

# HARD STUFF DONE RIGHT

2 0 1 7   A N N U A L   R E P O R T

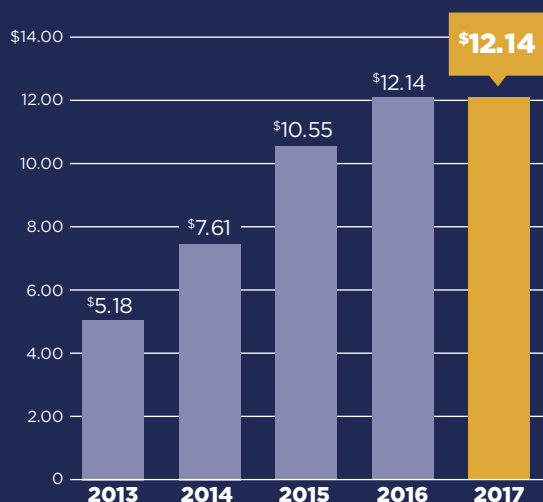
# FINANCIAL HIGHLIGHTS

**11.6%**  
OPERATING  
MARGIN - 2017



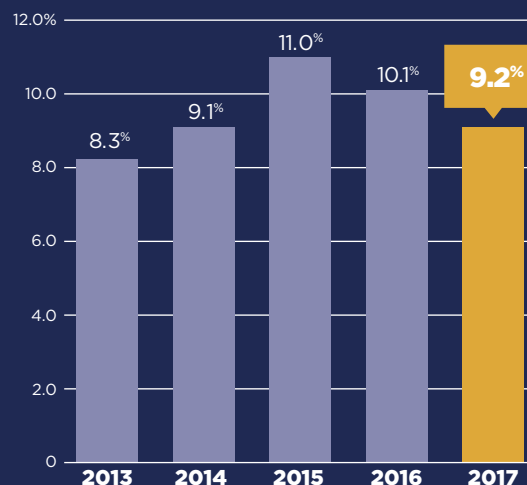
HII's Ingalls Shipbuilding division translated and launched the *Arleigh Burke*-class destroyer *Delbert D. Black* (DDG 119) in September 2017. Photo by Lance Davis/HII

## ADJUSTED DILUTED EPS<sup>1</sup>



<sup>1</sup> Adjusted Diluted EPS is a non-GAAP financial measure that excludes the tax effected goodwill and purchased intangibles impairment charges and losses on early extinguishment of debt. It also excludes the tax expense for both revaluation of net deferred tax assets and acceleration of discretionary pension contributions resulting from enactment of tax reform. Please see the page that precedes the back cover of this report for information on excluded items and a reconciliation of these measures to GAAP.

## ADJUSTED SEGMENT OPERATING MARGIN<sup>1</sup> (% of sales)



<sup>1</sup> Segment Operating Margin was adjusted in 2014 and 2015 to exclude goodwill impairment charges of \$47 million and \$75 million, respectively, and adjusted in 2015 to also exclude a purchased intangibles impairment charge of \$27 million. Including the goodwill and purchased intangibles impairment charges, the segment operating margin would have been 8.4% in 2014 and 9.5% in 2015.

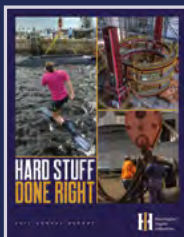
## OPERATING RESULTS

(\$ in millions, except per share amounts)

	2017	2016	2015	2014	2013
<b>SALES AND SERVICE REVENUES</b>	<b>\$7,441</b>	\$7,068	\$7,020	\$6,957	\$6,820
<b>OPERATING INCOME</b>	<b>865</b>	858	769	655	512
<b>OPERATING MARGIN</b>	<b>11.6%</b>	12.1%	11.0%	9.4%	7.5%
<b>ADJUSTED SEGMENT OPERATING INCOME<sup>1</sup></b>	<b>688</b>	715	769	632	567
<b>ADJUSTED SEGMENT OPERATING MARGIN<sup>1</sup></b>	<b>9.2%</b>	10.1%	11.0%	9.1%	8.3%
<b>DILUTED EPS</b>	<b>10.46</b>	12.14	8.36	6.86	5.18
<b>ADJUSTED DILUTED EPS<sup>2</sup></b>	<b>12.14</b>	12.14	10.55	7.61	5.18
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>814</b>	822	861	755	260

<sup>1</sup> Adjusted Segment Operating Income and Adjusted Segment Operating Margin are non-GAAP financial measures that exclude goodwill and purchased intangibles impairment charges. Please see the page that precedes the back cover of this report for information on excluded items and a reconciliation of these measures to GAAP.

<sup>2</sup> Adjusted Diluted EPS is a non-GAAP financial measure that excludes the tax effected goodwill and purchased intangibles impairment charges and losses on early extinguishment of debt. It also excludes the tax expense for both revaluation of net deferred tax assets and acceleration of discretionary pension contributions resulting from enactment of tax reform. Please see the page that precedes the back cover of this report for information on excluded items and a reconciliation of this measure to GAAP.



### FRONT COVER

Chloe Mallet, an ocean engineer at HII's Technical Solutions division, dives into the water during a testing demonstration of the Proteus dual-mode underwater vehicle (DMUV). Photo by Andrew Wardlow

A 400-metric ton caisson fixture in the Joint Manufacturing Assembly Facility (JMAF) at HII's Newport News Shipbuilding division will revolutionize the way submarines are built. Photo by John Whalen/HII

Riggers at HII's Ingalls Shipbuilding division connect steel cables to a crane boom in preparation for a night lift. Photo by Lance Davis/HII



**\$7.4  
BILLION  
IN REVENUE IN 2017**

A welder works on the hull of the aircraft carrier *John F. Kennedy* (CVN 79), which is under construction at HII's Newport News Shipbuilding division. Photo by Ashley Cowan/HII



# TO OUR SHAREHOLDERS, EMPLOYEES, CUSTOMERS AND COMMUNITIES:

**Huntington Ingalls Industries' trademark is "Hard Stuff Done Right."  
In 2017, we did a lot of hard stuff, and we did it right.**

Our Newport News and Ingalls Shipbuilding divisions delivered four ships in four classes: the first-of-class aircraft carrier *USS Gerald R. Ford* (CVN 78), the *Virginia*-class submarine *USS Washington* (SSN 787), the *San Antonio*-class amphibious transport dock *Portland* (LPD 27) and the *Arleigh Burke*-class destroyer *Ralph Johnson* (DDG 114). They also re-delivered the aircraft carrier *USS Abraham Lincoln* (CVN 72) following its refueling and complex overhaul and the destroyer *USS Ramage* (DDG 61) following its overhaul and modernization.

Meanwhile, our Technical Solutions division hit the ground running and made great progress in its first full year operating as a combined, integrated business. In fact, we ended 2017 with the news that a joint venture led by Technical Solutions and BWX Technologies, Inc. won the \$1.4 billion Los Alamos Legacy Cleanup Contract.



Los Alamos National Laboratory, New Mexico

Our operational success in 2017 goes hand-in-hand with strong financial results. Revenue for the year was \$7.4 billion, an increase of 5.3 percent over 2016. Operating income for the year was \$865 million and operating margin was 11.6 percent, compared to \$858 million and 12.1 percent, respectively, in 2016. Adjusted diluted earnings per share for the full year was \$12.14, consistent with 2016. New contract awards for the year were approximately \$8.1 billion, bringing total backlog to \$21.4 billion as of Dec. 31, 2017.

