Raytheon

# 2003 ANNUAL REPORT

OUR MISSION ▸▸▸

## ▸▸▸▸▸ CUSTOMER **SUCCESS**

At RAYTHEON, everything begins with the customer. Our customers are men and women in uniform, pilots and their passengers, and our partners, in government and industry. Our customers' success demands our best performance. That means meeting our commitments and being dependable. It's also forging strong bonds based on the highest ethical behavior. And it's working as one company to create solutions – the best and most innovative solutions, now and in the future. *Customer Success Is Our Mission* – and the basis for our growth.

ON THE COVER ▸▸▸

An F-15 fighter pilot prepares to take off. In 2003, F-15C Eagles flew with two improved combat capabilities provided by Raytheon: the first operational airborne Active Electronically Scanned Array radar and the AIM-9X next generation Sidewinder air-to-air missile.

GOALS FOR 2004 ►►►

Customer Growth People Productivity

WILLIAM H. SWANSON
Chairman and CEO

## DEAR FELLOW **SHAREHOLDERS** ►►►

► Raytheon's 2003 Annual Report tells the story of a company that is well positioned in defense, that has re-baselined its business aircraft operations to reflect difficult market conditions, that has enjoyed exceptional cash flow performance and that has put many of its issues behind it. While the company still has work to do, I believe we are focused on the right things and on the right path going forward. ►► STRONG GOVERNMENT AND DEFENSE BOOKINGS AND BACKLOG Government and Defense bookings for the year were $20 billion, up from $14.9 billion in 2002, pushing year-end 2003 Government and Defense backlog to a record $25 billion, an increase of $4 billion over the prior year. This strong bookings and backlog performance is a direct result, I believe, of our focus on our *customers*. ►► Government and Defense sales, which constitute the lion's share of total company sales, increased 7 percent compared with the prior year, after the elimination of intercompany sales. The increase was led by Integrated Defense Systems, Missile Systems and Space and Airborne Systems. Total company net sales in 2003 were $18.1 billion, up from $16.8 billion in 2002. ►► Income from continuing operations was $535 million or $1.29 per diluted share in 2003 compared with $756 million or $1.85 per diluted share in 2002. Income from continuing operations in 2003 was negatively affected by Network Centric Systems and Raytheon Technical Services Company, and by increased non-cash pension expense. It was positively affected by strong operating performance in a number of our other Government and Defense businesses. ►► Including the impact of discontinued operations, the company's net income in 2003 was $0.88 per diluted share compared with a net loss of $1.57 per diluted share in the prior year. ►► TAKING THE PULSE OF THE COMPANY My career with Raytheon began in 1972. It has been my privilege to work since then as an engineer on the shop floor, in materials, manufacturing, fabrication and quality, in systems integration and planning, in program and general management – and in almost all levels of leadership. These experiences have left me with a love for this company, its people and its customers – and a strong sense of stewardship on behalf of our shareholders. ►► While metrics are extremely important in leading a team of 78,000 people, one also needs to have a feel of the *pulse* of the company. I hold a view that you remember a third of what you read, half of what you hear, but 100 percent of what you *feel*. That feeling for the pulse of the company is very important. For this reason, I value one-on-one communication, in person when possible, electronically when not. I try to read all of my e-mails within 24 hours. Ideally, I like to have a clean e-mail

VISION ▸▸▸

Be the most admired defense and aerospace systems supplier through world-class people and technology.

STRATEGY ▸▸▸

Achieve above-market growth in our four Strategic Business Areas: Missile Defense; Precision Engagement; Intelligence, Surveillance and Reconnaissance; and Homeland Security.

Restore Raytheon Aircraft to preeminence in aviation, showcasing the Beechcraft® and Hawker® brands.

Be a Customer-Focused Company based on Performance, Relationships and Solutions.

TRIBUTE TO DAN BURNHAM

On behalf of the Board of Directors and the employees of Raytheon, I want to offer a special "thank you" to my predecessor, Dan Burnham, who stepped down as CEO on July 1, 2003, and retired as Chairman on January 28, 2004. Dan led the transformation of the company, helped give us financial flexibility, sharpened our focus and made sure we had a defense portfolio second to none. He launched and embedded Raytheon Six Sigma, introduced contemporary HR practices and managed a smooth leadership succession. His trust, friendship and confidence have been, and will continue to be, very important to me. On behalf of all of his friends at Raytheon, I wish Dan and his wife, Meg, all the very best as they embark on their wonderful, chosen path together. ▸▸▸ BILL SWANSON

screen before I go to sleep each night. ▸▸ A CUSTOMER-FOCUSED COMPANY Given all this, what kind of company do I believe Raytheon is today? The answer is: Raytheon today is a company committed to customer success. We believe that if you help the customer succeed, you will create the right conditions to meet the needs of all your constituents. We believe that customer focus creates customer success, that customer success drives growth and that growth creates shareholder value. So, we believe that a customer focus creates shareholder value. ▸▸ In our view, a customer-focused company has three pillars: performance, relationships and solutions. ▸▸ PERFORMANCE Performance is really as simple as "promises made and promises kept." It's taking one's commitments seriously; when we make them, we must fulfill them. During the year, our customers and partners showed confidence in us in many ways. We received awards for a ship-based radar for ballistic missile defense from the U.S. Navy; a next generation U.S. Air Force Distributed Common Ground System, the backbone of current and future intelligence and information systems; a U.S. Missile Defense Agency Kinetic Energy Interceptor to target hostile missiles in the boost phase; a role as Ground Sensor Integrator for U.S. Army Future Combat Systems; continued modernization of the radar on the Air Force B-2 bomber; technical services for NASA; and 50 Hawker 400XP light jets and eight Hawker 800XP mid-size jets – from NetJets Inc. ▸▸ RELATIONSHIPS Relationships are built on trust. Our customers depend on us. One of the most emotional examples of this personal bond is what it feels like to correspond with someone deployed in harm's way. Those who have had this experience know that it can be wrenching to receive an e-mail from someone stationed in a high-risk area while you're sitting at a computer screen in the safety of your office. You think long and hard before you compose your response. Before I press the "send" button, I always ask myself: *Have I listened? Have I helped? Have we done everything we can?* ▸▸ Listening. We are a company that listens; we're getting better and better at listening, but we need to get better still. Building positive relationships with our customers begins with listening – and trust. Integrity is something that only succeeds when it's embedded in the culture. We ask the members of the Raytheon team to treat the company's name as if it were their own. We ask the leaders of the team to create and maintain an environment in which people are encouraged to step forward so that we can address issues early. Everything we do must begin with integrity. ▸▸ SOLUTIONS We must develop and provide superior customer solutions, working as one company. We're a technology company at our core. We plan to drive Raytheon

PERFORMANCE ▸▸▸

Meet our commitments to our Customers, partners and each other, driving Customer Success.

RELATIONSHIPS ▸▸▸

Build positive, solid relationships with our Customers, partners and each other. Listen, anticipate, respond, follow-through.

SOLUTIONS ▸▸▸

Develop and provide superior Customer solutions, working as One Company.

technology as a key differentiator. You will see many examples of the company's technology solutions in this Annual Report. ▸▸ As we build on our strength in technology, we must also align our capabilities with the needs of our customers. I believe we have done so. We saw that alignment in Afghanistan and in Operation Iraqi Freedom. Our individual businesses work hard at this. We also have four Strategic Business Areas – Missile Defense; Precision Engagement; Intelligence, Surveillance and Reconnaissance; and Homeland Security – that are designed to facilitate customer solutions that cross our businesses and may even extend beyond our company. ▸▸ We understand that to succeed internationally, we must be sensitive to the unique needs of each of our customers – whether for Airborne Stand-off Radar systems and Paveway IV precision-guided bombs in the U.K.; combat control systems for Australian submarines; or solutions to meet evolving defense needs in Japan. ▸▸ RAYTHEON'S VALUES We are a company based on values: People, Integrity, Commitment, Excellence. We've talked about the last three. Now for the first: valuing people. That can sound nebulous; after all, who doesn't value people? But at Raytheon, it has specific meaning. It means treating people with respect and dignity, welcoming diversity and diverse opinions, helping our teammates improve their skills, recognizing and rewarding accomplishment and fostering teamwork and collaboration. ▸▸ To me, valuing people starts with a healthy and safe work environment. Since 1998, the company has reduced employee injuries by 78 percent. Now that Raytheon has reduced its injury rate to a level that many consider to be "world class," we are challenging the team to prevent every injury. The goal must be an injury-free workplace, because anything else is unacceptable. ▸▸ I do have a passion for our customers, this company and its people. I believe that if we help our customers succeed, our employees, partners and stockholders will share in our success. I also believe that if we stay focused on what matters, our company will be on a path to greatness. ▸▸ For all of the reasons above – and as illustrated in the pages that follow – at Raytheon, *Customer Success Is Our Mission*.

Sincerely,

WILLIAM H. SWANSON
Chairman and CEO

February 18, 2004

A WORLD LEADER IN MISSILE DEFENSE ▸▸▸

The Cobra Judy ship-based radar is an important element in the boost, midcourse and terminal phases of a layered defense system in which Raytheon partners with the United States and its allies. Raytheon will replace the existing Cobra Judy radar system with a dual-band radar suite and other related mission equipment.

## OUR MISSION: SUPERIOR **PERFORMANCE** ▸▸▸

Raytheon is proud to be a major partner in MISSILE DEFENSE, which requires superior performance and teamwork to guard effectively against missile attack. Raytheon is a partner with the U.S. Missile Defense Agency (MDA) and other companies in all three phases of the missile defense system – boost, midcourse defense and terminal defense. In the boost phase, Raytheon plays a key role in the Kinetic Energy Interceptor (KEI) program, developing the kill vehicle and technology to integrate it with the interceptor. The company is a leader in the development and deployment of kinetic vehicles for midcourse defense, including the Exoatmospheric Kill Vehicle. In all three phases of missile defense, Raytheon radars play a key role in surveillance, target tracking, discrimination and communication with interceptor missiles and kinetic vehicles.

The KEI high-speed interceptor offers the capability to destroy enemy missiles during their vulnerable boost phase of flight.

In December 2003, the Missile Defense Agency conducted a successful test of its Aegis Ballistic Missile Defense program with a Raytheon STANDARD Missile-3 intercepting a ballistic missile target in space.

### BOOST

Airborne Laser Track Illuminator Laser
Kinetic Energy Interceptor
Cobra Judy Radar System
Ballistic Missile Defense System Radar
Space Tracking and Surveillance System

### MIDCOURSE DEFENSE

Exoatmospheric Kill Vehicle
Ground Based Radar – Prototype
Sea-Based X-Band Radar
Upgraded Early Warning Radars
Ballistic Missile Defense System Radar
Space Tracking and Surveillance System
Cobra Dane Radar System
Cobra Judy Radar System

## ▸▸▸ THAT ACHIEVES **SUCCESS** FOR OUR CUSTOMERS

In the midcourse phase, Raytheon is developing the next generation shipboard Cobra Judy replacement system. It will provide foreign ballistic missile data collection for the MDA and strategic and related communities. For the midcourse and terminal phases, the company successfully tested its STANDARD Missile-3 in 2003. Raytheon also continued next generation development in upgraded early warning radar systems, the sensors for the Space Tracking and Surveillance System, and the mobile Ballistic Missile Defense System radar. Supported by the principles of Raytheon Six Sigma™ and our world-class Integrated Product Development System, our objective is to meet our commitments and help our customers defend against the proliferating missile threat.

### TERMINAL DEFENSE

STANDARD Missile-3
Patriot Air and Missile Defense System
Terminal High-Altitude Area Defense
  Ground-Based Radar
Terminal High-Altitude Area Defense
  Command and Control Battle Management

The Rt. Hon. The Lord Jones of Deeside (left), Lord Bach of Lutterworth, Minister of Defence Procurement, and Jack Kelble, President, Raytheon's Space and Airborne Systems, celebrate the opening of the AIRBORNE STAND-OFF RADAR (ASTOR) systems integration center in the U.K.

ENABLING DECISION SUPERIORITY ▸▸▸

The $1.4 billion ASTOR program for the U.K. is one example of Raytheon's innovative intelligence, surveillance and reconnaissance solutions that support interoperability among allies.

## OUR MISSION: DEDICATED **PEOPLE** ▸▸▸

Enduring customer relationships are integral to the development of INTELLIGENCE, SURVEILLANCE AND RECONNAISSANCE systems for the United States and its allies. We listen, anticipate, respond and follow-through. Our intense customer focus has yielded superior systems integration for the Global Hawk® unmanned aerial vehicle, U-2 reconnaissance plane and classified programs. Internationally, the $1.4 billion Airborne Stand-off Radar (ASTOR) program for the United Kingdom celebrated major customer milestones, strengthening Raytheon's bid to develop an airborne ground surveillance system for the North Atlantic Treaty Organization. The cornerstone of Raytheon's international presence is its global companies

▸▸▸ BUILDING STRONG **RELATIONSHIPS** THAT MEET CUSTOMER NEEDS

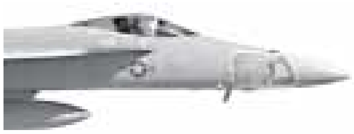
in the United Kingdom, Australia and Canada, as well as the joint venture, Thales-Raytheon Systems Company Limited. Raytheon Systems Limited™, United Kingdom, won Britain's Precision Guided Bomb program with the Paveway™ IV laser-guided bomb. Raytheon Australia Pty. Ltd. grew more than 30 percent in 2003 by acquiring Honeywell Aerospace Defence Services and winning contracts to replace the combat control system for Australia's Collins-class submarines. Raytheon Canada Ltd., in partnership with the Canadian government, expanded distribution of the world's first high-frequency surface wave radar. In 2003, Raytheon contracted business in 76 countries and strengthened its foundation for continued international growth.

Marshaling resources across the enterprise, Raytheon provides superior solutions for its customers. In the PRECISION ENGAGEMENT Strategic Business Area, Raytheon develops mission solutions that span the battlespace. One example of the company's success in partnering with its customers for outstanding mission solutions is the F/A-18 Super Hornet, the Navy's premier fighter and attack aircraft. Sophisticated Raytheon sensors make pilots aware of situations that change in an instant. Sensing systems, such as

Dave Weissgerber (left), Boeing program manager; Lt. Cmdr. Jaime Engdahl, NAVAIR program manager; and Debbie Ybarra, Raytheon program manager, celebrate the initial operational capability of the AN/ASQ-228 Advanced Targeting Forward-Looking Infrared pod.

## OUR MISSION: CUTTING-EDGE **TECHNOLOGIES** ▸▸▸

More than 9,000 Paveway™ laser-guided bombs were used during Operation Iraqi Freedom – more than any other precision-guided weapon.



The APG-79 Active Electronically Scanning Array radar brings a revolutionary air-to-air and air-to-ground capability to the F/A-18 Super Hornet.

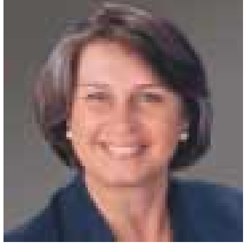
### MISSION SOLUTIONS THAT SPAN THE BATTLESPACE ▸▸▸

Raytheon works closely with its partners, Boeing and the U.S. Navy, to provide F/A-18 pilots with superior combat capability. Raytheon produces the fire control radar, targeting pod, counter-measures suite and air-to-air and air-to-ground weapons that give war fighters more speed, quality and flexibility in their decision-making.

the APG-79 Active Electronically Scanning Array radar, the AN/ASQ-228 Advanced Targeting Forward-Looking Infrared system, and the ALR-67(V)3&4 fourth-generation radar warning receiver, work in harmony to keep the air crew safe, protect the aircraft, and accomplish the mission. Raytheon weapon systems for the Super Hornet include the Joint Standoff Weapon, the Paveway™ III laser-guided bomb, the AMRAAM™ medium-range air-to-air missile and the AIM-9X Sidewinder short-range air-to-air missile, which achieved initial operational capability in 2003.

▸▸▸ THAT DELIVER INTEGRATED **SOLUTIONS**

LOUISE FRANCESCONI
President



▸ MISSILE SYSTEMS (MS), which reported sales of $3.5 billion in 2003, continued its leading position as a developer and supplier of innovative weapon systems and built on its core strengths to grow its business to support the evolving needs of its customers. ▸▸ Performance was highlighted by the successful use of those weapon systems in combat by U.S. and allied forces in Operation Iraqi Freedom. Raytheon's precision-guided weapons gave war fighters pinpoint accuracy and reduced collateral damage. Paveway laser-guided bombs and Tomahawk cruise missiles were key systems used during the conflict. ▸▸ To meet customer needs, the company tripled production of Paveway II from 2002 to 2003, and earned a $174 million production contract. Raytheon also accelerated efforts to recertify and remanufacture Tomahawks to incorporate system upgrades. Missile Systems continued to mature key programs in development to meet evolving battlefield requirements. ▸▸ The new Tactical Tomahawk proved its capabilities in a number of significant flight tests during 2003 and earned a $224 million initial production contract. The weapon is expected to become operational in 2004. Tactical Tomahawk incorporates innovative technologies and provides growth and advanced capabilities to the Navy, and the opportunity for stable business for Raytheon. ▸▸ The Evolved Sea Sparrow Missile, an advanced ship self-defense missile developed for the U.S. and NATO allies, was successfully fired from ships of the navies of the U.S., Australia and the Netherlands and completed Navy testing and evaluation, paving the way for full-rate production in 2004. AIM-9X, the next generation Sidewinder air-to-air missile, is now operationally fielded after a highly successful flight test. ▸▸ As part of the company's overall strategy to meet the needs of its international customers, Missile Systems earned contract awards in two key programs in 2003. The United Kingdom and New Zealand selected the Javelin™ anti-tank weapon system to meet their medium-range anti-armor needs. Missile Systems also provided technical support to Raytheon Systems Limited, which was selected to provide an upgraded Paveway designated as Paveway IV, to meet the Royal Air Force's precision-guided bomb needs, opening up new markets internationally and in the U.S. ▸▸ In the growing area of missile defense, Raytheon was part of a team awarded the Kinetic Energy Interceptor (KEI), a $4 billion contract to the team, from the Missile Defense Agency. KEI will provide the U.S. with the ability to destroy hostile missiles during the vulnerable boost phase of flight. ▸▸ Earlier in the year, the company secured an $881 million contract for engineering and manufacturing to continue development and begin deployment of the STANDARD Missile-3 as part of the Missile Defense Agency's sea-based Aegis Ballistic Missile Defense System. In addition, Raytheon delivered the first deployment version of the Exoatmospheric Kill Vehicle (EKV), which will be tested as part of the Ground-based Missile Defense system in 2004, and won a $177 million contract to build 15 additional EKVs. ▸▸ Based on the previous year's investments, Missile Systems secured nearly $190 million of leading-edge technology programs to deliver important new capabilities, one of which is the U.S. Air Force's Miniature Air Launched Decoy. ▸▸ The breadth of the Missile Systems portfolio continues to position the company to respond to the evolving needs of its customers with innovative, cost effective solutions.

## MISSILE SYSTEMS ▸▸▸

Scheduled for fleet introduction in 2004, the Tactical Tomahawk will have the capability to respond to changing battlefield conditions through the use of its loiter and mission flex features. The navigation and power source of the self-guided Tactical Tomahawk are shown in the wireframe of this image.

