10,206
Operating profit	**994**	899	690
Backlog at year-end	**29,580**	30,489	37,580

Net sales for Aeronautics decreased by $113 million, or 1%, in 2005 compared to 2004. The decrease was mainly due to anticipated declines in Combat Aircraft, which were partially offset by growth in Air Mobility. Combat Aircraft sales decreased by $480 million for the year primarily due to declines in F-16 volume, which more than offset higher F-35 and F-22 volume. The sales growth in Air Mobility was due to additional C-130J deliveries (15 in 2005 compared to 13 in 2004) and higher volume on other Air Mobility programs.

Net sales for Aeronautics increased by 15% in 2004 compared to 2003. The majority of the increase in sales, $1.5 billion, was due to higher volume on the F-35, F-16 and F-22 Combat Aircraft programs. In 2004, 83 F-16s were delivered, 21 more than in 2003. The remaining increase in sales was mainly due to higher C-5 activities in Air Mobility. There were 13 C-130J deliveries in 2004 compared to 15 deliveries in 2003.

Operating profit for the segment increased by 11% in 2005 compared to 2004. The increase was due to higher Air Mobility operating profit that exceeded a decline in Combat Aircraft operating profit. Air Mobility operating profit increased $100 million mainly due to improved performance and increased deliveries on the C-130J program. Combat Aircraft operating profit declined due to decreased F-16 deliveries (69 in 2005 compared to 83 in 2004) and reduced earnings on the F-35 development program, which more than offset increased volume and improved performance on the F-22 program.

Operating profit for the segment increased by 30% in 2004 compared to 2003. Combat Aircraft operating profit increased $95 million primarily as a result of higher sales volume on the programs discussed above and improved performance on the F-22 program. The remaining increase was primarily attributable to $85 million in operating profit recognized on the C-130Js delivered in 2004. The Corporation began recognizing profits on C-130J deliveries in 2004 upon resolution of certain technical aircraft performance risks, manufacturing performance improvements and the achievement of stable production as a result of securing a multi-year contract in 2003.

Backlog decreased in 2005 as compared to 2004 primarily as a result of sales volume on the F-35 and F-16 programs as well as deliveries of C-130J aircraft.

Electronic Systems

Electronic Systems' operating results included the following:

(In millions)	2005	2004	2003
Net sales	$10,580	$ 9,729	$ 8,996
Operating profit	1,113	969	858
Backlog at year-end	19,932	18,239	17,339

Net sales for Electronic Systems increased 9% in 2005 as compared to 2004. Higher volume in tactical and surface systems programs contributed to increased sales of $495 million at Maritime Systems & Sensors (MS2). Platform, Training & Transportation Solutions (PT&TS) sales increased $310 million primarily due to platform integration activities. Air defense and fire control programs contributed to increased sales of $40 million at Missiles & Fire Control (M&FC).

Net sales for Electronic Systems increased 8% in 2004 as compared to 2003. The increase in sales was due to higher volume in MS2 and M&FC. Higher volume on surface systems programs accounted for most of MS2's sales growth of $450 million. M&FC's sales increased $265 million, primarily due to higher volume on fire control and tactical missile programs.

Operating profit for the segment increased by 15% in 2005 compared to 2004. Operating profit increased by $80 million at M&FC mainly due to improved performance on fire control and air defense programs. Performance on surface systems programs contributed to an increase in operating profit of $50 million at MS2. PT&TS operating profit increased $10 million primarily due to improved performance on simulation and training programs.

Operating profit for the segment increased by 13% in 2004 compared to 2003. Operating profit increased $145 million due to improved performance on tactical missile and fire control programs at M&FC and on radar programs at MS2. The decrease in operating profit at PT&TS was due to a $25 million loss provision recorded in the third quarter of 2004 on certain international simulation and training contracts.

The increase in backlog during 2005 over 2004 resulted from increased orders on development programs.

Space Systems

Space Systems' operating results included the following:

(In millions)	2005	2004	2003
Net sales	$ 6,820	$ 6,359	$ 6,024
Operating profit	609	489	403
Backlog at year-end	15,925	16,112	12,813

Net sales for Space Systems increased by 7% in 2005 compared to 2004. During the year, sales growth in Satellites and Strategic & Defensive Missile Systems (S&DMS) offset declines in Launch Services. The $410 million increase in Satellites sales was due to higher volume on government satellite programs that more than offset declines in commercial satellite activities. There were no commercial satellite deliveries in 2005, compared to four in 2004. Increased sales of $235 million in S&DMS were attributable to the fleet ballistic missile and missile defense programs. The $180 million decrease in Launch Services' sales was mainly due to having three Atlas launches in 2005 compared to six in 2004.

Net sales for Space Systems increased by 6% in 2004 compared to 2003, as increases in Satellites of $320 million and S&DMS of $75 million more than offset a $55 million decrease in Launch Services. The increase in Satellites was due to increased volume on government satellite programs and one additional commercial satellite delivery in 2004. In S&DMS, the increase was primarily attributable to fleet ballistic missile programs. The lower volume in Launch Services was mainly due to a decline in the Titan launch vehicle program, which more than offset increases in both Atlas launches (six in 2004 compared to five in 2003) and Proton launches (four in 2004 compared to two in 2003).

Operating profit for the segment increased 25% in 2005 compared to 2004. Operating profit increased in Launch Services, S&DMS and Satellites. In Launch Services, the $60 million increase in operating profit was primarily attributable to improved performance on the Atlas vehicle program. Satellites' operating profit increased $35 million due to the higher volume and improved performance on government satellite programs, which more than offset the decreased operating profit due to the decline in commercial satellite deliveries. The $20 million increase in S&DMS was attributable to higher volume on fleet ballistic missile and missile defense programs.

Operating profit for the segment increased 21% in 2004 as compared to 2003. Launch Services' operating profit increased $65 million. This increase was primarily due to U.S. Government support of the Atlas program and the benefit resulting from the first quarter termination of a launch vehicle contract by a commercial customer, offset by a decline in activities on the Titan launch vehicle program. Satellites' operating profit increased $20 million due to commercial satellite deliveries, partially offset by lower profitability on a government satellite program. In 2003, government satellites operating profit reflected a $30 million charge related to a NASA satellite program.

The decrease in backlog during 2005 as compared to 2004 was mainly due to sales related to government satellite programs.

Integrated Systems & Solutions

Integrated Systems & Solutions' operating results included the following:

(In millions)	**2005**	2004	2003
Net sales	**$4,131**	$3,851	$3,422
Operating profit	**365**	334	291
Backlog at year-end	**3,974**	4,586	4,350

Net sales for IS&S increased by 7% in 2005 as compared to 2004 and by 13% in 2004 as compared to 2003. For both comparative periods, the sales increases were primarily attributable to a higher volume of intelligence, defense and information assurance activities.

Operating profit for the segment increased 9% in 2005 as compared to 2004 and by 15% in 2004 as compared to 2003. The increases in operating profit for both comparative periods were primarily attributable to higher volume and performance improvements on the activities described above.

The decrease in backlog during 2005 compared to 2004 was due to the U.S. Army's termination for convenience of the Aerial Common Sensor contract.

Information & Technology Services

Information & Technology Services' operating results included the following:

(In millions)	**2005**	2004	2003
Net sales	**$4,010**	$3,802	$3,176
Operating profit	**351**	285	226
Backlog at year-end	**5,414**	4,560	4,817

Net sales for I&TS increased by 5% in 2005 as compared to 2004. The increase in sales was primarily attributable to higher volumes of $460 million in Information Technology and Defense Services, which more than offset a sales decline of $250 million in NASA programs. Information Technology's sales increase includes the impact of organic growth and the purchase of SYTEX in March 2005.

Net sales for I&TS increased by 20% in 2004 as compared to 2003. The increase in sales was primarily attributable to higher volume of $510 million in Information Technology. Information Technology's sales improved due to organic growth, as well as the net impact of our purchase of Affiliated Computer Services' federal government IT business and the concurrent sale of our commercial IT business in November 2003. The remaining increase in sales of $120 million was primarily attributable to higher volume in Defense Services, which offset a decline in NASA sales.

Operating profit for the segment increased by 23% in 2005 as compared to 2004. The operating profit increase was mainly due to higher volume and improved performance in Information Technology and Defense Services.

Operating profit for the segment increased by 26% in 2004 as compared to 2003. The operating profit increase was mainly due to Information Technology volume and program performance.

The increase in backlog was attributable to growth in our Information Technology line of business.

Unallocated Corporate (Expense) Income, Net

The following table shows the components of net unallocated Corporate (expense) income.

(In millions)	**2005**	2004	2003
FAS/CAS pension adjustment	**$(626)**	$(595)	$(300)
Items not considered in segment operating performance	**173**	(215)	(153)
Other, net	**7**	(77)	4
	$(446)	$(887)	$(449)

The FAS/CAS pension adjustment represents the difference between pension costs calculated and funded in accordance with CAS and pension expense determined in accordance with FAS 87. That difference is not included in segment operating results and therefore is a reconciling item between operating profit from the business segments and consolidated operating profit. The CAS funding amount is allocated among the business segments and is included as an expense item in the segments' cost of goods sold. A majority of the cost is also passed along to our customers through contract pricing, and is consequently included in the segments' sales.

The following table shows the CAS funding that is included as expense in the segments' operating results, the related FAS (expense) income, and the resulting FAS/CAS pension adjustment:

(In millions)	**2005**	2004	2003
FAS 87 expense	**$(1,124)**	$(884)	$(484)
Less: CAS expense and funding	**(498)**	(289)	(184)
FAS/CAS pension adjustment—expense	**$ (626)**	$(595)	$(300)

As disclosed in Note 13 to the financial statements, FAS 87 expense increased primarily due to higher recognized net actuarial losses and higher service cost in 2005, and due to a lower expected return on plan assets in addition to these other two factors in 2004.

Certain items are excluded from segment results as part of senior management's evaluation of segment operating performance consistent with the management approach promulgated by FAS 131, *Disclosures about Segments of an Enterprise and Related Information*. For example, gains and losses related to the disposition of businesses or investments managed by Corporate, as well as other Corporate activities such as charges recorded related to the early repayment of debt, are not considered by management in evaluating the operating performance of business segments. Therefore, for purposes of segment reporting, the following items were included in "Unallocated Corporate (expense) income, net" for 2005, 2004 and 2003:

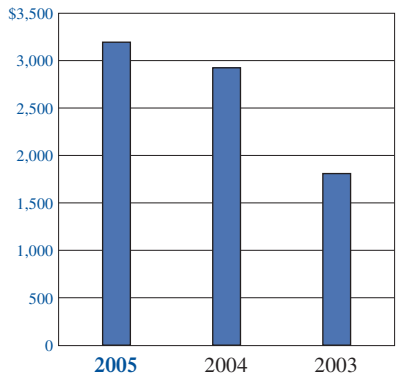
(In millions, except per share data)	Operating Profit (Loss)	Net Earnings (Loss)	Earnings (Loss) Per Share
YEAR ENDED DECEMBER 31, 2005			
Gains related to Inmarsat transactions	**$ 126**	**$ 82**	**$ 0.18**
Gain on sale of interest in Intelsat	**47**	**31**	**0.07**
Gain on sale of interest in NeuStar	**30**	**19**	**0.04**
Impairment charge related to a satellite	**(30)**	**(19)**	**(0.04)**
	$ 173	**$ 113**	**$ 0.25**
YEAR ENDED DECEMBER 31, 2004			
Charge for Pit 9 litigation	$(180)	$(117)	$(0.26)
Charge for early retirement of debt	(154)	(100)	(0.22)
Gain on sale of interest in New Skies	91	59	0.13
Gain on sale of COMSAT General business	28	4	0.01
Benefit from closure of an IRS examination	—	144	0.32
	$(215)	$ (10)	$(0.02)
YEAR ENDED DECEMBER 31, 2003			
Charge for early retirement of debt	$(146)	$ (96)	$(0.21)
Charge related to exit from the commercial mail sorting business	(41)	(27)	(0.06)
Gain on partial reversal of Space Imaging charge	19	13	0.03
Gain on sale of the commercial IT business	15	8	0.02
	$(153)	$(102)	$(0.22)

The increase in the "Other, net" component of unallocated Corporate (expense) income, net of $84 million from 2004 to 2005 was primarily due to higher interest income due to a larger invested cash balance and higher interest rates in 2005. The decrease of $81 million from 2003 to 2004 was primarily due to lower earnings on our equity investments in 2004.

LIQUIDITY AND CASH FLOWS

We have a balanced cash deployment and disciplined growth strategy to enhance our businesses, increase shareholder value and position ourselves to take advantage of new business opportunities when they arise. Consistent with that strategy, we have invested in our business (*e.g.*, capital expenditures, independent research and development), repurchased shares, increased our dividends, opportunistically reduced our debt and made select acquisitions of businesses. The following provides an overview of our execution of this strategy.

Net Cash Provided By Operating Activities
(In millions)



Operating Activities

Net cash provided by operating activities increased by $270 million to $3.2 billion in 2005 as compared to 2004 after having increased by $1.1 billion to $2.9 billion in 2004 as compared to 2003. In 2005, the increase was primarily attributable to an increase in net earnings of $559 million as compared to 2004, which more than offset a $386 million reduction in working capital improvements between the years. In 2004, the increase was attributable to an increase in net earnings of $213 million, and also to an increase in working capital improvements of $799 million compared to 2003. The remaining increase in cash between the periods was due to the timing of income tax payments and various other operating activities. The focus on improving our cash management processes continues to contribute to the aggregate reduction in operating working capital accounts (receivables, inventories, accounts payable, and customer advances and amounts in excess of costs incurred), including an aggregate reduction of $106 million in 2005 as compared to a reduction of $492 million in 2004. Although we will continue to focus on management of operating working capital accounts, we do not expect the rate of improvements we have experienced in prior periods to continue.

Investing Activities

Capital expenditures—Capital expenditures for property, plant and equipment amounted to $865 million in 2005, $769 million in 2004 and $687 million in 2003. We expect our capital expenditures to increase over the next two years consistent with the expected growth in our business and to support specific program requirements.

Acquisitions, divestitures and other activities—We have a process to selectively identify businesses for acquisition that meet our financial targets and disciplined growth strategy. We have focused on government information technology providers, systems integrators and complementary technologies. We paid $564 million for four businesses in 2005, $91 million for two businesses in 2004 and $645 million for two businesses in 2003.

During 2005, we received proceeds of $935 million from the divestiture of non-core equity investments. The proceeds included $752 million from the sale of our investment in Intelsat, Ltd., $140 million from the sale of Inmarsat shares and the redemption of certain Inmarsat equity-related investments, and $33 million from the sale of our NeuStar investment.

During 2004, New Skies Satellites, N.V. was sold to a private equity firm. Our portion of the proceeds was $148 million, $140 million of which was received in 2004. Also during 2004, we received cash from Inmarsat Group Holdings, Ltd. amounting to $50 million which reduced the amount of our investment. In 2003, Inmarsat Ventures, Ltd. was acquired by a consortium of private equity firms in a leveraged buyout transaction. In exchange for our interest, we received cash of $114 million and retained an ownership interest in the new Inmarsat holding company, Inmarsat Group Holdings, Ltd., valued at $96 million. Also in 2003, we paid $130 million related to our guarantee of Space Imaging, LLC's borrowings under its credit facility.

Financing Activities

Issuance and repayment of long-term debt—Cash provided from operations has been our principal source of funds to reduce our long-term debt. In 2005, we used $133 million of cash for the early retirement and scheduled repayment of long-term debt. In 2004, we used $1.1 billion of cash for the early retirement and scheduled repayment of long-term debt. Of that amount, $951 million related to the early retirement of debt through tender offers for which we incurred $163 million of associated costs. In 2003, we issued $1.0 billion of floating rate convertible senior debentures that bear interest at three-month LIBOR less 25 basis points, reset quarterly. We used the proceeds of that issuance, along with cash from operations, to repay $2.2 billion of debt in advance of its maturity and retire other high cost debt. We used $175 million of cash for debt issuance and repayment costs to complete those transactions in 2003.

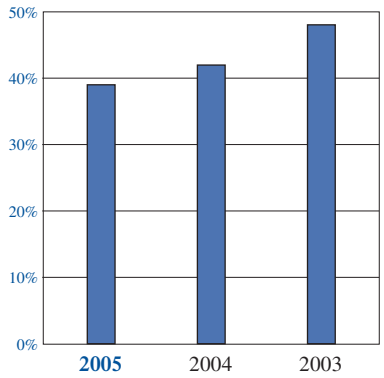
Share repurchases and dividends—We also used cash in each of the last three years for common share repurchase activity as follows: $1,222 million for 19.7 million common shares in 2005, of which $1,211 million for 19.5 million of those common shares, as well as $99 million for 1.8 million common shares purchased in 2004, was settled during the year; $772 million for 14.7 million common shares in 2004, of which $673 million for 12.9 million common shares was settled during the year; and $482 million in 2003 for 10.7 million common shares. These purchases were made under a share repurchase program in place for the repurchase of up to 88 million shares of our common stock from time-to-time at management's discretion, including 45 million shares that were authorized for repurchase under the program in September 2005. As of December 31, 2005, we had repurchased a total of 46.1 million shares under the program, and there remained approximately 41.9 million shares that may be repurchased in the future.

The payment of dividends on our common shares is one of the key components of our balanced cash deployment strategy. Shareholders were paid cash dividends of $462 million in 2005, $405 million in 2004 and $261 million in 2003. We have increased our quarterly dividend rate in each of the last three years. We paid a quarterly dividend of $0.25 per share during each of the first three quarters of 2005 and $0.30 per share for the last quarter of 2005. We paid a quarterly dividend of $0.22 per share during each of the first three quarters of 2004 and $0.25 per share for the last quarter of 2004. In 2003, we paid quarterly dividends of $0.12 per share during each of the first three quarters of the year and $0.22 per share for the last quarter of 2003.