*Continued on page 6*

Our financial performance and stability in our first seven years as a publicly traded company were recognized when HII was added to the Standard and Poor's 500 in January.

Importantly, we also continue to make great progress on our "Path to 2020" business strategy:

- We invested more than \$350 million in major capital projects in 2017, including continued construction of the Joint Manufacturing Assembly Facility at Newport News and a variety of "Shipyards of the Future" upgrades at Ingalls. We also continue to invest in integrated digital shipbuilding technology and training at both divisions.
- We increased our quarterly cash dividend from \$0.60 per share to \$0.72 per share in the fourth quarter of 2017. The Board of Directors also authorized an increase in our share repurchase program from \$1.2 billion to \$2.2 billion.
- We continued to grow our government services business through our Technical Solutions division. In addition to the Los Alamos award, Technical Solutions entered joint ventures in 2017 that led to work at the Department of Energy's Nevada National Security Site and in the U.S. Navy's Extra Large Unmanned Undersea Vehicle (XLUUV) program.

As our work becomes more diverse, so does our workforce. We are committed to improving diversity and inclusion at every level of the business. Our goal is to ensure that HII is a company where the least-empowered person in the room has the confidence to speak up. We're proud of the work we're doing to that end—and the fact that we were recognized by the Human Rights Campaign in 2017 as a Best Place to Work for LGBTQ Equality.

We're also very proud of the work we're doing in benefits and wellness—emphasizing physical, mental and financial well-being for our employees and their families. It's worth noting that more than 31,000 employees are eligible to use HII's two Family Health Centers, guaranteeing them and their families convenient, high-quality health care for only \$15 per visit.



TOP: Juan Lorenzo-Rios operates a new robotic plasma cutting line—one of the "Shipyards of the Future" investments at HII's Ingalls Shipbuilding division. Photo by Andrew Young/HII

BOTTOM: Leaveil Dabney and Ashley Stachura operate a laser scanner in the steel fabrication shop at HII's Newport News Shipbuilding division. Photo by Matt Hildreth/HII

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NEARLY  
38,000  
EMPLOYEES  
WORLDWIDE

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Many of our employees were among those impacted by Hurricanes Harvey, Irma and Maria. HII donated \$125,000 to the American Red Cross after the storms, but we're more proud of the fact that HII's employees donated more than \$165,000 of their own money to the Red Cross, The Salvation Army and OneAmericaAppeal.org through cash donations and a voluntary leave-based donation program. Our employees' response following these natural disasters—not to mention our United Way campaigns and numerous other charitable efforts in 2017—are the latest examples of HII employees stepping up to offer help whenever and wherever it's needed.

While we are proud of the hard stuff we have accomplished—not to mention the 132- and 80-year legacies at Newport News and Ingalls—we are focused more than ever on the future. We strongly believe that HII is a company of more dreams than memories.

Thank you for your interest and investment in HII and for your belief in our future.

Sincerely,

A handwritten signature in blue ink that reads "Tom Fargo". The signature is written in a cursive, flowing style.

**Adm. Thomas B. Fargo**  
U.S. Navy (Ret.)  
*Chairman of the Board*

A handwritten signature in blue ink that reads "C. Michael Petters". The signature is written in a cursive, flowing style.

**C. Michael Petters**  
*President and CEO*



# FREEDOM DELIVERED.

For more than a century, HII's Newport News and Ingalls shipbuilding divisions in Virginia and Mississippi have built and delivered more ships in more ship classes than any other U.S. naval shipbuilder.

A large submarine, the USS Washington (SSN 787), is shown from a rear-quarter perspective, moving through the ocean. The submarine's conning tower is prominent, with an American flag and a green flag flying from it. The sea is dark blue with white-capped waves, and the sky is filled with scattered white clouds.

**USS Washington (SSN 787)**  
Delivered on May 26, 2017





**USS Gerald R. Ford (CVN 78)**  
Delivered on June 1, 2017



**Ralph Johnson (DDG 114)**  
Delivered on November 15, 2017



**Portland (LPD 27)**  
Delivered on September 18, 2017



**USS Ramage (DDG 61)**  
Re-delivered on August 22, 2017



**USS Abraham Lincoln (CVN 72)**  
Re-delivered on May 12, 2017

# OUR DIVISIONS

Huntington Ingalls Industries is America's largest military shipbuilding company and a provider of professional services to partners in government and industry. Headquartered in Newport News, Virginia, HII employs nearly 38,000 people operating both domestically and internationally.

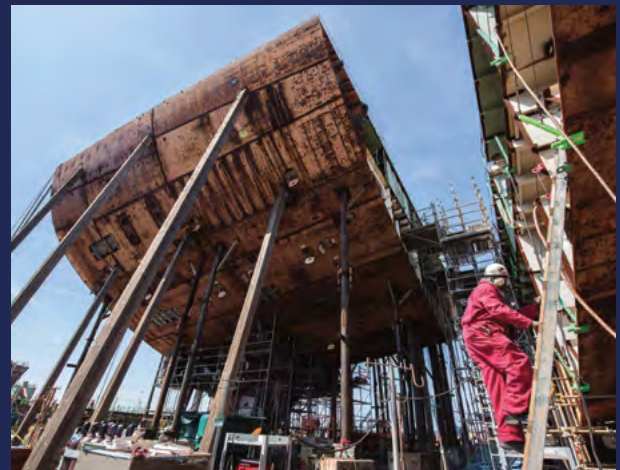


**Ingalls Shipbuilding** was founded in 1938 in Pascagoula, Mississippi. The division currently designs and builds *America*-class amphibious assault ships (LHAs), *San Antonio*-class amphibious transport docks (LPDs) and *Arleigh Burke*-class destroyers (DDGs) for the U.S. Navy and *Legend*-class National Security Cutters (NSCs) for the U.S. Coast Guard. Ingalls also supports the design of the Navy's next-generation amphibious ship, LX(R).

**FACTOID:** Ingalls christened five ships in 2017: the amphibious assault ship *Tripoli* (LHA 7); the destroyers *Paul Ignatius* (DDG 117) and *Delbert D. Black* (DDG 119); and the National Security Cutters *Kimball* (WMSL 756) and *Midgett* (WMSL 757).

