

HARRIS CORP /DE/
Form 10-Q
May 04, 2016

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

FORM 10-Q
(Mark One)

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

For the quarterly period ended April 1, 2016

or

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

For the transition period from _____ to _____

Commission File Number: 1-3863

HARRIS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 34-0276860

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1025 West NASA Boulevard 32919
Melbourne, Florida
(Address of principal executive offices) (Zip Code)

(321) 727-9100
(Registrant's telephone number, including area code)

No changes
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

The number of shares outstanding of the registrant's common stock as of April 29, 2016 was 124,725,874 shares.

HARRIS CORPORATION
 FORM 10-Q
 For the Quarter Ended April 1, 2016
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This Quarterly Report on Form 10-Q contains trademarks, service marks and registered marks of Harris Corporation and its subsidiaries.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

HARRIS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF INCOME

(Unaudited)

	Quarter Ended		Three Quarters Ended	
	April 1, 2016	April 3, 2015	April 1, 2016	April 3, 2015
	(In millions, except per share amounts)			
Revenue from product sales and services	\$1,909	\$1,187	\$5,563	\$3,548
Cost of product sales and services	(1,312)	(754)	(3,813)	(2,324)
Engineering, selling and administrative expenses	(309)	(220)	(877)	(603)
Impairment of goodwill and other assets	—	—	(367)	—
Non-operating loss	(1)	—	—	—
Interest income	—	—	1	2
Interest expense	(46)	(34)	(139)	(79)
Income from continuing operations before income taxes	241	179	368	544
Income taxes	(71)	(53)	(185)	(154)
Income from continuing operations	170	126	183	390
Discontinued operations, net of income taxes	(2)	—	(19)	—
Net income	\$168	\$126	\$164	\$390
Net income per common share				
Basic				
Continuing operations	\$1.37	\$1.21	\$1.47	\$3.73
Discontinued operations	(0.02)	—	(0.15)	—
	\$1.35	\$1.21	\$1.32	\$3.73
Diluted				
Continuing operations	\$1.36	\$1.20	\$1.46	\$3.69
Discontinued operations	(0.02)	—	(0.15)	—
	\$1.34	\$1.20	\$1.31	\$3.69
Cash dividends paid per common share	\$0.50	\$0.47	\$1.50	\$1.41
Basic weighted average common shares outstanding	124.0	103.7	123.7	104.1
Diluted weighted average common shares outstanding	125.1	104.8	124.8	105.2

See accompanying Notes to Condensed Consolidated Financial Statements (Unaudited).

HARRIS CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
 (Unaudited)

	Quarter Ended		Three Quarters Ended	
	April 1, 2016	April 3, 2015	April 1, 2016	April 3, 2015
	(In millions)			
Net income	\$168	\$126	\$164	\$390
Other comprehensive loss:				
Foreign currency translation loss, net of income taxes	(5)	(37)	(52)	(111)
Net unrealized gain (loss) on hedging derivatives, net of income taxes	—	(24)	1	(25)
Net unrecognized gain (loss) on postretirement obligations, net of income taxes	1	—	(3)	12
Other comprehensive loss, net of income taxes	(4)	(61)	(54)	(124)
Total comprehensive income	\$164	\$65	\$110	\$266

See accompanying Notes to Condensed Consolidated Financial Statements (Unaudited).

HARRIS CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEET
 (Unaudited)

	April 1, 2016	July 3, 2015
	(In millions, except shares)	
Assets		
Current Assets		
Cash and cash equivalents	\$ 302	\$ 481
Receivables	1,054	1,168
Inventories	992	1,015
Income taxes receivable	144	87
Deferred compensation plan investments	14	267
Other current assets	139	165
Assets of disposal group held for sale	221	—
Total current assets	2,866	3,183
Non-current Assets		
Property, plant and equipment	1,007	1,165
Goodwill	5,940	6,348
Other intangible assets	1,576	1,775
Non-current deferred income taxes	362	502
Other non-current assets	149	154
Total non-current assets	9,034	9,944
	\$ 11,900	\$ 13,127
Liabilities and Equity		
Current Liabilities		
Short-term debt	\$ 91	\$ 33
Accounts payable	529	581
Compensation and benefits	187	255
Other accrued items	387	490
Advance payments and unearned income	328	433
Income taxes payable	14	57
Deferred compensation plan liabilities	7	267
Current portion of long-term debt	383	130
Liabilities of discontinued operations	30	28
Liabilities of disposal group held for sale	56	—
Total current liabilities	2,012	2,274
Non-current Liabilities		
Defined benefit plans	1,716	1,943
Long-term debt	4,319	5,053
Non-current deferred income taxes	8	12
Other long-term liabilities	478	443
Total non-current liabilities	6,521	7,451
Equity		
Shareholders' Equity:		
Preferred stock, without par value; 1,000,000 shares authorized; none issued	—	—
Common stock, \$1.00 par value; 500,000,000 shares authorized; issued and outstanding 124,481,216 shares at April 1, 2016 and 123,675,756 shares at July 3, 2015	124	124