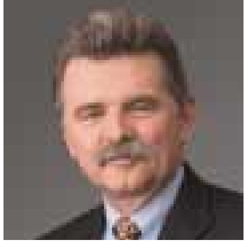
DAN SMITH
President

▸ INTEGRATED DEFENSE SYSTEMS (IDS), which reported sales of $2.9 billion in 2003, emerged as an industry-leading mission systems integrator during the year with major domestic and international awards and solid performance on existing contracts. ▸▸ In support of their customers, employees from IDS deployed alongside U.S. soldiers during both Operation Enduring Freedom and Operation Iraqi Freedom. Engineers and support personnel volunteered to train military personnel on new equipment, assist with repairs and provide logistics support for our military customers. ▸▸ The U.S. Navy awarded Raytheon a $1 billion contract for the Cobra Judy Replacement Mission Equipment program. Under the contract, Raytheon will replace the existing Cobra Judy, a surveillance and data collection system that supports U.S. treaty monitoring activities, with a dual-band radar suite consisting of X-band and S-band active phased array sensors and other related mission equipment. ▸▸ Under a three-year $1.3 billion contract, Raytheon serves as the electronics and weapons systems integrator for DD(X), the next generation destroyer being developed for the U.S. Navy. During 2003, DD(X) passed critical milestones with the successful completion of the Navy's System Requirements Review, and major ship subsystems successfully passed Preliminary Design Reviews on schedule. ▸▸ Late in the year, Raytheon was selected by the U.S. Army to enter into negotiations for development of the Surface-Launched AMRAAM air defense system, SLAMRAAM™, that will provide air defense capability against the emerging cruise missile threat, tactical ballistic missiles, unmanned aircraft and helicopters. ▸▸ The U.S. Missile Defense Agency awarded Raytheon a $350 million contract to design, integrate and test a forward-deployable Ballistic Missile Defense System radar. The radar will be a transportable, X-band, phased array radar with sufficient sensitivity to detect, track and discriminate threat missiles. ▸▸ Raytheon's radar and integration expertise was rewarded when the U.S. Space and Missile Defense Command awarded the company an $894 million contract to produce two Joint Land Attack Cruise Missile Defense Elevated Netted Sensor systems. The systems will be used to counter the growing cruise missile threat. ▸▸ Major international awards included a U.S. Navy Foreign Military Sales contract from the Royal Australian Navy to develop five Combat Control System Mk 2 weapons control systems for the Australian Navy's Collins-class diesel submarines. ▸▸ Raytheon also received a contract for 24 Mk 54 torpedoes, demonstrating a renewed commitment by the U.S. Navy to the U.S. industrial base for torpedoes and reinforcing Raytheon's position as the sole U.S. supplier of lightweight and heavyweight torpedoes. ▸▸ During 2003, Raytheon completed the acquisition of Solipsys Corporation of Laurel, Md., a specialist in DoD data integration and display. ▸▸ Combining world-class people with flawless performance, strong customer relationships and innovative solutions, Raytheon Integrated Defense Systems is defining its position as a mission systems integrator of choice.

## INTEGRATED DEFENSE SYSTEMS ▸▸▸

Raytheon is teamed with the U.S. Navy to design the SPY-3 Multi-Function Radar, an active phased array X-band radar to meet advanced surface search and control requirements. SPY-3 will serve next generation aircraft carriers, amphibious warfare ships and DD(X), the next generation destroyer for which Raytheon serves as the electronics and weapons systems integrator. The first SPY-3 was delivered to the Navy to begin testing in 2003. The wireframe in the beams of this image highlights the robust functionality of the SPY-3.

MIKE KEEBAUGH
President



▸ INTELLIGENCE AND INFORMATION SYSTEMS (IIS), which reported sales of $2 billion in 2003, is on the leading edge of transformation in the intelligence community, the military services and the civilian agencies of government, providing solutions in signal and image processing, geospatial intelligence, air- and space-borne command and control, ground engineering support, weather and environmental management, and information technology. ▸▸ A major 2003 mission integration win was the contract for the U.S. Air Force Distributed Common Ground System (DCGS) – the backbone of both current and future intelligence and information systems. The U.S. Air Force also extended Raytheon's Global Broadcast System (GBS) contract for two years. ▸▸ Operational support continued for the U-2 and Global Hawk systems and Raytheon delivered the first production Global Hawk Ground Station Mission Control Element, which manages the unmanned aircraft and its sensors and controls a number of air vehicles simultaneously. The contract was extended to Consolidated Field Support for the U-2 aircraft. ▸▸ IIS recently transitioned to operation an advanced intelligence management program on the date we committed to deliver four years ago and delivered another classified system that disseminates time-critical imagery and near-real-time mission planning data to war fighters. ▸▸ Business with the National Security Agency grew with wins in three classified programs. Raytheon also expanded its special technical support to vital classified intelligence and law enforcement activities. ▸▸ The Federal IT business base expanded with the win of a five-year contract for information technology operations and maintenance for NASA's Earth Observing System (EOS). ▸▸ Multiple customers selected Raytheon to define requirements in key mission areas. Raytheon won study contracts to identify advanced architecture concepts for the next generation weather system from the National Oceanic and Atmospheric Administration (NOAA) and a requirements definition contract for the transformational architecture for the Air Force Military Satellite Communications (MILSATCOM) program. The company was also selected to perform architecture definition for the next generation national signals ground study. ▸▸ IIS assumed management of the Homeland Security Strategic Business Area in late 2003 and is serving this dynamic market with solutions in national border management, key enabling information technologies and secure communication systems. ▸▸ The Garland, Texas, site achieved Capability Maturity Model Integration (CMMI®) Level 3 certification rating in 2003 and other locations are on schedule to duplicate this accomplishment in 2004. ▸▸ IIS capabilities are helping pave the way to transformation in all our customer communities.

## INTELLIGENCE AND INFORMATION SYSTEMS ▸▸▸

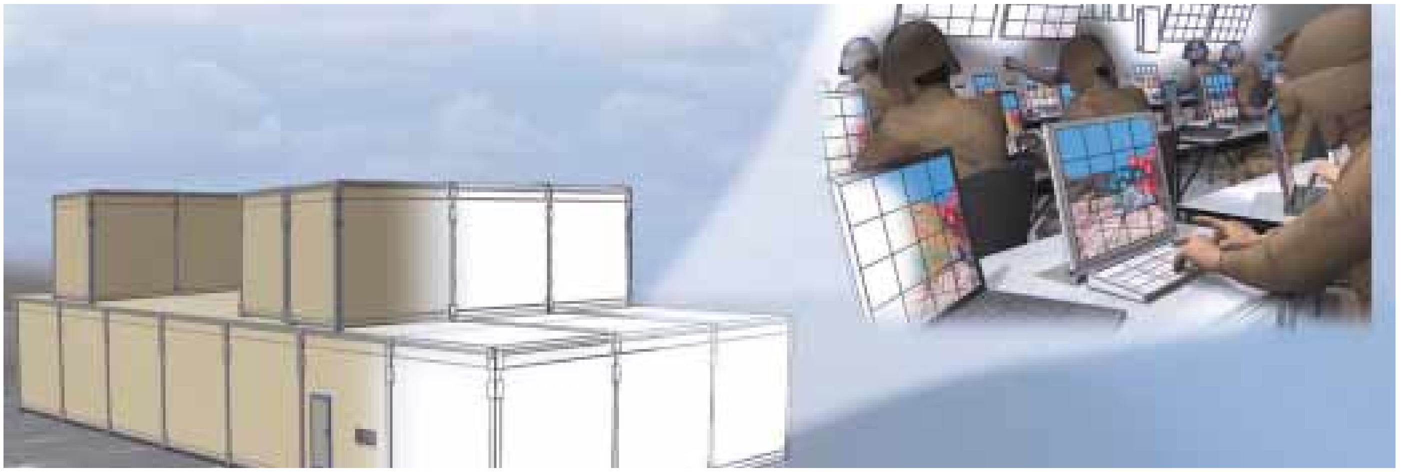
Raytheon won the contract to provide the next generation Distributed Common Ground System (DCGS), building on 25 years of experience supporting DCGS worldwide operations. DCGS, the backbone of current and future intelligence and information systems, integrates multiple intelligence systems into a single, worldwide enterprise, delivering time-critical, decision-quality information to leaders who need it most. The wireframe in this image shows how DCGS integrates worldwide intelligence systems to provide decision-quality information for the war fighter.


▸ SPACE AND AIRBORNE SYSTEMS (SAS), which reported sales of $3.7 billion in 2003, is delivering impressive results on numerous programs and directing Raytheon's domestic and international business pursuits in several areas. ▸▸ Space and Airborne Systems is well positioned to take advantage of the resurgent federal interest in space exploration. Sensors built by the business for the National Aeronautics and Space Administration began exploring Mars upon arrival in January 2004. Raytheon will supply up to seven visible infrared imaging radiometer suite (VIIRS) instruments for the National Polar-orbiting Operational Environmental Satellite System. The first VIIRS instrument is scheduled for launch in 2006. ▸▸ After a superlative Navy evaluation of the Advanced Targeting Forward-Looking Infrared (ATFLIR), developed for the F/A-18, pilots are anxious for widespread use. The Navy has asked for full-rate production. The ATFLIR can observe a target, designate it for attack, or choose a target designated by another observer. ▸▸ The Navy conducted the first flight test of another SAS system for the F/A-18, the revolutionary APG-79 Active Electronically Scanning Array radar. The flight verified the successful integration of the radar with on-board avionic systems and showed that various subsystems were working properly. ▸▸ The Air Force awarded the business a contract to continue upgrading the radar on the B-2 bomber. This is the second phase of a multi-year program to retrofit the B-2 fleet with a new Ku-band active-array radar antenna. Raytheon is a partner in the Multi-platform Radar Technology Insertion Program for the E-10A, an airborne command post in development by the Air Force, and SAS is spearheading Raytheon's bid for the aircraft's battle management command-and-control system contract. ▸▸ Led by Space and Airborne Systems, Raytheon is serving as prime contractor and system integrator on the Airborne Stand-off Radar (ASTOR) program for the United Kingdom. The company is winning international recognition for designing and developing ASTOR on schedule and within budget. This effort earned Raytheon an invitation from the North Atlantic Treaty Organization (NATO) to bid on developing an airborne surveillance system that NATO expects to field by 2010. ▸▸ Global Hawk and Predator® unmanned aerial vehicles owed much of their success in Operation Iraqi Freedom to Raytheon sensing and targeting systems. Unmanned systems represent a high-growth opportunity that Raytheon is pursuing aggressively. ▸▸ With significant success, the business continues to receive and perform on new classified program awards. ▸▸ SAS continues to be at the forefront of advanced systems for intelligence, surveillance and reconnaissance; precision engagement; and missile defense.

## SPACE AND AIRBORNE SYSTEMS ▸▸▸

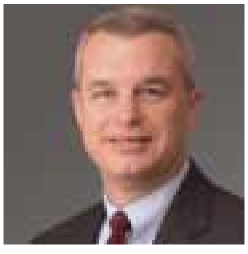
Equipped with sensors and other electronic systems developed by Raytheon, the Global Hawk® unmanned aerial vehicle performed superbly in Operation Iraqi Freedom. Although it flew less than 10 percent of the intelligence and reconnaissance missions, it accounted for more than half of the targets generated to destroy air defenses. The wireframe in this image reveals the location of the Integrated Sensor Suite that Raytheon produces for the Global Hawk.

JACK KELBLE
President



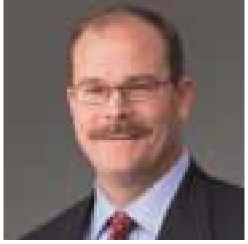
## NETWORK CENTRIC SYSTEMS ▸▸▸

General Tommy Franks led Operation Iraqi Freedom from Qatar, in Raytheon's CENTCOM Deployable Headquarters (CDHQ). This portable command and control center was designed and delivered by NCS to the U.S. Army within nine months of request. The modular design provides networking of all computer servers and communications systems anywhere CENTCOM can be deployed. The wireframe of the monitors and the screens highlights the information Raytheon helps deliver to the CDHQ.



COLIN SCHOTTLAENDER
President

▸ NETWORK CENTRIC SYSTEMS (NCS), which reported sales of $2.8 billion in 2003, provided the war fighter with systems to network and securely distribute information throughout the battlespace. Thermal soldier systems – including the X-100 Pocket Scope, and the suite of light, medium and heavy Thermal Weapon Sights – detected threats, protected crews and continually provided reliable information for mission success. The Long Range Advanced Scout Surveillance System and Driver's Vision Enhancer met battlefield requirements for fire control, as well as for reconnaissance, surveillance and target acquisition for ground combat forces on the newly fielded Brigade Combat Team in all theaters of conflict. ▸▸ Army Airborne Command and Control Systems (A2C2S) provided a flying tactical operations center for commanders in Iraq, enabling the first simultaneous aerial observation and battle command. At customer request, fielding was accelerated to meet combat requirements. Advanced Field Artillery Tactical Data System (AFATDS) has provided an unprecedented level of combined and joint arms synergy on the battlefield. Customer partnership for upgrading this system made deconfliction of Time Sensitive Targets occur more rapidly. Enhanced Position Location Reporting System (EPLRS) and Special Operations radios continue to meet the needs of enhanced networked data flow, while reducing equipment weight. ▸▸ Network Centric Systems leadership and systems integration expertise led Raytheon to key U.S. Army and Navy transformation contracts in 2003, including the Ground Sensor Integrator award for Future Combat Systems (FCS), the FCS Battle Command Mission Execution award and the Cooperative Engagement Capability ship self-defense system. ▸▸ With collaboration essential to military transformation, NCS leads the Raytheon partnership with the Institute for Soldier Nanotechnology (ISN), a joint research collaboration between the U.S. Army, the Massachusetts Institute of Technology and Raytheon. Work with the ISN is focused on the "Soldier as a System" in the system of systems concept of integration. ▸▸ Beyond the military arena, the Federal Aviation Administration accepted and deployed the Standard Terminal Automation Replacement System (STARS) in the United States. STARS replaces an aging Air Traffic Management system in more than 200 major airports. Proven Raytheon technology is being adopted for a variety of domestic safety and security applications including firefighting, law enforcement, transportation and industrial and homeland security. ▸▸ Secure, integrated, innovative, networked technology from Network Centric Systems is helping to integrate major defense and government systems to secure and improve our lives.



BRYAN EVEN
President

▸ RAYTHEON TECHNICAL SERVICES COMPANY LLC (RTSC), which reported sales of $2 billion in 2003, provides technology solutions for defense, federal and commercial customers worldwide. It specializes in customized engineering services; logistics and supply chain management; training; and science, research and technology. ▸▸ Maintaining its 15-year partnership with the Defense Threat Reduction Agency (DTRA), Raytheon continues supporting DTRA's mission: safeguarding the world's interests from weapons of mass destruction (chemical, biological, radiological, nuclear and high explosives) by controlling and reducing the threat and providing quality tools and services for the war fighter. In 2003, RTSC was awarded projects to provide operations, supply chain and logistics services in Russia, Ukraine and Iraq. In Russia, RTSC supports the elimination of SS-25 missiles, mobile launchers and support vehicles and renovation of SS-25 launcher and vehicle elimination facilities. ▸▸ In addition to supporting simulators NASA uses to perform crew training for manned space missions, RTSC provides NASA with space and earth science, information technology and engineering support services. In 2003, NASA selected RTSC to provide real-time mission support, operation and sustaining engineering for the Neutral Buoyancy Laboratory and the Space Vehicle Mockup Facility at Johnson Space Center. These facilities are used to prepare astronauts for space flights and space walks. NASA also selected Raytheon to manage and operate the Canberra Deep Space Communication Complex at Tidbinbilla, the primary focus for NASA's space-communications activities within Australia. The space tracking station is one of three facilities forming NASA's Deep Space Network. ▸▸ RTSC orchestrated the unprecedented offloading of a refueling tanker from a sea-ice berthing for the National Science Foundation (NSF). Ice at the NSF's logistics and science hub in Antarctica prevented icebreakers from opening a channel wide enough for the tanker to reach the station. Without fuel, two base stations would not have been fully operational the following season – jeopardizing the customer's mission of conducting science on the southernmost continent. RTSC successfully pumped 6,500,000 gallons of fuel across nearly four miles of ice – safely and without damaging the environment. ▸▸ RTSC is working across the company to integrate engineering, technology and logistics capabilities to offer customers full service product support solutions.

## RAYTHEON TECHNICAL SERVICES COMPANY LLC ▸▸▸

NASA selected Raytheon to provide real-time mission support, operation and sustaining engineering for the Neutral Buoyancy Laboratory (shown here) and the Space Vehicle Mockup Facility. These facilities are used to train astronauts and flight controllers on mission-critical skills at Johnson Space Center in Houston. The astronauts shown here are preparing for space flights and space walks using underwater mockups and pressurized suits to simulate the weightless environment.

Artwork based on NASA photo.

JIM SCHUSTER
Chairman and Chief Executive Officer
Raytheon Aircraft Company

▸ RAYTHEON AIRCRAFT COMPANY (RAC), which reported sales of $2.1 billion in 2003, continued to drive down costs through a series of targeted initiatives, while achieving its financial, customer service and quality commitments. With the general aviation industry in a three-year slump, the company continued to be a more predictable performer, meeting its financial commitments for eight consecutive quarters. ▸▸ Pursuing its goal of providing the industry's finest customer service and support, RAC used new systems technology to create a comprehensive communications tracking system that provides customers with more efficient and personalized service. In keeping with its commitment to deliver the highest quality aircraft, the company achieved record final acceptance quality levels in 2003. ▸▸ Raytheon Aircraft's™ revitalization of the Hawker and Beechcraft brands continued in 2003 with the addition of the Hawker 400XP jet to the Hawker line of business jets. With a 200-pound gross weight increase over its predecessor, the Beechjet® 400A aircraft, the Hawker 400XP jet is positioned as the entry-level light jet in the Hawker brand. This gives corporate customers the option of upgrading to the mid-size Hawker 800XP jet and the new super mid-size Hawker Horizon® jet. The Horizon program dramatically increased its flight testing in early 2003, began FAA flight tests in October and conducted long-range flights that validated standard aircraft range and performance estimates. ▸▸ The Beechcraft Premier I™ jet, with its speed, roomy cockpit, cabin and baggage compartment, Pro Line 21™ avionics and handling qualities, was praised in a survey of operators, conducted in December 2003, by *Business and Commercial Aviation* magazine. One customer said the plane had "the best service I have ever had." Another remarked, "I've never owned an airplane like this before and now I've got the 'wow!' syndrome." ▸▸ At October's National Business Aviation Association convention, the Beechcraft division announced a significant upgrade to the Beechcraft King Air™ B200 and 350 aircraft with the addition of Collins Pro Line 21 "glass aircraft cockpit" avionics. ▸▸ Raytheon Aircraft ended 2003 by announcing an order of $360 million from NetJets Inc. for 50 Hawker 400XP light jets, eight Hawker 800XP mid-size jets, and a long-term maintenance agreement that includes the existing Hawker 800XP and Hawker 1000 business jets in the NetJets® fleet of fractionally owned aircraft. The order includes an option for an additional 50 Hawker 400XP aircraft, which brings the total potential order value to more than $600 million. ▸▸ Raytheon Aircraft's Government Business Division delivered its 200th T-6A aircraft while receiving a $228 million order from the U.S. Government for an additional 47 aircraft and related training devices. The contract is part of the multi-billion-dollar Joint Primary Aircraft Training System program for military pilots. ▸▸ Raytheon Aircraft continues to pursue its goal of being recognized as the world's leading general aviation manufacturer by making product quality and customer service its top priorities.

## RAYTHEON AIRCRAFT COMPANY ▸▸▸

The Hawker 400XP was re-branded in 2003 to join the Hawker family of corporate aircraft. In December 2003, fractional operator NetJets Inc. ordered 50 Hawker 400XPs with an option for 50 more. An earlier version of the aircraft, based on the Beechjet 400A, serves as the tanker/transport pilot trainer for the U.S. Air Force known as the T-1A Jayhawk. The propulsion system highlighted in this illustration helps make the Hawker 400XP the fastest light business jet in the industry.