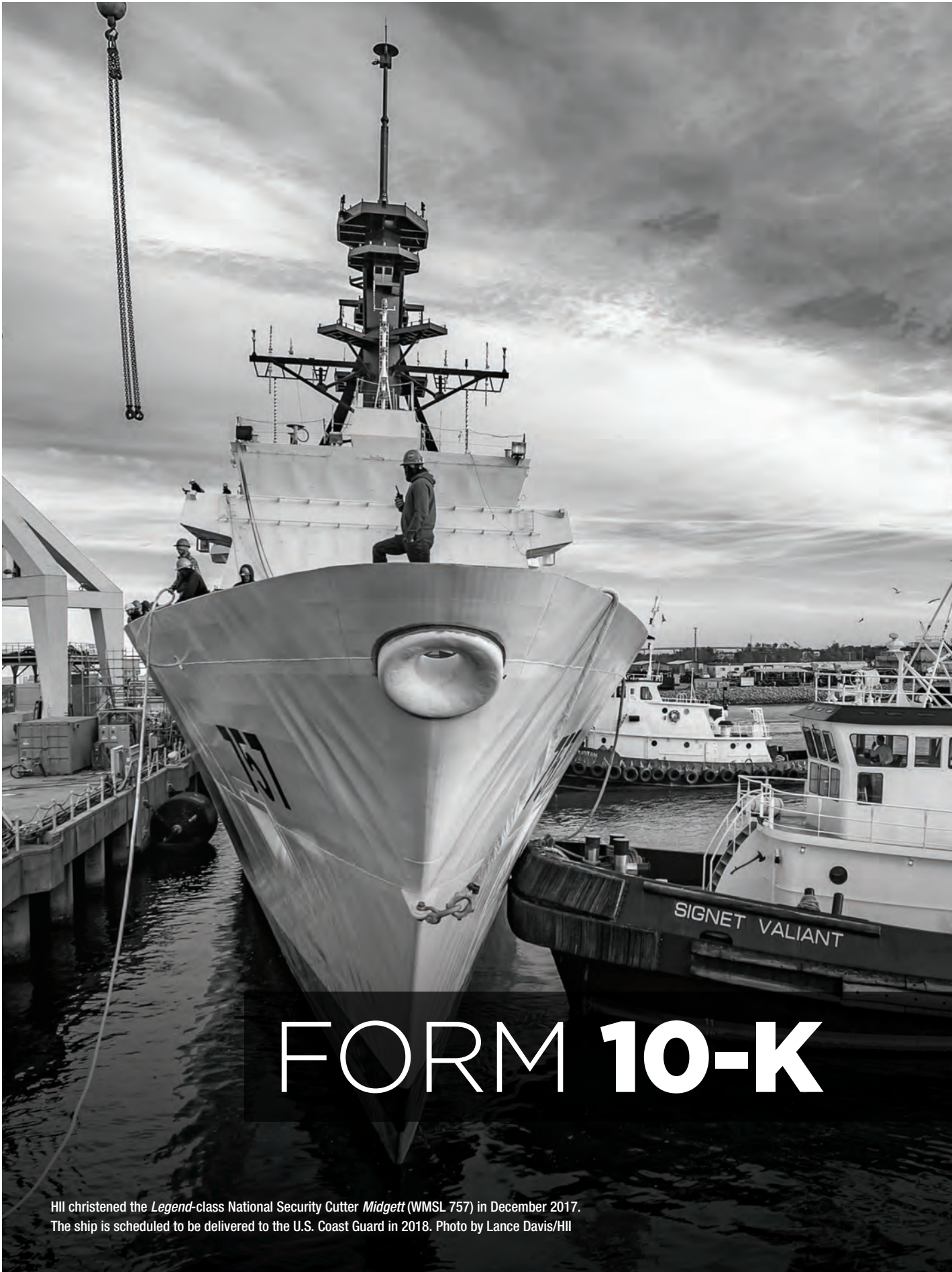
**Newport News Shipbuilding** was founded in 1886 in Newport News, Virginia. The division currently designs and builds *Gerald R. Ford*-class aircraft carriers (CVNs) and *Virginia*-class attack submarines (SSNs) for the U.S. Navy. It also performs refueling and complex overhaul (RCOH) work on *Nimitz*-class aircraft carriers and recently completed the inactivation of the first-ever nuclear-powered aircraft carrier, *Enterprise* (CVN 65). Newport News also supports the design of the Navy's *Columbia*-class ballistic missile submarines (SSBNs).

**FACTOID:** Newport News celebrated three notable aircraft carrier milestones in 2017: 50 percent structural completion of *John F. Kennedy* (CVN 79); first cut of steel for *Enterprise* (CVN 80); and the start of the refueling and complex overhaul of USS *George Washington* (CVN 73).



**Technical Solutions** was established in December 2016 when HII acquired Camber Corp., a government services company headquartered in Huntsville, Alabama, and combined it with HII's non-shipbuilding subsidiaries. Technical Solutions currently provides fleet maintenance and modernization, unmanned solutions and rapid prototyping, agile software development and network engineering, training systems, logistics support, nuclear engineering and fabrication, and oil and gas engineering.

**FACTOID:** Technical Solutions demonstrated its Proteus dual-mode undersea vehicle (DMUV) at the U.S. Navy's Advanced Naval Technology Exercise in 2017. A Boeing-HII team was subsequently awarded a contract to participate in the concept of operations development phase for the Navy's Extra Large Unmanned Undersea Vehicle (XLUUV) program.



# FORM 10-K

Hill christened the *Legend*-class National Security Cutter *Midgett* (WMSL 757) in December 2017. The ship is scheduled to be delivered to the U.S. Coast Guard in 2018. Photo by Lance Davis/Hill

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

**FORM 10-K**

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

**For the fiscal year ended December 31, 2017**

**OR**

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

**Commission file number 001-34910**

**HUNTINGTON INGALLS INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

**DELAWARE**

(State or other jurisdiction of incorporation or organization)

**90-0607005**

(I.R.S. Employer Identification No.)

**4101 Washington Avenue**

**Newport News, VA 23607**

(Address of principal executive offices)

**(757) 380-2000**

(Registrant's telephone number, including area code)

**Securities registered pursuant to section 12(b) of the Act:**

**Title of each class**

Common Stock, \$0.01 par value

**Name of each exchange on which registered**

New York Stock Exchange

**Securities registered pursuant to section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2017, the aggregate market value (based upon the closing price of the stock on the New York Stock Exchange) of the registrant's common stock held by non-affiliates was approximately \$8,443 million.

As of February 9, 2018, 44,785,776 shares of the registrant's common stock were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Rule 14A for the registrant's 2018 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

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## PART I

### ITEM 1. BUSINESS

#### History and Organization

Huntington Ingalls Industries, Inc. ("HII", the "Company", "we", "us", or "our") is America's largest military shipbuilding company and a provider of professional services to partners in government and industry. For more than a century, our Ingalls Shipbuilding segment ("Ingalls") in Mississippi and Newport News Shipbuilding segment ("Newport News") in Virginia have built more ships in more ship classes than any other U.S. naval shipbuilder. Our Technical Solutions segment, established in the fourth quarter of 2016, provides a range of services to the governmental, energy, and oil and gas markets.

We conduct most of our business with the U.S. Government, primarily the Department of Defense ("DoD"). As prime contractor, principal subcontractor, team member, or partner, we participate in many high-priority U.S. defense technology programs. Ingalls includes our non-nuclear ship design, construction, repair, and maintenance businesses. Newport News includes all of our nuclear ship design, construction, overhaul, refueling, and repair and maintenance businesses. We also provide a wide range of professional services, including fleet support, integrated missions solutions, nuclear and environmental, and oil and gas services through our Technical Solutions segment.

Headquartered in Newport News, Virginia, we employ approximately 38,000 people operating both domestically and internationally. We became an independent, publicly-owned company in 2011, when we were spun off from Northrop Grumman.

#### Ingalls

Through our Ingalls segment, we design and construct non-nuclear ships for the U.S. Navy and U.S. Coast Guard, including amphibious assault ships, surface combatants, and national security cutters ("NSC"). We are the sole builder of amphibious assault ships and one of two builders of surface combatants for the U.S. Navy. We are the sole builder of large multi-mission NSCs for the U.S. Coast Guard. Our Ingalls segment is located in Pascagoula, Mississippi on 800 acres along the Pascagoula River. This shipyard offers a collection of manufacturing capabilities that includes a 660-ton gantry crane and a Land Based Test Facility.