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Other capital	2,080	2,031
Retained earnings	1,232	1,258
Accumulated other comprehensive loss	(70) (16
Total shareholders' equity	3,366	3,397
Noncontrolling interests	1	5
Total equity	3,367	3,402
	\$ 11,900	\$ 13,127

See accompanying Notes to Condensed Consolidated Financial Statements (Unaudited).

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HARRIS CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
 (Unaudited)

	Three Quarters Ended	
	April 1, 2016	April 3, 2015
	(In millions)	
Operating Activities		
Net income	\$ 164	\$ 390
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	163	164
Amortization of intangible assets from Exelis Inc. acquisition	99	—
Share-based compensation	29	26
Pension contributions	(134)	—
Pension income	(17)	—
Net liability reduction for certain post-employment benefit plans	(101)	—
Impairment of goodwill and other assets	367	—
Adjustment to loss on sales of businesses, net	20	—
(Increase) decrease in:		
Accounts receivable	102	(87)
Inventories	(22)	(17)
Increase (decrease) in:		
Accounts payable and accrued expenses	(175)	(111)
Advance payments and unearned income	(87)	(25)
Income taxes	70	46
Other	29	9
Net cash provided by operating activities	507	395
Investing Activities		
Cash paid for fixed income securities	(19)	—
Additions of property, plant and equipment	(84)	(102)
Proceeds from sale of property, plant and equipment	2	—
Proceeds from sale of Cyber Integration Center	—	7
Adjustment to proceeds from sales of businesses, net	(11)	—
Net cash used in investing activities	(112)	(95)
Financing Activities		
Proceeds from borrowings	118	14
Repayments of borrowings	(510)	(46)
Proceeds from exercises of employee stock options	36	34
Repurchases of common stock	—	(150)
Cash dividends	(189)	(149)
Other financing activities	(15)	(39)
Net cash used in financing activities	(560)	(336)
Effect of exchange rate changes on cash and cash equivalents	(14)	(37)
Net decrease in cash and cash equivalents	(179)	(73)

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Cash and cash equivalents, beginning of year	481	561
Cash and cash equivalents, end of quarter	\$302	\$488
See accompanying Notes to Condensed Consolidated Financial Statements (Unaudited).		

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note A — Significant Accounting Policies and Recent Accounting Standards

Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of Harris Corporation and its consolidated subsidiaries. As used in these Notes to Condensed Consolidated Financial Statements (Unaudited) (these “Notes”), the terms “Harris,” “Company,” “we,” “our” and “us” refer to Harris Corporation and its consolidated subsidiaries. Intracompany transactions and accounts have been eliminated in consolidation. The accompanying condensed consolidated financial statements have been prepared by Harris, without an audit, in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, such interim financial statements do not include all information and footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with GAAP for annual financial statements. In the opinion of management, such interim financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of our financial position, results of operations and cash flows for the periods presented therein. The results for the third quarter and first three quarters of fiscal 2016 are not necessarily indicative of the results that may be expected for the full fiscal year or any subsequent period. The balance sheet at July 3, 2015 has been derived from our audited financial statements, but does not include all of the information and footnotes required by GAAP for annual financial statements. We provide complete, audited financial statements in our Annual Report on Form 10-K, which includes information and footnotes required by the rules and regulations of the SEC. The information included in this Quarterly Report on Form 10-Q (this “Report”) should be read in conjunction with the Management’s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and accompanying Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended July 3, 2015 (our “Fiscal 2015 Form 10-K”).

As further discussed in Note B — Discontinued Operations and Divestitures in these Notes, we recorded a loss in discontinued operations in the second quarter of fiscal 2016 based on a final determination rendered in a dispute over the amount of the post-closing working capital adjustment to the purchase price for our former broadcast communications operation (“Broadcast Communications”), which we sold on February 4, 2013. We did not restate our historical financial results of operations to account for Broadcast Communications as discontinued operations for the periods prior to the second quarter of fiscal 2016 presented in this Report because the amounts were not material. Unless otherwise specified, disclosures in these Notes relate solely to our continuing operations.