# FINANCIAL TABLE OF CONTENTS ▸

# FIVE-YEAR STATISTICAL SUMMARY

| *(In millions except share amounts and total employees)* | **2003** | 2002 | 2001 | 2000 | 1999 |
|---|---|---|---|---|---|
| **RESULTS OF OPERATIONS ▸▸▸** | | | | | |
| Net sales | **$18,109** | $16,760 | $16,017 | $15,817 | $16,142 |
| Operating income | **1,316** | 1,783 | 766(1) | 1,580 | 1,645 |
| Interest expense | **537** | 497 | 696 | 761 | 724 |
| Income from continuing operations | **535** | 756 | 2(1) | 477 | 546 |
| Loss from discontinued operations, net of tax | **(170)** | (887) | (757) | (339) | (94) |
| Cumulative effect of change in accounting principle, net of tax | **–** | (509) | – | – | (53) |
| Net income (loss) | **365** | (640) | (755)(1) | 138 | 399 |
| Diluted earnings per share from continuing operations | **$ 1.29** | $ 1.85 | $ 0.01(1) | $ 1.40 | $ 1.60 |
| Diluted earnings (loss) per share | **0.88** | (1.57) | (2.09)(1) | 0.40 | 1.17 |
| Dividends declared per share | **0.80** | 0.80 | 0.80 | 0.80 | 0.80 |
| Average diluted shares outstanding *(in thousands)* | **415,429** | 408,031 | 361,323 | 341,118 | 340,784 |
| **FINANCIAL POSITION AT YEAR-END ▸▸▸** | | | | | |
| Cash and cash equivalents | **$ 661** | $ 544 | $ 1,214 | $ 871 | $ 230 |
| Current assets | **6,585** | 7,190 | 9,647 | 9,444 | 10,732 |
| Property, plant, and equipment, net | **2,711** | 2,396 | 2,196 | 2,339 | 2,224 |
| Total assets | **23,668** | 23,946 | 26,773 | 27,049 | 28,222 |
| Current liabilities | **3,849** | 5,107 | 5,815 | 5,071 | 7,998 |
| Long-term liabilities (excluding debt) | **3,281** | 2,831 | 1,846 | 2,021 | 1,886 |
| Long-term debt | **6,517** | 6,280 | 6,874 | 9,051 | 7,293 |
| Subordinated notes payable | **859** | 858 | 857 | – | – |
| Total debt | **7,391** | 8,291 | 9,094 | 9,927 | 9,763 |
| Stockholders' equity | **9,162** | 8,870 | 11,381 | 10,906 | 11,045 |
| **GENERAL STATISTICS ▸▸▸** | | | | | |
| Total backlog | **$27,542** | $25,666 | $25,605 | $25,709 | $24,034 |
| U.S. government backlog included above | **21,353** | 18,254 | 16,943 | 16,650 | 14,575 |
| Capital expenditures | **428** | 458 | 461 | 421 | 507 |
| Depreciation and amortization | **393** | 364 | 677 | 642 | 646 |
| Total employees from continuing operations | **77,700** | 76,400 | 81,100 | 87,500 | 90,600 |

(1) Includes charges of $745 million pretax related to the Company's commuter aircraft business and Starship aircraft portfolio, $484 million after-tax, or $1.34 per diluted share.

Certain prior year amounts have been reclassified to conform with the current year presentation.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## ▸▸▸ OVERVIEW

Raytheon Company (the "Company") is one of the largest defense electronics contractors in the world, serving all branches of the U.S. military and other U.S. government agencies, NATO, and many allied governments. The Company is a leader in defense electronics, including missiles; radar; sensors and electro-optics; intelligence, surveillance, and reconnaissance (ISR); command, control, communication, and information systems; naval systems; air traffic control systems; and technical services. The Company's defense businesses are well positioned to capitalize on emerging opportunities in missile defense; precision engagement; intelligence, surveillance, and reconnaissance; and homeland security. Due to the multi-year defense spending cycle, recent increased budget authorizations in these areas are expected to favorably impact the Company's defense businesses over the next several years.

Raytheon Aircraft is a leading provider of business and special mission aircraft and delivers a broad line of jet, turboprop, and piston-powered airplanes to individual, corporate, and government customers worldwide.

**DEFENSE INDUSTRY CONSIDERATIONS** Recent events, including the global War on Terrorism, Operation Enduring Freedom, and Operation Iraqi Freedom, have altered the defense and security environment of the United States. These events have had, and for the foreseeable future are likely to continue to have, a significant impact on the markets for defense and advanced technology systems and products. The U.S. Department of Defense continues to focus on both supporting ongoing operations and transforming our military to confront future threats. Our customers plan to operate in a new paradigm. They define an approach that emphasizes speed, precision, and flexibility, by sharing superior knowledge, enabling forces to seize and sustain initiative, concentrate combat power, and prevent an enemy response. In this new environment, the need for advanced technology and defense electronics is clear.

The recent growth in military expenditures is driven by the multi-pronged approach required to fight the War on Terrorism, replenish war materials consumed during continued operations in Afghanistan and Iraq, and sustain the momentum in pursuit of transformation.

The Company's strategy is designed to capitalize on the breadth and depth of the Company's technology and extensive domain expertise in order to meet the evolving needs of the Company's customers. The Company is focusing on the following Strategic Business Areas, which are aligned with the ongoing military operations and Department of Defense transformation goals:

- ▸▸ Missile Defense
- ▸▸ Precision Engagement
- ▸▸ Intelligence, Surveillance and Reconnaissance
- ▸▸ Homeland Security

*MISSILE DEFENSE* The Company provides an extensive array of technologies and is a major partner in missile defense. The Company is committed to helping the U.S. Missile Defense Agency, the organization responsible for developing an operational Ballistic Missile Defense System achieve its objectives. The President's commitment to have a U.S. missile defense system operational by 2004 is reinforced by the increase in emphasis and funding in the latest budgets. The Company's broad array of technologies covers all three phases of the missile defense system – boost, midcourse, and terminal defense – and includes Standard Missile-3, Space Tracking and Surveillance System, Cobra Judy, Exo-Atmospheric Kill Vehicle, Early Warning Radar, Sea-Based X-Band Radar, High Power Discriminator, Terminal High-Altitude Area Defense, and Patriot.

*PRECISION ENGAGEMENT* The Company provides mission solutions across the entire precision engagement chain. The Company's customers are increasingly looking for mission solutions that address the need to operate jointly (across services and between allied forces), work in a new net-centric paradigm, minimize collateral damage, and strike time sensitive targets. The Company's precision engagement systems include: U-2 sensor suite, F-15 and F/A-18 Active Electronically Scanned Array radars, Advanced Medium Range Air-to-Air Missile, Situation Awareness Data Link, NetFires, Joint Standoff Weapon, Paveway, Tactical Tomahawk, F/A-18 Radar Warning Receiver, High Power Microwave, and High Energy Lasers.

*INTELLIGENCE, SURVEILLANCE AND RECONNAISSANCE* The Company's innovative sensing, processing, and dissemination technologies effectively compress the information gap from hours to minutes. The Company provides integrated systems solutions for observing, locating, processing, deciding, and disseminating actionable information, enabling network-centric operations for decision makers. These abilities are crucial for war fighters to achieve information dominance throughout the entire battlespace. The Company's key ISR programs include: Global Hawk sensor suite, E-10A Battle Management Command and Control, Space Based Radar, National Polar-orbiting Operational Environmental Satellite Systems, Future Combat Systems, DD(X), and numerous classified programs.

*HOMELAND SECURITY* In the area of Homeland Security, the Company has skills, experience, and technology in areas such as airport security; command, control, and communication; and the integration and fusion of sensory inputs for real-time decision support. This is still a new market with significant uncertainty and the ultimate customers and available funding have yet to be determined.

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)** ▸▸▸▸▸▸▸▸▸▸▸▸▸▸

Unlike many major defense contractors, the Company provides electronics for a wide range of missions and platforms. The Company has several thousand programs which the Company believes reduces some of the risk and volatility often inherent in the defense industry.

The Company generally acts as a prime contractor or subcontractor on its programs. The funding of U.S. government programs is subject to Congressional authorization and appropriation. While Congress generally appropriates funds on a fiscal year basis, major defense programs are usually conducted under binding contracts over multiple years. The termination of funding for a U.S. government program could result in a loss of future revenues, which would have a negative effect on the Company's financial position and results of operations. U.S. government contracts are also subject to oversight audits and contain provisions for termination. Failure to comply with U.S. government regulations could lead to suspension or debarment from U.S. government contracting.

Sales to the U.S. government may be affected by changes in procurement policies, budget considerations, changing defense requirements, and political developments. The influence of these factors, which are largely beyond the Company's control, could impact the Company's financial position or results of operations.

**AIRCRAFT INDUSTRY CONSIDERATIONS** The health of the markets for Raytheon Aircraft's products and services is influenced by a number of key economic and environmental factors including:

- Economic growth or sustained market stability
- The industry-wide level of inventory of used aircraft available for sale
- Regulatory and environmental factors including continued open access to national airspace and airports and operational equipment requirements
- Introduction of new products

While the economy has shown signs of recovery by most measures including GDP, corporate profits, and personal disposable income, the general aviation market continues to be depressed from its peak performance in 2001. Historically, the industry has lagged the U.S. economic recovery by 12–18 months.

Traditionally, the used aircraft market has led the recovery of the new aircraft market by approximately nine months, however, the current size of the worldwide fleet of used aircraft available for sale and a slower economic recovery could delay market demand for new aircraft.

The size of the worldwide fleet of used aircraft available for sale has created intense price pressure on new aircraft and, as a result, many manufacturers have reduced line or production rates to avoid oversupplying the market with products that will only be moved through deep discounting. To support a recovery of the new aircraft market, the current worldwide inventory of used aircraft must be reduced.

Despite the increased activity in the used aircraft market during the last half of 2003 and strong fourth quarter sales activity for new aircraft, driven in large part by the bonus depreciation benefit of the Jobs Growth Tax Relief Reconciliation Act of 2003, the industry consensus is that the market for new aircraft will remain flat to slightly higher through 2005 with a modest recovery beginning in 2006.

**FINANCIAL SUMMARY** As discussed in more detail throughout Management's Discussion and Analysis of Financial Condition and Results of Operations:

Gross bookings were $22.7 billion in 2003, $17.9 billion in 2002, and $17.0 billion in 2001 resulting in backlog of $27.5 billion, $25.7 billion, and $25.6 billion at December 31, 2003, 2002, and 2001, respectively. Backlog represents future sales and cash flow that will be recognized over the next several years.

Net sales were $18.1 billion in 2003, $16.8 billion in 2002, and $16.0 billion in 2001. The increase in sales was a result of strong growth at the defense businesses, primarily Integrated Defense Systems, Missile Systems, and Space and Airborne Systems.

Operating income was $1.3 billion in 2003, $1.8 billion in 2002, and $0.8 billion in 2001. Operating income as a percent of net sales was 7.3 percent, 10.6 percent, and 4.8 percent in 2003, 2002, and 2001, respectively. Included in operating income was a FAS/CAS Pension Adjustment, described below in Consolidated Results of Operations, of $109 million of expense in 2003, $210 million of income in 2002, and $386 million of income in 2001. The FAS/CAS Pension Adjustment in 2004 is expected to be approximately $450 million of expense. Also included in operating income were 2003 charges at Network Centric Systems and Technical Services of $276 million, 2001 charges at Raytheon Airline Aviation Services™ of $745 million, and 2001 goodwill amortization of $334 million.

Operating cash flow from continuing operations was $2.1 billion in 2003, $2.2 billion in 2002, and $0.8 billion in 2001. The increase from 2001 was due to better working capital management at the defense businesses and better inventory management at Raytheon Aircraft. Although the Company will continue to focus on working capital management at the defense businesses, this level of improvement is not expected to continue into the foreseeable future.

## ▸▸▸ CRITICAL ACCOUNTING POLICIES

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

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

The Company uses lot accounting for new commercial aircraft introductions at Raytheon Aircraft. Lot accounting involves selecting an initial lot size at the time a new aircraft begins to be delivered and measuring an average cost over the entire lot for each aircraft sold. The costs attributed to aircraft delivered are based on the estimated average cost of all aircraft in the lot and are determined under the learning curve concept which anticipates a predictable decrease in unit costs from cost reduction initiatives and as tasks and production techniques become more efficient through repetition. Once production costs stabilize, which is expected by the time the initial lot has been completed, the use of lot accounting is discontinued. The selection of lot size is a critical judgment. The Company determines lot size based on several factors, including the size of firm backlog, the expected annual production for the aircraft, and experience on similar new aircraft. The size of the initial lot for the Beechcraft Premier I, the only aircraft the Company is currently utilizing lot accounting for, is 200 units. In 2003, the Company recorded a pretax charge of $22 million to reflect the expected loss on the initial lot. A five percent increase in the remaining estimated cost to produce the aircraft would reduce the Company's operating income by approximately $20 million.

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

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

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

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)** ▸▸▸▸▸▸▸▸▸▸▸▸▸▸

other asset classes in which the Company has invested pension plan assets, and the expectations for future returns of each asset class. Since the Company's investment policy is to employ active management strategies in all asset classes, the potential exists to outperform the broader markets, therefore, the expected returns were adjusted upward. The expected return for each asset class was then weighted based on the target asset allocation to develop the long-term ROA assumption. The long-term ROA assumption is based on target asset allocations of between 65 and 70 percent equities with a 9.75% expected return, between 20 and 25 percent fixed income with a 5.25% expected return, up to 5 percent real estate with an 8.25% expected return, and between 5 and 10 percent other (including private equity and cash) with a 10.5% expected return. The long-term ROA assumption for the Company's domestic pension plans in 2004 is 8.75%. The discount rate assumption was determined by using a model consisting of a theoretical bond portfolio that matches the Company's pension liability duration. The discount rate assumption for the Company's domestic pension plans in 2004 is 6.25%. The Company's pension expense is expected to be approximately $700 million in 2004 and $750 million in 2005. For every 2.5 percent that the actual domestic pension plan asset return exceeds or is less than the long-term ROA assumption for 2004, the Company's pension expense for 2004 will change by approximately $15 million. If the Company adjusts the discount rate assumption for 2005 up or down by 25 basis points, the Company's pension expense would change by approximately $40 million.

Effective January 1, 2004, the Company changed the measurement date for its pension and other postretirement benefit plans from October 31 to December 31. This change in measurement date will be accounted for as a change in accounting principle. The cumulative effect of this change in accounting principle is anticipated to be a gain of $34 million after-tax for pension benefits and a gain of $7 million after-tax for other postretirement benefits and will be recognized in 2004. Using the Company's year end as the measurement date for pension and other postretirement benefit plans more appropriately reflects the plans' financial status for the years then ended.

## ▸▸▸ CONSOLIDATED RESULTS OF OPERATIONS

Net sales were $18.1 billion in 2003, $16.8 billion in 2002, and $16.0 billion in 2001. The increase in sales was due primarily to higher U.S. Department of Defense expenditures in the Company's defense businesses, primarily Integrated Defense Systems, Missile Systems, and Space and Airborne Systems. Sales to the U.S. Department of Defense were 65 percent of sales in 2003, 62 percent in 2002, and 59 percent in 2001. Total sales to the U.S. government, including foreign military sales, were 74 percent of sales in 2003, 73 percent in 2002, and 70 percent in 2001. International sales, including foreign military sales, were 19 percent of sales in 2003, 21 percent in 2002, and 22 percent in 2001. While international sales have remained flat, the amount as a percent of sales has declined as a result of increased sales to the U.S. Department of Defense.

Gross margin (net sales less cost of sales) was $3.1 billion in 2003, $3.4 billion in 2002, and $2.4 billion in 2001, or 17.2 percent of sales in 2003, 20.3 percent in 2002, and 14.7 percent in 2001. Included in gross margin was a FAS/CAS Pension Adjustment, described below, of $109 million of expense, $210 million of income, and $386 million of income in 2003, 2002, and 2001, respectively. The change in the FAS/CAS Pension Adjustment was due primarily to the reduction in the Company's long-term return on asset assumption and the actual rate of return on pension plan assets over the last several years. The decrease in gross margin as a percent of sales in 2003 was due, in part, to charges of $237 million at Network Centric Systems and $39 million at Technical Services, described below in Segment Results. Included in gross margin in 2001 was goodwill amortization of $334 million, which was discontinued January 1, 2002 as described below. Excluding goodwill amortization, gross margin was $2.7 billion or 16.8 percent of sales in 2001. Included in gross margin in 2001 were charges of $745 million at Raytheon Aviation Airline Services,™ described below in Segment Results.

Statement of Financial Accounting Standards No. 87, Employers' Accounting for Pensions (SFAS No. 87), outlines the methodology used to determine pension expense or income for financial reporting purposes, which is not necessarily indicative of the funding requirements of pension plans, which are determined by other factors. A major factor for determining pension funding requirements are Cost Accounting Standards (CAS) that proscribe the allocation to and recovery of pension costs on U.S. government contracts. The Company now reports the difference between SFAS No. 87 (FAS) pension expense or income and CAS pension expense as a separate line item in the Company's segment results called FAS/CAS Pension Adjustment. The results for each segment only include pension expense as determined under CAS, which can generally be recovered through the pricing of products and services to the U.S. government.

Administrative and selling expenses were $1,306 million or 7.2 percent of sales in 2003, $1,170 million or 7.0 percent of sales in 2002, and $1,131 million or 7.1 percent of sales in 2001. Included in administrative and selling expenses in 2002 was a $29 million gain on the sale of the Company's corporate headquarters.

Research and development expenses were $487 million or 2.7 percent of sales in 2003, $449 million or 2.7 percent of sales in 2003, and $456 million or 2.8 percent of sales in 2001.

Operating income was $1,316 million or 7.3 percent of sales in 2003, $1,783 million or 10.6 percent of sales in 2002, and

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

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

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

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

The effective tax rate was 29.8 percent in 2003 and 29.7 percent in 2002, reflecting the U.S. statutory rate of 35 percent reduced by ESOP dividend deductions, foreign sales corporation tax credits, and research and development tax credits applicable to certain government contracts. The effective tax rate was 98.0 percent in 2001, reflecting the U.S. statutory rate of 35 percent reduced by foreign sales corporation tax credits and research and development tax credits applicable to certain government contracts, increased by non-deductible amortization of goodwill. Excluding the effect of goodwill amortization, the effective tax rate was 29.3 percent in 2001. At December 31, 2003, the Company had net operating loss carryforwards of $1.4 billion that expire in 2020 through 2023. The Company believes it will be able to utilize all of these carryforwards over the next 3 years.

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

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

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

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

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)** ▸▸▸▸▸▸▸▸▸▸▸▸▸▸

## ▸▸▸ SEGMENT RESULTS

Reportable segments have been determined based upon product lines and include the following: Integrated Defense Systems, Intelligence and Information Systems, Missile Systems, Network Centric Systems, Space and Airborne Systems, Technical Services, Aircraft, and Other. In 2003, the Company began reporting its defense businesses in six segments. In addition, the Company's Commercial Electronics businesses were reassigned to the new defense businesses. Also, the Company created an Other segment comprised of Flight Options LLC, Raytheon Airline Aviation Services LLC, and Raytheon Professional Services LLC. Also in 2003, the Company changed the way pension expense or income is reported in the Company's segment results as described above in Consolidated Results of Operations. Information for all periods presented was restated to reflect these changes.