#### ***Amphibious Assault Ships***

We construct amphibious assault and expeditionary warfare ships for the U.S. Navy, which include the U.S. Navy large deck amphibious ships ("LHA") and amphibious transport dock ships ("LPD"). The LHA is a key component of the U.S. Navy-Marine Corps requirement for 11 Expeditionary Strike Groups/Amphibious Readiness Groups, and design, construction, and modernization of LHAs are core to our Ingalls operations. In 2007, we were awarded the construction contract for USS *America* (LHA 6), the first in a new class of enhanced amphibious assault ships designed from the keel up to be an aviation optimized Marine assault platform. We delivered USS *America* (LHA 6) in the second quarter of 2014, are currently constructing *Tripoli* (LHA 7), scheduled for delivery in 2018, and in 2016 we were awarded the construction contract for *Bougainville* (LHA 8).

The LPD program is a long-running production program in which we have generated efficiencies through ship-over-ship learning. We delivered *Portland* (LPD 27) in the third quarter of 2017 and USS *John P. Murtha* (LPD 26) in 2016, and are currently constructing *Fort Lauderdale* (LPD 28), scheduled for delivery in 2021. In 2017 we were awarded an advance procurement contract for LPD 29.

#### ***Surface Combatants***

We are a design agent for, and one of only two companies that constructs, the *Arleigh Burke* class (DDG 51) guided missile destroyers, a class of surface combatant. We have delivered 30 *Arleigh Burke* class (DDG 51) destroyers to the U.S. Navy, including *Ralph Johnson* (DDG 114) in the fourth quarter of 2017 and USS *John Finn* (DDG 113) in 2016. In 2013, we were awarded a multi-year contract totaling \$3.3 billion for construction of five additional *Arleigh Burke* class (DDG 51) destroyers as a part of a larger U.S. Navy order for nine *Arleigh Burke* class (DDG 51) destroyers. We are currently constructing *Paul Ignatius* (DDG 117), *Delbert D. Black* (DDG 119), *Frank E. Petersen*



Jr. (DDG 121), *Lenah H. Sutcliffe Higbee* (DDG 123), and *Jack H. Lucas* (DDG 125), with deliveries scheduled in 2018, 2019, 2020, 2021 and 2023, respectively.

### **National Security Cutters**

The U.S. Coast Guard's recapitalization program is designed to replace aging and operationally expensive ships and aircraft used to conduct missions in excess of 50 miles from the shoreline. The flagship of this program is the *Legend* class NSC, a multi-mission platform we designed and continue to build. We delivered USCGC *Hamilton* (NSC 4), USCGC *James* (NSC 5), and USCGC *Munro* (NSC 6) to the U.S. Coast Guard in 2014, 2015, and 2016, respectively. *Kimball* (NSC 7), *Midgett* (NSC 8) and *Stone* (NSC 9) are currently under construction and scheduled for delivery in 2018, 2019, and 2020, respectively.

### **Newport News**

The core business of our Newport News segment is designing and constructing nuclear-powered ships, such as aircraft carriers and submarines, and the refueling and overhaul and the inactivation of such ships. Our Newport News shipyard is located on approximately 550 acres near the mouth of the James River, which adjoins the Chesapeake Bay. The shipyard has two miles of waterfront property and heavy industrial facilities, which include seven graving docks, a floating dry dock, two outfitting berths, five outfitting piers, module outfitting facilities, and various other workshops. Our Newport News shipyard also has a 2,170-foot dry dock serviced by a 1,050-ton gantry crane capable of supporting two aircraft carriers at one time.

### **Design, Construction, Refueling and Complex Overhaul, and Inactivation of Aircraft Carriers**

Engineering, design, and construction of U.S. Navy nuclear aircraft carriers are core to Newport News operations. Aircraft carriers are the largest ships in the U.S. Navy's fleet, with a displacement of over 90,000 tons. Newport News has designed and built more than 30 aircraft carriers for the U.S. Navy since 1933, including all ten *Nimitz* class (CVN 68) aircraft carriers currently in active service, as well as the first ship of the next generation *Gerald R. Ford* class (CVN 78) aircraft carriers.

We delivered the U.S. Navy's newest carrier, USS *Gerald R. Ford* (CVN 78), in 2017. We also received awards in 2009 through 2016 totaling \$7.6 billion for construction preparation, detail design, and construction of the second *Gerald R. Ford* class (CVN 78) aircraft carrier, *John F. Kennedy* (CVN 79), and awards totaling \$392 million for advance planning and long-lead time material acquisition for the third *Gerald R. Ford* class (CVN 78) aircraft carrier, *Enterprise* (CVN 80).

We continue to be the exclusive prime contractor for nuclear aircraft carrier refueling and complex overhaul ("RCOH"). Each RCOH takes nearly four years to complete, with the work accounting for approximately 35% of all maintenance and modernization during an aircraft carrier's 50 year service life. RCOH services include propulsion work (refueling of reactors; propulsion plant modernization; and propulsion plant repairs), restoration of service life (dry docking, tank, and void maintenance; hull, shafting, propellers, and rudders; launch and recovery system; piping repairs; and component refurbishment), and modernization (electrical systems; aviation support systems; warfare; interoperability; and environmental compliance). We provide ongoing maintenance services for the U.S. Navy aircraft carrier fleet through both RCOH and fleet support across the globe.

In 2017, we completed the RCOH for USS *Abraham Lincoln* (CVN 72) and redelivered the ship to the U.S. Navy. We are currently performing the RCOH of USS *George Washington* (CVN 73). We believe our position as the exclusive designer and builder of nuclear-powered aircraft carriers, our RCOH performance on the first six *Nimitz* class (CVN 68) carriers, and our highly trained workforce, as well as the fact that RCOH work is capital-intensive and has high barriers to entry due to its nuclear component, strongly position us for RCOH contract awards on the remaining *Nimitz* class (CVN 68) carriers, as well as future work on *Gerald R. Ford* class (CVN 78) aircraft carriers.

The U.S. Navy awarded us a \$745 million contract in 2013 to inactivate the decommissioned *Enterprise* (CVN 65), the world's first nuclear-powered aircraft carrier, which was built by us and commissioned in 1961. The decommissioned *Enterprise* (CVN 65) inactivation is scheduled to be completed in 2018. Aircraft carriers have a lifespan of approximately 50 years, and we believe the ten *Nimitz* class (CVN 68) carriers delivered by us that are currently in active service, as well as *Gerald R. Ford* class (CVN 78) aircraft carriers we will deliver in the future, present a significant opportunity for inactivation contracts as they reach the end of their lifespans. We believe we are well positioned as the U.S. Navy's shipyard of choice for these contract awards.

## ***Design and Construction of Nuclear-Powered Submarines***

We are one of only two companies in the United States capable of designing and building nuclear-powered submarines for the U.S. Navy. Newport News has delivered 60 submarines to the U.S. Navy since 1960, comprised of 46 fast attack and 14 ballistic missile submarines. Of the 52 nuclear-powered fast attack submarines currently in active service, 25 were delivered by Newport News. Our nuclear submarine program, located at our Newport News shipyard, includes construction, engineering, design, research, and integrated planning.