Use of Estimates

The preparation of financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the amounts reported in the accompanying condensed consolidated financial statements and these Notes. These estimates and assumptions are based on experience and other information available prior to issuance of the accompanying condensed consolidated financial statements and these Notes. Materially different results can occur as circumstances change and additional information becomes known.

Reclassifications

Certain prior year amounts have been reclassified in our Condensed Consolidated Financial Statements (Unaudited) to conform to current year classifications.

Adoption of New Accounting Standards

In the first quarter of fiscal 2016, we adopted an accounting standard issued by the Financial Accounting Standards Board (“FASB”) that eliminates the requirement for an acquirer in a business combination to retrospectively account for measurement-period adjustments. Instead, the new guidance requires that the cumulative impact of a measurement-period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. This standard is to be applied prospectively. The adoption of this standard did not have a material impact on our financial position, results of operations or cash flows.

In the second quarter of fiscal 2016, we adopted an accounting standard issued by the FASB that simplifies the presentation of deferred income taxes by requiring entities to classify all deferred tax assets and liabilities as non-current in a classified statement of financial position instead of separating deferred tax assets and liabilities into current and non-current amounts. Consequently, entities may no longer allocate valuation allowances between current

and non-current deferred tax assets because those allowances also will be classified as non-current. This standard was applied retrospectively, and as a result,

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we reclassified certain prior-period amounts in the accompanying Condensed Consolidated Financial Statements (Unaudited) to conform with current-period classifications as follows:

In the accompanying Condensed Consolidated Balance Sheet (Unaudited), we reclassified \$341 million of current deferred income tax assets from the "Current deferred income taxes" line item in the assets section and \$7 million of current deferred income tax liabilities from the "Current deferred income taxes" line item in the liabilities and equity section, which resulted in an increase of \$339 million to the "Non-current deferred income taxes" line item in the assets section and a net increase of \$5 million to the "Non-current deferred income taxes" line item in the liabilities and equity section.

In the accompanying Condensed Consolidated Statement of Cash Flows (Unaudited), we reclassified \$20 million from the "Non-current deferred income taxes" line item to the "Income taxes" line item in the operating activities section.

Other than those reclassifications, the adoption of this standard did not have any impact on our financial position, results of operations or cash flows.

Accounting Standards Issued But Not Yet Effective

In May 2014, the FASB issued a comprehensive new revenue recognition standard that supersedes nearly all revenue recognition guidance under GAAP and International Financial Reporting Standards and supersedes some cost guidance for construction-type and production-type contracts. The guidance in this standard is principles-based, and consequently, entities will be required to use more judgment and make more estimates than under prior guidance, including identifying contract performance obligations, estimating variable consideration to include in the contract price and allocating the transaction price to separate performance obligations. The guidance in this standard is applicable to all contracts with customers, regardless of industry-specific or transaction-specific fact patterns. Additionally, this standard provides guidance for transactions that were not previously addressed comprehensively (e.g., service revenue, contract modifications and licenses of intellectual property) and modifies guidance for multiple-element arrangements. The core principle of this standard is that entities should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. To help financial statement users better understand the nature, amount, timing and potential uncertainty of the revenue that is recognized, this standard requires significantly more interim and annual disclosures. This standard allows for either "full retrospective" adoption (application to all periods presented) or "modified retrospective" adoption (application to only the most current period presented in the financial statements, as well as certain additional required footnote disclosures). In August 2015, the FASB issued an accounting standards update that defers the effective date of this standard by one year, while permitting entities to elect to adopt one year earlier on the original effective date. As a result, this standard is now effective for fiscal years, and interim reporting periods within those years, beginning after December 15, 2017, which for us is our fiscal 2019. In March 2016 and April 2016, the FASB issued two accounting standards updates that clarify its new revenue recognition guidance on accounting for licenses of intellectual property and identifying performance obligations as well as principal versus agent guidance. We are currently evaluating the impact the new revenue recognition standard will have on our financial position, results of operations and cash flows.

In February 2016, the FASB issued a new lease standard that supersedes existing lease guidance under GAAP. This standard requires lessees to record most leases on their balance sheets but recognize expenses on their income statements in a manner similar to existing lease guidance under GAAP. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, with the option to use certain relief. Full retrospective application is prohibited. This standard is effective for fiscal years, and interim reporting periods within those years, beginning after December 15, 2018, which for us is our fiscal 2020. We are currently evaluating the impact this standard will have on our financial position, results of operations and cash flows.