**Net Sales**

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

**Operating Income**

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

**Operating Margin**

| | **2003** | 2002 | 2001 |
|---|---|---|---|
| Integrated Defense Systems | **11.6%** | 12.2% | 10.5% |
| Intelligence and Information Systems | **9.5** | 9.5 | 8.0 |
| Missile Systems | **12.0** | 12.3 | 8.9 |
| Network Centric Systems | **0.7** | 9.0 | 8.6 |
| Space and Airborne Systems | **13.4** | 13.2 | 12.4 |
| Technical Services | **5.5** | 5.4 | 6.0 |
| Aircraft | **0.1** | (1.9) | (3.1) |
| Other | **(5.9)** | (5.7) | (366.2) |
| FAS/CAS Pension Adjustment | | | |
| Corporate and Eliminations | | | |
| Total | **7.3%** | 10.6% | 4.8% |

Integrated Defense Systems (IDS) provides mission systems integration for the air, surface, and subsurface battlespace. IDS had 2003 sales of $2.9 billion versus $2.4 billion in 2002 and $2.3 billion in 2001. The increase in sales in 2003 was due to continued growth on DD(X), the Navy's future destroyer program, as well as strong missile defense sales. The increase in sales in 2002 was due to higher missile defense volume. Operating income was $331 million in 2003 versus $289 million in 2002 and $238 million in 2001. Excluding goodwill amortization, operating income was $256 million in 2001 or 11.3 percent of net sales. The decrease in operating margin in 2003 was due to lower volume on higher margin international programs

Intelligence and Information Systems (IIS) provides signal and image processing, geospatial intelligence, airborne and spaceborne command and control, ground engineering support, weather and environmental management, and information technology. IIS had 2003 sales of $2.0 billion versus $1.9 billion in 2002 and $1.7 billion in 2001. The increase in sales in 2003 and 2002 was due to strong growth in classified programs, as well as the start-up of the NPOESS (National Polar-orbiting Operational Environmental Satellite Systems) program. Operating income was $194 million in 2003 versus $180 million in 2002 and $139 million in 2001. Excluding goodwill amortization, operating income was $179 million in 2001 or 10.3 percent of net sales.

Missile Systems (MS) provides air-to-air, precision strike, surface Navy air defense, and land combat missiles, guided projectiles, kinetic kill vehicles, and directed energy weapons. MS had 2003 sales of $3.5 billion versus $3.0 billion in 2002 and $2.9 billion in 2001. The increase in sales in 2003 was due to the Tomahawk remanufacture program reaching full rate production and several production programs transitioning from engineering development to low rate initial production including Air Intercept Missile (AIM-9X), Evolved Sea Sparrow Missile (ESSM), and Tactical Tomahawk. Sales also increased on several missile defense programs in order to meet accelerated deployment. The increase in sales in 2002 was due to the ramp up on the Exo-Atmospheric Kill Vehicle program and the transition of the ESSM program to full rate production. Operating income was $424 million in 2003 versus $373 million in 2002 and $257 million in 2001. Excluding goodwill amortization, operating income was $356 million in 2001 or 12.3 percent of net sales.

Network Centric Systems (NCS) provides network centric solutions to integrate sensors, communications, and command and control to manage the battlespace. NCS had 2003 sales of $2.8 billion versus $3.1 billion in 2002 and $2.9 billion in 2001. Operating income was $19 million in 2003 versus $278 million in 2002 and $246 million in 2001. Excluding goodwill amortization, operating income was $313 million in 2001 or 10.9 percent of net sales. The decrease in sales and operating income in 2003 was due to charges affecting operating income totaling $237 million which also resulted in a $228 million reduction in sales. Performance deterioration in ten programs primarily within the Air Traffic Management Systems business and the Communications business resulted in a charge in the third quarter of 2003 of $147 million. There were a number of unfavorable events that occurred on these ten programs including unsuccessful resolution of technical issues, inability to achieve production rates and milestones, customer directed delays and reductions in scheduled deliveries, and unfavorable rulings and negotiations on contractual matters. In the first six months of 2003, the Company recorded a $50 million charge on two of these programs related to schedule and production delays. In addition to the ten programs, the Company recorded a charge of $40 million in the third quarter of 2003 resulting from negative developments on a few claims and other performance issues in other parts of the business.

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

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

Raytheon Aircraft Company (RAC) designs, manufactures, markets, and provides after-market support for business jets, turboprops, and piston-powered aircraft for the world's commercial, fractional ownership, and military aircraft markets. RAC had 2003 sales of $2.1 billion versus $2.0 billion in 2002 and $2.5 billion in 2001. The decrease in sales in 2002 was due to lower aircraft deliveries, the divestiture of a majority interest in the Company's aviation support business in June 2001, and the divestiture of a majority interest in the Company's aircraft fractional ownership business in March 2002. Operating income was $2 million in 2003 versus an operating loss of $39 million in 2002 and $77 million in 2001. Excluding goodwill amortization, RAC had an operating loss of $69 million in 2001 or (2.8) percent of net sales.

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

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

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

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)** ▸▸▸▸▸▸▸▸▸▸▸▸▸▸

of commuter aircraft and reduced the book value of commuter aircraft inventory and equipment leased to others accordingly. In addition, the Company adjusted the book value of notes receivable and established a reserve for off balance sheet receivables where there was recourse to the Company based on the Company's estimate of exposures on customer financed assets due to defaults, refinancing, and remarketing of these aircraft. Immediately prior to the charge, the Company had exposure on approximately $1,600 million of commuter-related assets consisting of 511 aircraft including financing receivables, inventory, and leases. At December 31, 2003 and 2002, the Company's exposure on commuter-related assets was approximately $650 million consisting of 349 aircraft and approximately $800 million consisting of 433 aircraft, respectively. Commuter aircraft customers are generally thinly capitalized companies that are dependent on the commuter aircraft industry. A downturn in this industry could have a material adverse effect on these customers and the Company.

The Company also recorded a $52 million charge related to a fleet of Starship aircraft in 2001. During the first three quarters of 2001, the Company had not sold any of these aircraft and recorded a charge to reduce the value of the aircraft to their estimated fair value.

In 2002, the Company bought back the remaining off balance sheet receivables, described below in Financial Condition and Liquidity. In connection with the buyback of the off balance sheet receivables, the Company recorded the long-term receivables at estimated fair value, which included an assessment of the value of the underlying aircraft. As a result of this assessment, the Company adjusted the value of certain underlying aircraft, including both commuter and Starship aircraft, some of which were written down to scrap value. There was no net income statement impact as a result of this activity.

**Backlog at December 31**

| *(In millions)* | **2003** | 2002 | 2001 |
|---|---|---|---|
| Integrated Defense Systems | **$ 6,526** | $ 5,011 | $ 4,400 |
| Intelligence and Information Systems | **3,899** | 3,540 | 3,052 |
| Missile Systems | **5,028** | 3,509 | 3,437 |
| Network Centric Systems | **3,259** | 2,853 | 3,208 |
| Space and Airborne Systems | **4,865** | 4,523 | 5,075 |
| Technical Services | **1,510** | 1,603 | 1,958 |
| Aircraft | **2,279** | 4,396 | 4,114 |
| Other | **176** | 231 | 361 |
| Total | **$27,542** | $25,666 | $25,605 |
| Funded backlog included above | **$17,532** | $17,062 | $17,057 |
| U.S. government backlog included above | **$21,353** | $18,254 | $16,943 |

Funded backlog excludes U.S. and foreign government contracts for which funding has not been appropriated.

**Gross Bookings**

| *(In millions)* | **2003** | 2002 | 2001 |
|---|---|---|---|
| Integrated Defense Systems | **$ 4,344** | $ 2,987 | $ 2,558 |
| Intelligence and Information Systems | **2,371** | 2,478 | 1,957 |
| Missile Systems | **5,117** | 3,110 | 3,236 |
| Network Centric Systems | **3,118** | 2,582 | 2,534 |
| Space and Airborne Systems | **3,619** | 2,372 | 2,471 |
| Technical Services | **1,398** | 1,339 | 1,250 |
| Aircraft | **2,207** | 2,953 | 2,783 |
| Other | **519** | 99 | 228 |
| Total | **$22,693** | $17,920 | $17,017 |

The increase in backlog in 2003 was due to strong bookings across the defense businesses, particularly several large contract awards at Integrated Defense Systems and Missile Systems. In 2003, the Company reduced its reported Aircraft backlog by $834 million related to an order received from Flight Options as a result of Flight Options being consolidated with the Company in the second quarter of 2003 as described below in Major Affiliated Entities. In addition, an Aircraft customer canceled its order for 50 Hawker Horizon aircraft resulting in an $895 million backlog reduction.

## ▸▸▸ DISCONTINUED OPERATIONS

In 2000, the Company sold its Raytheon Engineers & Constructors businesses (RE&C) to Washington Group International, Inc. (WGI). In May 2001, WGI filed for bankruptcy protection. As a result of the sale and the WGI bankruptcy, the Company was required to perform various contract and lease obligations in connection with a number of different projects under letters of credit, surety bonds, and guarantees (Support Agreements) that it had provided to project owners and other parties.

Among the projects involved were two construction projects, the Mystic Station facility in Everett and the Fore River facility in Weymouth (the "Massachusetts Projects"). Following WGI's abandonment of these projects in 2001, the Company undertook construction efforts on these projects, subsequently delivered care, custody, and control of these projects to their owners, and, as of December 31, 2003, was continuing to perform work on these projects. On February 23, 2004, the Company closed on a settlement agreement with the project owners and other interested parties. The settlement included, among other things, a payment to the Company of approximately $30 million, the return to the Company of approximately $73 million in letters of credit the Company had provided to the project owners, and a release of various claims related to these projects. In addition, under the settlement, the Company remained responsible for all subcontractor and vendor claims prior to the settlement and the project owners assumed responsibility for all post-settlement obligations, including completing the construction of the projects, and all punch list and warranty obligations. The Company believes that the obligations retained on these projects are not material.

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

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

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

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

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

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

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

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

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

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)** ▸▸▸▸▸▸▸▸▸▸▸▸▸▸

## ▸▸▸ FINANCIAL CONDITION AND LIQUIDITY

Net cash provided by operating activities in 2003 was $1,569 million versus $1,039 million in 2002 and $155 million in 2001. Net cash provided by operating activities from continuing operations was $2,102 million in 2003 versus $2,235 million in 2002 and $751 million in 2001. The increase in net cash provided by operating activities from continuing operations from 2001 was due to better working capital management at the defense businesses, better inventory management at Raytheon Aircraft, a $156 million tax refund received in 2002 as a result of the Job Creation and Worker Assistance Act of 2002, and $95 million received from the close-out of certain interest rate swaps, described below in Capital Structure and Resources. Although the Company will continue to focus on working capital management at the defense businesses, this level of improvement is not expected to continue into the foreseeable future. As the Company continues to convert portions of existing financial systems to a new integrated financial package, certain planned delays in billings to customers may occur during 2004, however, the Company does not expect these delays to negatively impact full year cash flow results.

Savings and investment plan activity includes certain items related to the Company's 401(k) plan that were funded through the issuance of the Company's common stock and are non-cash operating activities included on the statement of cash flows. In 2004, these items may be funded by the issuance of the Company's common stock or through purchases of the Company's common stock on the open market.

Net cash used in investing activities was $243 million in 2003 versus $719 million in 2002 and $47 million in 2001. The Company provides long-term financing to its aircraft customers. Origination of financing receivables was $402 million in 2003, $431 million in 2002, and $663 million in 2001. In 2003, the Company received proceeds of $279 million related to the sale of certain general aviation finance receivables, described below in Off Balance Sheet Financing Arrangements. The Company also maintained a program under which it sold general aviation and commuter aircraft long-term receivables under a receivables purchase facility through the end of 2002. Sale of financing receivables was $263 million in 2002 and $696 million in 2001. The Company bought out the receivables that remained in the facility in 2002 for $1,029 million, brought the related assets onto the Company's books, and eliminated the associated $1.4 billion receivables purchase facility. Repurchase of financing receivables was $347 million in 2002 and $329 million in 2001.

Capital expenditures were $428 million in 2003, $458 million in 2002, and $461 million in 2001. Capital expenditures in 2004 are expected to approximate $475 million. In 1998, the Company entered into a $490 million property sale and five-year operating lease (synthetic lease) facility under which property, plant, and equipment was sold and leased back to the Company. In 2003, the lease facility expired and the Company bought back the assets remaining in the lease facility for $125 million. Proceeds from sales of property, plant, and equipment were $25 million in 2003, $11 million in 2002, and $9 million in 2001. Capitalized expenditures for internal use software were $98 million in 2003, $138 million in 2002, and $149 million in 2001. Capitalized expenditures for internal use software in 2004 are expected to approximate $160 million. In 2003, the Company paid $130 million related to the Space Imaging® credit facility guarantee, described below in Major Affiliated Entities.

Proceeds from the sale of operating units and investments were $111 million in 2003 versus $1,166 million in 2002 and $266 million in 2001. In 2003, the Company sold the remaining interest in its former aviation support business for $97 million and other investments for $14 million. In 2002, the Company sold its AIS business for $1,123 million, described above in Discontinued Operations, and an investment for $43 million, described below in Major Affiliated Entities. In 2001, the Company sold a majority interest in its aviation support business for $154 million, its recreational marine business for $100 million, and other investments for $12 million. Total sales and operating income related to the businesses divested in 2001 were $248 million and $13 million, respectively, in 2001.

Payments for purchases of acquired companies, net of cash received, were $60 million in 2003 versus $10 million in 2002. There were no acquisitions in 2001.

In October 2001, the Company and Hughes® Electronics agreed to a settlement regarding the purchase price adjustment related to the Company's merger with the defense business of Hughes Electronics Corporation (Hughes Defense). Under the terms of the agreement, Hughes Electronics agreed to reimburse the Company approximately $635 million of its purchase price, with $500 million received in 2001 and the balance received in 2002. The settlement resulted in a $555 million reduction in goodwill.

Net cash used in financing activities was $1,209 million in 2003 versus $990 million in 2002. Net cash provided by financing activities was $235 million in 2001. Dividends paid to stockholders were $331 million in 2003, $321 million in 2002, and $281 million in 2001. The quarterly dividend rate was $0.20 per share for each of the four quarters of 2003, 2002, and 2001.

## ▸▸▸ CAPITAL STRUCTURE AND RESOURCES

Total debt was $7.4 billion at December 31, 2003 and $8.3 billion at December 31, 2002. Cash and cash equivalents were $661 million at December 31, 2003 and $544 million at December 31, 2002. The Company's outstanding debt has interest rates ranging from 1.6% to 8.3% and matures at various dates through 2028. Total debt as a percentage of total capital was 44.7 percent and 48.3 percent at December 31, 2003 and 2002, respectively.

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

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

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

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

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

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

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

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

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

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

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)** ▸▸▸▸▸▸▸▸▸▸▸▸▸▸

issued 31,578,900 shares of common stock for $33.25 per share. The proceeds of the offerings were $1,388 million, net of $56 million of offering costs, and were used to reduce debt and for general corporate purposes.

The Company's need for, cost of, and access to funds are dependent on future operating results, as well as conditions external to the Company. Cash and cash equivalents, cash flow from operations, proceeds from divestitures, and other available financing resources are expected to be sufficient to meet anticipated operating, capital expenditure, and debt service requirements during the next twelve months and for the foreseeable future.

## ▸▸▸ OFF BALANCE SHEET FINANCING ARRANGEMENTS

In 2003, the Company sold $337 million of general aviation finance receivables to a qualifying special purpose entity which in turn issued beneficial interests in these receivables to a commercial paper conduit, received proceeds of $279 million, retained a subordinated interest in and servicing rights to the receivables, and recognized a gain of $2 million. The sale was non-recourse to the Company, and effectively reduced the Company's exposure to general aviation market risk for receivables by approximately 25 percent.

## ▸▸▸ MAJOR AFFILIATED ENTITIES

In 2002, the Company formed a joint venture, Flight Options LLC (FO), whereby the Company contributed its Raytheon Travel Air® fractional ownership business and loaned the new entity $20 million. In June 2003, the Company participated in a financial recapitalization of FO. As a result of this recapitalization, the Company now owns approximately 66 percent of FO and is consolidating FO's results in its financial statements. Prior to the financial recapitalization, 100 percent of FO's $20 million of losses were recorded in other expense in the first six months of 2003 since the Company had been meeting all of FO's financing requirements. The consolidation of FO did not have a significant effect on the Company's financial position or results of operations, although the Company's reported revenue, operating income, and other expense changed as a result of the consolidation of FO's results. FO's customers, in certain instances, have the contractual ability to require FO to buy back their fractional share based on its current fair market value. The estimated value of this potential obligation was approximately $575 million at December 31, 2003.

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

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

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

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

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

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

In addition, the Company has entered into joint ventures formed specifically to facilitate a teaming arrangement between two contractors for the benefit of the customer, generally the U.S. government, whereby the Company receives a subcontract from the joint venture in the joint venture's capacity as prime contractor. Accordingly, the Company records the work it performs for the joint venture as operating activity.

### ▸▸▸ COMMITMENTS AND CONTINGENCIES

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

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

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

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

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

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

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

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)** ▸▸▸▸▸▸▸▸▸▸▸▸▸▸

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

In May 2003, two purported class action lawsuits were filed on behalf of participants in the Company's savings and investment plans who invested in the Company's stock between August 19, 1999 and May 27, 2003. The two class action complaints are brought pursuant to the Employee Retirement Income Security Act (ERISA). Both lawsuits are substantially similar and have been consolidated into a single action. The complaints allege that the Company and certain members of the Company's Investment Committee breached ERISA fiduciary and co-fiduciary duties by allegedly failing to (1) disseminate necessary information regarding the savings and investment plans' investment in the Company's stock, (2) diversify the savings and investment plans' assets away from the Company's stock, (3) monitor investment alternatives to the Company's stock, and (4) avoid conflicts of interest.

Although the Company believes that it and the other defendants have meritorious defenses to each and all of the aforementioned class action and derivative complaints and intends to contest each lawsuit vigorously, an adverse resolution of any of the lawsuits could have a material adverse effect on the Company's financial position and results of operations. The Company is not presently able to reasonably estimate potential losses, if any, related to any of the lawsuits.

In addition, various claims and legal proceedings generally incidental to the normal course of business are pending or threatened against the Company. While the ultimate liability from these proceedings is presently indeterminable, any additional liability is not expected to have a material adverse effect on the Company's financial position or results of operations.

The Company is involved in various stages of investigation and cleanup related to remediation of various environmental sites. The Company's estimate of total environmental remediation costs expected to be incurred is $119 million. Discounted at 8.5 percent, the Company estimates the liability to be $72 million before U.S. government recovery and had this amount accrued at December 31, 2003. A portion of these costs are eligible for future recovery through the pricing of products and services to the U.S. government. The recovery of environmental cleanup costs from the U.S. government is considered probable based on the Company's long history of receiving reimbursement for such costs. Accordingly, the Company has recorded $47 million at December 31, 2003 for the estimated future recovery of these costs from the U.S. government, which is included in contracts in process. The Company leases certain government-owned properties and is generally not liable for environmental remediation at these sites, therefore, no provision has been made in the financial statements for these costs. Due to the complexity of environmental laws and regulations, the varying costs and effectiveness of alternative cleanup methods and technologies, the uncertainty of insurance coverage, and the unresolved extent of the Company's responsibility, it is difficult to determine the ultimate outcome of these matters, however, any additional liability is not expected to have a material adverse effect on the Company's financial position or results of operations.