In February 1997, we executed a teaming agreement with Electric Boat Corporation ("Electric Boat"), a division of General Dynamics Corporation ("General Dynamics"), to build *Virginia* class (SSN 774) fast attack nuclear submarines cooperatively. Under the present arrangement, we build the stern, habitability and machinery spaces, torpedo room, sail, and bow, while Electric Boat builds the engine room, control room, and pressure hull structure. Work on the reactor plant and the final assembly, test, outfit, and delivery of the submarines alternate between Electric Boat and us.

The four submarines of the first block and six submarines of the second block of *Virginia* class (SSN 774) submarines have been delivered. In 2008, the team was awarded a construction contract for the third block of eight *Virginia* class (SSN 774) submarines. The multi-year contract increased construction from one submarine per year to two submarines per year. The first submarine under this contract was delivered in 2014 and the last submarine of the third block is scheduled for delivery in 2019. In 2014, the team was awarded a construction contract for the fourth block of ten *Virginia* class (SSN 774) submarines, continuing the two submarines per year production rate. The first submarine of the block IV contract is scheduled for delivery in 2019, and the last is scheduled for delivery in 2023.

## ***Columbia Class (SSBN 826) Submarines***

Newport News is participating in designing the *Columbia* class (SSBN 826) submarine as a replacement for the current aging *Ohio* class nuclear ballistic missile submarines ("SSBN"), which were first introduced into service in 1981. The *Ohio* class SSBN includes 14 nuclear ballistic missile submarines and four nuclear cruise missile submarines ("SSGN"). The *Columbia* class (SSBN 826) program currently anticipates 12 new ballistic missile submarines. The U.S. Navy has initiated the design process for the new class of submarines, and, in early 2017, the DOD signed the acquisition decision memorandum approving the *Columbia* class (SSBN 826) program's Milestone B, which formally authorizes the program's entry into the engineering and manufacturing development phase. We continue to perform design work as a subcontractor to Electric Boat, and we have entered into a teaming agreement with Electric Boat to build modules for the entire *Columbia* class (SSBN 826) submarine program that leverages our *Virginia* class (SSN 774) experience. The teaming agreement is subject to the U.S. Navy's concurrence. Newport News was awarded a contract from Electric Boat in 2017 to begin integrated product and process development for the *Columbia* class. Construction of the first *Columbia* class (SSBN 826) submarine is expected to begin in 2021, with procurement of long-lead-time materials and advance construction beginning prior to that time. We believe the *Columbia* class (SSBN 826) of submarines represents a significant future opportunity.

## ***Naval Nuclear Support Services***

Newport News provides additional services to and in support of the U.S. Navy, ranging from services supporting the Navy's carrier and submarine fleets to maintenance services at U.S. Navy training facilities. Fleet services include design, construction, maintenance, and disposal activities for in service U.S. Navy nuclear ships worldwide through mobile and in-house capabilities. We also provide maintenance services on nuclear reactor prototypes, such as those at the Kenneth A. Kesselring Site, a research and development facility in New York that supports the U.S. Navy.

## **Technical Solutions**

Our Technical Solutions segment was established in 2016 to enhance strategic and operational alignment among our services businesses. The Technical Solutions segment includes businesses that are focused on life-cycle sustainment services to the U.S. Navy fleet and other maritime customers; high-end information technology ("IT") and mission-based solutions for DoD, intelligence, and federal civilian customers; nuclear and non-nuclear fabrication, equipment repair, and technical engineering services; nuclear management and operations and environmental management services for DoE, DoD, state and local governments, and private sector companies;

and full-service engineering, procurement, construction management ("EPCM") and engineering and field services solutions for the oil and gas industry. Our Technical Solutions segment is comprised of our subsidiaries AMSEC, Camber Corporation ("Camber"), Continental Maritime of San Diego ("CMSD"), Newport News Industrial Corporation ("NNI"), Stoller Newport News Nuclear ("SN3"), Undersea Solutions Corporation ("USC"), and UniversalPegasus International ("UPI").

### ***Fleet Support Services***

Our fleet support services provide comprehensive life-cycle sustainment services to the U.S. Navy fleet and other DoD and commercial maritime customers. Our ship technical and waterfront services include maintenance, modernization, and repair on all ship classes; naval architecture, marine engineering, and design; integrated logistics support; technical documentation development; warehousing, asset management, and material readiness; operational and maintenance training development and delivery; software design and development; IT infrastructure support and data delivery and management; and cyber security and information assurance. In addition to our broad array of life-cycle sustainment services, we provide undersea vehicle and specialized craft development and prototyping services.

### ***Integrated Missions Solutions Services***

Our integrated missions solutions services include high-end IT and mission-based solutions to DoD, intelligence, and federal civilian customers, such as the Administrative Office of the United States Courts and the U.S. Postal Service. The services and solutions we provide are accessible through a broad portfolio of contract vehicles and include agile software engineering, development, and integration; Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance ("C4ISR") engineering and software integration; mobile application development and network engineering; modeling, simulation, and training; force protection and emergency management training and exercises; unmanned systems development, integration, operations, and maintenance; and mission-oriented intelligence, surveillance, and reconnaissance analytics.

### ***Nuclear and Environmental Services***

Our nuclear and environmental services focus on nuclear management and operations and nuclear and non-nuclear fabrication and repair. We provide site management, nuclear and industrial facilities operations and maintenance, decontamination and decommissioning, and radiological and hazardous waste management services to DoE, DoD, state and local governments, and private sector companies. We also provide a wide range of services, including fabrication, equipment repair, and technical engineering services, to commercial industries, the National Aeronautics and Space Administration, DoD, and DoE. As part of our nuclear and environmental services, we participate in several joint ventures, including Newport News Nuclear BWXT Los Alamos, LLC ("N3B"), Mission Support and Test Services, LLC ("MSTS"), and Savannah River Nuclear Solutions, LLC ("SRNS"). We have a 51% ownership interest in N3B, which, in 2017, was awarded the Los Alamos Legacy Cleanup Contract at the DoE/ National Nuclear Security Administration's Los Alamos National Laboratory located northwest of Santa Fe, New Mexico. We have a 23% ownership interest in MSTS, which, in 2017, was awarded a contract for site management and operations at the Nevada National Security Site located northwest of Las Vegas, Nevada. We have a 34% ownership interest in SRNS, which provides site management and operations at the DoE's Savannah River Site near Aiken, South Carolina.

### ***Oil and Gas Services***

We deliver engineering, procurement, and construction management services to the oil and gas industry for major pipeline, production, and treatment facilities. These services include full life-cycle services for domestic and international projects, from concept identification through detail design, execution and construction, and decommissioning. We also offer related field services, including survey, inspection, commissioning and start-up, operations and maintenance, and optimization and debottlenecking.

## **Corporate**

Huntington Ingalls Industries, Inc. was incorporated in Delaware on August 4, 2010. Our principal executive offices are located at 4101 Washington Avenue, Newport News, Virginia 23607. Our telephone number is (757) 380-2000, and our home page on the Internet is [www.huntingtoningalls.com](http://www.huntingtoningalls.com). References to our website in this report are provided as a convenience and do not constitute, and should not be viewed as, incorporation by reference of the information contained on, or available through, the website. Accordingly, such information should not be considered part of this report.

## **Summary Segment Financial Data**

For a more complete understanding of our segment financial information, see Segment Operating Results in Item 7 and Note 9: Segment Information in Item 8.