In March 2016, the FASB issued an accounting standards update making final targeted amendments to the accounting for employee share-based payments. These amendments will require entities to recognize the income tax effects of awards when the awards vest or are settled, will change an employer's accounting for an employee's use of shares to satisfy the employer's statutory income tax withholding obligation and will require entities to elect whether to account

for forfeitures of share-based payments by either recognizing forfeitures of awards as they occur or estimating the number of awards expected to be forfeited as is currently required. The required method of adoption varies by amendment. This accounting standards update is effective for fiscal years, and interim reporting periods within those years, beginning after December 15, 2016, which for us is our fiscal 2018. Early adoption is permitted in any annual or interim period, but all of the guidance is required to be adopted in the same period and any adjustments must be reflected as of the beginning of the fiscal year. We are currently evaluating the impact this accounting standards update will have on our financial position, results of operations and cash flows.

Note B — Discontinued Operations and Divestitures

In the third quarter of fiscal 2016, we entered into a definitive agreement for the divestiture of our composite aerostructures business ("Aerostructures"), which is part of our Electronic Systems segment, for \$187 million in cash at closing and the assumption of a \$23 million capitalized lease, and determined the business met the held for sale criteria under GAAP. Aerostructures had income before income taxes of \$3 million and \$4 million for the quarter and three quarters ended April 1, 2016, respectively, and is not strategic to our business. We acquired Aerostructures as part of our acquisition of Exelis Inc. and its subsidiaries (collectively, "Exelis") in May 2015. We completed the divestiture on April 8, 2016, during the fourth quarter of fiscal 2016.

Summarized balance sheet information for Aerostructures is as follows:

April 1,
2016
(In
millions)
Receivables
Inventories
Other
Current
assets
Total
Current
assets
Property,
plant
and
equipment
Goodwill
Other
Intangible
assets
Other
Non-current
assets
Total
Non-current
assets
Assets
of
disposal
group
held
for
sale

Current
liabilities
Non-current
liabilities
Liabilities
of
disposal

group
held
for
sale

On February 4, 2013, we completed the sale of Broadcast Communications to an affiliate of The Gores Group, LLC (the “Buyer”) pursuant to a definitive Asset Sale Agreement entered into December 5, 2012 for \$225 million, including \$160 million in cash, subject to customary adjustments (including a post-closing working capital adjustment), a \$15 million subordinated promissory note (which was collected in fiscal 2014) and an earnout of up to \$50 million based on future performance. Broadcast Communications was recorded as discontinued operations in connection with the sale.

Based on a dispute between us and the Buyer over the amount of the post-closing working capital adjustment, we and the Buyer previously appointed a nationally recognized accounting firm to render a final determination of such dispute. On January 29, 2016, the accounting firm rendered its final determination as to the disputed items, in which it concluded substantially in our favor and partly in the Buyer’s favor. As a result of such determination, we recorded a loss in discontinued operations in the second quarter of fiscal 2016 of \$21 million (\$17 million after-tax or \$0.14 per diluted share) and adjusted current liabilities of discontinued operations to \$43 million. In the third quarter of fiscal 2016, discontinued operations consisted of a \$2 million (\$2 million after-tax) increase in the loss on discontinued operations due to third-party costs related to the dispute. We did not restate our historical financial results of operations to account for Broadcast Communications as discontinued operations for the periods prior to the second quarter of fiscal 2016 presented in this Report because the amounts were not material. Unless otherwise specified, the information set forth in these Notes, other than this Note B — Discontinued Operations and Divestitures, relates solely to our continuing operations.

Note C — Stock Options and Other Share-Based Compensation

During the three quarters ended April 1, 2016, we had options or other share-based compensation outstanding under two shareholder-approved stock incentive plans (“SIPs”), the Harris Corporation 2005 Equity Incentive Plan (As Amended and Restated Effective August 27, 2010) and the Harris Corporation 2015 Equity Incentive Plan. We have granted the following types of share-based awards under these SIPs: stock options, restricted stock awards, restricted stock unit awards, performance share awards, performance share unit awards and awards of immediately vested shares of our common stock. We believe that such awards more closely align the interests of participants with those of shareholders. Certain share-based awards provide for accelerated vesting if there is a change in control (as defined under our SIPs). The compensation cost related to our share-based awards that was charged against income was \$10 million and \$29 million for the quarter and three quarters ended April 1, 2016, respectively. The compensation cost related to our share-based awards that was charged against income was \$9 million and \$26 million for the quarter and three quarters ended April 3, 2015, respectively.