CAPITAL STRUCTURE AND RESOURCES

At December 31, 2005 our total long-term debt amounted to $5.0 billion. Our long-term debt is almost entirely in the form of publicly issued notes and debentures. The majority of our long-term debt bears interest at fixed rates; however, $1.0 billion of convertible debentures issued in 2003 have a floating interest rate based on LIBOR. In 2005, we repaid $133 million of long-term debt, including scheduled and early debt repayments. Through our repayment activities, our long-term debt balance has declined over the last five years from $9.9 billion at December 31, 2000. We improved our debt-to-total capitalization ratio from 58% at December 31, 2000 to 39% at December 31, 2005.

Debt-To-Total Capital Ratio



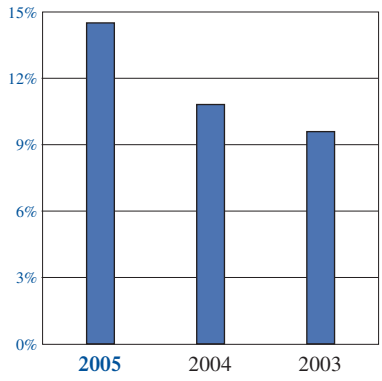
Our stockholders' equity amounted to $7.9 billion at December 31, 2005, an increase of $846 million from December 31, 2004. The increase came from net earnings and stock plan activities partially offset by our share repurchases and payment of dividends.

Return on invested capital (ROIC) improved by 370 basis points during 2005 to 14.5%. We define ROIC as net income plus after-tax interest expense divided by average invested capital (stockholders' equity plus debt), after adjusting stockholders' equity by adding back our minimum pension liability balance. We believe that reporting ROIC provides investors with greater visibility into how effectively Lockheed Martin uses the capital invested in its operations. We use ROIC to evaluate multi-year investment decisions and as a long-term

performance measure. We also use ROIC as a factor in evaluating management performance under certain of our incentive compensation plans. The adjustment to add back the minimum pension liability is a revision to our calculation in 2005 which we believe more closely links ROIC to management performance.

ROIC is not a measure of financial performance under generally accepted accounting principles in the U.S., and may not be defined and calculated by other companies in the same manner. ROIC should not be considered in isolation or as an alternative to net earnings as an indicator of performance. See Note (f) to the Consolidated Financial Data—Five Year Summary on page 74 for additional information concerning how we calculate ROIC. That information reflects the revision to the calculation as discussed in the preceding paragraph for all periods presented.

Revised Return On Invested Capital Ratio[(1)]



[(1)] Calculation was revised in 2005. See Note (f) to the Consolidated Financial Data—Five Year Summary on page 74 for additional information on the calculation.

At December 31, 2005, we had in place a $1.5 billion revolving credit facility which expires in July 2010. There were no borrowings outstanding under the facility at December 31, 2005. Borrowings under the credit facility would be unsecured and bear interest at rates based, at our option, on the Eurodollar rate or a bank Base Rate (as defined). Each bank's obligation to make loans under the credit facility is subject to, among other things, our compliance with various representations, warranties and covenants, including covenants limiting our ability and the ability of certain of our subsidiaries to encumber our assets, and a covenant not to exceed a maximum leverage ratio. We cancelled our $500 million 364-day credit facility on June 17, 2005.

We have agreements in place with banking institutions to provide for the issuance of commercial paper. There were no commercial paper borrowings outstanding at December 31, 2005. If we were to issue commercial paper, the borrowings would be supported by the $1.5 billion credit facility.

We have an effective shelf registration statement on file with the Securities and Exchange Commission to provide for the issuance of up to $1 billion in debt securities. If we were to issue debt under this shelf registration, we would expect to use the net proceeds for general corporate purposes. These purposes may include repayment of debt, working capital needs, capital expenditures, acquisitions and any other general corporate purpose.

We actively seek to finance our business in a manner that preserves financial flexibility while minimizing borrowing costs to the extent practicable. Our management continually reviews changes in financial, market and economic conditions to manage the types, amounts and maturities of our indebtedness. We may at times refinance existing indebtedness, vary our mix of variable-rate and fixed-rate debt, or seek alternative financing sources for our cash and operational needs.

Cash and cash equivalents, short-term investments, cash flow from operations and other available financing resources are expected to be sufficient to meet anticipated operating, capital expenditure and debt service requirements, as well as acquisition and other discretionary investment needs, projected over the next three years.

CONTRACTUAL COMMITMENTS AND OFF-BALANCE SHEET ARRANGEMENTS

At December 31, 2005, we had contractual commitments to repay debt, make payments under operating leases, settle obligations related to agreements to purchase goods and services, and settle other long-term liabilities. Capital lease obligations were negligible. Payments due under these long-term obligations and commitments are as follows:

	Payments Due By Period				
(In millions)	Total	Less Than 1 Year	1–3 Years	3–5 Years	After 5 Years
Long-term debt[a]	$ 4,986	$ 202	$ 136	$ 248	$4,400
Operating lease obligations	1,157	261	386	262	248
Purchase obligations					
Operating activities	23,566	11,001	7,880	2,752	1,933
Capital expenditures	462	344	118	—	—
Other long-term liabilities	1,289	213	256	169	651
Total contractual cash obligations	$31,460	$12,021	$8,776	$3,431	$7,232

(a) Long-term debt includes scheduled principal payments only.

Generally, our long-term debt obligations are subject to, along with other things, compliance with certain covenants, including covenants limiting our ability and the ability of certain of our subsidiaries to encumber our assets.

Purchase obligations related to operating activities include agreements and requirements contracts that give the supplier recourse to us for cancellation or nonperformance under the contract or contain terms that would subject us to liquidated damages. Such agreements and contracts may, for example, be related to direct materials, obligations to sub-contractors and outsourcing arrangements. Total purchase obligations in the preceding table include approximately $22 billion related to contractual commitments entered into as a result of contracts we have with our U.S. Government customers. However, the U.S. Government would generally be required to pay us for any costs we incur relative to these commitments if they were to terminate the related contracts "for convenience" pursuant to FAR. For example, if we had commitments to purchase goods and services that were entered into as a result of a specific contract we received from our U.S. Government customer and the customer terminated the contract for convenience, any amounts we would be required to pay to settle the related commitments, as well as amounts previously incurred, would generally be reimbursed by the customer. This would also be true in cases where we perform sub-contract work for a prime contractor under a U.S. Government contract. The termination for convenience language may also be included in contracts with foreign, state and local governments. In addition, we have contracts with customers that do not include termination for convenience provisions, including contracts with commercial customers.

Total purchase obligations in the preceding table related to capital expenditures generally include amounts for facilities and equipment at various of our locations, related to customer contracts.

Amounts related to "Other long-term liabilities" in the preceding table represent the contractual obligations for certain long-term liabilities recorded as of December 31, 2005. Such amounts mainly include expected payments under deferred compensation plans, non-qualified pension plans and environmental liabilities. Obligations related to environmental liabilities represent our estimate of remediation payment obligations under government consent decrees and agreements, excluding amounts reimbursed by the U.S. Government in its capacity as a potentially responsible party under an agreement entered into in 2000.

We also may enter into industrial participation agreements, sometimes referred to as offset agreements, as a condition to obtaining orders for our products and services from certain customers in foreign countries. These agreements are designed to enhance the social and economic environment of the foreign country by requiring the contractor to promote investment in the country. Offset agreements may be satisfied through activities that do not require us to use cash, including transferring technology, providing manufacturing and other consulting support to in-country projects, and the purchase by third parties (*e.g.*, our vendors) of supplies from in-country vendors. These agreements may also be satisfied through our use of cash for such activities as purchasing supplies from in-country vendors, providing financial support for in-country projects, and building or leasing facilities for in-country operations. We do not commit to offset agreements until orders for our products or services are definitive. Offset programs generally extend over several years and may provide for penalties in the event we fail to perform in accordance with offset requirements. No such penalties have been incurred during the last

five years. The amounts ultimately applied against our offset agreements are based on negotiations with the customer and generally require cash outlays that represent only a fraction of the original amount in the offset agreement. At December 31, 2005, we had outstanding offset agreements totaling $8.4 billion, primarily related to our Aeronautics segment, that extend through 2015. To the extent we have entered into purchase obligations at December 31, 2005 that also satisfy offset agreements, those amounts are included in the preceding table.

We have entered into standby letter of credit agreements and other arrangements with financial institutions and customers mainly relating to advances received from customers and/or the guarantee of future performance on some of our contracts. At December 31, 2005, we had outstanding letters of credit, surety bonds and guarantees, as follows:

	Commitment Expiration By Period				
(In millions)	Total Commitment	Less Than 1 Year[a]	1–3 Years[a]	3–5 Years	After 5 Years
Standby letters of credit	$2,630	$2,425	$171	$18	$16
Surety bonds	434	79	352	3	—
Guarantees	2	1	1	—	—
Total commitments	$3,066	$2,505	$524	$21	$16

(a) Approximately $2,262 million and $49 million of standby letters of credit in the "Less Than 1 Year" and "1-3 Year" periods, respectively, and approximately $38 million of surety bonds in the "Less Than 1 Year" period are expected to renew for additional periods until completion of the contractual obligation.

Included in the table above is approximately $200 million representing letter of credit and surety bond amounts for which related obligations or liabilities are also recorded in the balance sheet, either as reductions of inventories, as customer advances and amounts in excess of costs incurred, or as other liabilities. Approximately $2 billion of the standby letters of credit in the table above were to secure advance payments received under an F-16 contract from an international customer. These letters of credit are available for draw down in the event of our nonperformance, and the amount available will be reduced as certain events occur throughout the period of performance in accordance with the contract terms. Similar to the letters of credit for the F-16 contract, other letters of credit and surety bonds are available for draw down in the event of our nonperformance.

At December 31, 2005, we had no material off-balance sheet arrangements as those arrangements are defined by the Securities and Exchange Commission (SEC).

QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK

Our main exposure to market risk relates to interest rates and foreign currency exchange rates. Our financial instruments that are subject to interest rate risk principally include fixed-rate and floating rate long-term debt. If interest rates were to change by plus or minus 1%, interest expense would increase or decrease by approximately $10 million related to our floating rate debt. The estimated fair values of the Corporation's long-term debt instruments at December 31, 2005 aggregated approximately $6.2 billion, compared with a carrying amount of approximately $5.0 billion. The majority of our long-term debt obligations are not callable until maturity. We have used interest rate swaps in the past to manage our exposure to fixed and variable interest rates; however, at year-end 2005, we had no such agreements in place.

We use forward foreign exchange contracts to manage our exposure to fluctuations in foreign currency exchange rates, and do so in ways that qualify for hedge accounting treatment. These exchange contracts hedge the fluctuations in cash flows associated with firm commitments or specific anticipated transactions contracted in foreign currencies, or hedge the exposure to rate changes affecting foreign currency denominated assets or liabilities. Related gains and losses on these contracts, to the extent they are effective hedges, are recognized in income at the same time the hedged transaction is recognized or when the hedged asset or liability is adjusted. To the extent the hedges are ineffective, gains and losses on the contracts are recognized in the current period. At December 31, 2005, the fair value of forward exchange contracts outstanding, as well as the amounts of gains and losses recorded during the year then ended, were not material. We do not hold or issue derivative financial instruments for trading or speculative purposes.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued FAS 123(R), *Share-Based Payments*, which will impact our net earnings and earnings per share and change the classification of certain elements of the statement of cash flows. FAS 123(R) requires stock options and other share-based payments made to employees to be accounted for as compensation expense and recorded at fair

value, and to reflect the related excess tax benefit received upon exercise of the options, if any, in the statement of cash flows as a financing activity inflow rather than an adjustment of operating activity as currently presented. We currently use the Black-Scholes model to compute the fair value of our stock options in connection with our disclosure of the pro forma effects on net earnings and earnings per share as if compensation cost had been recognized for such options at the date of grant (see Note 1 to the financial statements).

We adopted FAS 123(R), and related SEC rules included in SAB No. 107, on a modified prospective basis effective January 1, 2006. We will continue to use the Black-Scholes option-pricing model to estimate the fair value of stock options granted subsequent to the date of adoption. The Lockheed Martin Amended and Restated 2003 Incentive Performance Award Plan provides for the grant of various types of stock-based incentive awards, including options to purchase common stock, stock appreciation rights, restricted stock and stock units. The types and mix of stock-based incentive awards are evaluated on an ongoing basis and may vary based on management's overall strategy regarding compensation, including consideration of the impact of the expensing of stock option awards on our results of operations subsequent to the adoption of FAS 123(R). Based on current analyses and information, we expect that the combination of expensing stock options upon adoption of FAS 123(R) in 2006 and grants of restricted stock units will result in additional expense, net of state income tax benefits, totaling approximately $100 million (or a reduction in net earnings per share of $0.15) on a full year basis.

We also adopted FASB Interpretation No. (FIN) 47, *Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143,* in the fourth quarter of 2005. FIN 47 clarifies the term "conditional asset retirement obligation" as used in FAS 143, *Accounting for Asset Retirement Obligations,* and requires that a liability and a corresponding increase in the value of the underlying asset be recorded, and depreciation on the increased asset value be expensed, if the fair value of the obligation can be reasonably estimated. The types of asset retirement obligations that are covered by FIN 47 are those for which an entity has a legal obligation to perform an asset retirement activity, even though the timing and/or method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. An example of a condition giving rise to an asset retirement obligation is the presence of embedded asbestos, radiation sources or other regulated materials in buildings or equipment. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The adoption of FIN 47 did not have a significant impact on our financial position or results of operations. This is primarily due to the fact that the fair values of the majority of our asset retirement obligations could not be reasonably estimated because they had indeterminate settlement dates, since the range of time over which we may settle the obligations is unknown and could not be estimated. Consistent with the provisions of FIN 47, each obligation will be recorded at the time the settlement date is no longer indeterminate and the obligation can be reasonably estimated.

In May 2004, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.* This FSP provides specific authoritative guidance on the accounting for the federal subsidy to eligible sponsors of retiree health care benefits provided under this law. Using this guidance, we estimated a projected reduction in our accumulated postretirement benefit obligation as of December 31, 2004 of $295 million from the effects of the new law. This obligation will be recognized over the remaining service lives of the employees eligible for the benefit. In January 2005, the Center for Medicare and Medicaid Services released regulations governing the application of the law and continued to provide clarifying guidance during 2005. Based on this guidance, the impact of adoption of the FSP was a reduction of the FAS 106 postretirement expense for the year ended December 31, 2005 of approximately $35 million. The postretirement expense computed under FAS 106 does not include the effects of U.S. Government Cost Accounting Standards or income tax benefits. The adoption of the FSP did not have a material impact on our results of operations, financial position or cash flows for the year ended December 31, 2005.

CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures, including internal control over financial reporting, that are designed to ensure that information required to be disclosed in our periodic filings with the SEC is reported within the time periods specified in the SEC's rules and forms, and to provide reasonable assurance that assets are safeguarded and transactions are properly executed and recorded. Our disclosure controls and procedures are also designed to ensure that information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating such controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to use its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, we have investments in certain unconsolidated entities. As we do not control or manage these entities, our controls and procedures with respect to those entities are necessarily substantially more limited than those we maintain with respect to our consolidated subsidiaries.

We routinely review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating the activities of two or more business units, and migrating certain processes to our Shared Services centers. In addition, when we acquire new businesses, we review the controls and procedures of the acquired business as part of our integration activities.

We performed an evaluation of the effectiveness of our disclosure controls and procedures, including internal control over financial reporting, as of December 31, 2005. The evaluation was performed with the participation of senior management of each business segment and key Corporate functions, and under the supervision of the CEO and CFO. Based on our evaluation, we concluded that our disclosure controls and procedures were effective as of December 31, 2005.

During 2005, we also performed a separate evaluation of our internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act, including performing self-assessment and monitoring procedures. Based on those activities and other evaluation procedures, our management, including the CEO and CFO, concluded that internal control over financial reporting was effective as of December 31, 2005. Management's report on our financial statements and internal control over financial reporting appears on page 41. In addition, both our assessment and the effectiveness of internal control over financial reporting were audited by our independent registered public accounting firm. Their report appears on page 42.

There were no changes in our internal control over financial reporting during the most recently completed fiscal quarter that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

MANAGEMENT'S REPORT ON THE FINANCIAL STATEMENTS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Lockheed Martin is responsible for the consolidated financial statements and all related financial information contained in this Annual Report on Form 10-K. The consolidated financial statements, which include amounts based on estimates and judgments, have been prepared in accordance with accounting principles generally accepted in the United States. Management believes the consolidated financial statements fairly present, in all material respects, the financial condition, results of operations and cash flows of the Corporation. The consolidated financial statements have been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report included herein.

The management of Lockheed Martin is also responsible for establishing and maintaining an adequate system of internal control over financial reporting of the Corporation (as defined by the Securities Exchange Act of 1934). This system is designed to provide reasonable assurance, based on an appropriate cost-benefit relationship, that assets are safeguarded and transactions are properly executed and recorded. An environment that provides for an appropriate level of control consciousness is maintained through a comprehensive program of management testing to identify and correct deficiencies, examinations by internal auditors and audits by the Defense Contract Audit Agency for compliance with federal government rules and regulations applicable to contracts with the U.S. Government.

Management conducted an evaluation of the effectiveness of the Corporation's system of internal control over financial reporting based on the framework in *Internal Control–Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Corporation's system of internal control over financial reporting was effective as of December 31, 2005. Management's assessment has been audited by Ernst & Young LLP, as stated in their report included herein.

Essential to the Corporation's internal control system is management's dedication to the highest standards of integrity, ethics and social responsibility. To support these standards, management has issued the Code of Ethics and Business Conduct (the Code). The Code provides for a help line that employees can use to confidentially or anonymously communicate to the Corporation's ethics office complaints or concerns about accounting, internal control or auditing matters. These matters are forwarded directly to the Audit Committee of the Corporation's Board of Directors.

The Audit Committee, which is composed of five directors who are not members of management, has oversight responsibility for the Corporation's financial reporting process and the audits of the consolidated financial statements and internal control over financial reporting. Both the independent auditors and the internal auditors meet periodically with members of the Audit Committee, with or without management representatives present. The Audit Committee recommended, and the Board of Directors approved, that the audited consolidated financial statements be included in the Corporation's Annual Report on Form 10-K for filing with the Securities and Exchange Commission.