## **Customers**

Our revenues are primarily derived from the U.S. Government. In 2017, 2016, and 2015, approximately 87%, 89%, and 89%, respectively, of our revenues were generated from the U.S. Navy, and approximately 6%, 6%, and 7%, respectively, were generated from the U.S. Coast Guard. In 2017, 2016, and 2015, we generated approximately 3%, 4%, and 3%, respectively, of our revenues from commercial customers and 4%, 1%, and 1%, respectively, from other government agencies.

## **Intellectual Property**

We develop and incorporate into our vessels new technologies, manufacturing processes, and systems-integration practices. In addition to owning a large portfolio of proprietary intellectual property, we license intellectual property rights to and from others. The U.S. Government receives non-exclusive licenses to our intellectual property developed in the performance of U.S. Government contracts and unlimited license rights in technical data developed under our U.S. Government contracts when such data is developed entirely at government expense. The U.S. Government may use or authorize others to use the intellectual property licensed to the government. While our intellectual property rights are important to our operations, we do not believe that any existing patent, license, or other intellectual property right is of such importance that its loss or termination would have a material impact on our business.

## **Seasonality**

No material portion of our business is seasonal. The timing of our revenue recognition is based on several factors, including the timing of contract awards, the incurrence of contract costs, contract cost estimation, and unit deliveries. See Critical Accounting Policies, Estimates, and Judgments - Revenue Recognition in Item 7.

## **Backlog**

As of each of December 31, 2017 and 2016, our total backlog was approximately \$21 billion. We expect approximately 31% of backlog at December 31, 2017, to be converted into sales in 2018.

Total backlog includes both funded backlog (firm orders for which funding is contractually obligated by the customer) and unfunded backlog (firm orders for which funding is not currently contractually obligated by the customer). Unfunded backlog excludes unexercised contract options and unfunded Indefinite Delivery/Indefinite Quantity orders. For contracts having no stated contract values, backlog includes only the amounts committed by the customer. Backlog is converted into sales as work is performed or deliveries are made. For backlog by segment, see Backlog in Item 7.

## **Raw Materials**

The most significant material we use is steel. Other materials we use in large quantities include paint, aluminum, pipe, electrical cable, and fittings. All of these materials are currently available in adequate supply. In connection with our U.S. Government contracts, we are required to procure certain materials and component parts from supply sources approved by the U.S. Government. Generally, for long-term contracts, we obtain price quotations for many of our materials requirements from multiple suppliers to ensure competitive pricing. While we have not generally

been dependent upon any one supply source, we currently have only one supplier for certain component parts as a result of consolidation in the defense industry. We believe that these single source suppliers, as well as our overall supplier base, are adequate to meet our foreseeable needs. We have mitigated some supply risk by negotiating long-term agreements with certain raw material suppliers. In addition, we have mitigated price risk related to raw material purchases through certain contractual arrangements with customers.

## **Research and Development**

We conduct research and development activities as part of our normal business operations to facilitate innovative product development and evolution. Our research and development activities primarily include Independent Research and Development ("IR&D") related to government programs. We recover a significant portion of our IR&D expenditures through overhead charges to U.S. Government contracts, consistent with U.S. Government regulations. We include IR&D expenses in general and administrative expenses. Company-sponsored IR&D expenses totaled \$17 million for the year ended December 31, 2017, and \$19 million for each of the years ended December 31, 2016 and December 31, 2015.

At our Virginia Advanced Shipbuilding and Carrier Integration Center ("VASCIC"), located in Newport News, Virginia, we conduct on-site warfare systems testing, training, and laboratory research for the next generation of aircraft carriers, submarines, and other ships. VASCIC serves as the focal point for the integration of ship systems and the application of new technologies. It includes a classified facility and an integration area that facilitates research and development related to setup and testing of electronics, as well as hull, mechanical, and electrical systems, prior to introducing new equipment on board a ship. It also has modeling and simulation capability for visualization using 3-D displays. We believe VASCIC represents a competitive advantage for us by developing future naval capabilities, reducing total ownership cost, and facilitating technology transfer.

## **Governmental Regulation and Supervision**

Our business is affected by a variety of laws and regulations relating to the award, administration, and performance of U.S. Government contracts. See Risk Factors in Item 1A.

We operate in a heavily regulated environment and are routinely audited and reviewed by the U.S. Government and its agencies, including the U.S. Navy's Supervisor of Shipbuilding, the Defense Contract Audit Agency ("DCAA"), and the Defense Contract Management Agency ("DCMA"). These agencies evaluate our contract performance, cost structures, and compliance with applicable laws, regulations, and standards, as well as the adequacy of our business systems and processes relative to U.S. Government requirements. Business systems subject to audit or review include our accounting systems, purchasing systems, billing systems, property management and control systems, cost estimating systems, earned value management systems, compensation systems, and management information systems. If an audit uncovers improper or illegal activities, we may be subject to administrative, civil, or criminal proceedings, which could result in fines, penalties, repayments, or compensatory, treble, or other damages. Certain U.S. Government findings against a contractor can also lead to suspension or debarment from future U.S. Government contracts or the loss of export privileges. In addition, any costs we incur that are determined to be unallowable or improperly allocated to a specific contract will not be recovered or must be refunded if already reimbursed.

The U.S. Government has the ability to decrease or withhold contract payments if it determines significant deficiencies exist in business systems subject to its review. In the past, the U.S. Government has, in certain instances, withheld contract payments upon its assessment that significant deficiencies existed with one or more of our business systems. When appropriate, we must modify our affected business systems to address the U.S. Government's determinations.

The U.S. Government generally has the ability to terminate contracts, in whole or in part, with little or no prior notice, for convenience or for default based on performance. In the event of termination of a contract for convenience, a contractor is normally able to recover costs already incurred on the contract and receive profit on those costs up to the amount authorized under the contract, but not the anticipated profit that would have been earned had the contract been completed. Such a termination could also result in the cancellation of future work on the related program. Termination resulting from our default could expose us to various liabilities, including excess procurement costs, and could have a material effect on our ability to compete for future contracts.

Government contractors must comply with significant regulatory requirements, including those related to procurement. Our contracts with the U.S. Government may result in Requests for Equitable Adjustments ("REAs"), which represent requests for the U.S. Government to make appropriate adjustments to contract terms, including pricing, delivery schedule, technical requirements, or other affected terms, due to changes in the original contract requirements and resulting delays and disruption in contract performance for which the U.S. Government is responsible. We prepare, submit, and negotiate REAs in the ordinary course of business, and large REAs are not uncommon at the conclusion of both new construction and RCOH activities. Such REAs are not considered claims under the Contract Disputes Act of 1978, although they may be converted to such claims if good faith negotiations to resolve the REAs are not satisfactory.

In cases where there are multiple suppliers, contracts for the construction and conversion of U.S. Navy ships and submarines are generally subject to competitive bidding. In evaluating proposed prices, the U.S. Navy sometimes requires that each bidder submit information on pricing, estimated costs of completion, and anticipated profit margins to enable the Navy to assess cost realism. The U.S. Navy uses this information and other data to determine an estimated cost for each bidder. Under U.S. Government regulations, certain costs, including certain financing costs and marketing expenses, are not allowable contract costs and, therefore, are not recoverable. The U.S. Government also regulates the methods by which all allowable costs, including overhead, are allocated to government contracts.