Grants to participants under our SIPs during the third quarter ended April 1, 2016 consisted of 14,000 restricted stock awards. Grants to participants under our SIPs during the three quarters ended April 1, 2016 consisted of 1,658,000 stock options, 114,270 restricted stock awards and 292,665 performance share unit awards. The fair value as of the grant date of each stock option award was determined using the Black-Scholes-Merton option-pricing model, which used the following assumptions: expected dividend yield of 2.50 percent; expected volatility of 23.01 percent; risk-free interest rates averaging 1.52 percent; and expected term in years of 5.05. The fair value as of the grant date of each restricted stock award was based on the closing price of our common stock on the grant date. The fair value as of the grant date of each performance share unit award was determined based on the fair value from a multifactor Monte Carlo valuation model that simulates our stock price and total shareholder return (“TSR”) relative to other companies in our TSR peer group, less a discount to reflect the delay in payments of cash dividend-equivalents that are made only upon vesting.

Note D — Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are summarized below:

	April 1, July 3, 2016	2015
	(1)	(1)
(In millions)		
Foreign currency translation, net of income taxes of \$29 million and \$15 million at April 1, 2016 and July 3, 2015,	\$ (14)	\$ (62)

respectively
 Net
 unrealized
 loss
 on
 hedging
 derivatives,
 net
 of
 income
 taxes
 of
 \$(18) (19)
 million
 and
 \$12
 million
 at
 April 1,
 2016
 and
 July 3,
 2015,
 respectively
 Unrecognized
 postretirement
 obligations,
 net
 of
 income
 taxes
 of
 \$41
 million 62 65
 and
 \$42
 million
 at
 April 1,
 2016
 and
 July 3,
 2015,
 respectively
 \$(70) \$(16)

(1) Reclassifications out of accumulated other comprehensive loss to earnings were not material for the three quarters ended April 1, 2016 or April 3, 2015.

Note E — Receivables

Receivables are summarized below:

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	April 1, 2016	July 3, 2015
	(In millions)	
Accounts receivable	\$732	\$837
Unbilled costs and accrued earnings on cost-plus contracts	331	343
	1,063	1,180
Less allowances for collection losses	(9)	(12)
	\$1,054	\$1,168

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Note F — Inventories

Inventories are summarized below:

	April 2016	July 3, 2015
	(In millions)	
Unbilled costs and accrued earnings on fixed-price contracts	\$524	\$463
Finished products	119	100
Work in process	154	256
Raw materials and supplies	195	196
	\$992	\$1,015

Unbilled costs and accrued earnings on fixed-price contracts were net of progress payments of \$65 million at April 1, 2016 and \$85 million at July 3, 2015.

Note G — Property, Plant and Equipment

Property, plant and equipment are summarized below:

	April 1, 2016	July 3, 2015
	(In millions)	
Land	\$45	\$45
Software capitalized for internal use	138	155
Buildings	608	587
Machinery and equipment	1,336	1,526
	2,127	2,313
Less accumulated depreciation and amortization	(1,120)	(1,148)
	\$1,007	\$1,165

Depreciation and amortization expense related to property, plant and equipment was \$42 million and \$141 million for the quarter and three quarters ended April 1, 2016, respectively. Depreciation and amortization expense related to property, plant and equipment was \$36 million and \$109 million for the quarter and three quarters ended April 3, 2015, respectively.

Note H — Goodwill

As discussed in Note R — Business Segments, we adjusted our segment reporting in the first quarter of fiscal 2016 to reflect our new organizational structure that was effective at the beginning of fiscal 2016, which resulted in changes to our operating segments, which are also our reportable segments and are referred to as our business segments. In accordance with GAAP, we have reassigned goodwill using a relative fair value approach. Because our accounting for our acquisition of Exelis in the fourth quarter of fiscal 2015 is still preliminary, we assigned the goodwill acquired as a result of the acquisition on a provisional basis. Immediately before and after our goodwill assignments, we completed an assessment of any potential goodwill impairment under our former and new segment reporting structure and determined that no impairment existed.

In addition, we test our goodwill for impairment annually, or under certain circumstances, more frequently, such as when events or circumstances indicate there may be an impairment. See Note N — Impairment of Goodwill and Other Assets in these Notes for information regarding a non-cash charge for impairment of goodwill and other assets related to Harris CapRock Communications recorded in the second quarter of fiscal 2016 in our Critical Networks segment.