The Company issues guarantees and has banks and surety companies issue, on its behalf, letters of credit and surety bonds to meet various bid, performance, warranty, retention, and advance payment obligations. Approximately $1,316 million, $890 million, and $389 million of these guarantees, letters of credit, and surety bonds, for which there were stated values, were outstanding at December 31, 2003, respectively and $1,614 million, $1,227 million, and $458 million were outstanding at December 31, 2002, respectively. These instruments expire on various dates through 2007. At December 31, 2003, the amount of guarantees, letters of credit, and surety bonds, for which there were stated values, that remained outstanding was $90 million, $146 million, and $283 million, respectively, related to discontinued operations and are included in the numbers above. Additional guarantees of project performance for which there is no stated value also remain outstanding.

In 1997, the Company provided a first loss guarantee of $133 million on $1.3 billion of U.S. Export-Import Bank debt through 2015 related to the Brazilian government's System for the Vigilance of the Amazon (SIVAM) program.

The following is a schedule of the Company's contractual obligations outstanding (excluding working capital items) at December 31, 2003:

| *(In millions)* | Total | Less than 1 Year | 1–3 years | 4–5 years | After 5 years |
|---|---|---|---|---|---|
| Debt | $ 6,564 | $ 15 | $1,208 | $1,709 | $3,632 |
| Subordinated notes payable | 863 | – | 863 | – | – |
| Interest payments | 7,031 | 395 | 740 | 592 | 5,304 |
| Operating leases | 1,477 | 294 | 507 | 349 | 327 |
| IT outsourcing | 392 | 68 | 131 | 128 | 65 |
| Equity security unit distributions | 156 | 65 | 91 | – | – |
| Pension contributions | 635 | 320 | 315 | – | – |
| Total | $17,118 | $1,157 | $3,855 | $2,778 | $9,328 |

Interest payments include interest on debt that is redeemable at the option of the Company.

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

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

## ▸▸▸ ACCOUNTING STANDARDS

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

In December 2003, the FASB issued Statement of Financial Accounting Standards No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106. Information about foreign plans is required by this accounting standard for fiscal years ending after June 15, 2004, including additional disclosures about assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans.

## ▸▸▸ FORWARD-LOOKING STATEMENTS

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

# CONSOLIDATED BALANCE SHEETS

| (In millions except share amounts) December 31: | 2003 | 2002 |
|---|---|---|
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | **$ 661** | $ 544 |
| Accounts receivable, less allowance for doubtful accounts of $35 in 2003 and $73 in 2002 | **485** | 675 |
| Contracts in process | **2,762** | 3,016 |
| Inventories | **1,998** | 2,032 |
| Deferred federal and foreign income taxes | **466** | 601 |
| Prepaid expenses and other current assets | **154** | 247 |
| Assets from discontinued operations | **59** | 75 |
| Total current assets | **6,585** | 7,190 |
| Property, plant, and equipment, net | **2,711** | 2,396 |
| Deferred federal and foreign income taxes | **337** | 281 |
| Prepaid retiree benefits | **703** | 676 |
| Goodwill | **11,479** | 11,170 |
| Other assets, net | **1,853** | 2,233 |
| Total assets | **$23,668** | $23,946 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities | | |
| Notes payable and current portion of long-term debt | **$ 15** | $ 1,153 |
| Advance payments, less contracts in process of $1,071 in 2003 and $1,688 in 2002 | **1,038** | 819 |
| Accounts payable | **833** | 776 |
| Accrued salaries and wages | **767** | 710 |
| Other accrued expenses | **1,153** | 1,316 |
| Liabilities from discontinued operations | **43** | 333 |
| Total current liabilities | **3,849** | 5,107 |
| Accrued retiree benefits and other long-term liabilities | **3,281** | 2,831 |
| Long-term debt | **6,517** | 6,280 |
| Subordinated notes payable | **859** | 858 |
| Commitments and contingencies (note M) | | |
| Stockholders' equity | | |
| Preferred stock, par value $0.01 per share, 200,000,000 shares authorized, none outstanding in 2003 and 2002 | | |
| Common stock, par value $0.01 per share, 1,450,000,000 shares authorized, 418,136,000 and 408,209,000 shares outstanding in 2003 and 2002, respectively, after deducting 168,000 and 97,000 treasury shares in 2003 and 2002, respectively | **4** | 4 |
| Additional paid-in capital | **8,421** | 8,146 |
| Accumulated other comprehensive income | **(2,194)** | (2,180) |
| Treasury stock, at cost | **(6)** | (4) |
| Retained earnings | **2,937** | 2,904 |
| Total stockholders' equity | **9,162** | 8,870 |
| Total liabilities and stockholders' equity | **$23,668** | $23,946 |

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

# CONSOLIDATED STATEMENTS OF OPERATIONS

| *(In millions except per share amounts)* Years Ended December 31: | **2003** | 2002 | 2001 |
|---|---|---|---|
| Net sales | **$18,109** | $16,760 | $16,017 |
| Cost of sales | **15,000** | 13,358 | 13,664 |
| Administrative and selling expenses | **1,306** | 1,170 | 1,131 |
| Research and development expenses | **487** | 449 | 456 |
| Total operating expenses | **16,793** | 14,977 | 15,251 |
| Operating income | **1,316** | 1,783 | 766 |
| Interest expense | **537** | 497 | 696 |
| Interest income | **(50)** | (27) | (36) |
| Other expense, net | **67** | 237 | 6 |
| Non-operating expense, net | **554** | 707 | 666 |
| Income from continuing operations before taxes | **762** | 1,076 | 100 |
| Federal and foreign income taxes | **227** | 320 | 98 |
| Income from continuing operations | **535** | 756 | 2 |
| Loss from discontinued operations, net of tax | **(170)** | (887) | (757) |
| Income (loss) before accounting change | **365** | (131) | (755) |
| Cumulative effect of change in accounting principle, net of tax | **–** | (509) | – |
| Net income (loss) | **$ 365** | $ (640) | $ (755) |
| Earnings per share from continuing operations | | | |
| Basic | **$ 1.30** | $ 1.88 | $ 0.01 |
| Diluted | **1.29** | 1.85 | 0.01 |
| Earnings (loss) per share | | | |
| Basic | **$ 0.88** | $ (1.59) | $ (2.12) |
| Diluted | **0.88** | (1.57) | (2.09) |

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

# CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

| Years Ended December 31, 2003, 2002, and 2001 *(In millions except per share amounts)* | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Income | Treasury Stock | Retained Earnings | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2000 | $ 3 | $ 6,477 | $ (106) | $(382) | $4,914 | $10,906 |
| Net loss | | | | | (755) | (755) |
| Other comprehensive income | | | | | | |
| Minimum pension liability | | | (100) | | | (100) |
| Foreign exchange translation | | | (4) | | | (4) |
| Unrealized losses on interest-only strips | | | (2) | | | (2) |
| Comprehensive income | | | | | | (861) |
| Dividends declared—$0.80 per share | | | | | (292) | (292) |
| Issuance of common stock | 1 | 1,369 | | | | 1,370 |
| Common stock plan activity | | 36 | | | | 36 |
| Trust preferred security distributions | | (6) | | | | (6) |
| Treasury stock activity | | (153) | | 381 | | 228 |
| Balance at December 31, 2001 | 4 | 7,723 | (212) | (1) | 3,867 | 11,381 |
| Net loss | | | | | (640) | (640) |
| Other comprehensive income | | | | | | |
| Minimum pension liability | | | (2,002) | | | (2,002) |
| Interest rate lock | | | (2) | | | (2) |
| Foreign exchange translation | | | 31 | | | 31 |
| Cash flow hedges | | | 5 | | | 5 |
| Comprehensive income | | | | | | (2,608) |
| Dividends declared—$0.80 per share | | | | | (323) | (323) |
| Issuance of common stock | | 328 | | | | 328 |
| Common stock plan activity | | 106 | | | | 106 |
| Trust preferred security distributions | | (11) | | | | (11) |
| Treasury stock activity | | | | (3) | | (3) |
| Balance at December 31, 2002 | 4 | 8,146 | (2,180) | (4) | 2,904 | 8,870 |
| Net income | | | | | **365** | **365** |
| Other comprehensive income | | | | | | |
| Minimum pension liability | | | **(118)** | | | **(118)** |
| Foreign exchange translation | | | **82** | | | **82** |
| Cash flow hedges | | | **19** | | | **19** |
| Unrealized gains on residual interest securities | | | **2** | | | **2** |
| Interest rate lock | | | **1** | | | **1** |
| Comprehensive income | | | | | | **351** |
| Dividends declared—$0.80 per share | | | | | **(332)** | **(332)** |
| Issuance of common stock | | **264** | | | | **264** |
| Common stock plan activity | | **22** | | | | **22** |
| Trust preferred security distributions | | **(11)** | | | | **(11)** |
| Treasury stock activity | | | | **(2)** | | **(2)** |
| Balance at December 31, 2003 | **$ 4** | **$8,421** | **$(2,194)** | **$ (6)** | **$ 2,937** | **$ 9,162** |

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

| *(In millions)* Years Ended December 31: | **2003** | 2002 | 2001 |
|---|---|---|---|
| Cash flows from operating activities | | | |
| Income from continuing operations | **$ 535** | $ 756 | $ 2 |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities from continuing operations, net of the effect of acquisitions and divestitures | | | |
| Depreciation and amortization | **393** | 364 | 677 |
| Deferred federal and foreign income taxes | **94** | 264 | 7 |
| Net gain on sales of operating units and investments | **(82)** | (4) | (74) |
| Savings and investment plan activity | **190** | 181 | 193 |
| Decrease (increase) in accounts receivable | **193** | (20) | (20) |
| Decrease in contracts in process | **285** | 152 | 528 |
| Decrease (increase) in inventories | **110** | 10 | (288) |
| Decrease (increase) in prepaid expenses and other current assets | **78** | 124 | (74) |
| Increase (decrease) in advance payments | **136** | (52) | (268) |
| Increase (decrease) in accounts payable | **26** | (105) | (109) |
| Increase in accrued salaries and wages | **60** | 137 | 57 |
| (Decrease) increase in other accrued expenses | **(163)** | 223 | 251 |
| Other adjustments, net | **247** | 205 | (131) |
| Net cash provided by operating activities from continuing operations | **2,102** | 2,235 | 751 |
| Net cash used in operating activities from discontinued operations | **(533)** | (1,196) | (596) |
| Net cash provided by operating activities | **1,569** | 1,039 | 155 |
| Cash flows from investing activities | | | |
| Origination of financing receivables | **(402)** | (431) | (663) |
| Sale of financing receivables | **279** | 263 | 696 |
| Repurchase of financing receivables | **–** | (347) | (329) |
| Collection of financing receivables not sold | **588** | 156 | 121 |
| Buy-out of off balance sheet receivables facility | **–** | (1,029) | – |
| Expenditures for property, plant, and equipment | **(428)** | (458) | (461) |
| Synthetic lease maturity payment | **(125)** | – | – |
| Proceeds from sales of property, plant, and equipment | **25** | 11 | 9 |
| Capitalized expenditures for internal use software | **(98)** | (138) | (149) |
| Increase in other assets | **(3)** | (36) | (6) |
| Space Imaging debt guarantee payment | **(130)** | – | – |
| Proceeds from sales of operating units and investments | **111** | 1,166 | 266 |
| Payment for purchases of acquired companies, net of cash received | **(60)** | (10) | – |
| Hughes Defense settlement | **–** | 134 | 500 |
| Net cash used in investing activities from continuing operations | **(243)** | (719) | (16) |
| Net cash used in investing activities from discontinued operations | **–** | – | (31) |
| Net cash used in investing activities | **(243)** | (719) | (47) |
| Cash flows from financing activities | | | |
| Dividends | **(331)** | (321) | (281) |
| (Decrease) increase in short-term debt and other notes | **–** | (163) | 140 |
| Issuance of long-term debt, net of offering costs | **1,113** | 566 | – |
| Repayments of long-term debt | **(2,078)** | (1,294) | (1,910) |
| Issuance of equity security units | **–** | – | 837 |
| Issuance of common stock | **74** | 147 | 1,426 |
| Proceeds under common stock plans | **13** | 75 | 25 |
| Net cash (used in) provided by financing activities from continuing operations | **(1,209)** | (990) | 237 |
| Net cash used in financing activities from discontinued operations | **–** | – | (2) |
| Net cash (used in) provided by financing activities | **(1,209)** | (990) | 235 |
| Net increase (decrease) in cash and cash equivalents | **117** | (670) | 343 |
| Cash and cash equivalents at beginning of year | **544** | 1,214 | 871 |
| Cash and cash equivalents at end of year | **$ 661** | $ 544 | $ 1,214 |

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## ▸▸▸NOTE A: ACCOUNTING POLICIES

**PRINCIPLES OF CONSOLIDATION** The consolidated financial statements include the accounts of Raytheon Company (the "Company") and all wholly-owned and majority-owned domestic and foreign subsidiaries (except for RC Trust I, as described in Note J, Equity Security Units). All material intercompany transactions have been eliminated. Certain prior year amounts have been reclassified to conform with the current year presentation.

**REVENUE RECOGNITION** Sales under long-term government contracts are recorded under the percentage of completion method. Incurred costs and estimated gross margins are recorded as sales as work is performed based on the percentage that incurred costs bear to estimated total costs utilizing the Company's estimates of costs and contract value. Cost estimates include direct and indirect costs such as labor, materials, warranty, and overhead. Some contracts contain incentive provisions based upon performance in relation to established targets, which are included at estimated realizable value. Contract change orders and claims are included when they can be reliably estimated and realization is probable. Since many contracts extend over a long period of time, revisions in cost and contract value estimates during the progress of work have the effect of adjusting earnings applicable to performance in prior periods in the current period. When the current contract estimate indicates a loss, provision is made for the total anticipated loss in the current period.

Revenue from aircraft sales are recognized at the time of physical delivery of the aircraft. Revenue from certain qualifying non-cancelable aircraft lease contracts are accounted for as sales-type leases. The present value of all payments, net of executory costs, are recorded as revenue, and the related costs of the aircraft are charged to cost of sales. Associated interest, using the interest method, is recorded over the term of the lease agreements. All other leases for aircraft are accounted for under the operating method wherein revenue is recorded as earned over the rental period. Service revenue is recognized ratably over contractual periods or as services are performed.

**PRODUCT WARRANTY** Costs incurred under warranty provisions performed under long-term contracts are accounted for as contract costs as the work is performed. The estimation of these costs is an integral part of the determination of the pricing of the Company's products and services.

Warranty provisions related to aircraft sales are determined based upon an estimate of costs that may be incurred under warranty and other post-sales support programs. Activity related to aircraft warranty provisions was as follows:

| *(In millions)* | |
|---|---|
| Balance at December 31, 2001 | $ 19 |
| Accruals for aircraft deliveries in 2002 | 25 |
| Accruals related to prior year aircraft deliveries | 10 |
| Warranty services provided in 2002 | (27) |
| Balance at December 31, 2002 | 27 |
| Accruals for aircraft deliveries in 2003 | **27** |
| Accruals related to prior year aircraft deliveries | **8** |
| Warranty services provided in 2003 | **(23)** |
| Balance at December 31, 2003 | **$ 39** |

**LOT ACCOUNTING** The Company uses lot accounting for new commercial aircraft introductions at Raytheon Aircraft. Lot accounting involves selecting an initial lot size at the time a new aircraft begins to be delivered and measuring an average cost over the entire lot for each aircraft sold. The costs attributed to aircraft delivered are based on the estimated average cost of all aircraft in the lot and are determined under the learning curve concept, which anticipates a predictable decrease in unit costs from cost reduction initiatives and as tasks and production techniques become more efficient through repetition. Costs incurred on in-process and delivered aircraft in excess of the estimated average cost were included in inventories and totaled $84 million and $110 million at December 31, 2003 and 2002, respectively. Once production costs stabilize, which is expected by the time the initial lot has been completed, the use of lot accounting is discontinued. The Company determines lot size based on several factors, including the size of firm backlog, the expected annual production on the aircraft, and experience on similar new aircraft. The size of the initial lot for the Beechcraft Premier I, the only aircraft for which the Company is currently utilizing lot accounting for, is 200 units.

**RESEARCH AND DEVELOPMENT EXPENSES** Expenditures for company-sponsored research and development projects are expensed as incurred. Customer-sponsored research and development projects performed under contracts are accounted for as contract costs as the work is performed.

**FEDERAL AND FOREIGN INCOME TAXES** The Company and its domestic subsidiaries provide for federal income taxes on pretax accounting income at rates in effect under existing tax law. Foreign subsidiaries have recorded provisions for income taxes at applicable foreign tax rates in a similar manner.

**CASH AND CASH EQUIVALENTS** Cash and cash equivalents consist of cash and short-term, highly liquid investments with original maturities of 90 days or less.

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

| *(In millions)* | |
|---|---|
| Balance at December 31, 2000 | $132 |
| Provisions | 2 |
| Utilizations | (21) |
| Balance at December 31, 2001 | 113 |
| Provisions | 2 |
| Utilizations | (42) |
| Balance at December 31, 2002 | 73 |
| Provisions | **1** |
| Utilizations | **(39)** |
| Balance at December 31, 2003 | **$ 35** |

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

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

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

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

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

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

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

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

**Notes to Consolidated Financial Statements (Continued)** ▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸

In accordance with SFAS No. 142, goodwill amortization was discontinued as of January 1, 2002. The following adjusts reported income from continuing operations and basic and diluted earnings per share (EPS) from continuing operations to exclude goodwill amortization:

| *(In millions except per share amounts)* | 2001 |
|---|---|
| Reported income from continuing operations | $ 2 |
| Goodwill amortization, net of tax | 305 |
| Adjusted income from continuing operations | $ 307 |
| Reported basic EPS from continuing operations | $0.01 |
| Goodwill amortization, net of tax | 0.86 |
| Adjusted basic EPS from continuing operations | $0.87 |
| Reported diluted EPS from continuing operations | $0.01 |
| Goodwill amortization, net of tax | 0.84 |
| Adjusted diluted EPS from continuing operations | $0.85 |

The following adjusts reported net loss and basic and diluted loss per share to exclude goodwill amortization:

| *(In millions except per share amounts)* | 2001 |
|---|---|
| Reported net loss | $ (755) |
| Goodwill amortization, net of tax | 333 |
| Adjusted net loss | $ (422) |
| Reported basic loss per share | $(2.12) |
| Goodwill amortization, net of tax | 0.94 |
| Adjusted basic loss per share | $(1.18) |
| Reported diluted loss per share | $(2.09) |
| Goodwill amortization, net of tax | 0.92 |
| Adjusted diluted loss per share | $(1.17) |

Intangible assets subject to amortization consisted primarily of drawings and intellectual property totaling $59 million (net of $38 million of accumulated amortization) at December 31, 2003 and $27 million (net of $30 million of accumulated amortization) at December 31, 2002. Amortization expense is expected to approximate $11 million for each of the next five years.

In 2002, the Company adopted Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Accordingly, upon indication of possible impairment, the Company evaluates the recoverability of held-for-use long-lived assets by measuring the carrying amount of the assets against the related estimated undiscounted future cash flows. When an evaluation indicates that the future undiscounted cash flows are not sufficient to recover the carrying value of the asset, the asset is adjusted to its estimated fair value. In order for long-lived assets to be considered held-for-disposal, the Company must have committed to a plan to dispose of the assets.

During the first half of 2001, the Company experienced a significant decrease in the volume of used commuter aircraft sales. An evaluation of commuter aircraft market conditions and the events of September 11, 2001 indicated the market weakness would continue into the foreseeable future. As a result, the Company completed an analysis of the estimated fair value of the various models of commuter aircraft and reduced the book value of commuter aircraft inventory and equipment leased to others accordingly. In addition, the Company adjusted the book value of notes receivable and established a reserve for off balance sheet receivables based on the Company's estimate of exposures on customer financed assets due to defaults, refinancing, and remarketing of these aircraft. As a result of these analyses, the Company recorded a charge of $693 million in the third quarter of 2001 which consisted of a reduction in inventory of $158 million, a reduction of equipment leased to others of $174 million, a reserve for notes receivable of $16 million, and a reserve for off balance sheet receivables of $345 million. The balance of this reserve was $361 million at December 31, 2001. In 2002, the Company utilized $121 million of this reserve, leaving a balance of $240 million at the time the Company bought back the remaining off balance sheet receivables, as described in Note H, Other Assets.