Our business, our contracts with various agencies of the U.S. Government, and our subcontracts with other prime contractors are subject to a variety of laws and regulations, including, but not limited to, the Federal Acquisition Regulation ("FAR"), the Truth in Negotiations Act, the Procurement Integrity Act, the False Claims Act, Cost Accounting Standards, the International Traffic in Arms Regulations promulgated under the Arms Export Control Act, the Close the Contractor Fraud Loophole Act, and the Foreign Corrupt Practices Act. A noncompliance determination by a government agency may result in reductions in contract values, contract modifications or terminations, penalties, fines, repayments, compensatory, treble, or other damages, or suspension or debarment.

## **Competition**

In our primary business of designing, building, overhauling, and repairing military ships, we primarily compete with General Dynamics and, to a lesser extent, smaller shipyards, one or more of which could team with a large defense contractor. Intense competition related to programs, resources, and funding, and long operating cycles are key characteristics of both our business and the shipbuilding defense industry in general. It is common industry practice to share work on major programs among a number of companies. A company competing to be a prime contractor may, upon ultimate award of the contract to another party, become a subcontractor for the prime contracting party. It is not uncommon to compete for a contract award with a peer company and, simultaneously, perform as a supplier to or a customer of such competitor on other contracts. The nature of major defense programs, conducted under binding long-term contracts, allows companies that perform well to benefit from a level of program continuity not common in many industries.

We believe we are well-positioned in our markets. Because we are the only company currently capable of building, refueling, and inactivating the U.S. Navy's nuclear-powered aircraft carriers, we believe we are in a strong competitive position to be awarded each contract to perform such activities. Even so, the government periodically revisits whether refueling of nuclear-powered aircraft carriers should be performed in private or public facilities. If a U.S. Government owned shipyard were to become capable and engaged in the refueling of nuclear-powered aircraft carriers, our market position could be significantly and adversely affected.

Although we have competed with another large defense contractor to construct a large deck amphibious ship, which was awarded to us, we are currently the only builder of large deck amphibious assault and expeditionary warfare ships for the U.S. Navy, including LHAs and LPDs. We are also the sole builder of NSCs for the U.S. Coast Guard and strongly positioned to be awarded future contracts for these types of vessels. We are one of only two companies currently designing and building nuclear-powered submarines for the U.S. Navy, and we are party to a long-term teaming agreement with the other company for the production of such vessels. We are one of only two companies that builds the U.S. Navy's current fleet of *Arleigh Burke* class (DDG 51) destroyers and are strongly positioned to be awarded future contracts for these types of ships as well.

Our success in the shipbuilding defense industry depends upon our ability to develop, market, and produce our products and services at a cost consistent with the U.S. Navy's budget, as well as our ability to provide the

workforce, technologies, facilities, equipment, and financial capacity needed to deliver those products and services with maximum efficiency.

We compete with a variety of companies in the provision of services to the government, energy, and oil and gas markets.

### **Environmental, Health, and Safety**

Our manufacturing operations are subject to and affected by federal, state, and local laws and regulations relating to the protection of the environment. We accrue estimated costs to complete environmental remediation when we determine it is probable we will incur expenses in the future, in amounts we can reasonably estimate, to address environmental conditions at currently or formerly owned or leased operating facilities, or at sites where we are named a Potentially Responsible Party ("PRP") by the U.S. Environmental Protection Agency ("EPA") or similarly designated by another environmental agency. The inherent difficulties in estimating future environmental remediation costs, resulting from uncertainties regarding the extent of required remediation, determination of legally responsible parties, and the status of laws and regulations and their interpretations, can cause our estimated remediation costs to change.

We assess the potential impact on our financial statements of future environmental remediation costs by estimating, on a site-by-site basis, the range of reasonably possible remediation costs that we could incur, taking into account currently available information at each site, the current state of technology, and our prior experience in remediating contaminated sites. We review our estimates periodically and adjust them to reflect changes in facts, technology, and legal circumstances. We record accruals for environmental remediation costs on an undiscounted basis in the accounting period in which it becomes probable we have incurred a liability and the costs can be reasonably estimated. We would record related insurance recoveries only when we determine that collection is probable, and we do not include any litigation costs related to environmental matters in our environmental remediation accrual.

We either expense or capitalize environmental expenditures as appropriate. Capitalized expenditures relate to long-lived improvements in current operating facilities. We accrue environmental remediation costs at sites involving multiple parties based upon our expected share of liability, taking into account the financial viability of other jointly liable parties. We may incur remediation costs exceeding our accrued amount if other PRPs do not pay their allocable share of remediation costs, which could have a material effect on our business, financial position, results of operations, or cash flows.

As of December 31, 2017, our probable future costs for environmental remediation were approximately \$1 million, which were accrued in other current liabilities in the consolidated statement of financial position. Although information gained as projects progress may materially affect our accrued liability, we do not anticipate that future remediation expenditures will have a material effect on our financial position, results of operations, or cash flows.

In October 2014, we ceased shipbuilding construction operations at our Avondale, Louisiana shipyard ("Avondale"). We may incur additional environmental costs in the future related to our wind down of shipbuilding at Avondale. Any additional costs are not reasonably estimable at this time due to insufficient information about the nature, timing, and extent of any potential environmental remediation we may be required to perform or the related costs that we may incur. Accordingly, such potential environmental costs associated with the wind down of Avondale are not included in our \$1 million accrual for environmental remediation costs or otherwise reflected in our consolidated financial statements. We expect that a significant portion of any future environmental remediation costs we might incur at Avondale would be recoverable in accordance with government accounting practices under the FAR.

We believe we are in material compliance with environmental laws and regulations, and historical environmental compliance costs have not been material to our business. We could be affected by new environmental laws or regulations, including any enacted in response to concerns over climate change, other aspects of the environment, or natural resources. We have made investments we believe are necessary to comply with environmental laws, but we expect to continue to incur capital and operating costs in the future to comply with current and future environmental laws and regulations. At this time, we do not believe such costs will have a material effect on our financial position, results of operations, or cash flows.

With regard to occupational health and safety, the shipbuilding and ship repair industry involves work with hazardous materials and processes and remains one of the most hazardous industries. According to the Bureau of Labor Statistics, the shipbuilding and ship repair industry (NAICS 336611) ranks among the highest in several injury

metrics. We have experienced one fatality in the past seven years. We strive to keep our Occupational Safety and Health Administration ("OSHA") compliance programs strong. In 1995, our Newport News shipyard became the first shipyard to be awarded the Star Award from OSHA's Voluntary Protection Program ("OSHA VPP"). To earn this award, we joined efforts with our unions and supported participation in the OSHA VPP, in which all parties assist each other to make our shipyard a safer place to work. Our CMSD facility has also been certified as an OSHA VPP Star Site.

The U.S. Navy, Nuclear Regulatory Commission, and DoE each regulate and control various matters relating to nuclear materials we handle. Subject to certain requirements and limitations, our contracts with the U.S. Navy and DoE generally provide for indemnity by the U.S. Government for losses resulting from our nuclear operations. For our commercial nuclear operations, we rely primarily on insurance carried by nuclear facility operators for risk mitigation, and we maintain limited insurance coverage for losses in excess of the coverage of facility operators.