The assignment of goodwill by business segment, and changes in the carrying amount of goodwill for the three quarters ended April 1, 2016 by business segment, were as follows:

	Communication Systems	Space and Intelligence Systems	Electronic Systems	Critical Networks	Total
	(In millions)				
Balance at July 3, 2015	\$760	\$ 1,446	\$ 1,718	\$ 2,424	\$6,348
Impairment of goodwill	—	—	—	(290)	(290)
Decrease from reclassification to held for sale asset (1)	—	—	(61)	—	(61)
Currency translation adjustments	—	(7)	(2)	(39)	(48)
Other (including true-ups of previously estimated purchase price allocations) (2)	17	(12)	26	(40)	(9)
Balance at April 1, 2016	\$777	\$ 1,427	\$ 1,681	\$ 2,055	\$5,940

During the third quarter of fiscal 2016, we determined Aerostructures met the held for sale criteria and reclassified Aerostructures' assets to current assets in accordance with GAAP. We included Aerostructures' assets in the (1) "Assets of disposal group held for sale" line item in the accompanying Condensed Consolidated Balance Sheet (Unaudited) as of April 1, 2016. See Note B — Discontinued Operations and Divestitures and Note T — Subsequent Events in these Notes for additional information.

Our accounting for the Exelis acquisition is still preliminary. The fair value estimates for the assets acquired and liabilities assumed were based on preliminary calculations, and our estimates and assumptions are subject to change as we obtain additional information for our estimates during the measurement period (up to one year from the acquisition date). The primary areas of these preliminary estimates that are not yet finalized relate to certain (2) tangible assets, liabilities acquired (including environmental reserves), and tax-related items. During the three quarters ended April 1, 2016, we recorded several purchase price adjustments which impacted goodwill, the largest of which reduced current liabilities by \$82 million related to previously unrecognized tax benefits and to deferred revenue based on the fair value of a customer contract.

Note I — Accrued Warranties

Changes in our liability for standard product warranties, which is included as a component of the “Other accrued items” and “Other long-term liabilities” line items in the accompanying Condensed Consolidated Balance Sheet (Unaudited), during the three quarters ended April 1, 2016 were as follows:

	(In millions)
Balance at July 3, 2015	\$ 36
Warranty provision for sales	15
Settlements	(14)
Other adjustments to warranty liability, including those for foreign currency translation	(2)
Balance at April 1, 2016	\$ 35

We also sell extended product warranties and recognize revenue from these arrangements over the warranty period. Costs of warranty services under these arrangements are recognized as incurred. Deferred revenue associated with extended product warranties was \$28 million at April 1, 2016 and \$36 million at July 3, 2015 and is included as a component of the “Advance payments and unearned income” and “Other long-term liabilities” line items in the accompanying Condensed Consolidated Balance Sheet (Unaudited).

Note J — Long-Term Debt

As disclosed in Note 13: “Long-Term Debt” in our Notes to Consolidated Financial Statements in our Fiscal 2015 Form 10-K, in connection with our acquisition of Exelis, Harris Corporation fully and unconditionally guaranteed all of the long-term fixed-rate debt securities issued by Exelis Inc. outstanding at the time of the acquisition, consisting of \$250 million in aggregate principal amount of 4.25% senior notes due October 1, 2016 and \$400 million in aggregate principal amount of 5.55% senior notes due October 1, 2021 (together, the “Exelis Notes”), as indicated in the table in Note 13: “Long-Term Debt” in our Notes to Consolidated Financial Statements in our Fiscal 2015 Form 10-K. In addition, Exelis Inc. fully and unconditionally guaranteed all of the long-term fixed-rate debt securities issued by Harris Corporation outstanding at the time of the acquisition, consisting of the nine other series of fixed-rate debt securities listed in the “2015” column in the table in Note 13: “Long-Term Debt” in our Notes to Consolidated Financial Statements in our Fiscal 2015 Form 10-K, in an aggregate principal amount of \$3.226 billion. On December 31, 2015, Exelis Inc. merged with and into Harris Corporation, with Harris Corporation being the surviving corporation in the merger, the separate existence of Exelis Inc. ceased, Harris Corporation assumed the obligations of Exelis Inc. under the Exelis Notes, and the cross guarantees of our outstanding long-term fixed-rate debt securities as described above terminated.