The Company also recorded a $52 million charge in the third quarter of 2001 related to a fleet of Starship aircraft. During the first three quarters of 2001, the Company had not sold any of these aircraft and recorded a charge to reduce the value of the aircraft to their estimated fair value. The charge consisted of a reduction in the value of aircraft in inventory of $31 million, a reduction in the value of equipment leased to others of $14 million, and a reserve of $7 million related to the Company's estimate of exposures on customer financed assets due to defaults, refinancing, and remarketing of these aircraft.

In connection with the buyback of the off balance sheet receivables, the Company recorded the long-term receivables at estimated fair value, which included an assessment of the value of the underlying aircraft. As a result of this assessment, the Company adjusted the value of certain underlying aircraft, including both commuter and Starship aircraft, some of which were written down to scrap value. There was no net income statement impact as a result of this activity.

**COMPUTER SOFTWARE** Internal use computer software is stated at cost less accumulated amortization and is amortized using the straight-line method over its estimated useful life, generally 10 years.

**INVESTMENTS** Investments, which are included in other assets, include equity ownership of 20 percent to 50 percent in unconsolidated affiliates and of less than 20 percent in other companies. Investments in unconsolidated affiliates are accounted for under the equity method. Investments in other companies with readily determinable market prices are stated at estimated fair value with unrealized gains and losses included in other comprehensive income. Other investments are stated at cost.

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

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

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

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

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

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

**INTEREST RATE AND FOREIGN CURRENCY CONTRACTS** The Company meets its working capital requirements with a combination of variable rate short-term and fixed rate long-term financing. The Company enters into interest rate swap agreements or interest rate locks with commercial and investment banks primarily to manage interest rates associated with the Company's financing arrangements. The Company also enters into foreign currency forward contracts with commercial banks only to fix the dollar value of specific commitments and payments to international vendors and the value of foreign currency denominated receipts. The hedges used by the Company are transaction driven and are directly related to a particular asset, liability, or transaction for which a commitment is in place. These instruments are executed with credit-worthy institutions and the majority of the foreign currencies are denominated in currencies of major industrial countries. The Company does not hold or issue financial instruments for trading or speculative purposes.

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

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

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

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

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

## Notes to Consolidated Financial Statements (Continued)

Company's net income and earnings per share would have approximated the pro forma amounts indicated below:

| (In millions except per share amounts) | 2003 | 2002 | 2001 |
|---|---|---|---|
| Reported net income (loss) | **$ 365** | $ (640) | $ (755) |
| Stock-based compensation expense included in reported net income (loss), net of tax | **5** | 4 | 8 |
| Compensation expense determined under the fair value method for all stock-based awards, net of tax | **(73)** | (63) | (57) |
| Pro forma net income (loss) | **$ 297** | $ (699) | $ (804) |
| Reported basic earnings (loss) per share | **$ 0.88** | $(1.59) | $(2.12) |
| Reported diluted earnings (loss) per share | **0.88** | (1.57) | (2.09) |
| Pro forma basic earnings (loss) per share | **$ 0.72** | $(1.74) | $(2.25) |
| Pro forma diluted earnings (loss) per share | **0.72** | (1.71) | (2.23) |

The weighted-average fair value of each stock option granted in 2003, 2002, and 2001 was estimated as $8.57, $13.46, and $9.25, respectively, on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Expected life | **4 years** | 4 years | 4 years |
| Assumed annual dividend growth rate | **–** | – | 1% |
| Expected volatility | **40%** | 40% | 40% |
| Assumed annual forfeiture rate | **8%** | 12% | 12% |

The risk free interest rate (month-end yields on 4-year treasury strips equivalent zero coupon) ranged from 2.0% to 3.0% in 2003, 2.5% to 4.7% in 2002, and 3.7% to 5.0% in 2001.

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

In December 2003, the FASB issued Statement of Financial Accounting Standards No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106. Information about foreign plans is required by this accounting standard for fiscal years ending after June 15, 2004, including additional disclosures about assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans.

**RISKS AND UNCERTAINTIES** The Company is engaged in supplying defense-related equipment to the U.S. and foreign governments, and is subject to certain business risks specific to that industry. Sales to the government may be affected by changes in procurement policies, budget considerations, changing concepts of national defense, political developments abroad, and other factors.

The highly competitive market for business and special mission aircraft is also subject to certain business risks. These risks include timely development and certification of new product offerings, the current state of the general aviation and commuter aircraft markets, and government regulations affecting commuter aircraft.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

## ▸▸▸ NOTE B: DISCONTINUED OPERATIONS

In 2000, the Company sold its Raytheon Engineers & Constructors businesses (RE&C) to Washington Group International, Inc. (WGI). In May 2001, WGI filed for bankruptcy protection. As a result of the sale and the WGI bankruptcy, the Company was required to perform various contract and lease obligations in connection with a number of different projects under letters of credit, surety bonds, and guarantees (Support Agreements) that it had provided to project owners and other parties.

Among the projects involved were two construction projects, the Mystic Station facility in Everett and the Fore River facility in Weymouth (the "Massachusetts Projects"). Following WGI's abandonment of these projects in 2001, the Company undertook construction efforts on these projects, subsequently delivered care, custody, and control of these projects to their owners, and, as of December 31, 2003, was continuing to perform work on these projects. On February 23, 2004, the Company closed on a settlement agreement with the project owners and other interested parties. The settlement included, among other things, a payment to the Company of approximately $30 million, the return to the Company of approximately $73 million in letters of credit the Company had provided to the project owners, and a release of various claims related to these projects. In addition, under the settlement, the Company remained responsible for all subcontractor and vendor claims prior to the settlement and the project owners assumed responsibility for all post-settlement obligations, including completing the construction of the projects, and all punch list and warranty obligations. The Company believes that the obligations retained on these projects are not material.

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

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

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

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

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

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

| *(In millions)* | **2003** | 2002 |
|---|---|---|
| Current liabilities | **$ 37** | $ 319 |
| Total liabilities | **$ 37** | $ 319 |

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

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

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

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

## Notes to Consolidated Financial Statements (Continued)

The components of assets and liabilities related to AIS were as follows at December 31:

| (In millions) | 2003 | 2002 |
|---|---|---|
| Current assets | **$59** | $75 |
| Total assets | **$59** | $75 |
| Current liabilities | **$ 6** | $14 |
| Total liabilities | **$ 6** | $14 |

In 2003, the total loss from discontinued operations was $261 million pretax, $170 million after-tax, or $0.41 per diluted share versus $1,013 million pretax, $887 million after-tax, or $2.17 per diluted share in 2002 and $1,138 million pretax, $757 million after-tax, or $2.10 per diluted share in 2001.

### ▸▸▸NOTE C: ACQUISITIONS AND DIVESTITURES

In 2003, the Company acquired Solipsys Corporation for $170 million, net of cash received, to be paid over two years. The Company paid $40 million, net, in cash in 2003 and intends to make the remaining payments, which have been accrued, in cash. In addition, the Company may be required to make certain performance-based incentive payments. Assets acquired included $7 million of contracts in process. Liabilities assumed included $2 million of accounts payable and $3 million of accrued salaries and wages. The Company also recorded $8 million of intangible assets and $160 million of goodwill (at Integrated Defense Systems) in connection with this acquisition.

In 2003, the Company acquired the Aerospace and Defence Services business unit of Honeywell® International Inc. for $20 million in cash. Assets acquired included $4 million of contracts in process. Liabilities assumed included $1 million of accounts payable and $2 million of other accrued expenses. The Company also recorded $8 million of intangible assets and $11 million of goodwill (at Technical Services) in connection with this acquisition.

In 2002, the Company acquired JPS Communications,™ Inc. for $10 million in cash. Assets acquired included $2 million of accounts receivable and $2 million of inventories. The Company also recorded $4 million of goodwill (at Network Centric Systems) and $2 million of intangible assets in connection with this acquisition.

Pro forma financial information has not been provided for these acquisitions as they are not material either individually or in the aggregate. In addition, the Company has entered into other acquisition and divestiture agreements in the normal course of business that have not been separately disclosed as they are not material.

In 2002, the Company formed a joint venture with Flight Options, Inc. whereby the Company contributed its Raytheon Travel Air® fractional ownership business and loaned the new entity $20 million. In June 2003, the Company participated in a financial recapitalization of Flight Options LLC (FO) and exchanged certain FO debt for equity. As a result of this recapitalization, the Company now owns approximately 66 percent of FO and is consolidating FO's results in its financial statements. Assets acquired included $83 million of inventories and $27 million of other current assets. Liabilities assumed included $97 million of notes payable and long-term debt, $90 million of advance payments, and $77 million of accounts payable and accrued expenses. The Company also recorded $26 million of intangible assets and $128 million of goodwill in connection with this recapitalization.

In 2001, the Company sold its recreational marine business for $100 million and recorded a gain of $39 million. Additional information about certain other acquisitions and divestitures is included in Note H, Other Assets.

The Company merged with the defense business of Hughes Electronics Corporation (Hughes Defense) in December 1997. In October 2001, the Company and Hughes Electronics agreed to a settlement regarding the purchase price adjustment related to the Company's merger with Hughes Defense. Under the terms of the merger agreement, Hughes Electronics agreed to reimburse the Company approximately $635 million of its purchase price, with $500 million received in 2001 and the balance received in 2002. The settlement resulted in a $555 million reduction in goodwill.

### ▸▸▸NOTE D: RESTRUCTURING

Prior to 2000, the Company recorded restructuring charges and exit costs in connection with the 1997 acquisition of Texas Instruments' defense business and merger with Hughes Defense. The Company essentially completed all related restructuring initiatives in 2000 except for ongoing idle facility costs.

Restructuring charges and exit costs recognized in connection with business combinations include the cost of involuntary employee termination benefits and related employee severance costs, facility closures, and other costs associated with the Company's approved plans. Employee termination benefits include severance, wage continuation, medical, and other benefits. Facility closure and related costs include disposal costs of property, plant, and equipment, lease payments, lease termination costs, and net gain or loss on sales of closed facilities.

In 2001, the Company determined that the cost of certain restructuring initiatives would be lower than originally planned and recorded an $8 million favorable adjustment to cost of sales.

In 2002, the Company determined that the cost of certain restructuring initiatives would be lower than originally planned and recorded a $4 million favorable adjustment to cost of sales, a $3 million favorable adjustment to general and administrative expenses, and a $1 million reduction in goodwill.

Activity related to restructuring initiatives was as follows:

**Exit Costs**

| *(In millions)* | **2003** | 2002 | 2001 |
|---|---|---|---|
| Accrued liability at beginning of year | **$4** | $17 | $47 |
| Changes in estimate | | | |
| Severance and other employee-related costs | **–** | – | – |
| Facility closure and related costs | **–** | (1) | – |
| | **–** | (1) | – |
| Costs incurred | | | |
| Severance and other employee-related costs | **–** | 2 | 3 |
| Facility closure and related costs | **3** | 10 | 27 |
| | **3** | 12 | 30 |
| Accrued liability at end of year | **$1** | $ 4 | $17 |
| Cash expenditures | **$3** | $ 4 | $18 |

**Restructuring**

| *(In millions)* | **2003** | 2002 | 2001 |
|---|---|---|---|
| Accrued liability at beginning of year | **$–** | $ 7 | $28 |
| Changes in estimate | | | |
| Severance and other employee-related costs | **–** | (3) | (4) |
| Facility closure and related costs | **–** | (4) | (4) |
| | **–** | (7) | (8) |
| Costs incurred | | | |
| Severance and other employee-related costs | **–** | – | 6 |
| Facility closure and related costs | **–** | – | 7 |
| | **–** | – | 13 |
| Accrued liability at end of year | **$–** | $ – | $ 7 |
| Cash expenditures | **$–** | $ – | $ 8 |

## ▸▸▸NOTE E: CONTRACTS IN PROCESS

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

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

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

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

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

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

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

## ▸▸▸NOTE F: INVENTORIES

Inventories consisted of the following at December 31:

| *(In millions)* | **2003** | 2002 |
|---|---|---|
| Finished goods | **$ 669** | $ 597 |
| Work in process | **1,023** | 1,042 |
| Materials and purchased parts | **306** | 393 |
| Total | **$1,998** | $2,032 |

**Notes to Consolidated Financial Statements (Continued)** ▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸▸

Inventories at Raytheon Aircraft, Raytheon Airline Aviation Services, and Flight Options totaled $1,603 million at December 31, 2003 (consisting of $647 million of finished goods, $717 million of work in process, and $239 million of materials and parts) and $1,612 million at December 31, 2002 (consisting of $557 million of finished goods, $761 million of work in process, and $294 million of materials and parts).

Included in inventories was $103 million and $76 million at December 31, 2003 and 2002, respectively, related to the Horizon aircraft. The Company anticipates certification of the Horizon aircraft in the third quarter of 2004 and first delivery by year end 2004.

## ▸▸▸ NOTE G: PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consisted of the following at December 31:

| *(In millions)* | **2003** | 2002 |
|---|---|---|
| Land | **$ 90** | $ 91 |
| Buildings and leasehold improvements | **1,769** | 1,606 |
| Machinery and equipment | **3,592** | 3,083 |
| Equipment leased to others | **189** | 189 |
| | **5,640** | 4,969 |
| Less accumulated depreciation and amortization | **(2,929)** | (2,573) |
| Total | **$ 2,711** | $ 2,396 |

Depreciation expense was $333 million, $305 million, and $289 million in 2003, 2002, and 2001, respectively. Accumulated depreciation of equipment leased to others was $25 million and $39 million at December 31, 2003 and 2002, respectively.

In 1998, the Company entered into a $490 million property sale and five-year operating lease (synthetic lease) facility under which property, plant, and equipment was sold and leased back to the Company. In 2003, the lease facility expired and the Company bought back the assets remaining in the lease facility for $125 million.

Future minimum lease payments from non-cancelable aircraft operating leases, which extend to 2014, amounted to $73 million at December 31, 2003 and were due as follows :

| *(In millions)* | |
|---|---|
| 2004 | $17 |
| 2005 | 11 |
| 2006 | 10 |
| 2007 | 8 |
| 2008 | 7 |
| Thereafter | 20 |

## ▸▸▸ NOTE H: OTHER ASSETS

Other assets, net consisted of the following at December 31:

| *(In millions)* | **2003** | 2002 |
|---|---|---|
| Long-term receivables | | |
| Due from customers in installments to 2015 | **$ 464** | $ 969 |
| Other, principally due through 2005 | **40** | 17 |
| Sales-type leases, due in installments to 2013 | **50** | 135 |
| Computer software, net | **456** | 397 |
| Pension-related intangible asset | **199** | 217 |
| Investments | **146** | 154 |
| Other noncurrent assets | **498** | 344 |
| Total | **$1,853** | $2,233 |

The Company provides long-term financing to its aircraft customers. The underlying aircraft serve as collateral for general aviation and commuter aircraft receivables. The Company maintains reserves for estimated uncollectible aircraft-related long-term receivables. The balance of these reserves was $60 million and $69 million at December 31, 2003 and 2002, respectively. The reserves for estimated uncollectible aircraft-related long-term receivables represent the Company's current estimate of future losses. The Company established these reserves based on an overall evaluation of identified risks. As a part of that evaluation, the Company considered certain specific receivables and considered factors including extended delinquency and requests for restructuring, among other things. Long-term receivables included commuter aircraft receivables of $363 million and $680 million at December 31, 2003 and 2002, respectively.

The Company accrues interest on long-term aircraft customer receivables in accordance with the terms of the underlying notes. When a long-term aircraft receivable is over 90 days past due, the Company generally stops accruing interest. At December 31, 2003 and 2002, there were $37 million and $38 million, respectively, of long-term aircraft receivables on which the Company was not accruing interest. Interest payments related to these receivables are credited to income when received. Once a receivable has been brought current, the Company begins to accrue interest again. Interest deemed to be uncollectible is written off at the time that determination is made.

In 2003, the Company sold an undivided interest in $337 million of general aviation finance receivables, received proceeds of $279 million, retained a subordinated interest in and servicing rights to the receivables, and recognized a gain of $2 million. In connection with the sale, the Company formed a qualifying special purpose entity (QSPE) for the sole purpose of buying these receivables. The

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

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

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

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

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

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

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

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

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

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

In addition, the Company has entered into joint ventures formed specifically to facilitate a teaming arrangement between two contractors for the benefit of the customer, generally the U.S. government, whereby the Company receives a subcontract from the joint venture in the joint venture's capacity as prime contractor. Accordingly, the Company records the work it performs for the joint venture as operating activity.

Certain joint ventures and equity and cost method investments are not listed separately in the table above as the Company's investment in these entities is less than $5 million. Information for these joint ventures and investments has not been separately disclosed since they are not material either individually or in the aggregate.

## ▸▸▸ NOTE I: NOTES PAYABLE AND LONG-TERM DEBT

Notes payable and long-term debt consisted of the following at December 31:

| *(In millions)* | **2003** | 2002 |
|---|---|---|
| Notes payable at a weighted-average interest rate of 6.25% for 2003 and 4.48% for 2002 | **$ 15** | $ 1 |
| Current portion of long-term debt | **–** | 1,152 |
| Notes payable and current portion of long-term debt | **15** | 1,153 |
| Notes due 2003, 5.70%, not redeemable prior to maturity | **–** | 377 |
| Notes due 2003, 7.90%, not redeemable prior to maturity | **–** | 775 |
| Notes due 2005, 6.30%, not redeemable prior to maturity | **123** | 438 |
| Notes due 2005, floating rate, 1.64% at December 31, 2003, redeemable after 2004 | **200** | – |
| Notes due 2005, 6.50%, not redeemable prior to maturity | **689** | 687 |
| Notes due 2006, 8.20%, redeemable at any time | **191** | 797 |
| Notes due 2007, 4.50%, redeemable at any time | **224** | 224 |
| Notes due 2007, 6.75%, redeemable at any time | **924** | 920 |
| Notes due 2008, 6.15%, redeemable at any time | **542** | 542 |
| Notes due 2010, 6.00%, redeemable at any time | **222** | 222 |
| Notes due 2010, 6.55%, redeemable at any time | **244** | 244 |
| Notes due 2010, 8.30%, redeemable at any time | **398** | 398 |
| Notes due 2011, 4.85%, redeemable at any time | **496** | – |
| Notes due 2012, 5.50%, redeemable at any time | **346** | 345 |
| Notes due 2013, 5.375%, redeemable at any time | **419** | – |
| Debentures due 2018, 6.40%, redeemable at any time | **372** | 371 |
| Debentures due 2018, 6.75%, redeemable at any time | **249** | 249 |
| Debentures due 2025, 7.375%, redeemable after 2005 | **205** | 205 |
| Debentures due 2027, 7.20%, redeemable at any time | **359** | 359 |
| Debentures due 2028, 7.00%, redeemable at any time | **184** | 184 |
| Other notes with varying interest rates | **85** | 6 |
| Interest rate swaps | **45** | 89 |
| Less installments due within one year | **–** | (1,152) |
| Long-term debt | **6,517** | 6,280 |
| Subordinated notes payable | **859** | 858 |
| Total debt issued and outstanding | **$7,391** | $ 8,291 |

The floating rate notes due in 2005 are redeemable on or after June 10, 2004 at the option of the Company at a redemption price equal to 100 percent of par. The debentures due in 2025 are redeemable at the option of the Company on or after July 15, 2005 at redemption prices no greater than 103 percent of par. The notes and debentures redeemable at any time are at redemption prices equal to the present value of remaining principal and interest payments. Information about the subordinated notes payable is included in Note J, Equity Security Units.