ROBERT J. STEVENS
Chairman, President and Chief
Executive Officer

CHRISTOPHER E. KUBASIK
Executive Vice President and Chief
Financial Officer

REPORT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM, REGARDING INTERNAL CONTROL OVER FINANCIAL REPORTING

Board of Directors and Stockholders
Lockheed Martin Corporation

We have audited management's assessment, included in the accompanying Management's Report on the Financial Statements and Internal Control Over Financial Reporting, that Lockheed Martin Corporation maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Lockheed Martin Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Lockheed Martin Corporation maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Lockheed Martin Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Lockheed Martin Corporation and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of earnings, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005 of Lockheed Martin Corporation and our report dated February 22, 2006 expressed an unqualified opinion thereon.

Baltimore, Maryland
February 22, 2006

REPORT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM, ON THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Board of Directors and Stockholders
Lockheed Martin Corporation

We have audited the accompanying consolidated balance sheets of Lockheed Martin Corporation and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of earnings, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lockheed Martin Corporation and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Lockheed Martin Corporation's internal control over financial reporting as of December 31, 2005 based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 22, 2006 expressed an unqualified opinion thereon.

Baltimore, Maryland
February 22, 2006

CONSOLIDATED STATEMENT OF EARNINGS

(In millions, except per share data)	*Year Ended December 31,* 2005	2004	2003
NET SALES			
Products	**$31,518**	$30,202	$27,290
Services	**5,695**	5,324	4,534
	37,213	35,526	31,824
COST OF SALES			
Products	**28,800**	27,879	25,306
Services	**5,073**	4,765	4,099
Unallocated Corporate costs	**803**	914	443
	34,676	33,558	29,848
	2,537	1,968	1,976
Other income and expenses, net	**449**	121	43
Operating profit	**2,986**	2,089	2,019
Interest expense	**370**	425	487
Earnings before taxes	**2,616**	1,664	1,532
Income tax expense	**791**	398	479
NET EARNINGS	**$ 1,825**	$ 1,266	$ 1,053
EARNINGS PER COMMON SHARE:			
Basic	**$ 4.15**	$ 2.86	$ 2.36
Diluted	**$ 4.10**	$ 2.83	$ 2.34

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEET

(In millions)	*December 31,* 2005	2004
ASSETS		
Current assets		
Cash and cash equivalents	**$ 2,244**	$ 1,060
Short-term investments	**429**	396
Receivables	**4,579**	4,094
Inventories	**1,921**	1,864
Deferred income taxes	**861**	982
Other current assets	**495**	557
Total current assets	**10,529**	8,953
Property, plant and equipment, net	**3,924**	3,599
Investments in equity securities	**196**	812
Goodwill	**8,447**	7,892
Purchased intangibles, net	**560**	672
Prepaid pension asset	**1,360**	1,030
Other assets	**2,728**	2,596
	$27,744	$25,554
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	**$ 1,998**	$ 1,726
Customer advances and amounts in excess of costs incurred	**4,331**	4,028
Salaries, benefits and payroll taxes	**1,475**	1,346
Current maturities of long-term debt	**202**	15
Other current liabilities	**1,422**	1,451
Total current liabilities	**9,428**	8,566
Long-term debt	**4,784**	5,104
Accrued pension liabilities	**2,097**	1,660
Other postretirement benefit liabilities	**1,277**	1,236
Other liabilities	**2,291**	1,967
Stockholders' equity		
Common stock, $1 par value per share	**432**	438
Additional paid-in capital	**1,724**	2,223
Retained earnings	**7,278**	5,915
Accumulated other comprehensive loss	**(1,553)**	(1,532)
Other	**(14)**	(23)
Total stockholders' equity	**7,867**	7,021
	$27,744	$25,554

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
(In millions)	**2005**	2004	2003
OPERATING ACTIVITIES			
Net earnings	**$ 1,825**	$ 1,266	$ 1,053
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	**555**	511	480
Amortization of purchased intangibles	**150**	145	129
Deferred federal income taxes	**24**	(58)	467
Changes in operating assets and liabilities:			
Receivables	**(390)**	(87)	(258)
Inventories	**(39)**	519	(94)
Accounts payable	**239**	288	330
Customer advances and amounts in excess of costs incurred	**296**	(228)	(285)
Other	**534**	568	(13)
Net cash provided by operating activities	**3,194**	2,924	1,809
INVESTING ACTIVITIES			
Expenditures for property, plant and equipment	**(865)**	(769)	(687)
Acquisition of businesses/investments in affiliated companies	**(564)**	(91)	(821)
Proceeds from divestiture of businesses/investments in affiliated companies	**935**	279	234
Purchase of short-term investments, net	**(33)**	(156)	(240)
Other	**28**	29	53
Net cash used for investing activities	**(499)**	(708)	(1,461)
FINANCING ACTIVITIES			
Repayments of long-term debt	**(133)**	(1,089)	(2,202)
Issuances of long-term debt	**—**	—	1,000
Long-term debt repayment and issuance costs	**(12)**	(163)	(175)
Issuances of common stock	**406**	164	44
Repurchases of common stock	**(1,310)**	(673)	(482)
Common stock dividends	**(462)**	(405)	(261)
Net cash used for financing activities	**(1,511)**	(2,166)	(2,076)
Net increase (decrease) in cash and cash equivalents	**1,184**	50	(1,728)
Cash and cash equivalents at beginning of year	**1,060**	1,010	2,738
Cash and cash equivalents at end of year	**$ 2,244**	$ 1,060	$ 1,010

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(In millions, except per share data)	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Other	Total Stockholders' Equity	Compre-hensive Income (Loss)
Balance at December 31, 2002	$455	$ 2,796	$4,262	$(1,598)	$(50)	$ 5,865	
Net earnings	—	—	1,053	—	—	1,053	$1,053
Common stock dividends declared ($0.58 per share)	—	—	(261)	—	—	(261)	—
Repurchases of common stock	(11)	(471)	—	—	—	(482)	—
Stock-based awards and ESOP activity	2	152	—	—	33	187	—
Other comprehensive income (loss):							
Minimum pension liability	—	—	—	331	—	331	331
Net unrealized gain from available-for-sale investments	—	—	—	46	—	46	46
Other	—	—	—	17	—	17	17
Balance at December 31, 2003	446	2,477	5,054	(1,204)	(17)	6,756	$1,447
Net earnings	—	—	1,266	—	—	1,266	$1,266
Common stock dividends declared ($0.91 per share)	—	—	(405)	—	—	(405)	—
Repurchases of common stock	(15)	(757)	—	—	—	(772)	—
Stock-based awards and ESOP activity	7	503	—	—	(6)	504	—
Other comprehensive income (loss):							
Minimum pension liability	—	—	—	(285)	—	(285)	(285)
Reclassification adjustments related to available-for-sale investments	—	—	—	(56)	—	(56)	(56)
Other	—	—	—	13	—	13	13
Balance at December 31, 2004	438	2,223	5,915	(1,532)	(23)	7,021	$ 938
Net earnings	—	—	1,825	—	—	1,825	$1,825
Common stock dividends declared ($1.05 per share)	—	—	(462)	—	—	(462)	—
Repurchases of common stock	(20)	(1,202)	—	—	—	(1,222)	—
Stock-based awards and ESOP activity	14	703	—	—	9	726	—
Other comprehensive income (loss):							
Minimum pension liability	—	—	—	(105)	—	(105)	(105)
Net unrealized gain from available-for-sale investments	—	—	—	97	—	97	97
Other	—	—	—	(13)	—	(13)	(13)
Balance at December 31, 2005	**$432**	**$ 1,724**	**$7,278**	**$(1,553)**	**$(14)**	**$ 7,867**	**$1,804**

See accompanying Notes to Consolidated Financial Statements.

NOTE 1—SIGNIFICANT ACCOUNTING POLICIES

Organization—Lockheed Martin Corporation (Lockheed Martin or the Corporation) is engaged in the research, design, development, manufacture, integration, operation and sustainment of advanced technology systems, products and services. As a leading systems integrator, its products and services range from electronics and information systems, including integrated net-centric solutions, to missiles, aircraft, spacecraft and launch services. The Corporation serves customers in both domestic and international defense and commercial businesses, with its principal customers being agencies of the U.S. Government.

Basis of consolidation and classifications—The consolidated financial statements include the accounts of wholly-owned subsidiaries and other entities which the Corporation controls. Intercompany balances and transactions have been eliminated in consolidation. Receivables and inventories are primarily attributable to long-term contracts or programs in progress for which the related operating cycles are longer than one year. In accordance with industry practice, these items are included in current assets.

Certain amounts for prior years have been reclassified to conform with the 2005 presentation.

Use of estimates—The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions, including estimates of anticipated contract costs and revenues utilized in the earnings recognition process, that affect the reported amounts in the financial statements and accompanying notes. Due to the size and nature of many of the Corporation's programs, the estimation of total revenues and cost at completion is subject to a wide range of variables, including assumptions for schedule and technical issues. Actual results may differ from those estimates.

Cash and cash equivalents—Cash equivalents are generally composed of highly liquid instruments with original maturities of 90 days or less. Due to the short maturity of these instruments, carrying value on the Corporation's consolidated balance sheet approximates fair value.

Short-term investments—The Corporation's short-term investments consist of marketable securities that are categorized as available-for-sale securities as defined by Statement of Financial Accounting Standards (FAS) 115, *Accounting for Certain Investments in Debt and Equity Securities.* Realized gains and losses are recorded in other income and expenses. For purposes of computing realized gains and losses, cost is determined on a specific identification basis. The fair values of marketable securities are estimated based on quoted market prices for the respective securities.

The Corporation records short-term investments at fair value. At year end, the investment portfolio was composed of the following:

	Year Ended December 31,			
	2005		2004	
(In millions)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. treasury and government agency securities	**$125**	**$124**	$252	$251
Corporate debt securities	**145**	**144**	117	117
Mortgage-backed and other securities	**161**	**161**	28	28
	$431	**$429**	$397	$396

Approximately 60% of the securities had contractual maturities of one year or less. An additional 36% of the securities had contractual maturities of one to five years. Marketable securities sales proceeds totaled $461 million in 2005 and $384 million in 2004. Gross gains and losses related to sales of marketable securities for both years, as well as net unrealized gains and losses at each year end, were not material.

Receivables—Receivables consist of amounts billed and currently due from customers, and unbilled costs and accrued profits primarily related to revenues on long-term contracts that have been recognized for accounting purposes but not yet billed to customers. As such revenues are recognized, appropriate amounts of customer advances, performance-based payments and progress payments are reflected as an offset to the related receivables balance.

Inventories—Inventories are stated at the lower of cost or estimated net realizable value. Costs on long-term contracts and programs in progress represent recoverable costs incurred for production or contract-specific facilities and equipment, allocable operating overhead, advances to suppliers and, in the case of contracts with the U.S. Government, research and development and general and administrative expenses. Pursuant to contract provisions, agencies of the U.S. Government and certain other customers have title to, or a security interest in, inventories related to such contracts as a result of advances, performance-based payments and progress payments. Such advances and payments are reflected as an offset against the related inventory balances. General and administrative expenses related to commercial products and services provided essentially under commercial terms and conditions are expensed as incurred. Costs of other product and supply inventories are principally determined by the first-in first-out or average cost methods.

Property, plant and equipment—Property, plant and equipment are carried principally at cost. Depreciation is provided on plant and equipment generally using accelerated methods during the first half of the estimated useful lives of the assets; thereafter, straight-line depreciation is used. Estimated useful lives generally range from 10 to 40 years for buildings and five to 15 years for machinery and equipment.

Investments in equity securities—Investments in equity securities include the Corporation's ownership interests in affiliated companies that it does not control which are accounted for under the equity method of accounting. Under this method of accounting, which generally applies to investments that represent a 20% to 50% ownership of the equity securities of the investees, the Corporation's share of the net earnings or losses of the affiliated companies is included in other income and expenses. The Corporation recognizes currently gains or losses arising from issuances of stock by wholly-owned or majority-owned subsidiaries, or by equity method investees. These gains or losses are also included in other income and expenses.

Investments in equity securities also include the Corporation's ownership interests in companies in which its investment represents less than 20% ownership. If classified as available-for-sale under FAS 115, these investments are accounted for at fair value, with unrealized gains and losses reflected as a net after-tax amount under the caption of accumulated other comprehensive income (loss) in the statement of stockholders' equity. If declines in the value of investments accounted for under either the equity method or FAS 115 are determined to be other than temporary, a loss is recorded in earnings in the current period. The Corporation makes such determinations by considering, among other factors, the length of time the fair value of the investment has been less than the carrying value, future business prospects for the investee, information regarding market and industry trends for the investee's business, and investment analyst reports, if available. Investments not accounted for under one of these methods are generally accounted for under the cost method of accounting.

Goodwill—Goodwill is evaluated for potential impairment annually by comparing the fair value of a reporting unit, based on estimated future cash flows, to its carrying value including goodwill recorded by the reporting unit. If the carrying value exceeds the fair value, impairment is measured by comparing the derived fair value of goodwill to its carrying value, and any impairment determined is recorded in the current period.

Purchased intangibles, net—Intangible assets acquired as part of business combinations are amortized over their estimated useful lives unless their useful lives are determined to be indefinite. For material business combinations, amounts recorded related to purchased intangibles are determined from independent valuations. The Corporation's purchased intangibles primarily relate to contracts and programs and customer relationships which are amortized over periods of 15 years or less. Purchased intangibles are displayed in the consolidated balance sheet net of accumulated amortization of $1,788 million and $1,638 million at December 31, 2005 and 2004, respectively. Amortization expense related to these intangible assets was $150 million, $145 million and $129 million for the years ended December 31, 2005, 2004 and 2003, respectively, and is estimated to be $153 million in 2006, $125 million in 2007, $87 million in 2008, $68 million in 2009 and $63 million in 2010.

Customer advances and amounts in excess of cost incurred—The Corporation receives advances, performance-based payments and progress payments from customers which may exceed costs incurred on certain contracts, including contracts with agencies of the U.S. Government. Such advances, other than those reflected as a reduction of accounts receivable or inventories as discussed above, are classified as current liabilities.

Environmental matters—The Corporation records a liability for environmental matters when it is probable that a liability has been incurred and the amount can be reasonably estimated. In cases where a date to complete activities at a particular environmental site cannot be estimated by reference to agreements or otherwise, we project costs over a reasonable time frame not to exceed 20 years. Liabilities are not discounted unless the amount and timing of future cash payments are fixed or reliably determinable. A substantial portion of environmental costs are expected to be reflected in sales and cost of sales pursuant to U.S. Government agreement or regulation. At the time a liability is recorded for future environmental costs, an asset is recorded for estimated future recovery considered probable through the pricing of products and services to agencies of the U.S. Government. The portion of those costs expected to be allocated to commercial business or that is determined to be unallowable for pricing under U.S. Government contracts is reflected in cost of sales at the time the liability is established.

Sales and earnings—Sales and anticipated profits under long-term fixed-price design, development and production contracts are recorded on a percentage of completion basis, generally using units-of-delivery as the basis to measure progress toward completing the contract and recognizing revenue. Estimated contract profits are taken into earnings in proportion to recorded sales. Sales under certain long-term fixed-price development and production contracts which, among other factors, provide for the delivery of minimal quantities or require a substantial level of development effort in relation to total contract value, are recorded upon achievement of performance milestones or using the cost-to-cost method of accounting where sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. Sales under development and production cost-reimbursement-type contracts are recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs bear to total estimated costs. Sales of products and services provided essentially under commercial terms and conditions are recorded upon delivery and passage of title.

Incentives or penalties related to performance on design, development and production contracts are considered in estimating sales and profit rates, and are recorded when there is sufficient information to assess anticipated contract performance. Estimates of award fees are also considered in estimating sales and profit rates based on actual awards and anticipated performance. Incentive provisions which increase or decrease earnings based solely on a single significant event are generally not recognized until the event occurs. Amounts representing contract change orders, claims or other items are included in sales only when they can be reliably estimated and realization is probable.

Revenue under contracts for services other than those associated with design, development or production activities is generally recognized either as services are performed or when earned, depending on the contract. This methodology is primarily used by the Information & Technology Services segment. Revenue under such contracts is generally recognized on a straight-line basis over the period of contract performance, unless evidence suggests that the revenue is earned or the obligations are fulfilled in a different pattern. Costs incurred under these service contracts are expensed as incurred, except that initial "set-up" costs are capitalized and recognized over the life of the agreement. Incentives and award fees related to performance on services contracts are recognized when they are fixed and determinable, generally at the date of award.

Research and development and similar costs—Corporation-sponsored research and development costs primarily include independent research and development and bid and proposal efforts related to government products and services. Except for certain arrangements described below, these costs are generally included as part of the general and administrative costs that are allocated among all contracts and programs in progress under U.S. Government contractual arrangements. Corporation-sponsored product development costs not otherwise allocable are charged to expense when incurred. Under certain arrangements in which a customer shares in product development costs, the Corporation's portion of unreimbursed costs is generally expensed as incurred. Total independent research and development costs charged to cost of sales in 2005, 2004 and 2003, including costs related to bid and proposal efforts, totaled $1,042 million in 2005, $984 million in 2004 and $1,030 million in 2003. Costs incurred under customer-sponsored research and development programs pursuant to contracts are accounted for as sales and cost of sales under the contract.

Restructuring activities—Under existing U.S. Government regulations, certain costs incurred for consolidation or restructuring activities that can be demonstrated to result in savings in excess of the cost to implement those actions can be deferred and amortized for government contracting purposes and included as allowable costs in future pricing of the Corporation's products and services. Included in other assets in the consolidated balance sheet at December 31, 2005 and 2004 is $65 million and $95 million, respectively, of deferred costs related to various consolidation actions.

Impairment of certain long-lived assets—Generally, the carrying values of long-lived assets other than goodwill are reviewed for impairment if events or changes in the facts and circumstances indicate that their carrying values may not be recoverable. Any impairment determined is recorded in the current period and is measured by comparing the fair value based on estimated future cash flows of the related asset to its carrying value.