Note K — Postretirement Benefit Plans

The following table provides the components of our net periodic benefit cost (income) for our defined benefit plans, including defined benefit pension plans and other postretirement defined benefit plans:

	Quarter Ended April 1, 2016			Three Quarters Ended April 1, 2016		
	Pension	Other Benefits	Total	Pension	Other Benefits	Total
(In millions)						
Net periodic benefit cost (income)						
Service cost	\$ 18	\$ 1	\$ 19	\$ 56	\$ 4	\$ 60
Interest cost	63	3	66	186	10	196
Expected return on plan assets	(87)	(4)	(91)	(258)	(13)	(271)
Amortization of net actuarial loss	—	—	—	2	2	2
Amortization of prior service cost	—	—	—	(7)	(7)	(7)
Net periodic benefit cost	\$(6)	\$ —	\$(6)	\$(16)	\$(4)	\$(20)

benefit					
income					
Effect					
of					
curtailments	—	—	(121)	(121)	
or					
settlements					
(1)					
Total					
net					
post-employment	\$ —	\$(6)	\$(16)	\$(125)	\$(141)
benefit					
income					

We discontinued certain significantly underfunded post-employment benefit plans effective December 31, 2015. (1) Under GAAP, this resulted in a negative plan amendment and curtailment during the quarter ended January 1, 2016, a settlement as of December 31, 2015, and a net liability reduction of \$101 million. We contributed \$134 million to our qualified defined benefit pension plans during the three quarters ended April 1, 2016. We currently anticipate making additional contributions to our qualified defined benefit pension plans of approximately \$40 million during the remainder of fiscal 2016.

Note L — Income From Continuing Operations Per Common Share

The computations of income from continuing operations per common share are as follows:

	Quarter Ended		Three Quarters Ended	
	April 1, 2016	April 3, 2015	April 1, 2016	April 3, 2015
	(In millions, except per share amounts)			
Income from continuing operations	\$ 170	\$ 126	\$ 183	\$ 390
Adjustments for participating securities outstanding	—	(1)	(1)	(2)
Income from continuing operations used in per basic and diluted common share calculations (A)	\$ 170	\$ 125	\$ 182	\$ 388
Basic weighted average common shares outstanding (B)	124.0	103.7	123.7	104.1
Impact of dilutive share-based awards	1.1	1.1	1.1	1.1
Diluted weighted average common shares outstanding (C)	125.1	104.8	124.8	105.2
Income from continuing operations per basic common share (A)/(B)	\$ 1.37	\$ 1.21	\$ 1.47	\$ 3.73
Income from continuing operations per diluted common share (A)/(C)	\$ 1.36	\$ 1.20	\$ 1.46	\$ 3.69

Potential dilutive common shares primarily consist of employee stock options and performance share unit awards. Employee stock options to purchase approximately 1,618,558 and 765,438 shares of our common stock were outstanding at April 1, 2016 and April 3, 2015, respectively, but were not included as dilutive stock options in the computations of income from continuing operations per diluted common share because the effect would have been antidilutive.

Note M — Income Taxes

Our effective tax rate (income taxes as a percentage of income from continuing operations before income taxes) was 29.5 percent in the third quarter of fiscal 2016 compared with 29.6 percent in the third quarter of fiscal 2015.

In the third quarter of fiscal 2016, our effective tax rate benefited from the favorable impact of:

Amounts recorded in respect of our expected near-term recognition of a tax loss for the divestiture of Aerostructures, net of valuation allowance, following our classification of Aerostructures as held for sale as of the end of the third quarter of fiscal 2016;

Additional deductions and additional research credits claimed on our fiscal 2015 tax return compared with our recorded estimates at the end of fiscal 2015; and

State tax reductions resulting from our integration of Exelis operations.

This favorable impact was partially offset by the non-deductibility for tax purposes of additional portions of the impairment charge recorded in the second quarter of fiscal 2016 described in Note N — Impairment of Goodwill and Other Assets in these Notes, as that charge was finalized during the third quarter of fiscal 2016.

In the third quarter of fiscal 2015, our effective tax rate benefited from additional deductions (primarily related to manufacturing) and additional research credits claimed on our fiscal 2014 tax return compared with our recorded estimates at the end of fiscal 2014, as well as from finalizing issues with tax authorities.

Our effective tax rate was 50.3 percent in the first three quarters of fiscal 2016 compared with 28.3 percent in the first three quarters of fiscal 2015.