In 2003, the Company issued $425 million of long-term debt and used the proceeds to reduce the amounts outstanding under the Company's lines of credit. Also in 2003, the Company issued $500 million of long-term debt and $200 million of floating rate notes. The proceeds were used to partially fund the repurchase of long-term debt with a par value of $924 million at a loss of $77 million pretax, which was included in other expense, $50 million after-tax, or $0.12 per diluted share. The Company has on file a shelf registration with the Securities and Exchange Commission registering the issuance of up to $3.0 billion in debt securities, common or preferred stock, warrants to purchase any of the aforementioned securities, and/or stock purchase contracts, under which $1.3 billion remained outstanding at December 31, 2003.

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

In 2002, the Company issued $575 million of long-term debt to reduce the amounts outstanding under the Company's lines of credit. Also in 2002, the Company repurchased debt with a par value of $96 million at a gain of $2 million pretax, which was included in other income, or $1 million after-tax.

In 2001, the Company repurchased long-term debt with a par value of $1,375 million at a loss of $24 million pretax, which was included in other expense, $16 million after-tax, or $0.04 per diluted share.

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

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

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

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

| *(In millions)* | |
|---|---|
| 2004 | $ – |
| 2005 | 1,048 |
| 2006 | 228 |
| 2007 | 1,149 |
| 2008 | 544 |

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

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

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

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

## ▸▸▸NOTE J: EQUITY SECURITY UNITS

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

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

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

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

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

**Notes to Consolidated Financial Statements (Continued)**

were reset at 7%. Neither the Company nor RCTI received any proceeds from the remarketing. The proceeds were pledged to collateralize the holders' obligations under the contract to purchase the Company's common stock on May 15, 2004.

## ▸▸▸ NOTE K: STOCKHOLDERS' EQUITY

The changes in shares of common stock outstanding were as follows:

| *(In thousands)* | |
|---|---|
| Balance at December 31, 2000 | 340,620 |
| Issuance of common stock | 46,809 |
| Common stock plan activity | 1,230 |
| Treasury stock activity | 6,773 |
| Balance at December 31, 2001 | 395,432 |
| Issuance of common stock | 9,218 |
| Common stock plan activity | 3,638 |
| Treasury stock activity | (79) |
| Balance at December 31, 2002 | 408,209 |
| Issuance of common stock | **8,977** |
| Common stock plan activity | **1,021** |
| Treasury stock activity | **(71)** |
| Balance at December 31, 2003 | **418,136** |

The Company issued 6,486,000 and 5,100,000 shares of common stock in 2003 and 2002, respectively, to fund the Company Match and Company Contributions, as described in Note O, Pension and Other Employee Benefits. In addition, employee-directed 401(k) plan purchases (Employee Contributions) of the Company stock fund were funded through the issuance of 2,491,000 and 4,118,000 shares of common stock in 2003 and 2002, respectively. The Company issued 855,000 shares of common stock and 6,809,000 shares out of treasury in 2001 to fund the Company Match and Company Contributions.

In May 2001, the Company issued 14,375,000 shares of common stock for $27.50 per share. In October 2001, the Company issued 31,578,900 shares of common stock for $33.25 per share. The proceeds of the offerings were $1,388 million, net of $56 million of offering costs, and were used to reduce debt and for general corporate purposes.

Basic earnings per share (EPS) is computed by dividing net income by the weighted-average shares outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

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

| *(In thousands)* | **2003** | 2002 | 2001 |
|---|---|---|---|
| Average common shares outstanding for basic EPS | **412,686** | 401,444 | 356,717 |
| Dilutive effect of stock options, restricted stock, and equity security units | **2,743** | 6,587 | 4,606 |
| Shares for diluted EPS | **415,429** | 408,031 | 361,323 |

Stock options to purchase 30.6 million, 23.7 million, and 20.5 million shares of common stock outstanding at December 31, 2003, 2002, and 2001, respectively, did not affect the computation of diluted EPS. The exercise prices for these options were greater than the average market price of the Company's common stock during the respective years.

Stock options to purchase 15.3 million, 17.9 million, and 15.5 million shares of common stock outstanding at December 31, 2003, 2002, and 2001, respectively, had exercise prices that were less than the average market price of the Company's common stock during the respective periods and are included in the dilutive effect of stock options and restricted stock in the table above.

In 1995, the Board of Directors authorized the repurchase of up to 12 million shares of the Company's common stock to allow the Company to repurchase shares from time to time when warranted by market conditions. In 1998, the Board of Directors ratified and reauthorized the repurchase of 2.5 million shares that remained under the original authorization. There have been 11.8 million shares purchased under these authorizations through December 31, 2003. There were no shares repurchased under this program during 2003, 2002, and 2001.

In 1998, the Board of Directors authorized the purchase of up to 5 million shares of the Company's common stock per year to counter the dilution due to the exercise of stock options. There were no shares repurchased under this program during 2003, 2002, and 2001.

The Board of Directors is authorized to issue up to 200,000,000 shares of preferred stock, $0.01 par value per share, in multiple series with terms as determined by the Board of Directors.

The Company had a shareholder rights plan that protected the Company and its stockholders against hostile takeover tactics. In February 2004, the Company amended its shareholder rights plan. As a result of this amendment, the shareholder rights plan automatically expired at the close of business on March 1, 2004.

## ▸▸▸ NOTE L: FEDERAL AND FOREIGN INCOME TAXES

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

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

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

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

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

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

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

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

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

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

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

## ▸▸▸ NOTE M: COMMITMENTS AND CONTINGENCIES

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

| *(In millions)* | |
|---|---|
| 2004 | $294 |
| 2005 | 271 |
| 2006 | 236 |
| 2007 | 198 |
| 2008 | 151 |
| Thereafter | 327 |

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

**Notes to Consolidated Financial Statements (Continued)**

At December 31, 2003, the Company had commitments under an agreement to outsource a significant portion of its information technology function requiring minimum annual payments as follows:

| *(In millions)* | |
|---|---|
| 2004 | $68 |
| 2005 | 67 |
| 2006 | 64 |
| 2007 | 64 |
| 2008 | 64 |
| Thereafter | 65 |

In connection with certain aircraft sales, the Company had offered trade-in incentives whereby the customer will receive a predetermined trade-in value if they purchase another aircraft from the Company. The difference between the value of these trade-in incentives, the majority of which expire by the end of 2005, and the current estimated fair value of the underlying aircraft was approximately $34 million at December 31, 2003. There is a high degree of uncertainty inherent in the assessment of the likelihood and value of trade-in commitments.

The Company self-insures for losses and expenses for aircraft product liability up to a maximum of $10 million per occurrence and $50 million annually. Insurance is purchased from third parties to cover excess aggregate liability exposure from $50 million to $1.2 billion. This coverage also includes the excess of liability over $10 million per occurrence. The aircraft product liability reserve was $15 million and $12 million at December 31, 2003 and 2002, respectively.

The Company is involved in various stages of investigation and cleanup related to remediation of various environmental sites. The Company's estimate of total environmental remediation costs expected to be incurred is $119 million. Discounted at 8.5 percent, the Company estimates the liability to be $72 million before U.S. government recovery and had this amount accrued at December 31, 2003. A portion of these costs are eligible for future recovery through the pricing of products and services to the U.S. government. The recovery of environmental cleanup costs from the U.S. government is considered probable based on the Company's long history of receiving reimbursement for such costs. Accordingly, the Company has recorded $47 million at December 31, 2003 for the estimated future recovery of these costs from the U.S. government, which is included in contracts in process. The Company leases certain government-owned properties and is generally not liable for environmental remediation at these sites, therefore, no provision has been made in the financial statements for these costs. Due to the complexity of environmental laws and regulations, the varying costs and effectiveness of alternative cleanup methods and technologies, the uncertainty of insurance coverage, and the unresolved extent of the Company's responsibility, it is difficult to determine the ultimate outcome of these matters, however, any additional liability is not expected to have a material adverse effect on the Company's financial position or results of operations.

Environmental remediation costs expected to be incurred are:

| *(In millions)* | |
|---|---|
| 2004 | $25 |
| 2005 | 14 |
| 2006 | 11 |
| 2007 | 9 |
| 2008 | 7 |
| Thereafter | 53 |

The Company issues guarantees and has banks and surety companies issue, on its behalf, letters of credit and surety bonds to meet various bid, performance, warranty, retention, and advance payment obligations. Approximately $1,316 million, $890 million, and $389 million of these guarantees, letters of credit, and surety bonds, for which there were stated values, were outstanding at December 31, 2003, respectively, and $1,614 million, $1,227 million, and $458 million were outstanding at December 31, 2002, respectively. These instruments expire on various dates through 2007. At December 31, 2003, the amount of guarantees, letters of credit, and surety bonds, for which there were stated values, that remained outstanding was $90 million, $146 million, and $283 million, respectively, related to discontinued operations and are included in the numbers above. Additional guarantees of project performance for which there is no stated value also remain outstanding.

In 1997, the Company provided a first loss guarantee of $133 million on $1.3 billion of U.S. Export-Import Bank debt through 2015 related to the Brazilian government's System for the Vigilance of the Amazon (SIVAM) program.

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

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

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

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

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

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

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

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

In May 2003, two purported class action lawsuits were filed on behalf of participants in the Company's savings and investment plans who invested in the Company's stock between August 19, 1999 and May 27, 2003. The two class action complaints are brought pursuant to the Employee Retirement Income Security Act (ERISA). Both lawsuits are substantially similar and have been consolidated into a single action. The complaints allege that the Company and certain members of the Company's Investment Committee breached ERISA fiduciary and co-fiduciary duties by allegedly failing to (1) disseminate necessary information regarding the savings and investment plans' investment in the Company's stock, (2) diversify the savings and investment plans' assets away from the Company's stock, (3) monitor investment alternatives to the Company's stock, and (4) avoid conflicts of interest.

Although the Company believes that it and the other defendants have meritorious defenses to each and all of the aforementioned class action and derivative complaints and intends to contest each lawsuit vigorously, an adverse resolution of any of the lawsuits could have a material adverse effect on the Company's financial position and results of operations. The Company is not presently able to reasonably estimate potential losses, if any, related to any of the lawsuits.

In addition, various claims and legal proceedings generally incidental to the normal course of business are pending or threatened against the Company. While the ultimate liability from these proceedings is presently indeterminable, any additional liability is not expected to have a material adverse effect on the Company's financial position or results of operations.

## ▸▸▸NOTE N: EMPLOYEE STOCK PLANS

The 2001 Stock Plan and 1995 Stock Option Plan provide for the grant of both incentive and nonqualified stock options at an exercise price which is not less than 100 percent of the fair value on the date of grant. The 1991 Stock Plan provided for the grant of incentive stock options at an exercise price which is 100 percent of the fair value on the date of grant and nonqualified stock options at an exercise price which may be less than the fair value on the date of grant. The 1976 Stock Option Plan provided for the grant of both incentive and nonqualified stock options at an exercise price which is 100 percent of the fair value on the date of grant. No further grants are allowed under the 1991 Stock Plan and 1976 Stock Option Plan. All of these plans were approved by the Company's stockholders.

The plans also provide that all stock options may generally be exercised in their entirety from 1 to 6 years after the date of grant. Incentive stock options terminate 10 years from the date of grant, and those stock options granted after December 31, 1986 become exercisable to a maximum of $100,000 per year. Nonqualified stock options terminate 11 years from the date of grant, 10 years and a day if issued in connection with the 1995 Stock Option Plan, or as determined by the Management Development and Compensation Committee of the Board of Directors (MDCC) if issued under the 2001 Stock Plan.

The 2001 Stock Plan and 1991 Stock Plan also provide for the award of restricted stock and restricted units. The 2001 Stock Plan also provides for the award of stock appreciation rights. The 1997 Nonemployee Directors Restricted Stock Plan provides for the award of restricted stock to nonemployee directors. Restricted stock, restricted unit, and stock appreciation rights awards are determined by the MDCC and are compensatory in nature. Restricted stock, restricted units, and stock appreciation rights vest over a specified period of time as determined by the MDCC. Restricted stock awards entitle the participant to full dividend and voting rights. Unvested shares are restricted as to disposition and subject to forfeiture under certain circumstances. Compensation expense is recognized over the vesting period.

No further grants are allowed under the 2001 Stock Plan, 1997 Nonemployee Directors Restricted Stock Plan, and 1995 Stock Option Plan after January 31, 2011, November 25, 2006, and March 21, 2005, respectively.

Awards of 314,800; 201,800; and 207,100 shares of restricted stock and restricted units were made to employees and directors at a weighted-average fair value at the grant date of $30.02, $32.62, and $28.13 in 2003, 2002, and 2001, respectively. The required conditions for 200,100; 428,600; and 304,600 shares of restricted stock and restricted units were satisfied during 2003, 2002, and 2001, respectively. There were 13,000; 183,500; and 715,800 shares of restricted stock and restricted units forfeited during 2003, 2002, and 2001, respectively. There were 940,600; 837,600; and 1,249,300 shares of restricted stock and restricted units outstanding at December 31, 2003, 2002, and 2001, respectively. The amount of compensation expense recorded was $8 million, $7 million, and $12 million in 2003, 2002, and 2001, respectively. The balance of unearned compensation was $13 million and $12 million at December 31, 2003 and 2002, respectively.

There were 53.2 million, 59.2 million, and 70.6 million additional shares of common stock (including shares held in treasury) authorized for stock options and restricted stock awards at December 31, 2003, 2002, and 2001, respectively.

Stock option information for 2003, 2002, and 2001 follows:

| *(Share amounts in thousands)* | Shares | Weighted-Average Option Price |
|---|---|---|
| Outstanding at December 31, 2000 | 34,093 | $41.66 |
| Granted | 9,321 | 29.85 |
| Exercised | (1,275) | 20.68 |
| Expired | (2,942) | 43.79 |
| Outstanding at December 31, 2001 | 39,197 | 39.38 |
| Granted | 10,049 | 42.04 |
| Exercised | (3,575) | 22.89 |
| Expired | (3,527) | 44.35 |
| Outstanding at December 31, 2002 | 42,144 | 40.99 |
| Granted | **7,256** | **31.01** |
| Exercised | **(675)** | **30.96** |
| Expired | **(2,639)** | **46.19** |
| Outstanding at December 31, 2003 | **46,086** | **$39.27** |

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

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

| *(Share amounts in thousands)* | Options Exercisable | |
|---|---|---|
| Exercise Price Range | Shares | Weighted-Average Exercise Price |
| $18.19 to $29.92 | **11,398** | **$24.03** |
| $30.00 to $48.97 | **7,059** | **$40.00** |
| $51.06 to $59.44 | **7,409** | **$54.35** |
| $67.66 to $73.78 | **4,231** | **$68.49** |
| Total | **30,097** | |

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

## ▸▸▸ NOTE O: PENSION AND OTHER EMPLOYEE BENEFITS

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

The strategic asset allocation of the Company's domestic Pension Benefits and Other Benefits plans is diversified with an average and moderate level of risk consisting of investments in equity securities (including domestic and international equities and the Company's stock), debt securities, real estate, and other areas such as private equity and cash. The Company seeks to produce an active return on investment over the long-term commensurate with levels of investment risk which are prudent and reasonable given the prevailing capital market expectations. Target allocations are 48 to 77 percent for equity securities, 20 to 40 percent for debt securities, 2 to 7 percent for real estate, and 4 to 17 percent for other areas. The long-term return on asset assumption for the Company's domestic Pension Benefits plans for 2004 is 8.75%. The long-term return on asset assumption for the Company's domestic Pension Benefits plans was 8.75% in 2003 and 9.50% in 2002 and 2001. The long-term return on asset assumption for the Company's domestic Other Benefits plans was 7.75% in 2003 and 8.50% in 2002 and 2001. To develop the expected long-term rate of return on asset assumption, the Company considered the current level of expected returns on risk free investments, the historical level of the risk premium associated with the other asset classes in which the Company has invested domestic Pension Benefits and Other Benefits plan assets, and the expectations for future returns of each asset class. Since the Company's investment policy is to employ active management strategies in all asset classes, the potential exists to outperform the broader markets, therefore, the expected returns were adjusted upward. The expected return for each asset class was then weighted based on the target asset allocation to develop the long-term return on asset assumption.

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

**Pension Asset Information**

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

**Other Benefits Asset Information**

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

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

## Notes to Consolidated Financial Statements (Continued)

### Change in Benefit Obligation

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| *(In millions)* | **2003** | 2002 | **2003** | 2002 |
| Benefit obligation at beginning of year | **$12,023** | $11,460 | **$1,579** | $1,547 |
| Service cost | **271** | 279 | **15** | 21 |
| Interest cost | **799** | 792 | **106** | 105 |
| Plan participants' contributions | **29** | 27 | **–** | – |
| Amendments | **6** | 3 | **(46)** | (348) |
| Actuarial loss | **1,225** | 315 | **122** | 430 |
| Curtailments | **–** | – | **–** | (41) |
| Foreign exchange | **52** | 32 | **–** | – |
| Benefits paid | **(909)** | (885) | **(119)** | (135) |
| Benefit obligation at end of year | **$13,496** | $12,023 | **$1,657** | $1,579 |

In 2002, the Company recorded a $41 million Other Benefits curtailment gain, which is included in discontinued operations, as a result of the sale of AIS.

### Change in Plan Assets

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| *(In millions)* | **2003** | 2002 | **2003** | 2002 |
| Fair value of plan assets at beginning of year | **$9,156** | $10,429 | **$ 353** | $ 410 |
| Actual return on plan assets | **1,629** | (487) | **25** | (22) |
| Divestitures | **(10)** | – | **–** | – |
| Company contributions | **69** | 51 | **133** | 100 |
| Plan participants' contributions | **29** | 27 | **–** | – |
| Transfers between plans | **(10)** | – | **8** | – |
| Foreign exchange | **32** | 21 | **–** | – |
| Benefits paid | **(909)** | (885) | **(119)** | (135) |
| Fair value of plan assets at end of year | **$9,986** | $ 9,156 | **$ 400** | $ 353 |

The fair value of plan assets for the Company's domestic and foreign plans was $9,661 million and $325 million, respectively, at December 31, 2003 and $8,898 million and $258 million, respectively, at December 31, 2002.

### Funded Status – unrecognized components

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| *(In millions)* December 31: | **2003** | 2002 | **2003** | 2002 |
| Funded status | **$(3,510)** | $(2,867) | **$(1,257)** | $(1,226) |
| Unrecognized actuarial loss | **5,265** | 4,859 | **797** | 723 |
| Unrecognized transition (asset) obligation | **–** | (1) | **160** | 185 |
| Contributions | **–** | – | **–** | – |
| Unrecognized prior service cost | **170** | 184 | **(348)** | (347) |
| Prepaid (accrued) benefit cost | **$ 1,925** | $ 2,175 | **$ (648)** | $ (665) |

The table above reconciles the difference between the benefit obligation and the fair value of plan assets to the amounts recorded on the Company's balance sheet due to certain items that are amortized over future periods rather than recognized in the current period.