Derivative financial instruments—The Corporation sometimes uses derivative financial instruments to manage its exposure to fluctuations in foreign exchange rates and interest rates. The Corporation does not hold or issue derivative financial instruments for trading or speculative purposes. Derivatives are recorded as either other current assets or liabilities in the consolidated balance sheet, and periodically adjusted to fair value. The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on the intended use of the derivative and its resulting designation. Adjustments to reflect changes in fair values of derivatives that are not considered highly effective hedges are reflected in earnings. Adjustments to reflect changes in fair values of derivatives that are considered highly effective hedges are either reflected in earnings and largely offset by corresponding adjustments related to the fair values of the hedged items, or reflected net of income taxes in accumulated other comprehensive income (loss) until the hedged transaction occurs and the entire transaction is recognized in earnings. The change in fair value of the ineffective portion of a hedge is immediately recognized in earnings.

Interest rate swap agreements are designated as effective hedges of the fair value of certain existing fixed rate debt instruments. Forward currency exchange contracts qualify as hedges of the fluctuations in cash flows associated with firm commitments or specific anticipated transactions contracted in foreign currencies, or as hedges of the exposure to rate changes affecting foreign currency denominated assets or liabilities. At December 31, 2005, there were no interest rate swap agreements outstanding, and the fair value of forward currency exchange contracts outstanding, as well as the related amounts of gains and losses recorded during the year, were not material.

Stock-based compensation—The Corporation measures compensation cost for stock-based compensation plans using the intrinsic value method of accounting as prescribed in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. The Corporation has adopted those provisions of FAS 123, *Accounting for Stock-Based Compensation,* which require disclosure of the pro forma effects on net earnings and earnings per share as if compensation cost had been recognized based upon the fair value-based method at the date of grant for options awarded. The fair value information included in the table below was estimated at the date of grant of the options using the Black-Scholes option pricing model.

Upon retirement, the Corporation's stock option award agreements allow employees to retain all stock option awards held through the initial vesting date prior to retirement, and to continue vesting in the award as if their employment had continued. Effective January 2005, the Corporation recognizes fair value-based, pro forma compensation expense for active, retirement-eligible employees over the one-year initial vesting period, and for active, non-retirement-eligible employees, over the original three-year vesting periods of the award. Prior to 2005, the Corporation recognized fair value-based, pro forma compensation expense over the original vesting periods of each award for all employees, including those eligible to retire.

The pro forma disclosures for the year ended December 31, 2005 set forth below include $33 million ($0.08 per share) as an inception-to-date adjustment of fair value-based, pro forma compensation expense recognized in the first quarter of 2005 related to retirement eligible employees with outstanding and unvested 2004 and 2003 stock option awards, to reflect the service period as one year rather than the original vesting period.

The Corporation's reported and pro forma earnings per share information follows:

(In millions, except per share data)	**2005**	2004	2003
NET EARNINGS			
As reported	**$1,825**	$1,266	$1,053
Fair value-based compensation cost, net of taxes			
Fair value-based, pro forma compensation expense	**(56)**	(48)	(61)
Inception-to-date adjustment	**(33)**	—	—
Pro forma net earnings	**$1,736**	$1,218	$ 992
EARNINGS PER BASIC SHARE			
As reported	**$ 4.15**	$ 2.86	$ 2.36
Fair value-based, pro forma compensation expense	**(0.12)**	(0.11)	(0.14)
Inception-to-date adjustment	**(0.08)**	—	—
Pro forma	**$ 3.95**	$ 2.75	$ 2.22
EARNINGS PER DILUTED SHARE			
As reported	**$ 4.10**	$ 2.83	$ 2.34
Fair value-based, pro forma compensation expense	**(0.12)**	(0.11)	(0.14)
Inception-to-date adjustment	**(0.08)**	—	—
Pro forma	**$ 3.90**	$ 2.72	$ 2.20

The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2005	2004	2003
Risk-free interest rate	**3.70%**	3.19%	2.91%
Dividend yield	**1.73%**	1.50%	1.00%
Volatility factors related to expected price of Lockheed Martin stock	**0.259**	0.365	0.387
Expected option life	**5 years**	5 years	5 years

The weighted average fair value of each option granted during 2005, 2004 and 2003 was $14.16, $15.76 and $17.78, respectively.

Effective January 1, 2006, the Corporation adopted FAS 123(R), *Share-Based Payments,* and related Securities and Exchange Commission rules included in Staff Accounting Bulletin No. 107, on a modified prospective basis. The standard requires stock options and other share-based payments made to employees to be accounted for as compensation expense and recorded at fair value, and requires the related excess tax benefit received upon exercise of the options, if any, to be reflected in the statement of cash flows as a financing activity rather than an operating activity as currently presented. The Corporation will continue to use the Black-Scholes option pricing model to estimate the fair value of stock options granted subsequent to the date of adoption of FAS 123(R).

The Lockheed Martin Amended and Restated 2003 Incentive Performance Award Plan provides for the grant of various types of stock-based incentive awards, including options to purchase common stock, stock appreciation rights, restricted stock and stock units. The types and mix of stock-based incentive awards are evaluated on an ongoing basis and may vary based on management's overall strategy regarding compensation, including consideration of the impact of expensing stock option awards on the Corporation's results of operations subsequent to the adoption of FAS 123(R). Based on current analyses and information, the Corporation expects that the combination of expensing stock options upon adoption of FAS 123(R) in 2006 and grants of restricted stock units will result in additional expense, net of state income tax benefits, totaling approximately $100 million (or a reduction in net earnings per share of $0.15) on a full year basis.

Income taxes—The Corporation periodically assesses its tax filing exposures related to periods that are open to examination. Based on the latest available information, the Corporation reflects in its consolidated financial statements its best estimate of the tax liability and interest for those exposures where it is probable that an adjustment will be sustained. In 2004, the IRS closed its examination of the Corporation's tax returns through December 31, 2002. The IRS commenced its examination of the Corporation's 2003 and 2004 Federal tax returns in 2005.

Comprehensive income—Comprehensive income (loss) for the Corporation consists primarily of net earnings and the after-tax impact of: adjustments to the minimum pension liability, adjustments related to available-for-sale investments, and other activities related to hedging activities and foreign currency translation. Income taxes related to components of other comprehensive income are generally recorded based on a tax rate, including the effects of federal and state taxes, of 37%.

The accumulated balance of $(1,553) million of other comprehensive income (loss) at December 31, 2005 included the minimum pension liability of $(1,629) million, offset primarily by net unrealized gains from available-for-sale investments.

Recent accounting pronouncements—In 2005, the Corporation adopted the Financial Accounting Standards Board's (FASB) Staff Position (FSP) 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.* The impact of its adoption was a reduction of the FAS 106 postretirement expense as well as a reduction of costs determined under U.S. Government Cost Accounting Standards for the year ended December 31, 2005. The adoption of FSP 106-2 did not have a material impact on the Corporation's results of operations, financial position or cash flows for the year ended December 31, 2005. See Note 13—Postretirement Benefit Plans for additional information regarding the adoption of FSP 106-2.

The Corporation also adopted FASB Interpretation No. (FIN) 47, *Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143,* in the fourth quarter of 2005. FIN 47 clarifies the term "conditional asset retirement obligation" as used in FAS 143, *Accounting for Asset Retirement Obligations,* and requires that a liability and a corresponding increase in the value of the underlying asset be recorded, and depreciation on the increased asset value be expensed, if the fair value of the obligation can be reasonably estimated. The types of asset retirement obligations that are covered by FIN 47 are those for which an entity has a legal obligation to perform an asset retirement activity, even though the timing and/or method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. An example of a condition giving rise to an asset retirement obligation is the presence of embedded asbestos, radiation sources or other regulated materials in buildings or equipment. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The adoption of FIN 47 did not have a material impact on the Corporation's results of operations or financial position. This is primarily due to the fact that the fair values of the majority of its asset retirement obligations could not be reasonably estimated because they had indeterminate settlement dates, since the range of time over which it may settle the obligations is unknown and could not be estimated. Consistent with the provisions of FIN 47, each obligation will be recorded at the time the settlement date is no longer indeterminate and the obligation can be reasonably estimated.

NOTE 2—ACQUISITIONS AND DIVESTITURES

In March 2005, the Corporation completed its purchase of The SYTEX Group, Inc. (SYTEX). The total purchase price related to the Corporation's acquisition of SYTEX, including transaction-related costs, was approximately $480 million. Approximately $380 million of the purchase price was paid in cash at closing, with most of the remainder payable in 2006. The acquisition was accounted for under the purchase method of accounting. Purchase accounting adjustments were recorded by allocating the purchase price to the assets acquired and liabilities assumed based on their estimated fair values, and included recording goodwill of approximately $395 million, of which $360 million will be amortized for tax purposes. The acquisition expands the Corporation's information technology solutions and technical support services businesses with the U.S. Department of Defense and other federal agencies. The operations of SYTEX are included in the Information & Technology Services business segment.

In 2005, the Corporation completed the acquisitions of STASYS Limited, a U.K.-based technology and consulting firm specializing in network communications and defense interoperability, which is included in our Integrated Systems & Solutions business segment; INSYS Group Limited, a U.K.-based diversified supplier of military communications systems, weapons systems and advanced analysis services, which is included in our Electronic Systems business segment; and Coherent Technologies, Inc., a U.S.-based supplier of high-performance, laser-based remote sensing systems, which is included in our Space Systems business segment. The aggregate cash purchase price for these three acquisitions was $180 million. Purchase accounting adjustments included recording combined goodwill of $164 million, none of which will be amortized for tax purposes. These acquisitions were not material to our consolidated results of operations for 2005.

In November 2003, the Corporation and Affiliated Computer Services, Inc. (ACS) completed transactions whereby the Corporation acquired ACS' federal government information technology (IT) business, and ACS concurrently acquired the Corporation's commercial IT business. The total purchase price related to the Corporation's acquisition of ACS' federal government IT business, including transactions-related costs, was approximately $585 million. The accounting for the acquisition included recording an intangible asset of $57 million

related to a covenant not to compete that will be amortized over five years, an intangible asset of approximately $55 million related to contracts and customer relationships acquired that will be amortized over seven years, and goodwill of approximately $460 million which is neither amortizable nor tax deductible. The divestiture of the Corporation's commercial IT business resulted in a gain, net of state income taxes, of $15 million which was recorded in other income and expenses. The gain increased 2003 net earnings by approximately $8 million ($0.02 per share).

In 2005, Lockheed Martin and Boeing entered into an agreement to create a joint venture that would combine the production, engineering, test and launch operations associated with U.S. Government launches of the Corporation's Atlas launch vehicles and Boeing's Delta launch vehicles. The joint venture, named United Launch Alliance, LLC (ULA), is structured as a 50-50 joint venture and would be accounted for as an equity investment. Under the terms of the joint venture, Atlas and Delta expendable launch vehicles would continue to be available as alternatives on individual launch missions. The agreement also stipulates that, upon closing of the transaction, Lockheed Martin and Boeing will dismiss all claims against each other in the pending civil litigation related to a previous competition for launches under the Air Force EELV program (see Note 15 for a discussion of that litigation).

The closing of the ULA transaction is subject to conditions to closing, including government and regulatory approvals and agreements in the United States and internationally. On August 9, 2005, the European Commission determined that ULA was compatible with European Union merger control regulation. On October 24, 2005, the Federal Trade Commission (FTC) requested additional information from Lockheed Martin and Boeing related to ULA in response to the pre-merger notice under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR) submitted by the parties. The FTC's "second request" extends the period the FTC is permitted to review the transaction under the HSR Act. The parties currently plan to close the ULA transaction as soon as practicable following satisfaction of all the closing conditions. The Corporation does not expect that the formation of ULA will have a significant impact on the Corporation's results of operations or financial position for 2006. If the conditions to closing are not satisfied and the ULA transaction is not consummated by March 31, 2006, either Boeing or Lockheed Martin may terminate the joint venture agreement.

On February 17, 2006, the U.S. District Court for the Central District of California dismissed a lawsuit filed in October 2005, by Space Exploration Technologies Corporation (SpaceX) against Lockheed Martin and Boeing. The SpaceX complaint alleged that Lockheed Martin and Boeing violated various provisions of federal and California antitrust laws, the Racketeering Influenced and Corrupt Organizations Act and California unfair competition laws in connection with the Air Force Evolved Expendable Launch Vehicle (EELV) program and the formation of the United Launch Alliance joint venture. In its order, the district court concluded that SpaceX failed to allege an injury-in-fact, because SpaceX does not presently have a launch vehicle capable of meeting Air Force EELV requirements. The court gave SpaceX leave to file an amended complaint.

NOTE 3—EARNINGS PER SHARE

Basic and diluted per share results for all periods presented were computed based on the net earnings for the respective periods. The weighted average number of common shares outstanding during the period was used in the calculation of basic earnings per share. The weighted average number of common shares used in the calculation of diluted per share amounts is adjusted for the dilutive effects of stock options based on the treasury stock method.

Unless otherwise noted, all per share amounts cited in these financial statements are presented on a "per diluted share" basis.

The following table sets forth the computations of basic and diluted earnings per share:

(In millions, except per share data)	**2005**	2004	2003
NET EARNINGS FOR BASIC AND DILUTED COMPUTATIONS	**$1,825**	$1,266	$1,053
AVERAGE COMMON SHARES OUTSTANDING			
Average number of common shares outstanding for basic computations	**440.3**	443.1	446.5
Dilutive stock options	**5.4**	4.0	3.5
Average number of common shares outstanding for diluted computations	**445.7**	447.1	450.0
EARNINGS PER COMMON SHARE			
Basic	**$ 4.15**	$ 2.86	$ 2.36
Diluted	**$ 4.10**	$ 2.83	$ 2.34

NOTE 4—RECEIVABLES

(In millions)	2005	2004
U.S. Government		
Amounts billed	$1,364	$1,529
Unbilled costs and accrued profits	2,858	2,394
Less customer advances and progress payments	(563)	(594)
	3,659	3,329
Foreign governments and commercial		
Amounts billed	471	408
Unbilled costs and accrued profits	477	402
Less customer advances	(28)	(45)
	920	765
	$4,579	$4,094

Substantially all of the December 31, 2005 unbilled costs and accrued profits are expected to be billed during 2006.

NOTE 5—INVENTORIES

(In millions)	2005	2004
Work in process, primarily related to long-term contracts and programs in progress	$5,121	$4,697
Less customer advances and progress payments	(3,527)	(3,267)
	1,594	1,430
Other inventories	327	434
	$1,921	$1,864

Work in process inventories at December 31, 2005 and 2004 included general and administrative costs of $298 million and $321 million, respectively. For the years ended December 31, 2005, 2004 and 2003, general and administrative costs incurred and recorded in inventories totaled $1.9 billion, $1.8 billion and $1.9 billion, respectively, and general and administrative costs charged to cost of sales from inventories totaled $1.9 billion, $1.9 billion and $2.0 billion, respectively.

The Corporation has entered into agreements with suppliers located in Russia to provide launch services and rocket engines. Khrunichev State Research and Production Space Center (Khrunichev) is the Russian manufacturer of Proton launch vehicles and provider of related launch services. Inventories at December 31, 2005 included amounts advanced to Khrunichev to provide contracted launch services totaling $190 million. In addition, inventories at December 31, 2005 included advances of $70 million to RD AMROSS, a joint venture between Pratt & Whitney and NPO Energomash, for the development and purchase, subject to certain conditions, of RD-180 booster engines used for Atlas V launch vehicles.

Inventories at December 31, 2005, also included deferred costs related to upgrading a West Coast launch facility for the Atlas V program. Under the contract with the U.S. Government, the Corporation will recover these costs over future launches from that facility.

Approximately $555 million of costs included in 2005 inventories, including amounts advanced to Khrunichev and certain Atlas V program costs, are expected to be recovered after 2006.

NOTE 6—PROPERTY, PLANT AND EQUIPMENT

(In millions)	2005	2004
Land	$ 112	$ 95
Buildings	3,828	3,593
Machinery and equipment	5,384	4,972
	9,324	8,660
Less accumulated depreciation and amortization	(5,400)	(5,061)
	$3,924	$3,599

In 2005, the Corporation recorded a charge, net of state income tax benefits, of $30 million in cost of sales related to impairment in the value of a single telecommunications satellite operated by a wholly-owned subsidiary of the Corporation. The charge reduced net earnings by $19 million ($0.04 per share). The impairment charge was recorded due to concerns of overcapacity in markets served by the satellite.

During the year ended December 31, 2005, the Corporation recorded write-offs of fully depreciated property, plant and equipment totaling $216 million.

NOTE 7—INVESTMENTS IN EQUITY SECURITIES

(In millions)	2005	2004
Equity method investments (ownership interest at December 31, 2005):		
Intelsat, Ltd.	$ —	$703
Other	41	57
	41	760
Other investments (ownership interest at December 31, 2005):		
Inmarsat plc (5.3%)	146	46
Other	9	6
	155	52
	$196	$812

Other equity method investments include United Space Alliance, LLC (50% ownership interest) and other smaller joint ventures in which the Corporation participates.

In 2003, Inmarsat Ventures, Ltd. was acquired by a consortium of private equity firms in a leveraged buyout transaction. In exchange for its interest, the Corporation received cash of $114 million and a 14% ownership interest in the new Inmarsat holding company, Inmarsat Group Holdings, Ltd., valued at $96 million. The Corporation recorded a deferred gain of $42 million from the transaction, representing the differences between the consideration received and the carrying value of its investment in Inmarsat Ventures of $168 million. During 2004, the Corporation received cash from Inmarsat Group Holdings, Ltd. amounting to $50 million, reducing its investment to $46 million while maintaining its 14% ownership interest.

In June 2005, Inmarsat plc (Inmarsat) completed its initial public offering (IPO) of 150 million of its ordinary shares on the London Stock Exchange. The IPO had the effect of diluting the Corporation's ownership to 8.9%. Inmarsat used a portion of the proceeds to redeem certain remaining equity-related instruments held by shareholders, including the Corporation. As a result of these activities, the Corporation recognized the $42 million deferred gain that had been recorded in 2003 related to this investment. Subsequent to the IPO, the investment in Inmarsat has been accounted for at fair value, with the unrealized gains reflected as a net after-tax amount in other comprehensive income. In October 2005, the Corporation sold approximately 16 million of its Inmarsat shares in a private transaction for $89 million, further reducing its ownership percentage to 5.3%. The above transactions resulted in the recording of gains, net of state income taxes, totaling $126 million in other income and expenses, and an increase in 2005 net earnings of $82 million ($0.18 per share). At December 31, 2005, the increase in the fair value of Inmarsat shares held by the Corporation resulted in an increase in other comprehensive income of $93 million, net of income taxes. In January 2006, the Corporation sold an additional 12 million shares of Inmarsat for $75 million, reducing its ownership to 2.6%. The gain from this sale is expected to increase 2006 net earnings by $47 million ($0.11 per share).