In the first three quarters of fiscal 2016, our effective tax rate was negatively impacted by the non-deductibility for tax purposes of portions of the impairment charge recorded in the second quarter of fiscal 2016 described in Note N — Impairment of Goodwill and Other Assets in these Notes. This negative impact was partially offset by the favorable impact of:

The discrete items noted above favorably impacting the third quarter of fiscal 2016;

The effect of legislation enacted in the second quarter of fiscal 2016 that restored the U.S. Federal income tax credit for qualifying research and development (“R&D”) expenses for calendar year 2015 and made the credit permanent for the periods following December 31, 2015;

• The settlement of a state tax issue for an amount lower than the previously recorded estimate; and
• Several differences between GAAP and tax accounting for investments.

In the first three quarters of fiscal 2015, our effective tax rate benefited from:

- The discrete items noted above favorably impacting the third quarter of fiscal 2015;
- The effect of legislation enacted in the second quarter of fiscal 2015 that restored the U.S. Federal income tax credit for qualifying R&D expenses for calendar year 2014;
- Finalizing issues with Canadian and U.S. tax authorities for amounts lower than previously recorded estimates; and
- The recognition of foreign tax credits resulting from a dividend paid by a foreign subsidiary during fiscal 2013 that exceeded the U.S. tax liability in respect of the dividend.

See Note B — Discontinued Operations and Divestitures and Note T — Subsequent Events in these Notes for additional information.

Note N — Impairment of Goodwill and Other Assets

We test our goodwill and other indefinite-lived intangible assets for impairment annually, or under certain circumstances, more frequently, such as when events or circumstances indicate there may be impairment. Indications of potential impairment of goodwill related to Harris CapRock Communications (which is part of our Critical Networks segment) were present at the end of the quarter ended January 1, 2016 due to the downturn in the energy market and its impact on customer operations, which also resulted in a decrease in the fiscal 2016 outlook for Harris CapRock Communications. Consequently, in connection with the preparation of our financial statements for the quarter ended January 1, 2016, we performed an interim test of Harris CapRock Communications' goodwill for impairment as of the end of the quarter ended January 1, 2016.

To test for potential impairment of goodwill related to Harris CapRock Communications, we prepared an estimate of the fair value of the reporting unit based on projected discounted cash flows. The current carrying value of the Harris CapRock Communications reporting unit exceeded its estimated fair value, and accordingly, we allocated the estimated fair value to the assets and liabilities of the Harris CapRock Communications reporting unit to estimate the implied fair value of goodwill.

In conjunction with the above-described impairment test, we also conducted a test for impairment of other assets related to Harris CapRock Communications, including amortizable intangible assets and fixed assets, and impairment of these assets was considered prior to the conclusion of the goodwill impairment test. The estimated fair value of these other assets related to Harris CapRock Communications was determined based, in part, on an analysis of projected cash flows.

As a result of these impairment tests, we concluded that goodwill and other assets related to Harris CapRock Communications were impaired as of January 1, 2016, and we recorded an estimated non-cash impairment charge of \$367 million, of which \$290 million related to goodwill, in the quarter ended January 1, 2016. Due to the length of time necessary to measure the impairment of goodwill and other assets, our impairment analysis as of January 1, 2016 was preliminary. During the quarter ended April 1, 2016, we completed our impairment analysis which indicated that no adjustment was necessary to the impairment charge recorded during the quarter ended January 1, 2016. Most of the \$367 million impairment charge is not deductible for tax purposes. See Note M — Income Taxes in these Notes for the tax impact related to this impairment charge. The impairment does not cause us to be in noncompliance with the covenants under our credit arrangements, and we do not expect the impairment to impact our ongoing financial performance, although no assurances can be given.

Note O — Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal market (or most advantageous market, in the absence of a principal market) for the asset or liability in an orderly transaction between market participants at the measurement date. Entities are required to maximize the use of observable inputs and minimize the use of unobservable inputs in measuring fair value, and to utilize a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. The three levels of inputs used to measure fair value are as follows:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Observable inputs other than quoted prices included within Level 1, including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and inputs other than quoted prices that are observable or are derived principally from, or corroborated by, observable

market data by correlation or other means.

Level 3 — Unobservable inputs that are supported by little or no market activity, are significant to the fair value of the assets or liabilities, and reflect our own assumptions about the assumptions market participants would use in pricing the asset or liability developed using the best information available in the circumstances.

The following table presents the fair value hierarchy of our assets and liabilities measured at fair value on a recurring basis (at least annually) as of April 1, 2016:

	Level 1	Level 2	Level 3	Total
(In millions)				
Assets				
Deferred				
compensation				
plan				
investments:				
(1)				