### Funded Status – amounts recognized on the Balance Sheet

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| *(In millions)* December 31: | **2003** | 2002 | **2003** | 2002 |
| Prepaid benefit cost | **$ 669** | $ 661 | **$ 34** | $ 15 |
| Accrued benefit liability | **(2,384)** | (1,963) | **(682)** | (680) |
| Intangible asset | **199** | 217 | **–** | – |
| Employer contributions | **6** | 6 | **–** | – |
| Accumulated other comprehensive income | **3,435** | 3,254 | **–** | – |
| Prepaid (accrued) benefit cost | **$ 1,925** | $ 2,175 | **$(648)** | $(665) |

### Weighted-Average Year-End Benefit Obligation Assumptions

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| December 31: | **2003** | 2002 | **2003** | 2002 |
| Discount rate | **6.22%** | 6.95% | **6.25%** | 7.00% |
| Rate of compensation increase | **4.49%** | 4.46% | **4.50%** | 4.50% |
| Health care trend rate in the next year | | | **13.50%** | 13.50% |
| Gradually declining to a trend rate of | | | **5.75%** | 5.75% |
| In the years beyond | | | **2014** | 2013 |

The Company's foreign pension plan assumptions have been included in the table above.

The tables below outline the components of net periodic benefit cost and related actuarial assumptions of the Company's domestic and foreign Pension Benefits and Other Benefits plans.

### Components of Net Periodic Benefit Cost

| | Pension Benefits | | |
|---|---|---|---|
| *(In millions)* | **2003** | 2002 | 2001 |
| Service cost | **$ 271** | $ 279 | $ 258 |
| Interest cost | **799** | 792 | 797 |
| Expected return on plan assets | **(970)** | (1,194) | (1,249) |
| Amortization of transition asset | **–** | (4) | (5) |
| Amortization of prior service cost | **19** | 20 | 19 |
| Recognized net actuarial loss (gain) | **196** | 20 | (113) |
| Loss due to curtailments/settlements | **–** | 9 | 9 |
| Net periodic benefit cost (income) | **$ 315** | $ (78) | $ (284) |

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

**Components of Net Periodic Benefit Cost**

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

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

**Weighted-Average Net Periodic Benefit Cost Assumptions**

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

**Weighted-Average Net Periodic Benefit Cost Assumptions**

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

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

The projected benefit obligation and fair value of plan assets for pension plans with projected benefit obligations in excess of plan assets were $12,390 million and $8,731 million, respectively, at December 31, 2003, and $11,023 million and $8,022 million, respectively, at December 31, 2002.

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

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

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

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

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

The Company also makes an annual contribution to the Company stock fund of approximately one-half of one percent of salaries and wages, subject to certain limitations, of most U.S. salaried and hourly employees (Company Contributions). Total expense for the Company Contributions was $25 million, $26 million, and $28 million and the number of shares allocated to participant accounts was 884,000; 640,000; and 941,000 in 2003, 2002, and 2001, respectively.

The Company funded a portion of the Company Match and Company Contributions in 2003, 2002, and 2001 through the issuance of common stock.

At December 31, 2003, there was a total of $7.6 billion invested in the Company's defined contribution plan. At December 31, 2003, there was a total of $1.4 billion invested in the Company stock fund consisting of $519 million of Company Match which must remain invested in the Company stock fund for five years from the year in which the contribution was made or the year in which the employee reaches age 55, whichever is earlier; $202 million of Company Contributions which must remain invested in the Company stock fund until the employee reaches age 55 and completes 10 years of service; and $711 million over which there are no restrictions.

## ▸▸▸NOTE P: BUSINESS SEGMENT REPORTING

Reportable segments have been determined based upon product lines and include the following: Integrated Defense Systems, Intelligence and Information Systems, Missile Systems, Network Centric Systems, Space and Airborne Systems, Technical Services, Aircraft, and Other. In 2003, the Company began reporting its defense businesses in six segments. In addition, the Company's Commercial Electronics businesses were reassigned to the new defense businesses. Also, the Company created an Other segment comprised of Flight Options LLC (FO), Raytheon Airline Aviation Services LLC (RAAS), and Raytheon Professional Services LLC (RPS). FO offers services in the aircraft fractional ownership industry. RAAS manages the Company's commuter aircraft business and Starship aircraft portfolio. RPS works with customers to design and execute learning solutions.

Integrated Defense Systems (IDS) provides mission systems integration for the air, surface, and subsurface battlespace.

Intelligence and Information Systems (IIS) provides signal and image processing, geospatial intelligence, airborne and spaceborne command and control, ground engineering support, and weather and environmental management.

Missile Systems (MS) provides air-to-air, precision strike, surface Navy air defense, and land combat missiles, guided projectiles, kinetic kill vehicles, and directed energy weapons.

Network Centric Systems (NCS) provides network centric solutions to integrate sensors, communications, and command and control to manage the battlespace.

Space and Airborne Systems (SAS) provides electro-optical/infrared sensors, airborne radars, solid state high energy lasers, precision guidance systems, electronic warfare systems, and space-qualified systems for civil and military applications.

Technical Services (TS) provides technical, scientific, and professional services for defense, federal, and commercial customers worldwide.

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

In 2003, the Company changed the way pension expense or income is reported in the Company's segment results. Statement of Financial Accounting Standards (SFAS) No. 87, Employers' Accounting for Pensions, outlines the methodology used to determine pension expense or income for financial reporting purposes, which is not necessarily indicative of the funding requirements of pension plans which are determined by other factors. A major factor for determining pension funding requirements are Cost Accounting Standards (CAS) that proscribe the allocation to and recovery of pension costs on U.S. government contracts. The Company now reports the difference between SFAS No. 87 (FAS) pension expense or income and CAS pension expense as a separate line item in the Company's segment results called FAS/CAS Pension Adjustment. The results for each segment now only include pension expense as determined under CAS, which can generally be recovered through the pricing of products and services to the U.S. government. Previously, the Company's individual segment results included FAS pension expense or income, which consisted of CAS pension expense and an adjustment to reconcile CAS pension expense to FAS pension expense or income. Information for all periods presented was restated to reflect these changes.

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

Segment financial results were as follows:

**Net Sales**

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

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

**Operating Income**

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

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

**Free Cash Flow**

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

## Notes to Consolidated Financial Statements (Continued)

Free cash flow, defined as operating cash flow less capital expenditures and capitalized expenditures for internal use software, is used by the Company to evaluate cash flow performance by the segments. Corporate free cash flow includes the difference between amounts charged to the segments for interest and taxes on an intercompany basis and the amounts actually paid by the Company.

**Capital Expenditures**

| *(In millions)* | **2003** | 2002 | 2001 |
|---|---|---|---|
| Integrated Defense Systems | **$ 67** | $ 71 | $ 82 |
| Intelligence and Information Systems | **25** | 30 | 45 |
| Missile Systems | **76** | 44 | 35 |
| Network Centric Systems | **55** | 76 | 67 |
| Space and Airborne Systems | **106** | 116 | 103 |
| Technical Services | **12** | 20 | 3 |
| Aircraft | **57** | 81 | 95 |
| Other | **1** | – | 2 |
| Corporate | **29** | 20 | 29 |
| Total | **$428** | $458 | $461 |

**Depreciation and Amortization**

| *(In millions)* | **2003** | 2002 | 2001 |
|---|---|---|---|
| Integrated Defense Systems | **$ 53** | $ 47 | $ 60 |
| Intelligence and Information Systems | **29** | 27 | 65 |
| Missile Systems | **48** | 47 | 146 |
| Network Centric Systems | **62** | 62 | 121 |
| Space and Airborne Systems | **68** | 66 | 119 |
| Technical Services | **11** | 10 | 36 |
| Aircraft | **91** | 88 | 82 |
| Other | **16** | 12 | 26 |
| Corporate | **15** | 5 | 22 |
| Total | **$393** | $364 | $677 |

**Identifiable Assets**

| *(In millions)* December 31: | **2003** | 2002 |
|---|---|---|
| Integrated Defense Systems | **$ 1,657** | $ 1,612 |
| Intelligence and Information Systems | **1,910** | 1,926 |
| Missile Systems | **4,339** | 4,429 |
| Network Centric Systems | **3,653** | 3,914 |
| Space and Airborne Systems | **3,910** | 3,875 |
| Technical Services | **1,399** | 1,372 |
| Aircraft | **2,812** | 3,059 |
| Other | **912** | 899 |
| Corporate | **3,017** | 2,785 |
| Discontinued Operations | **59** | 75 |
| Total | **$23,668** | $23,946 |

**Operations by Geographic Areas**

| *(In millions)* | United States | Outside United States (Principally Europe) | Total |
|---|---|---|---|
| Sales | | | |
| **2003** | **$15,718** | **$2,391** | **$18,109** |
| 2002 | 14,155 | 2,605 | 16,760 |
| 2001 | 13,293 | 2,724 | 16,017 |
| Long-lived assets at | | | |
| **December 31, 2003** | **$ 5,381** | **$ 223** | **$ 5,604** |
| December 31, 2002 | 5,391 | 195 | 5,586 |

The country of destination was used to attribute sales to either United States or Outside United States. Sales to major customers in 2003, 2002, and 2001 were: U.S. government, including foreign military sales, $13,436 million, $12,255 million, and $11,161 million, respectively, and U.S. Department of Defense, $11,766 million, $10,406 million, and $9,512 million, respectively.

## ▸▸▸ NOTE Q: QUARTERLY OPERATING RESULTS (UNAUDITED)

*(In millions except per share amounts and stock prices)*

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

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

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

## ▸▸▸ NOTE R: FINANCIAL INSTRUMENTS

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

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

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

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

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

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

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

## ▸▸▸ NOTE S: OTHER INCOME AND EXPENSE

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

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

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

## COMPANY RESPONSIBILITY FOR FINANCIAL STATEMENTS

The financial statements and related information contained in this Annual Report have been prepared by and are the responsibility of the Company's management. The Company's financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reflect judgments and estimates as to the expected effects of transactions and events currently being reported. The Company's management is responsible for the integrity and objectivity of the financial statements and other financial information included in this Annual Report. To meet this responsibility, the Company maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and that transactions are properly executed and recorded. The system includes policies and procedures, internal audits, and Company officers' reviews.

The Audit Committee of the Board of Directors is composed solely of outside directors. The Audit Committee meets periodically and, when appropriate, separately with representatives of the independent auditors, Company officers, and the internal auditors to monitor the activities of each.

Upon recommendation of the Audit Committee, PricewaterhouseCoopers LLP, independent auditors, were selected by the Board of Directors to audit the Company's financial statements and their report follows.

Senior Vice President and
Chief Financial Officer

Chairman and
Chief Executive Officer

## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders of Raytheon Company

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Raytheon Company and its subsidiaries at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A to the consolidated financial statements, in 2002 the Company changed its method of accounting for goodwill and other intangible assets in accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, and its method of accounting for long-lived assets and discontinued operations in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

PricewaterhouseCoopers LLP

Boston, Massachusetts
January 26, 2004, except as to the second paragraph of Note B as to which the date is February 23, 2004, the last paragraph of Note J as to which the date is February 11, 2004 and the last paragraph of Note K as to which the date is March 1, 2004

# INVESTOR INFORMATION

## ▸▸▸ GLOBAL HEADQUARTERS
Raytheon Company, 870 Winter Street, Waltham, MA 02451
Telephone: 781.522.3000

## ▸▸▸ COMMON STOCK SYMBOL
Raytheon Company common stock is listed on the New York, Chicago, and Pacific stock exchanges. The stock symbol is: RTN

## ▸▸▸ ANNUAL MEETING
The 2004 Annual Meeting of Stockholders will be held on Wednesday, May 5, 2004, at 11:00 a.m.

The Mandarin Oriental Hotel
1330 Maryland Avenue, S.W.
Washington, D.C.

## ▸▸▸ STOCK TRANSFER AGENT, REGISTRAR AND DIVIDEND DISBURSING AGENT
American Stock Transfer & Trust Company is Raytheon's transfer agent and registrar. American Stock Transfer & Trust maintains the company's stockholder records and is responsible for disbursing dividend checks. Name and address changes, lost stock certificate replacement, stock ownership transfers, and Form 1099 questions should be directed to: Raytheon Company, c/o American Stock Transfer & Trust Company, 800.360.4519

**FIRST CLASS MAIL** 6201 15th Avenue, Brooklyn, NY 11219

**DIVIDEND DISTRIBUTION/DIRECT DIVIDEND DEPOSIT**
Common stock dividends are payable quarterly, upon authorization of the Board of Directors, normally at the end of January, April, July and October. Direct Dividend Deposit (via ACH) is available to Raytheon stockholders. For enrollment information, call: 800.360.4519

**DIVIDEND REINVESTMENT** As an added service to stockholders, Raytheon Company has a Dividend Reinvestment Plan, administered by American Stock Transfer & Trust Company. This plan gives stockholders the option of having their cash payments applied to the purchase of additional shares. For enrollment information about this plan, call: 800.360.4519

## ▸▸▸ INVESTOR RELATIONS
Securities analysts, investors and other members of the financial community requesting information about Raytheon should contact: Timothy C. Oliver, Vice President, Investor Relations, Raytheon Company, 870 Winter Street, Waltham, MA 02451, 781.522.5141

## ▸▸▸ MEDIA RELATIONS
Members of the news media requesting information about Raytheon should contact: James L. Fetig, Vice President, Media Relations, Raytheon Company, 870 Winter Street, Waltham, MA 02451, 781.522.5111

## ▸▸▸ WEB SITE
Raytheon's Web site offers financial information and facts about the company, its products and services. It is updated continually with news and information. Raytheon's Internet address is: http://www.raytheon.com

## ▸▸▸ COPIES OF REPORTS
Copies of the company's annual reports, latest SEC filings, quarterly earnings reports and other information may be requested through the company's Web site at http://www.raytheon.com or by calling: 781.522.5141

## ▸▸▸ TRADEMARKS
Raytheon® and **Raytheon**® are registered trademarks of Raytheon Company. *Customer Success is Our Mission*™ is a trademark of Raytheon Company. Hawker® is a registered trademark of BAE Systems, P.L.C. Beechcraft® is a registered trademark of Raytheon Aircraft Company. Paveway™ is a trademark of Raytheon Company. Raytheon Six Sigma™ and R6S™ are trademarks of Raytheon Company. Global Hawk® is a registered trademark of Northrop Grumman Corporation. AMRAAM™ is a trademark of Raytheon Company. Javelin™ is a trademark of Raytheon Company and Lockheed Martin Corporation. Raytheon Systems Limited™ is a trademark of Raytheon Systems Limited. SLAMRAAM™ is a trademark of Raytheon Company. CMMI® is a registered trademark of Carnegie Mellon University. Predator® is a registered trademark of General Atomics Aeronautical Systems, Inc. Raytheon Aircraft™ is a trademark of Raytheon Aircraft Company. Beechjet® is a registered trademark of Raytheon Aircraft Company. Horizon® is a registered trademark of Raytheon Aircraft Company. Premier I™ is a trademark of Raytheon Aircraft Company. Pro Line 21™ is a trademark of Rockwell Collins, Inc. King Air™ is a trademark of Raytheon Aircraft Company. NetJets® is a registered trademark of Columbia Insurance Company. Raytheon Aviation Airline Services™ is a trademark of Raytheon Aircraft Company. Raytheon Professional Services Company™ is a trademark of Raytheon Company. Boeing Business Jets® is a registered trademark of Boeing Management Company. Hughes™ is a trademark of Hughes Electronics Corporation. Space Imaging® is a registered trademark of Space Imaging, Inc. Thales-Raytheon Systems™ is a trademark of Thales-Raytheon Systems Company. HRL Laboratories® is a registered trademark of HRL Laboratories, LLC. TelASIC™ is a trademark of TelASIC Communications, Inc. Starship® is a registered trademark of Raytheon Aircraft Company. Solipsys™ is a trademark of Solipsys Corporation. Honeywell® is a registered trademark of Honeywell International Inc. JPS Communications™ is a trademark of Raytheon Company. Travel Air® is a registered trademark of Raytheon Aircraft Company. Flight Options® is a registered trademark of Flight Options, Inc.



Printed on recycled paper.

Design by Addison www.addison.com

# BOARD OF DIRECTORS AND LEADERSHIP TEAM

## ▸▸▸BOARD OF DIRECTORS

**WILLIAM H. SWANSON**
Chairman and
Chief Executive Officer
Raytheon Company

**BARBARA M. BARRETT**
International Business and
Aviation Attorney

**FERDINAND COLLOREDO-MANSFELD**
Retired Chairman and
Chief Executive Officer
Cabot Industrial Trust

**JOHN M. DEUTCH**
Institute Professor
Massachusetts Institute of
Technology

**THOMAS E. EVERHART**
President Emeritus
California Institute of Technology

**FREDERIC M. POSES**
Chairman and
Chief Executive Officer
American Standard Companies, Inc.

**WARREN B. RUDMAN***
of Counsel
Paul, Weiss, Rifkind,
Wharton & Garrison

**MICHAEL C. RUETTGERS**
Chairman
EMC Corporation

**RONALD L. SKATES**
Retired President and
Chief Executive Officer
Data General Corporation

**WILLIAM R. SPIVEY**
Retired President and
Chief Executive Officer
Luminent, Inc.

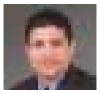
**LINDA G. STUNTZ**
Partner
Stuntz, Davis & Staffier, P.C.

**JOHN H. TILELLI, JR.**
President and
Chief Operating Officer
Cypress International, Inc.
Retired General, U.S. Army
Former Commander-in-Chief of
the United Nations Command,
Republic of Korea/United States
Combined Forces/United States
Forces Korea

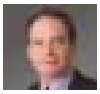
*Lead Director

## ▸▸▸LEADERSHIP TEAM

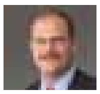
**WILLIAM H. SWANSON**
Chairman and
Chief Executive Officer
Raytheon Company



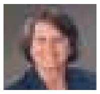
**RALPH H. ACABA**
Staff Executive
Raytheon Company



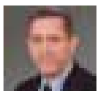
**THOMAS M. CULLIGAN**
Senior Vice President
Business Development, RII
Raytheon Company



**BRYAN J. EVEN**
President
Raytheon Technical
Services Company LLC

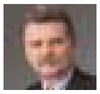


**LOUISE L. FRANCESCONI**
President
Missile Systems

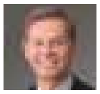


**CHARLES E. FRANKLIN**
Vice President
Company Evaluation Team
Raytheon Company

**JOHN D. HARRIS II**
Vice President
Contracts
Raytheon Company

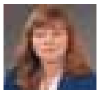


**MICHAEL D. KEEBAUGH**
President
Intelligence and Information
Systems



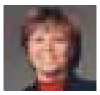
**JACK R. KELBLE**
President
Space and Airborne Systems

**KEITH J. PEDEN**
Senior Vice President
Human Resources
Raytheon Company



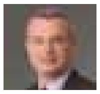
**PHYLLIS J. PIANO**
Vice President
Corporate Affairs and
Communications
Raytheon Company

**EDWARD S. PLINER**
Senior Vice President
Chief Financial Officer
Raytheon Company

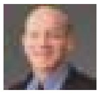


**REBECCA R. RHOADS**
Vice President
Chief Information Officer
Raytheon Company

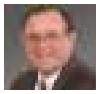
**DONALD M. RONCHI**
Vice President
Six Sigma, Supply
Chain and Learning
Raytheon Company



**COLIN J.R. SCHOTTLAENDER**
President
Network Centric Systems



**JAMES E. SCHUSTER**
Chairman and
Chief Executive Officer
Raytheon Aircraft Company



**GREGORY S. SHELTON**
Vice President
Engineering and Technology,
Manufacturing and Quality
Raytheon Company

**DANIEL L. SMITH**
President
Integrated Defense Systems

**JAY B. STEPHENS**
Senior Vice President
General Counsel
Raytheon Company

Raytheon

THE RAYTHEON TEAM: COMMITTED TO CUSTOMER SUCCESS

Raytheon employees pictured above are representative of the many members of the Raytheon team who have been honored for their work in technology, diversity, mentoring and customer focus.

An Equal Opportunity Employer