In January 2005, the Corporation completed the sale of its 25% interest in Intelsat, Ltd. to a private equity firm for $18.75 per share, or $752 million in total proceeds. The transaction resulted in the recording of a gain, net of state income taxes, of $47 million in other income and expenses, and an increase in net earnings of $31 million ($0.07 per share).

In the fourth quarter of 2005, the Corporation completed the sale of its interest in NeuStar, Inc. (NeuStar). The transaction resulted in the recording of a gain, net of state income taxes, of $30 million in other income and expenses, and an increase in net earnings of $19 million ($0.04 per share).

In November 2004, a private equity firm purchased the outstanding shares of New Skies Satellites, N.V. (New Skies). The Corporation sold its shares for $148 million. The transaction resulted in the recording of a gain, net of state income taxes, of $91 million in other income and expenses, and an increase in net earnings of $59 million ($0.13 per share). The carrying value of the Corporation's investment in New Skies was marked to market through other comprehensive income prior to the sale.

NOTE 8—DEBT

The Corporation's long-term debt is primarily in the form of publicly issued, fixed-rate and variable-rate notes and debentures, as follows:

(In millions)	Interest rate	2005	2004
Notes due 12/01/2005	7.95%	$ —	$ 14
Notes due 5/15/2006	7.25	193	205
Medium Term Notes due 2006-7	7.70–8.66	41	64
Notes due 6/15/2008	7.70	103	105
Notes due 12/01/2009	8.20	246	327
Debentures due 4/15/2013	7.375	150	150
Debentures due 5/01/2016	7.65	600	600
Debentures due 1/15/2023	8.375	100	100
Debentures due 9/15/2023	7.0	200	200
Notes due 6/15/2024	8.375	216	216
Debentures due 6/15/2025	7.625	150	150
Debentures due 5/01/2026	7.75	423	423
Debentures due 12/01/2029	8.5	1,250	1,250
Convertible Debentures due 8/15/2033	LIBOR -0.25	1,000	1,000
Debentures due 5/01/2036	7.20	300	300
Other		14	15
		4,986	5,119
Less current maturities		202	15
		$4,784	$5,104

In the fourth quarter of 2005, the Corporation repurchased $83 million of outstanding long-term debt in the open market. The charge associated with those repurchases was not material to the Corporation's results of operations or financial position.

In the fourth quarter of 2004, the Corporation completed tender offers to purchase for cash $285 million in principal amount of its outstanding 7.70% notes due June 15, 2008 and $666 million in principal amount of its 8.20% notes due December 1, 2009. The Corporation recorded a charge, net of state income tax benefits, totaling $154 million in other income and expenses related to the tender offers. The charge reduced 2004 net earnings by $100 million ($0.22 per share).

In 2003, the Corporation issued $1.0 billion in floating rate convertible debentures due in 2033. The debentures bear interest at a rate equal to three-month LIBOR less 25 basis points, reset quarterly. The interest rate in effect at December 31, 2005 was 4.09%. Interest on the debentures is payable quarterly through August 15, 2008, after which the interest will accrue as part of the value of the debenture and will be payable, along with the principal amount of the debenture, at maturity. The debentures are convertible by holders into shares of the Corporation's common stock on a contingent basis under the circumstances described in the indenture related to these securities as discussed below. The debentures are not convertible unless the price of the Corporation's common stock is greater than or equal to 130% of the applicable conversion price for a specified period during a quarter, or unless certain events occur including, among others: Lockheed Martin calling the debentures for redemption; Lockheed Martin distributing to all holders of its common stock certain rights to purchase shares of its common stock at less than market value on the trading day immediately preceding the declaration date of the distribution; and the credit rating assigned to the debentures by either Moody's or Standard & Poor's is lower than Ba1 or BB+.

The conversion price was $75.00 per share at December 31, 2005, and is expected to change over time as provided for in the indenture agreement. The conversion price is adjusted upon the occurrence of certain events including, but not limited to, the following: the payment of dividends and other distributions on Lockheed Martin common stock, payable exclusively in shares of our stock; the issuance to all holders of Lockheed Martin common stock of rights that allow them to purchase shares of its common stock at less than market price during a specified period; distributions by Lockheed Martin consisting exclusively of cash to all holders of our common stock, excluding any quarterly cash dividend that does not exceed $0.12 per share.

The Corporation has irrevocably elected and agreed to pay only cash in lieu of common stock for the accreted principal amount of the debentures in respect of its conversion obligations described above. The Corporation has retained the right, however, to elect to satisfy any and all conversion obligations in excess of the accreted principal amount of the debentures in cash or common stock or a combination of cash and common stock. There was no amount exceeding the accreted principal at the end of 2005, nor will there be until the market price exceeds the conversion price of the Corporation's stock. Accordingly, the debentures had no impact on the calculation of diluted earnings per share for 2005. The Corporation also has the right to redeem any or all of the debentures at any time after August 15, 2008.

In 2003, the Corporation completed the purchase of a total principal amount of $1.4 billion of notes and debentures through a combination of tender offers, redemption of callable debentures and repurchases in the open market. The Corporation recorded charges, net of state income tax benefits, totaling $146 million in other income and expenses related to these transactions. The charges reduced 2003 net earnings by $96 million ($0.21 per share).

The registered holders of $300 million of 40-year debentures issued in 1996 may elect, between March 1 and April 1, 2008, to have their debentures repaid by the Corporation on May 1, 2008.

At December 31, 2005, the Corporation had in place a $1.5 billion revolving credit facility which expires in July 2010. There were no borrowings outstanding under the facility at December 31, 2005. Borrowings under the credit facility would be unsecured and bear interest at rates based, at the Corporation's option, on the Eurodollar rate or a bank defined Base Rate. Each bank's obligation to make loans under the credit facility is subject to, among other things, the Corporation's compliance with various representations, warranties and covenants, including covenants limiting the ability of the Corporation and certain of its subsidiaries to encumber assets and a covenant not to exceed a maximum leverage ratio.

The Corporation's scheduled long-term debt maturities for the five years following December 31, 2005 are: $202 million in 2006; $33 million in 2007; $103 million in 2008; $247 million in 2009; $1 million in 2010; and $4,400 million thereafter.

The estimated fair values of the Corporation's long-term debt instruments at December 31, 2005 aggregated approximately $6.2 billion, compared with a carrying amount of approximately $5.0 billion. The fair values were estimated based on quoted market prices for those instruments that are publicly traded. For privately placed debt, the fair values were estimated based on the quoted market prices for similar issues, or on current rates offered to the Corporation for debt with similar remaining maturities. Unless otherwise indicated elsewhere in the notes to the financial statements, the carrying values of the Corporation's other financial instruments approximate their fair values.

Interest payments were $356 million in 2005, $420 million in 2004 and $519 million in 2003.

NOTE 9—INCOME TAXES

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

(In millions)	**2005**	2004	2003
Federal income taxes			
Current	**$742**	$445	$ (14)
Deferred	**24**	(58)	467
Total federal income taxes	**766**	387	453
Foreign income taxes	**25**	11	26
Total income taxes provided	**$791**	$398	$479

Net provisions for state income taxes are included in general and administrative expenses, which are primarily allocable to U.S. Government contracts. The net state income tax expense was $92 million for 2005, $78 million for 2004 and $38 million for 2003.

A reconciliation of income tax expense computed using the U.S. federal statutory income tax rate of 35% to actual income tax expense is as follows:

(In millions)	**2005**	2004	2003
Income tax expense at the U.S. federal statutory tax rate	**$916**	$ 582	$536
(Reduction) increase in tax expense from:			
Extraterritorial income exclusion benefit	**(66)**	(40)	(41)
U.S. production activity benefit	**(19)**	—	—
Tax deductible dividends	**(26)**	(21)	(15)
Closure of IRS examination	**—**	(144)	—
Other, net	**(14)**	21	(1)
Actual income tax expense	**$791**	$ 398	$479

The reduction in income tax expense of $144 million in 2004 from the closure of an IRS examination primarily resulted from the examination of tax periods through December 31, 2002.

Current income taxes payable of $71 million and $28 million at December 31, 2005 and 2004, respectively, are included in other current liabilities in the consolidated balance sheet.

The primary components of the Corporation's federal and foreign deferred income tax assets and liabilities at December 31 were as follows:

(In millions)	**2005**	2004
Deferred tax assets related to:		
Contract accounting methods	**$ 594**	$ 689
Accrued compensation and benefits	**516**	460
Accumulated postretirement benefit obligations	**497**	454
Pensions	**213**	197
Other	**71**	112
	1,891	1,912
Deferred tax liabilities related to:		
Purchased intangibles	**264**	264
Property, plant and equipment	**211**	229
	475	493
Net deferred tax assets	**$1,416**[(a)]	$1,419[(a)]

(a) These amounts included $555 million and $437 million, respectively, of net noncurrent deferred tax assets which are in other assets in the consolidated balance sheet.

Federal and foreign income tax payments, net of refunds received, were $599 million in 2005, $363 million in 2004 and $170 million in 2003. Included in these amounts are tax payments and refunds related to the Corporation's divestiture activities.

The Corporation realized an income tax cash benefit of $69 million in 2005, $34 million in 2004 and $13 million in 2003 as a result of exercises of employee stock options. This benefit is recorded in stockholders' equity under the caption, "Stock-based awards and ESOP activity."

NOTE 10—OTHER INCOME AND EXPENSES, NET

(In millions)	**2005**	2004	2003
Interest income	**$143**	$ 104	$ 75
Equity in net earnings (losses) of equity investees	**108**	67	107
Gains related to Inmarsat transactions	**126**	—	—
Gain on sale of interest in Intelsat	**47**	—	—
Gain on sale of interest in NeuStar	**30**	—	—
Charge for early repayment of debt	**(10)**	(154)	(146)
Gain on sale of interest in New Skies	**—**	91	—
Gain on sale of COMSAT General business	**—**	28	—
Gain on sale of commercial IT business	**—**	—	15
Other activities, net	**5**	(15)	(8)
	$449	$ 121	$ 43

NOTE 11—STOCKHOLDERS' EQUITY

At December 31, 2005, the authorized capital of the Corporation was composed of 1.5 billion shares of common stock, 50 million shares of series preferred stock, and 20 million shares of Series A preferred stock. Of the 434 million shares of common stock issued and outstanding, approximately 432 million shares were considered outstanding for balance sheet presentation purposes; the remaining shares were held by the Corporation in trusts established to pay future benefits to eligible retirees and dependents under certain benefit plans. No shares of the series preferred stock were issued and no shares of the Series A preferred stock were outstanding at December 31, 2005.

In October 2002, the Corporation announced a share repurchase program for the repurchase of up to 23 million shares of its common stock from time-to-time. Under the program, management has discretion to determine the number and price of the shares to be repurchased, and the timing of any repurchases in compliance with applicable law and regulation. In February 2004 and September 2005, an additional 20 million shares and 45 million shares, respectively, were authorized for repurchase under the program. The Corporation repurchased 19.7 million shares under the program in 2005 for $1.2 billion, 14.7 million shares in 2004 for $772 million and 10.7 million shares in 2003 for $482 million. From the inception of the program through December 31, 2005, a total of 46 million shares have been repurchased under the program for $2.5 billion. As of December 31, 2005, a total of 42 million shares may be repurchased in the future under the program.

As part of the share repurchase program, the Corporation may from time-to-time enter into structured share repurchase transactions with financial institutions. These agreements generally require an up-front cash payment in exchange for the right to receive shares of Lockheed Martin's common stock or cash at the expiration of the agreement, dependent upon the closing price of the common stock at the maturity date. The Corporation entered into several such transactions during 2005 which, in the aggregate, required up-front cash payments totaling $396 million. Based on the closing price of its common stock on the maturity dates of the agreements, certain of the transactions resulted in the Corporation repurchasing 3.1 million shares of common stock at a total cost of $195 million. These amounts are included in the total share repurchase figures included in the previous paragraph. The Corporation received its up-front cash payment plus a premium for the remaining transactions that did not result in the repurchase of shares. There were no such transactions outstanding at December 31, 2005.

NOTE 12—STOCK-BASED COMPENSATION

In April 2005, the stockholders approved the Lockheed Martin Amended and Restated 2003 Incentive Performance Award Plan (the Award Plan). Under the Award Plan, employees of the Corporation may be granted stock-based incentive awards, including options to purchase common stock, stock appreciation rights, restricted stock or stock units. The maximum number of shares that may be subject to such stock-based incentive awards in any calendar year is limited to 1.6% of the Corporation's common stock outstanding on the December 31 preceding the grant. The maximum number of shares that may be issued as restricted stock awards (RSAs) is limited to 28% of the total number of shares authorized to be issued under the Award Plan. Employees may also be granted cash-based incentive awards. These awards may be granted either individually or in combination with other awards.

The Award Plan requires that options to purchase common stock have an exercise price of not less than 100% of the market value of the underlying stock on the date of grant. Under the Award Plan, no award of options may become fully vested prior to the second anniversary of the grant and no portion of an option grant may become vested in less than one year, except for 1.5 million of options that are specifically exempted from vesting restrictions. The minimum vesting period for RSAs or stock units payable in stock is three years. Award agreements may provide for shorter vesting periods or vesting following termination of employment in the case of death, disability, divestiture, retirement or layoff. The Award Plan does not impose any minimum vesting periods on other types of awards. The maximum term of an option or any other award is 10 years. The Award Plan allows the Corporation to provide for financing by award recipients, other than executive officers, of the exercise or purchase price of common stock underlying an award, subject to certain conditions, by interest-bearing notes payable to the Corporation. There were no such notes payable at December 31, 2005.

Prior to April 2003, the Corporation granted stock-based and cash-based incentive awards pursuant to the Lockheed Martin Corporation 1995 Omnibus Performance Award Plan (the Omnibus Plan), which was approved by the stockholders in March 1995. Awards under the Omnibus Plan were similar to those authorized by the Award Plan except that the Omnibus Plan did not include any minimum vesting requirements.

Under the Award Plan, 590,000 and 25,000 RSAs were issued in 2004 and 2003, respectively. There were no RSAs issued in 2005. The shares were recorded based on the market value of the Corporation's common stock on the date of the award and the related compensation expense is recognized over the vesting period. The weighted average fair value of RSAs in 2004 and 2003 was $46.11 and $48.12, respectively. Recipients are entitled to receive cash dividends and to vote their respective shares, but are prohibited from selling or transferring shares prior to vesting. The RSAs generally vest over three to five years from the grant date. The impact of RSAs was not material to net earnings in 2005, 2004 or 2003.

In April 1999, the stockholders approved the Lockheed Martin Directors Equity Plan (the Directors Plan). Approximately 50% of each director's annual compensation is awarded under the Directors Plan. Directors of the Corporation may elect to receive such compensation in the form of stock units which track investment returns to changes in value of the Corporation's common stock with dividends reinvested, options to purchase common stock of the Corporation, or a combination of the two. The Directors Plan requires that options to purchase common stock have an exercise price of not less than 100% of the market value of the underlying stock on the date of grant. Except in certain circumstances, options and stock units issued under the Directors Plan vest on the first anniversary of the grant. The maximum term of an option is ten years.

The Award Plan and the Directors Plan, as well as the number of shares of Lockheed Martin common stock authorized for issuance under these plans, have been approved by the stockholders of the Corporation. At December 31, 2005, the number of shares of Lockheed Martin common stock reserved for issuance under the Corporation's stock option and award plans totaled 55.7 million.

The following table summarizes stock option and restricted stock activity related to the Corporation's plans during 2005, 2004 and 2003:

	Number of Shares *(In thousands)*		Weighted Average Exercise Price
	Available for Grant	Options Outstanding	
December 31, 2002	12,375	30,634	$39.42
Additional shares reserved	22,500	—	—
Retired Omnibus Plan shares	(4,814)	—	—
Options granted	(6,664)	6,664	51.08
Options exercised	—	(1,637)	26.96
Options terminated	29	(181)	49.12
Restricted stock awards	(25)	—	—
December 31, 2003	23,401	35,480	42.14
Options granted	(7,314)	7,314	49.27
Options exercised	—	(4,729)	34.23
Options terminated	160	(242)	51.66
Restricted stock awards	(590)	—	—
December 31, 2004	15,657	37,823	44.44
Additional shares reserved	**12,000**	**—**	**—**
Options granted	**(6,413)**	**6,413**	**57.81**
Options exercised	**—**	**(9,740)**	**41.70**
Options terminated	**300**	**(358)**	**53.93**
Restricted stock awards	**40**	**—**	**—**
December 31, 2005	**21,584**	**34,138**	**47.64**

Approximately 21.2 million, 26.4 million and 25.5 million outstanding options were exercisable by employees at December 31, 2005, 2004 and 2003, respectively.

In February 2006, an additional 3.8 million options and 1.3 million restricted stock units were granted to employees. The accounting treatment for restricted stock units is similar to the accounting for RSAs discussed earlier, except that the shares are not issued until the restricted stock units vest, no earlier than three years from the date of the award.

Information regarding options outstanding at December 31, 2005 follows:

Range of Exercise Prices	Number of Options *(In thousands)*	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life *(In years)*
Options outstanding:			
Less than $20.00	1,349	$18.17	4.0
$20.00–$29.99	536	25.12	4.4
$30.00–$39.99	5,106	35.98	3.8
$40.00–$50.00	8,683	48.36	6.4
Greater than $50.00	18,464	53.32	6.9
Total	34,138	$47.64	6.1
Options exercisable:			
Less than $20.00	1,349	$18.17	4.0
$20.00–$29.99	536	25.12	4.4
$30.00–$39.99	5,106	35.98	3.8
$40.00–$50.00	4,026	47.33	4.4
Greater than $50.00	10,209	51.07	5.5
Total	21,226	$43.99	4.8

Stock options granted in 2005 and 2004 under the Award Plan and stock options granted in 2003 under the Omnibus Plan have ten-year terms and generally vest over a three-year service period. Exercise prices of options awarded for all years were equal to the market price of the stock on the date of grant. Pro forma information regarding net earnings and earnings per share as if the Corporation had accounted for its employee stock options as compensation expense under the fair value method is included in Note 1.

NOTE 13—POSTRETIREMENT BENEFIT PLANS

Defined contribution plans—The Corporation maintains a number of defined contribution plans with 401(k) features that cover substantially all employees. Under the provisions of these 401(k) plans, employees' eligible contributions are matched by the Corporation at established rates. The Corporation's matching obligations were $273 million in 2005, $259 million in 2004 and $238 million in 2003, the majority of which were funded in Lockheed Martin common stock.

The Lockheed Martin Corporation Salaried Savings Plan is a defined contribution plan with a 401(k) feature that includes an ESOP. The ESOP purchased 34.8 million shares of the Corporation's common stock in 1989 with the proceeds from a $500 million note issue which was guaranteed by the Corporation. The final payment on the debt was made in May 2004. The Corporation's match in years prior to 2005 was partially fulfilled with stock released from the ESOP at approximately 2.2 million shares per year based upon the debt repayment schedule. Compensation costs recognized relative to the ESOP shares were $56 million and $108 million in 2004 and 2003, respectively. The remainder of the Corporation's match to the Salaried Savings Plan was fulfilled through purchases of common stock from participant account balance reallocations or through newly issued shares from the Corporation. Interest incurred on the ESOP debt, as well as the weighted average unallocated ESOP shares excluded in calculating earnings per share, in 2004 and 2003 were not material. The ESOP held approximately 46.1 million issued and outstanding shares of the Corporation's common stock at December 31, 2005, all of which were allocated to participant accounts.

Certain plans for hourly employees include a non-leveraged ESOP. In one such plan, the match is made, generally at the election of the participant, in either the Corporation's common stock or cash which is invested at the participant's direction in one of the plan's other investment options. The Corporation's contributions to these plans were made through small amounts of newly issued shares from the Corporation or cash contributed to the ESOP trust which was used by the trustee, if so elected, to purchase common stock from participant account balance reallocations or in the open market for allocation to participant accounts. This ESOP trust held approximately 2.7 million issued and outstanding shares of the Corporation's common stock at December 31, 2005, all of which were allocated to participant accounts.

Defined benefit pension plans, and retiree medical and life insurance plans—Most employees hired on or before December 31, 2005 are covered by defined benefit pension plans, and certain health care and life insurance benefits are provided to eligible retirees by the Corporation. Effective January 1, 2006, new non-union represented employees are not being covered by the defined benefit pension plans, but are eligible to participate in defined contribution plans. The Corporation currently plans to offer those employees the ability to participate in its retiree medical plans, but will not subsidize the cost of their participation effective January 1, 2006. The Corporation has made contributions to trusts (including Voluntary Employees' Beneficiary Association trusts and 401(h) accounts, the assets of which will be used to pay expenses of certain retiree medical plans) established to pay future benefits to eligible retirees and dependents. The Corporation uses December 31 as its measurement date. Benefit obligations as of the end of each year reflect assumptions in effect as of those dates. Net pension and net retiree medical costs for each of the years presented were based on assumptions in effect at the end of the respective preceding year.

The following provides a reconciliation of benefit obligations, plan assets and funded status of the plans:

	Defined Benefit Pension Plans		Retiree Medical and Life Insurance Plans	
(In millions)	**2005**	2004	**2005**	2004
CHANGE IN BENEFIT OBLIGATIONS				
Benefit obligations at beginning of year	**$27,015**	$24,364	**$3,827**	$3,810
Service cost	**852**	743	**59**	49
Interest cost	**1,535**	1,497	**208**	225
Benefits paid	**(1,331)**	(1,326)	**(369)**	(355)
Actuarial losses	**234**	1,731	**(61)**	7
Amendments	**116**	6	**(252)**	(2)
Participants' contributions	**—**	—	**104**	93
Benefit obligations at end of year	**$28,421**	$27,015	**$3,516**	$3,827

(In millions)	Defined Benefit Pension Plans 2005	Defined Benefit Pension Plans 2004	Retiree Medical and Life Insurance Plans 2005	Retiree Medical and Life Insurance Plans 2004
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	**$22,139**	$20,913	**$ 1,480**	$ 1,135
Actual return on plan assets	**1,570**	2,047	**125**	150
Benefits paid	**(1,331)**	(1,326)	**(369)**	(355)
Corporation's contributions	**1,054**	505	**181**	457
Participants' contributions	**—**	—	**104**	93
Fair value of plan assets at end of year	**$23,432**	$22,139	**$ 1,521**	$ 1,480
Unfunded status of the plans	**$ (4,989)**	$ (4,876)	**$ (1,995)**	$ (2,347)
Unrecognized net actuarial losses	**6,616**	6,603	**882**	1,008
Unrecognized prior service cost	**492**	461	**(164)**	103
Net amount recognized	**$ 2,119**	$ 2,188	**$ (1,277)**	$ (1,236)
AMOUNTS RECOGNIZED IN THE CONSOLIDATED BALANCE SHEET				
Prepaid assets	**$ 1,360**	$ 1,030	**$ —**	$ —
Accrued liabilities	**(2,097)**	(1,660)	**(1,277)**	(1,236)
Intangible asset	**476**	444	**—**	—
Accumulated other comprehensive loss related to minimum pension liability	**2,380**	2,374	**—**	—
Net amount recognized	**$ 2,119**	$ 2,188	**$ (1,277)**	$ (1,236)

The projected benefit obligations (PBO) for the Corporation's more significant defined benefit pension plans exceeded the fair value of the plans' assets at December 31, 2005 and 2004, as reflected in the table above.

At both December 31, 2005 and 2004, the Corporation's consolidated balance sheet included pretax additional minimum pension liabilities of $2.4 billion related to certain of its defined benefit pension plans. This liability is calculated on a plan-by-plan basis, and is required if the accumulated benefit obligation (ABO) of the plan exceeds the fair value of the plan assets and the plan's accrued pension liabilities. The ABO for all defined benefit pension plans was approximately $25 billion and $23 billion at December 31, 2005 and 2004, respectively.

For defined benefit pension plans in which the ABO was in excess of the fair value of the plans' assets, the PBO, ABO and fair value of the plans' assets were as follows:

(In millions)	2005	2004
Projected benefit obligation	**$17,969**	$17,051
Accumulated benefit obligation	**15,852**	14,792
Fair value of plan assets	**13,755**	13,132

The net pension cost as determined by FAS 87, *Employers' Accounting for Pensions,* and the net postretirement benefit cost as determined by FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* related to the Corporation's plans include the following components:

(In millions)	2005	2004	2003
DEFINED BENEFIT PENSION PLANS			
Service cost	**$ 852**	$ 743	$ 640
Interest cost	**1,535**	1,497	1,453
Expected return on plan assets	**$(1,740)**	$(1,698)	$(1,748)
Amortization of prior service cost	**85**	78	77
Recognized net actuarial losses	**392**	264	62
Total net pension expense	**$ 1,124**	$ 884	$ 484
RETIREE MEDICAL AND LIFE INSURANCE PLANS			
Service cost	**$ 59**	$ 49	$ 40
Interest cost	**208**	225	211
Expected return on plan assets	**(112)**	(88)	(69)
Amortization of prior service cost	**14**	8	1
Recognized net actuarial losses	**49**	60	49
Total net postretirement expense	**$ 218**	$ 254	$ 232

In May 2004, the FASB issued FASB Staff Position (FSP) 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.* This FSP provides specific authoritative guidance on the accounting for the federal subsidy to eligible sponsors of retiree health care benefits provided under this law. Using this guidance, the Corporation estimated a projected reduction in its accumulated postretirement benefit obligation as of December 31, 2004 of $295 million from the effects of the new law. This obligation will be recognized over

the remaining service lives of the employees eligible for the benefit. The impact of adoption of the FSP was a reduction of the FAS 106 postretirement expense for the year ended December 31, 2005 of approximately $35 million. The postretirement expense computed under FAS 106 does not include the effects of U.S. Government Cost Accounting Standards or income tax benefits.

The actuarial assumptions used to determine the benefit obligations at December 31, 2005 and 2004 related to the Corporation's defined benefit pension and postretirement benefit plans, as appropriate, are as follows:

	Benefit Obligation Assumptions	
	2005	2004
Discount rates	**5.625%**	5.75%
Rates of increase in future compensation levels	**5.000**	5.50

The decrease in the discount rate from December 31, 2004 to December 31, 2005 resulted in an increase in the projected benefit obligations of the Corporation's defined benefit pension plans at December 31, 2005 of approximately $465 million. The decrease in the rate of increase in future compensation levels from December 31, 2004 to December 31, 2005 resulted in a decrease in the projected benefit obligations of the Corporation's defined benefit pension plans at December 31, 2005 of approximately $483 million.

The actuarial assumptions used to determine the net expense related to the Corporation's defined benefit pension and postretirement benefit plans for the years ended December 31, 2005, 2004 and 2003, as appropriate, are as follows:

	Pension Cost Assumptions		
	2005	2004	2003
Discount rates	**5.75%**	6.25%	6.75%
Expected long-term rates of return on assets	**8.50**	8.50	8.50
Rates of increase in future compensation levels	**5.50**	5.50	5.50

The long-term rate of return assumption represents the expected average rate of earnings on the funds invested or to be invested to provide for the benefits included in the benefit obligations. That assumption is determined based on a number of factors, including historical market index returns, the anticipated long-term asset allocation of the plans, historical plan return data, plan expenses and the potential to outperform market index returns.

The medical trend rates used in measuring the postretirement benefit obligation were 10.2% in 2005 and 11.0% in 2004, and were assumed to ultimately decrease to 5.0% by the year 2012. An increase or decrease of one percentage point in the assumed medical trend rates would result in a change in the postretirement benefit obligation of approximately 5% and (4)%, respectively, at December 31, 2005, and a change in the 2005 postretirement service cost plus interest cost of approximately 4% and (4)%, respectively. The medical trend rate for 2006 is 10.0%.

The asset allocations of the Corporation's plans at December 31, 2005 and 2004, by asset category, were as follows:

	Defined Benefit Pension Plans		Retiree Medical and Life Insurance Plans	
	2005	2004	**2005**	2004
Asset category:				
Equity securities	**61%**	64%	**66%**	58%
Debt securities	**34**	32	**33**	41
Other	**5**	4	**1**	1
	100%	100%	**100%**	100%

Lockheed Martin Investment Management Company (LMIMCO), a wholly-owned subsidiary of the Corporation, has the fiduciary responsibility for making investment decisions related to the assets of the Corporation's defined benefit pension plans and retiree medical and life insurance plans. LMIMCO's investment objectives for the assets of the defined benefit pension plans are to minimize the net present value of expected funding contributions and to meet or exceed the rate of return assumed for plan funding purposes over the long term. The investment objective for the assets of the retiree medical and life insurance plans is to meet or exceed the rate of return assumed for the plans for funding purposes over the long term. The nature and duration of benefit obligations, along with assumptions concerning asset class returns and return correlations, are considered when determining an appropriate asset allocation to achieve the investment objectives.

Investment policies and strategies governing the assets of the plans are designed to achieve investment objectives within prudent risk parameters. Risk management practices include the use of external investment managers and the maintenance of a portfolio diversified by asset class, investment approach and security holdings, and the maintenance of sufficient liquidity to meet benefit obligations as they come due.

LMIMCO's investment policies require that asset allocations of defined benefit pension plans be maintained within the following ranges:

Investment Groups	Asset Allocation Ranges
Equity securities	35–70%
Non-U.S. equity securities	0–25%
Debt securities	10–60%
Cash	0–35%
Other	0–15%

Current policies for the plans target an asset mix of 65% in total equity securities and 35% in debt and other securities.

Investment policies for all plans limit the use of alternative investments and derivatives. Investments in alternative asset classes or structures (*e.g.*, real estate, private equity, hedge funds and commodities) are limited to 15% of plan assets. Investments in derivatives are subject to additional limitations and constraints, including a maximum notional value of futures of no more than 5% of plan assets.

Equity securities purchased by external investment managers and included in the assets of the defined benefit pension plans included issued and outstanding common stock of the Corporation in the amounts of $11 million (less than 0.05% of total plan assets) and $16 million (less than 0.08% of total plan assets) at December 31, 2005 and 2004, respectively. Equity securities included in the assets of the retiree medical and life insurance plans included less than $1 million (less than 0.07% of total plan assets) of the Corporation's issued and outstanding common stock at both December 31, 2005 and 2004.

The Corporation generally refers to U.S. Government Cost Accounting Standards (CAS) and Internal Revenue Code rules in determining funding requirements for its pension plans. The Corporation made discretionary prepayments totaling $980 million in 2005 to the defined benefit pension plans' trust which will reduce its cash funding requirements for 2006. In 2006, the Corporation expects to contribute $100 million—$110 million to its defined benefit pension plans and $230 million—$240 million to its retiree medical and life insurance plans, after giving consideration to the 2005 prepayments.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

(In millions)	Pension Benefits	Other Benefits
2006	$1,380	$ 260
2007	1,430	260
2008	1,490	270
2009	1,550	270
2010	1,610	270
Years 2011–2015	9,190	1,340

The Corporation sponsors nonqualified defined benefit plans to provide benefits in excess of qualified plan limits. The aggregate liabilities for these plans at December 31, 2005 were approximately $450 million. The expense associated with these plans totaled $58 million in 2005, $61 million in 2004 and $60 million in 2003. The Corporation also sponsors a small number of foreign benefit plans. The liabilities and expenses associated with these plans are not material to the Corporation's results of operations, financial position or cash flows.

NOTE 14—LEASES

Total rental expense under operating leases was $324 million, $318 million and $301 million for 2005, 2004 and 2003, respectively.

Future minimum lease commitments at December 31, 2005 for all operating leases that have a remaining term of more than one year were approximately $1.2 billion ($261 million in 2006, $210 million in 2007, $176 million in 2008, $141 million in 2009, $121 million in 2010 and $248 million in later years). Certain major plant facilities and equipment are furnished by the U.S. Government under short-term or cancelable arrangements.

NOTE 15—LEGAL PROCEEDINGS, COMMITMENTS AND CONTINGENCIES

The Corporation or its subsidiaries are parties to or have property subject to litigation and other proceedings, including matters arising under provisions relating to the protection of the environment. In the opinion of management and in-house counsel, the probability is remote that the outcome of these matters will have a material adverse effect on the Corporation's consolidated results of operations, financial position or cash flows. The results of legal proceedings, however, cannot be predicted with certainty. These matters include the following items, all of which have been previously reported:

On June 17, 2002, the Corporation was served with a grand jury subpoena issued by the United States District Court for the Central District of California. The subpoena sought documents relating to an international sales agent engaged by Loral Corporation in connection with the sale of synthetic aperture radars to the Government of Korea in 1996. On December 20, 2005, the Corporation was advised that the grand jury's investigation was closed.

On February 6, 2004, the Corporation submitted a certified contract claim to the United States seeking contractual indemnity for remediation and litigation costs (past and future) associated with its former facility in Redlands, California. The claim was submitted pursuant to a claim sponsorship agreement with The Boeing Company, executed in 2001, in Boeing's capacity as the prime contractor on the Short Range Attack Missile (SRAM) program. The contract for the SRAM program, which formed a significant portion of the Corporation's work at the Redlands facility, contained special contractual indemnities from the U.S. Air Force, as authorized by Public Law 85-804. On August 31, 2004, the United States denied the claim. The Corporation's appeal of that decision is pending before the Armed Services Board of Contract Appeals.

On August 28, 2003, the Department of Justice filed complaints in partial intervention in two previously reported lawsuits filed under the *qui tam* provisions of the Civil False Claims Act in the United States District Court for the Western District of Kentucky, *United States ex rel. Natural Resources Defense Council, et al v. Lockheed Martin Corporation, et al,* and *United States ex rel. John D. Tillson v. Lockheed Martin Energy Systems, Inc., et al.* The Department alleges that the Corporation committed violations of the Resource Conservation and Recovery Act at the Paducah Gaseous Diffusion Plant by failing to properly handle, store, and transport hazardous waste and that it violated the False Claims Act by purportedly misleading DoE officials and state regulators regarding the nature and extent of environmental noncompliance at the plant. The Corporation disputes the allegations and is defending against them.

On June 10, 2003, Lockheed Martin filed a civil complaint in the United States District Court for the Middle District of Florida in Orlando against The Boeing Company (Boeing) and various individuals. On May 24, 2004, the Corporation filed an amended and supplemental complaint, which presently alleges that the defendants solicited, acquired and used Lockheed Martin's proprietary information during the competition for awards under the U.S. Air Force's Evolved Expendable Launch Vehicle (EELV) programs and others in violation of Federal and state laws. On August 9, 2004, Boeing filed a six-count counterclaim. The counterclaim alleges tortious interference with business and contract, unfair and deceptive trade practices under Florida law, and false advertising under the Lanham Act, based on the Corporation's purported disclosure to the U.S. Air Force and the government of Boeing's possession and use of Lockheed Martin's documents in the EELV and other competitions. In connection with the proposed formation of United Launch Alliance (see Note 2), Boeing and Lockheed Martin have agreed, simultaneous with the closing of the transaction, that they will immediately dismiss all claims against each other. On May 5, 2005, upon motions of Boeing and the Corporation, the U.S. District Court suspended all activity in the cases pending the outcome of the transaction.

On July 28, 2003, BAE SYSTEMS North America, Inc. and BAE SYSTEMS Information and Electronic Systems Integration, Inc. filed a lawsuit against the Corporation in the Chancery Court for New Castle County in Delaware, seeking damages of not less than $40 million. BAE sought indemnification from Lockheed Martin for BAE's payment of a civil judgment entered in 2001 and related costs arising from a lawsuit involving one of the Aerospace Electronics Systems businesses purchased by BAE from the Corporation in November 2000. As a result of a settlement reached by the parties on November 18, 2005, the lawsuit was dismissed.

Nine lawsuits were filed against the Corporation as a result of an incident in July 2003 at its aircraft parts manufacturing facility in Meridian, Mississippi, which resulted in the deaths of seven of its employees and the wounding of eight others. Six of the lawsuits were filed in the U.S. District Court for the Southern District of Mississippi, and three lawsuits were filed in the Circuit Court of Lauderdale County, Mississippi. The lawsuits allege various torts, including wrongful death, intentional infliction of injury, negligent supervision, intentional infliction of emotional distress and, in the case of the federal actions, racial or gender discrimination. On July 14, 2005, the U.S. Court of Appeals for the Fifth Circuit reversed the District Court's decision denying our motion for partial summary judgment in the *Erica Willis Tanks v. Lockheed Martin* lawsuit and dismissed the wrongful death and other state tort claims. On August 26, 2005, the District Court dismissed the wrongful death and other state tort claims in the other five lawsuits pending before it. One of the lawsuits filed in state court, *Fitzgerald v. Lockheed Martin,* has settled.

In a lawsuit filed in the U.S. District Court for the Northern District of California, Space Systems Loral alleges that the Corporation's series A2100, 3000, 4000, 5000 and 7000 satellites infringe a patent relating to a method and apparatus to minimize attitude changes resulting from satellite thruster operations. The Corporation believes that its satellites do not infringe the patent and is vigorously defending the case.

As described in the "Environmental Matters" discussion below, Lockheed Martin is subject to federal and state requirements for protection of the environment, including those for discharge of hazardous materials and remediation of contaminated sites. As a result, the Corporation is a party to or has its property subject to various other lawsuits or proceedings involving environmental matters. Due in part to their complexity and pervasiveness, such requirements have resulted in the Corporation being involved with related legal proceedings, claims and remediation obligations.

The Corporation has been in litigation with certain residents of Redlands, California since 1997 regarding allegations of personal injury, property damage, and other tort claims on behalf of individuals and putative classes of individuals arising from its alleged contribution to regional groundwater contamination. In March and April 2005, the California Court of Appeal issued orders staying all trial and appellate proceedings pending further order of the Court, including staying the trial of 14 claims that was to have commenced in May 2005 in the California Superior Court for San Bernardino County. Following an unsuccessful settlement conference, the trial proceedings remain stayed pending further review and action by the Court of Appeal.

Environmental matters—The Corporation is involved in environmental proceedings and potential proceedings relating to soil and groundwater contamination, disposal of hazardous waste and other environmental matters at several of its current or former facilities. At December 31, 2005 and 2004, the aggregate amount of liabilities recorded relative to environmental matters was $464 million and $420 million, respectively. Environmental cleanup activities usually span several years, which makes estimating liabilities more judgmental due to, for example, changing remediation technologies, assessments of the extent of contamination and continually evolving regulatory environmental standards. These factors are considered in estimates of the timing and amount of any future costs that may be required for remediation actions. The recorded liabilities have not been discounted, as the timing of cash payments is not fixed or cannot be reliably determined.

About 60% of the liability at December 31, 2005 relates to sites in Redlands, Burbank, and Glendale, California, and in Great Neck, New York, mainly for remediation of soil and groundwater contamination. The remainder of the liability related to other properties (including current operating facilities and certain facilities operated in prior years) for which the Corporation's obligation is probable and the financial exposure can be estimated. In cases where a date to complete activities at a particular environmental site cannot be estimated by reference to agreements or otherwise, the Corporation projects costs over an appropriate time frame not to exceed 20 years. The extent of the Corporation's financial exposure cannot in all cases be reasonably determined at this time. The Corporation also is pursuing claims for contribution to site cleanup costs against other potentially responsible parties (PRPs), including the U.S. Government.

At Redlands, California, in response to administrative orders issued by the California Regional Water Quality Control Board, the Corporation is investigating the impact and potential remediation of regional groundwater contamination by perchlorates and chlorinated solvents and has submitted a plan approved by the Regional Board to maintain public water supplies with respect to chlorinated solvents during the investigation. Following further study of perchlorate health effects by both the National Academy of Sciences and by the U.S. EPA, California reaffirmed a six ppb public health goal for perchlorates in March 2005. Although the six ppb public health goal is not a legally enforceable drinking water standard, the Corporation has developed and is in the process of implementing a preliminary remediation plan to meet the six ppb goal in anticipation that California may promulgate an enforceable standard at that level.

The Corporation also is conducting remediation activities pursuant to various consent decrees and orders relating to soil or groundwater contamination at certain sites of former operations, including sites in Burbank and Glendale, California and Great Neck, New York. Under the Burbank and Glendale orders, the Corporation, among other things, is obligated to construct and fund the operations of soil and groundwater treatment facilities through 2018 and 2012, respectively. Responsibility for the long-term operation of the Burbank and Glendale facilities has been assumed by the respective localities. In addition, under an agreement related to the Burbank and Glendale remediation activities, the U.S. Government reimburses the Corporation in an amount equal to approximately 50% of expenditures for certain remediation activities in its capacity as a PRP under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

Letters of credit and other matters—The Corporation has entered into standby letter of credit agreements, surety bonds and other arrangements with financial institutions primarily relating to advances received from customers and/or the guarantee of future performance on certain of its contracts. The Corporation had total outstanding letters of credit and other arrangements aggregating approximately $3.1 billion at December 31, 2005 and $3.0 billion at December 31, 2004. Letters of credit and surety bonds are available for draw down in the event of the Corporation's nonperformance.

NOTE 16—INFORMATION ON BUSINESS SEGMENTS

The Corporation operates in five business segments: Aeronautics, Electronic Systems, Space Systems, Integrated Systems & Solutions (IS&S), and Information & Technology Services (I&TS). The business segments have been organized based on the nature of the products and services offered. In the following tables of financial data, the total of the operating results of these business segments is reconciled, as appropriate, to the corresponding consolidated amount. With respect to the caption "Operating profit," the reconciling item "Unallocated Corporate expense, net" includes the FAS/CAS pension adjustment (see discussion below), earnings and losses from equity investments, interest income, costs for certain stock-based compensation programs, the effects of items not considered part of management's evaluation of segment operating performance, Corporate costs not allocated to the operating segments and other miscellaneous Corporate activities. For financial data other than "Operating profit" where amounts are reconciled to consolidated totals, all activities other than those pertaining to the principle business segments are included in "Corporate activities."

The FAS/CAS pension adjustment represents the difference between pension expense or income calculated for financial reporting purposes under GAAP in accordance with FAS 87, and pension costs calculated and funded in accordance with U.S. Government Cost Accounting Standards (CAS), which are reflected in the business segment results. CAS is a major factor in determining pension funding requirements for the Corporation, and governs the extent of allocability and recoverability of pension costs on government contracts. The CAS expense is recovered through the pricing of the Corporation's products and services on U.S. Government contracts, and therefore recognized in segment net sales. The results of operations of the Corporation's segments only include pension expense as determined and funded in accordance with CAS rules.

Transactions between segments are generally negotiated and accounted for under terms and conditions similar to other government and commercial contracts; however, these intercompany transactions are eliminated in consolidation and for purposes of the presentation of "Net sales" in the related table that follows. Other accounting policies of the business segments are the same as those described in Note 1—Significant Accounting Policies.

Following is a brief description of the activities of the principal business segments:

- *Aeronautics*—Engaged in the design, research and development, systems integration, production, sustainment, support and upgrade of advanced military aircraft and related technologies. Its customers include the military services of the United States and allied countries throughout the world. Major products and programs include the 5TH Generation F-35 Joint Strike Fighter and F-22 air dominance attack and multi-mission combat aircraft; the F-16 multi-role fighter; the C-130J tactical transport aircraft; the C-5 strategic airlift aircraft; and support for the F-117 stealth fighter and special mission and reconnaissance aircraft (*e.g.*, P-3 Orion, S-3 Viking and U-2). The Corporation also produces major components for the F-2 fighter and is a co-developer of the C-27J tactical transport aircraft and the T-50 advanced jet trainer.

- *Electronic Systems*—Engaged in the design, research, development, integration, production and sustainment of high performance systems for undersea, shipboard, land and airborne applications. Major product lines include: missiles and fire control systems; air and theater missile defense systems; surface ship and submarine combat systems; anti-submarine and undersea warfare systems; avionics and ground combat vehicle integration; systems integration and program management for fixed and rotary-wing aircraft systems; radars; platform integration systems; homeland security systems; surveillance and reconnaissance systems; advanced aviation management solutions; security and information technology solutions; and simulation and training systems.

- *Space Systems*—Engaged in the design, research, development, engineering and production of satellites, strategic and defensive missile systems and launch services. The Satellite product line includes both government and commercial satellites. Strategic & Defensive Missile Systems include airborne and missile defense technologies and fleet ballistic missiles. Launch Services include launches on Atlas, Proton, and Titan launch vehicles, and also include the Space Shuttle's external tank.

- *Integrated Systems & Solutions*—Engaged in the design, research, development, integration and management of net-centric solutions supporting the command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR) activities of the U.S. Department of Defense (DoD), intelligence agencies, other federal agencies and allied countries. IS&S provides technology, full life-cycle support and highly specialized talent in the areas of software and systems engineering, including expertise in space, air and ground systems. IS&S serves as the Corporation's focal point for customers with joint and net-centric operations requiring overarching architectures, horizontal systems integration, software development, and inter-connected capabilities for the gathering, processing, storage and delivery of on-demand information for mission management, modeling and simulation, and large-scale systems integration. In that role, IS&S operates the Center for Innovation, a state-of-the-art facility for modeling and simulation.

- *Information & Technology Services*—Engaged in a wide array of information technology (IT), IT-related, and other technology services to federal agencies and other customers. Major product lines include: IT integration and management; enterprise solutions; application development, maintenance, and consulting for strategic programs for the DoD and civil government agencies; aircraft and engine maintenance and modification services; management, operation, maintenance, training and logistics support for military, homeland security and civilian systems; launch, mission and analysis services for military, classified and commercial satellites; engineering, science and information services for the National Aeronautics and Space Administration (NASA); and research, development, engineering and science in support of nuclear weapons stewardship and naval reactor programs.

Selected Financial Data by Business Segment

(In millions)	**2005**	2004	2003
NET SALES			
Aeronautics	**$11,672**	$11,785	$10,206
Electronic Systems	**10,580**	9,729	8,996
Space Systems	**6,820**	6,359	6,024
Integrated Systems & Solutions	**4,131**	3,851	3,422
Information & Technology Services	**4,010**	3,802	3,176
	$37,213	$35,526	$31,824
OPERATING PROFIT[a]			
Aeronautics	**$ 994**	$ 899	$ 690
Electronic Systems	**1,113**	969	858
Space Systems	**609**	489	403
Integrated Systems & Solutions	**365**	334	291
Information & Technology Services	**351**	285	226
Total business segments	**3,432**	2,976	2,468
Net unallocated Corporate expense[b]	**(446)**	(887)	(449)
	$ 2,986	$ 2,089	$ 2,019
INTERSEGMENT REVENUE			
Aeronautics	**$ 99**	$ 77	$ 43
Electronic Systems	**655**	607	573
Space Systems	**179**	217	140
Integrated Systems & Solutions	**632**	580	491
Information & Technology Services	**914**	765	797
	$ 2,479	$ 2,246	$ 2,044

Selected Financial Data by Business Segment (continued)

(In millions)	2005	2004	2003
DEPRECIATION AND AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT			
Aeronautics	$ 130	$ 105	$ 89
Electronic Systems	182	162	160
Space Systems	134	134	120
Integrated Systems & Solutions	44	28	29
Information & Technology Services	14	40	42
Total business segments	504	469	440
Corporate activities	51	42	40
	$ 555	$ 511	$ 480
AMORTIZATION OF PURCHASED INTANGIBLES			
Aeronautics	$ 50	$ 50	$ 50
Electronic Systems	48	47	47
Space Systems	8	8	8
Integrated Systems & Solutions	15	14	14
Information & Technology Services	18	14	8
Total business segments	139	133	127
Corporate activities	11	12	2
	$ 150	$ 145	$ 129
EXPENDITURES FOR PROPERTY, PLANT AND EQUIPMENT			
Aeronautics	$ 190	$ 187	$ 210
Electronic Systems	333	248	204
Space Systems	192	161	143
Integrated Systems & Solutions	74	60	35
Information & Technology Services	31	44	41
Total business segments	820	700	633
Corporate activities	45	69	54
	$ 865	$ 769	$ 687
ASSETS[c]			
Aeronautics	$ 2,503	$ 2,579	$ 3,061
Electronic Systems	9,345	8,853	8,740
Space Systems	3,110	3,018	2,986
Integrated Systems & Solutions	2,147	2,138	2,223
Information & Technology Services	2,885	2,170	2,342
Total business segments	19,990	18,758	19,352
Corporate activities[d]	7,754	6,796	6,823
	$27,744	$25,554	$26,175

(In millions)	2005	2004	2003
GOODWILL			
Aeronautics	$ —	$ —	$ —
Electronic Systems	5,196	5,128	5,075
Space Systems	509	453	453
Integrated Systems & Solutions	1,353	1,317	1,357
Information & Technology Services	1,389	994	994
	$ 8,447	$ 7,892	$ 7,879
CUSTOMER ADVANCES AND AMOUNTS IN EXCESS OF COSTS INCURRED			
Aeronautics	$ 1,488	$ 1,526	$ 2,051
Electronic Systems	1,549	1,221	1,049
Space Systems	1,128	1,167	1,042
Integrated Systems & Solutions	85	101	98
Information & Technology Services	81	13	16
	$ 4,331	$ 4,028	$ 4,256

(a) Operating profit included equity in net earnings (losses) of equity investees as follows:

(In millions)	*2005*	*2004*	*2003*
Electronic Systems	*$ 4*	*$ 5*	*$ —*
Space Systems	*72*	*71*	*51*
Information & Technology Services	*35*	*16*	*15*
Total business segments	*111*	*92*	*66*
Corporate activities	*(3)*	*(25)*	*41*
	$ 108	*$ 67*	*$ 107*

(b) Net unallocated Corporate expense includes the following:

(In millions)	*2005*	*2004*	*2003*
FAS/CAS pension adjustment	*$ (626)*	*$ (595)*	*$ (300)*
Items not considered in segment operating performance	*173*	*(215)*	*(153)*
Other	*7*	*(77)*	*4*
	$ (446)	*$ (887)*	*$ (449)*

For information regarding the items not considered in management's evaluation of segment operating performance, see Notes 2, 7, 8, 9, 10 and 17 to the consolidated financial statements.

(c) The Corporation has no significant long-lived assets located in foreign countries.

(d) Assets primarily include cash, investments, deferred income taxes and the prepaid pension asset.

Net Sales by Customer Category

(In millions)	2005	2004	2003
U.S. GOVERNMENT			
Aeronautics	$ 8,883	$ 7,876	$ 6,613
Electronic Systems	8,504	7,909	7,363
Space Systems	6,409	5,180	4,928
Integrated Systems & Solutions	4,016	3,742	3,252
Information & Technology Services	3,816	3,589	2,799
	$31,628	$28,296	$24,955
FOREIGN GOVERNMENTS[a][b]			
Aeronautics	$ 2,770	$ 3,896	$ 3,580
Electronic Systems	1,917	1,731	1,526
Space Systems	—	4	—
Integrated Systems & Solutions	60	29	16
Information & Technology Services	90	94	79
	$ 4,837	$ 5,754	$ 5,201
COMMERCIAL[b]			
Aeronautics	$ 19	$ 13	$ 13
Electronic Systems	159	89	107
Space Systems	411	1,175	1,096
Integrated Systems & Solutions	55	80	154
Information & Technology Services	104	119	298
	$ 748	$ 1,476	$ 1,668
	$37,213	$35,526	$31,824

(a) Sales made to foreign governments through the U.S. Government are included in the foreign governments category above.

(b) International sales, including export sales reflected in the foreign governments and commercial categories above, were approximately $5.1 billion, $6.0 billion and $5.6 billion in 2005, 2004 and 2003, respectively.

NOTE 17—SUMMARY OF QUARTERLY INFORMATION (UNAUDITED)

	2005 Quarters			
(In millions, except per share data)	First[a]	Second[b]	Third	Fourth[c]
Net sales	$8,488	$9,295	$9,201	$10,229
Operating profit	630	764	706	886
Net earnings	369	461	427	568
Basic earnings per share	0.84	1.03	0.97	1.31
Diluted earnings per share	0.83	1.02	0.96	1.29

	2004 Quarters			
(In millions, except per share data)	First	Second	Third	Fourth[d]
Net sales	$8,347	$8,776	$8,438	$ 9,965
Operating profit	536	544	561	448
Net earnings	291	296	307	372
Basic earnings per share	0.66	0.67	0.69	0.84
Diluted earnings per share	0.65	0.66	0.69	0.83

(a) Net earnings for the first quarter of 2005 included the following items: a gain related to the sale of our 25% interest in Intelsat, Ltd. which increased net earnings by $31 million ($0.07 per share); and a charge related to impairment in the value of a single telecommunications satellite operated by one of our wholly-owned subsidiaries which reduced net earnings by $19 million ($0.04 per share).

(b) Net earnings for the second quarter of 2005 included the following items: recognition of a deferred gain related to the June 2005 initial public offering of shares of Inmarsat which increased net earnings by $27 million ($0.06 per share).

(c) Net earnings for the fourth quarter of 2005 included the following items: a gain related to the sale of Inmarsat shares in a private transaction which increased net earnings by $55 million ($0.13 per share); a gain related to the sale of the Corporation's interest in NeuStar which increased net earnings by $19 million ($0.04 per share).

(d) Net earnings for the fourth quarter of 2004 included the following items: a charge related to Pit 9 litigation which decreased net earnings by $117 million ($0.26 per share); a charge related to the early repayment of debt which decreased net earnings by $100 million ($0.22 per share); the closure of an IRS examination which increased net earnings by $144 million ($0.32 per share); a gain on the sale of interest in New Skies Satellites, N.V. which increased net earnings by $59 million ($0.13 per share); and a gain on the sale of COMSAT General business which increased net earnings by $4 million ($0.01 per share).

CONSOLIDATED FINANCIAL DATA—FIVE YEAR SUMMARY

(In millions, except per share data and ratios)	**2005[a]**	2004[b]	2003[c]	2002[d]	2001[e]
OPERATING RESULTS					
Net sales	**$37,213**	$35,526	$31,824	$26,578	$23,990
Cost of sales	**34,676**	33,558	29,848	24,629	22,447
	2,537	1,968	1,976	1,949	1,543
Other income and expenses, net	**449**	121	43	(791)	(710)
Operating profit	**2,986**	2,089	2,019	1,158	833
Interest expense	**370**	425	487	581	700
Earnings from continuing operations before income taxes	**2,616**	1,664	1,532	577	133
Income tax expense	**791**	398	479	44	90
Earnings from continuing operations	**1,825**	1,266	1,053	533	43
Loss from discontinued operations	**—**	—	—	(33)	(1,089)
Net earnings (loss)	**$ 1,825**	$ 1,266	$ 1,053	$ 500	$ (1,046)
EARNINGS (LOSS) PER COMMON SHARE					
Basic:					
Continuing operations	**$ 4.15**	$ 2.86	$ 2.36	$ 1.20	$ 0.10
Discontinued operations	**—**	—	—	(0.07)	(2.55)
	$ 4.15	$ 2.86	$ 2.36	$ 1.13	$ (2.45)
Diluted:					
Continuing operations	**$ 4.10**	$ 2.83	$ 2.34	$ 1.18	$ 0.10
Discontinued operations	**—**	—	—	(0.07)	(2.52)
	$ 4.10	$ 2.83	$ 2.34	$ 1.11	$ (2.42)
CASH DIVIDENDS	**$ 1.05**	$ 0.91	$ 0.58	$ 0.44	$ 0.44
CONDENSED BALANCE SHEET DATA					
Current assets	**$10,529**	$ 8,953	$ 9,401	$10,626	$10,778
Property, plant and equipment, net	**3,924**	3,599	3,489	3,258	2,991
Goodwill	**8,447**	7,892	7,879	7,380	7,371
Purchased intangibles, net	**560**	672	807	814	939
Other assets	**4,284**	4,438	4,599	4,901	5,635
Total	**$27,744**	$25,554	$26,175	$26,979	$27,714
Current maturities of long-term debt	**$ 202**	$ 15	$ 136	$ 1,365	$ 89
Other current liabilities	**9,226**	8,551	8,757	8,456	9,600
Long-term debt	**4,784**	5,104	6,072	6,217	7,422
Other postretirement benefit liabilities	**1,277**	1,236	1,440	1,480	1,565
Other liabilities	**4,388**	3,627	3,014	3,596	2,595
Stockholders' equity	**7,867**	7,021	6,756	5,865	6,443
Total	**$27,744**	$25,554	$26,175	$26,979	$27,714
COMMON SHARES AT YEAR-END	**432**	438	446	455	441
RETURN ON INVESTED CAPITAL[f]	**14.5%**	10.8%	9.6%	6.0%	(3.7)%
CASH FLOW DATA					
Cash provided by operating activities	**$ 3,194**	$ 2,924	$ 1,809	$ 2,288	$ 1,825
Cash (used for) provided by investing activities	**(499)**	(708)	(1,461)	(539)	139
Cash (used for) provided by financing activities	**(1,511)**	(2,166)	(2,076)	77	(2,557)
NEGOTIATED BACKLOG	**$74,825**	$73,986	$76,899	$70,385	$71,269

Notes to Five Year Summary

(a) Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments (see the section, "Results of Operations" in Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)) which, on a combined basis, increased earnings from continuing operations before income taxes by $173 million, $113 million after tax ($0.25 per share).

(b) Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments (see the section, "Results of Operations" in MD&A) which, on a combined basis, decreased earnings from continuing operations before income taxes by $215 million, $154 million after tax ($0.34 per share). Also includes a reduction in income tax expense resulting from the closure of an Internal Revenue Service examination of $144 million ($0.32 per share). These items reduced earnings by $10 million after tax ($0.02 per share).

(c) Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments (see the section, "Results of Operations" in MD&A) which, on a combined basis, decreased earnings from continuing operations before income taxes by $153 million, $102 million after tax ($0.22 per share).

(d) Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments which, on a combined basis, decreased earnings from continuing operations before income taxes by $1,112 million, $632 million after tax ($1.40 per share). In 2002, the Corporation adopted FAS 142 which prohibits the amortization of goodwill.

(e) Includes the effects of items not considered in senior management's assessment of the operating performance of the Corporation's business segments which, on a combined basis, decreased earnings from continuing operations before income taxes by $973 million, $651 million after tax ($1.50 per share). Also includes a gain from the disposal of a business and charges for the Corporation's exit from its global telecommunications services business which is included in discontinued operations and which, on a combined basis, increased the net loss by $1 billion ($2.38 per share).

(f) The Corporation defines return on invested capital (ROIC) as net income plus after-tax interest expense divided by average invested capital (stockholders' equity plus debt), after adjusting stockholders' equity by adding back the minimum pension liability. The adjustment to add back the minimum pension liability is a revision to our calculation in 2005, which the Corporation believes more closely links ROIC to management performance. Further, the Corporation believes that reporting ROIC provides investors with greater visibility into how effectively Lockheed Martin uses the capital invested in its operations. The Corporation uses ROIC to evaluate multi-year investment decisions and as a long-term performance measure, and also uses ROIC as a factor in evaluating management performance under certain incentive compensation plans. ROIC is not a measure of financial performance under GAAP, and may not be defined and calculated by other companies in the same manner. ROIC should not be considered in isolation or as an alternative to net earnings as an indicator of performance. The following calculations of ROIC reflect the revision to the calculation discussed above for all periods presented.

(In millions)	***2005***	*2004*	*2003*	*2002*	*2001*
Net earnings	***$ 1,825***	*$ 1,266*	*$ 1,053*	*$ 500*	*$ (1,046)*
Interest expense (multiplied by 65%)[1]	***241***	*276*	*317*	*378*	*455*
Return	***$ 2,066***	*$ 1,542*	*$ 1,370*	*$ 878*	*$ (591)*
Average debt[2,5]	***$ 5,077***	*$ 5,932*	*$ 6,612*	*$ 7,491*	*$ 8,782*
Average equity[3,5]	***7,590***	*7,015*	*6,170*	*6,853*	*7,221*
Average minimum pension liability[3,4,5]	***1,545***	*1,296*	*1,504*	*341*	*6*
Average invested capital	***$14,212***	*$14,243*	*$14,286*	*$14,685*	*$16,009*
Return on invested capital	***14.5%***	*10.8%*	*9.6%*	*6.0%*	*(3.7)%*

[1] Represents after-tax interest expense utilizing the federal statutory rate of 35%.

[2] Debt consists of long-term debt, including current maturities, and short-term borrowings (if any).

[3] Equity includes non-cash adjustments for other comprehensive losses, primarily for the additional minimum pension liability.

[4] Minimum pension liability values reflect the cumulative value of entries identified in our Statement of Stockholders Equity under the caption "Minimum pension liability." The annual minimum pension liability adjustments to equity were: 2001 = ($33 million); 2002 = ($1,537 million); 2003 = $331 million; 2004 = ($285 million); 2005 = ($105 million). As these entries are recorded in the fourth quarter, the value added back to our average equity in a given year is the cumulative impact of all prior year entries plus 20% of the current year entry value.

[5] Yearly averages are calculated using balances at the start of the year and at the end of each quarter.

CORPORATE DIRECTORY

(As of March 1, 2006)

BOARD OF DIRECTORS

E. C. "Pete" Aldridge, Jr.
Former Under Secretary of Defense

Nolan D. Archibald
Chairman, President &
Chief Executive Officer
The Black & Decker Corporation

Marcus C. Bennett
Retired Executive Vice President
and Chief Financial Officer
Lockheed Martin Corporation

James O. Ellis, Jr.
President and Chief Executive Officer
Institute of Nuclear Power Operations

Gwendolyn S. King
President
Podium Prose
(A Washington, D.C.-based
Speaker's Bureau)

James M. Loy
Senior Counselor
The Cohen Group

Douglas H. McCorkindale
Chairman
Gannett Co., Inc.

Eugene F. Murphy
Former Vice Chairman and
Executive Officer
General Electric Company

Joseph W. Ralston
Vice Chairman
The Cohen Group

Frank Savage
Chief Executive Officer
Savage Holdings LLC

James M. Schneider
Senior Vice President and
Chief Financial Officer
Dell Inc.

Anne Stevens
Executive Vice President
Ford Motor Company
Chief Operating Officer, The Americas

Robert J. Stevens
Chairman, President and
Chief Executive Officer
Lockheed Martin Corporation

James R. Ukropina
Chief Executive Officer
Directions, LLC
(A Management and Consulting Firm)

Douglas C. Yearley
Chairman Emeritus
Phelps Dodge Corporation

COMMITTEES

Audit Committee
Mr. Yearley, Chairman
Ms. Stevens and Messrs. Aldridge,
Schneider and Ukropina

Ethics and Corporate
Responsibility Committee
Mrs. King, Chairman
Messrs. Bennett, Loy,
Ralston and Savage

Executive Committee
Mr. Stevens, Chairman
Mrs. King and Messrs. Archibald,
McCorkindale, Ukropina and Yearley

Management Development and
Compensation Committee and
Stock Option Subcommittee
Mr. Archibald, Chairman
Mrs. King, Ms. Stevens
and Messrs. Aldridge,
Murphy and Schneider

Nominating and Corporate
Governance Committee
Mr. Ukropina, Chairman
Messrs. Archibald, Ellis,
McCorkindale and Murphy

Strategic Affairs and
Finance Committee
Mr. McCorkindale, Chairman
Messrs. Bennett, Ellis, Loy,
Ralston, Savage and Yearley

CORPORATE DIRECTORY

(As of March 1, 2006)

OFFICERS

Kenneth Asbury
Vice President

Sondra L. Barbour
Vice President

James F. Berry
Vice President

Dennis R. Boxx
Senior Vice President

Charles T. Burbage
Vice President

Michael F. Camardo
Executive Vice President
Information & Technology Services

Joseph R. Cleveland
Vice President

James B. Comey
Senior Vice President and
General Counsel

Robert B. Coutts
Executive Vice President
Electronic Systems

Brian D. Dailey
Senior Vice President

Kenneth J. Disken
Senior Vice President

John J. Freeh
Vice President

Theofanis G. Gavrilis
Vice President

Linda R. Gooden
Vice President

Jeffrey K. Harris
Vice President

Ralph D. Heath
Executive Vice President
Aeronautics

Marillyn A. Hewson
Senior Vice President

Arthur E. Johnson
Senior Vice President

Michael J. Joyce
Vice President

Christopher E. Kubasik
Executive Vice President and
Chief Financial Officer

Maryanne R. Lavan
Vice President

Joanne M. Maguire
Vice President

G. Thomas Marsh
Executive Vice President
Space Systems

Frank C. Meyer
Vice President

Fred P. Moosally
Vice President

James R. Ryan
Vice President

Stanton D. Sloane
Executive Vice President
Integrated Systems & Solutions

Martin T. Stanislav
Vice President and Controller

Robert J. Stevens
Chairman, President and
Chief Executive Officer

Robert H. Trice
Senior Vice President

Lillian M. Trippett
Vice President, Corporate Secretary
and Associate General Counsel

Anthony G. Van Schaick
Vice President and Treasurer

Mary M. VanDeWeghe
Senior Vice President

GENERAL INFORMATION

December 31, 2005

As of December 31, 2005, there were approximately 42,800 holders of record of Lockheed Martin common stock and 434,264,432 shares outstanding.

COMMON STOCK PRICES

(In dollars)	High	Low	Close
2005 Quarters			
1st	**61.47**	**52.54**	**61.06**
2nd	**65.46**	**58.28**	**64.87**
3rd	**65.24**	**59.82**	**61.04**
4th	**64.28**	**58.50**	**63.63**
2004 Quarters			
1st	52.19	43.10	45.64
2nd	52.50	45.73	52.08
3rd	56.00	51.05	55.78
4th	61.77	52.19	55.55

TRANSFER AGENT & REGISTRAR

Computershare Trust Company, N.A.
Shareholder Services
P.O. Box 43010
Providence, Rhode Island 02940-3010
Telephone: 1-877-498-8861
TDD for the hearing impaired: 1-800-952-9245
Internet: http://www.computershare.com

DIVIDEND REINVESTMENT PLAN

Lockheed Martin Direct Invest, our direct stock purchase and dividend reinvestment plan, provides new investors and current stockholders with a convenient, cost-effective way to purchase Lockheed Martin common stock, increase holdings and manage the investment. For more information about Lockheed Martin Direct Invest, contact our transfer agent, Computershare Trust Company, N.A. at 1-877-498-8861, or to view plan materials online and enroll electronically, access Internet site http://www.shareholder.com/lmt/shareholder.cfm#drip.

INDEPENDENT AUDITORS

Ernst & Young LLP
621 East Pratt Street
Baltimore, MD 21202

COMMON STOCK

Stock symbol: LMT
Listed: New York Stock Exchange (NYSE)

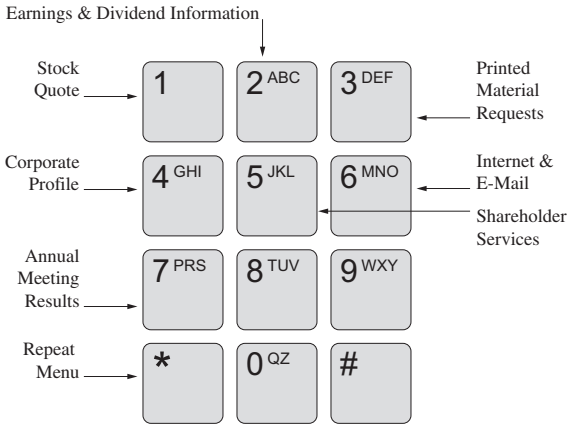
ANNUAL REPORT ON FORM 10-K

Stockholders may obtain, without charge, a copy of Lockheed Martin's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission for the year ended December 31, 2005 by writing to:
Lockheed Martin Investor Relations MP 280
6801 Rockledge Drive, Bethesda, MD 20817

The CEO/CFO certifications required to be filed with the SEC pursuant to Section 302 of the Sarbanes-Oxley Act are included as Exhibits 31.1 and 31.2 to our 2005 Annual Report on Form 10-K. In addition, an annual CEO certification regarding compliance with the NYSE's Corporate Governance listing standards was submitted by the Corporation's CEO to the NYSE on May 12, 2005.

For accessing the Lockheed Martin Investor Relations homepage on the Internet use the Uniform Resource Locator: http://www.lockheedmartin.com/investor.

Lockheed Martin Shareholder Direct
1-800-568-9758



Financial results, stock quotes, dividend news as well as other Lockheed Martin information are available by calling the above toll-free number. The information will be read to the caller and certain of the information can also be received by mail, fax or E-mail. You may also reach Shareholder Services for account information or Investor Relations for additional information on Lockheed Martin via the toll-free number.

FORWARD-LOOKING STATEMENTS—SAFE HARBOR PROVISIONS

This Annual Report contains statements which, to the extent that they are not recitations of historical fact, constitute forward-looking statements within the meaning of the federal securities laws. The words "believe," "estimate," "anticipate," "project," "intend," "expect," "plan," "outlook," "forecast" and similar expressions are intended to identify forward-looking statements. Numerous factors, including potentially the following factors, could affect the Corporation's forward-looking statements and actual performance: the availability of government funding for our products and services both domestically and internationally; changes in government and customer priorities and requirements (including changes to respond to Department of Defense reviews, Congressional actions, budgetary constraints, cost-cutting initiatives, terrorist threats and homeland security); the impact of continued military operations in Iraq and Afghanistan and spending for disaster relief on funding for existing defense programs; the award or termination of contracts; difficulties in developing and producing operationally advanced technology systems; the timing and customer acceptance of product deliveries; performance issues with key suppliers, subcontractors and customers; return on pension plan assets, interest and discount rates, and other changes that may impact pension plan assumptions; charges from any future impairment reviews that may result in the recognition of losses, and a reduction in the book value of goodwill or other long-term assets; the future impact of legislation or changes in accounting or tax rules, interpretations or pronouncements; the future impact of acquisitions or divestitures, joint ventures or teaming arrangements; the outcome of legal proceedings and other contingencies (including lawsuits, government investigations or audits, government or regulatory approvals, and environmental remediation efforts); the competitive environment for the Corporation's products and services; and economic, business and political conditions domestically and internationally.

For a discussion identifying additional important factors that could cause actual results to vary materially from those anticipated in the forward-looking statements, see the Corporation's filings with the SEC including, but not limited to, the discussion of "Government Contracts and Regulation" and "Risk Factors" on page 22 and on pages 24 through 32 of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005 (Form 10-K), "Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 17 through 40 of this Annual Report, and "Note 1—Significant Accounting Policies," "Note 2—Acquisitions and Divestitures," and "Note 15—Legal Proceedings, Commitments and Contingencies" of the Notes to Consolidated Financial Statements of the Audited Consolidated Financial Statements on pages 48 through 53, pages 53 through 54, and pages 66 through 68, respectively, included in this Annual Report and included in the Form 10-K.

The Corporation's actual financial results likely will be different from those projected due to the inherent nature of projections. Given these uncertainties, you should not rely on forward-looking statements in making investment decisions. The forward-looking statements contained in this Annual Report speak only as of the date of the Report. The Corporation expressly disclaims a duty to provide updates to forward-looking statements after the date of this Annual Report to reflect the occurrence of subsequent events, changed circumstances, changes in its expectations, or the estimates and assumptions associated with them. The forward-looking statements in this Annual Report are intended to be subject to the safe harbor protection provided by the federal securities laws.

LOCKHEED MARTIN

Our Vision

Powered by Innovation, Guided by Integrity, We Help

Our Customers Achieve Their Most Challenging Goals

Our Value Statements

Do What's Right

Respect Others

Perform With Excellence

designed by curran & connors, inc. / www.curran-connors.com
Photography: Eric Schulzinger

LOCKHEED MARTIN

Lockheed Martin Corporation
6801 Rockledge Drive
Bethesda, MD 20817
www.lockheedmartin.com