## **Employees**

We have approximately 38,000 employees. We are the largest industrial employer in Virginia and the largest private employer in Mississippi. We employ individuals specializing in 19 crafts and trades, with approximately 5,400 engineers and designers and approximately 2,400 employees with advanced degrees. Our workforce contains many third-, fourth-, and fifth-generation employees, and approximately 1,450 employees have 40 or more years of continuous service. Employees in our shipbuilding divisions with more than 40 years of service achieve the honor of "Master Shipbuilder." As of December 31, 2017, we had 1,091 Master Shipbuilders at Newport News and 355 at Ingalls. We employ more than 6,000 veterans across the enterprise.

More than 1,500 apprentices are trained by our two shipbuilding units each year in more than 27 crafts and advanced programs. From nuclear pipe welders to senior executives, we employ approximately 4,500 apprentice alumni, 3,000 at Newport News and 1,500 at Ingalls.

Approximately 50% of our employees are covered by a total of nine collective bargaining agreements and two site stabilization agreements. Newport News has four collective bargaining agreements covering represented employees, one of which covers approximately 50% of Newport News employees and was renewed in July 2017. The remaining collective bargaining agreements at Newport News expire in August 2018, December 2018, and November 2020. Newport News craft workers employed at the Kesselring Site near Saratoga Springs, New York are represented under an indefinite DoE site agreement. Ingalls has five collective bargaining agreements covering represented employees, all of which expire in March 2022. Approximately 35 Technical Solutions craft employees at the Hanford Site near Richland, Washington are represented under an indefinite DoE site stabilization agreement. We believe our relationship with our employees is satisfactory.

## **Available Information**

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, as well as any amendments to those reports, are available free of charge through our website after we file them with the Securities and Exchange Commission ("SEC"). You can learn more about us by reviewing our SEC filings on the investor relations page on our website at [www.huntingtoningalls.com](http://www.huntingtoningalls.com).

Our SEC filings are also available at the Public Reference Room of the SEC at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling 1-800-SEC-0330.

The SEC also maintains a website at [www.sec.gov](http://www.sec.gov) that contains reports, proxy statements, and other information about SEC registrants, including us.

## **Executive Officers of the Registrant**

See Executive Officers of the Registrant in Item 4A for information about our executive officers.



## Forward-Looking Statements

Statements in this Annual Report on Form 10-K and in our other filings with the SEC, as well as other statements we may make from time to time, other than statements of historical fact, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those expressed in these statements. Factors that may cause such differences include:

- Changes in government and customer priorities and requirements (including government budgetary constraints, shifts in defense spending, and changes in customer short-range and long-range plans);
- Our ability to estimate our future contract costs and perform our contracts effectively;
- Changes in procurement processes and government regulations and our ability to comply with such requirements;
- Our ability to deliver our products and services at an affordable life cycle cost and compete within our markets;
- Natural and environmental disasters and political instability;
- Our ability to execute our strategic plan, including with respect to share repurchases, dividends, capital expenditures, and strategic acquisitions;
- Adverse economic conditions in the United States and globally;
- Changes in key estimates and assumptions regarding our pension and retiree health care costs;
- Security threats, including cyber security threats, and related disruptions; and
- Other risk factors discussed herein and in our other filings with the SEC.

There may be other risks and uncertainties that we are unable to predict at this time or that we currently do not expect to have a material adverse effect on our business, and we undertake no obligation to update or revise any forward-looking statements. You should not place undue reliance on any forward looking statements that we may make.

## Item 1A. Risk Factors

An investment in our common stock or debt securities involves risks and uncertainties. We seek to identify, manage, and mitigate risks to our business, but risk and uncertainty cannot be eliminated or necessarily predicted. You should consider the following factors carefully, in addition to the other information contained in this Annual Report on Form 10-K, before deciding to purchase our securities.

***We depend heavily on a single customer, the U.S. Government, for substantially all of our business, and changes affecting this customer's priorities and spending could have a material adverse effect on our financial position, results of operations, or cash flows.***

Our business consists primarily of the design, construction, repair, and maintenance of nuclear-powered ships, such as aircraft carriers and submarines, and non-nuclear ships, such as surface combatants and expeditionary warfare and amphibious assault ships, for the U.S. Navy and coastal defense surface ships for the U.S. Coast Guard, as well as the refueling and overhaul and inactivation of nuclear-powered ships for the U.S. Navy. Substantially all of our revenues in 2017 were derived from products and services sold to the U.S. Government, and we expect this to continue in the foreseeable future. In addition, most of our backlog as of December 31, 2017, was U.S. Government related. Our U.S. Government contracts are subject to various risks, including our customers' political and budgetary constraints and processes, changes in customers' short-range and long-range strategic plans, the timing of contract awards, significant changes in contract scheduling, intense contract and funding competition, difficulty in forecasting costs and schedules for bids on developmental and sophisticated technical work, and contractor suspension or debarment in the event of certain violations of legal or regulatory requirements. Any of these factors could affect our business with the U.S. Government, which would have a material adverse effect on our financial position, results of operations, or cash flows.

***Significant delays or reductions in appropriations for our programs, changes in customer priorities, and potential contract terminations could have a material adverse effect on our financial position, results of operations, or cash flows.***

We are directly dependent upon congressional funding of U.S. Navy and U.S. Coast Guard programs. The funding of U.S. Government programs is subject to congressional budget authorization and appropriation processes. For certain programs, Congress appropriates funds on a fiscal year basis even though a program may be performed over several fiscal years. Consequently, programs are often partially funded initially and receive additional funding only as Congress makes additional appropriations. If we incur costs in excess of existing funding on a contract, we may be at risk for recovery of those costs unless and until additional funds are appropriated. We cannot predict the extent to which total funding or funding for individual programs will be included, increased, or reduced as part of the annual budget process or through continuing resolutions or individual supplemental appropriations.

The impact of Congressional actions to reduce the federal debt and resulting pressures on federal spending could adversely affect the total funding of individual contracts or funding for individual programs and delay purchasing or payment decisions by our customers. In August 2011, the Budget Control Act (the "BCA") established limits on U.S. Government discretionary spending, including a reduction of defense spending by approximately \$487 billion from fiscal years 2012 through 2021, representing approximately 8% of planned defense spending. The BCA also provided that the defense budget would face "sequestration" cuts of up to an additional \$500 billion during that same period to the extent that discretionary spending limits are exceeded, representing approximately 9% of planned defense spending, and \$500 billion for non-defense discretionary spending, including the U.S. Coast Guard.

The Bipartisan Budget Act of 2018 (the "BBA 2018") provided sequestration relief for fiscal years 2018 and 2019. Sequestration remains in effect, however, for fiscal years 2020 and 2021. Long-term uncertainty is continuing with respect to overall levels of defense spending across the future years defense plan, and it is likely that U.S. Government discretionary spending levels will continue to be subject to significant pressure. For additional information relating to the U.S. defense budget, see the Business Environment section of Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7.

Demand for our products and services can also be affected by potential changes in customer priorities due to changes in military strategy and planning. In response to the need for cheaper alternatives and the proliferation of "smart weapons," future strategy reassessments by the DoD may result in decreased demand for our shipbuilding programs, including our aircraft carrier programs. For the year ended December 31, 2017, our aircraft carrier

programs accounted for approximately 31% of our consolidated revenue. We cannot predict the impact of changes to customer priorities on existing, follow-on, replacement, or future programs. A shift of priorities to programs in which we do not participate and related reductions in funding for or the termination of programs in which we do participate could have a material adverse effect on our financial position, results of operations, or cash flows.

The U.S. Government generally has the ability to terminate contracts, in whole or in part, with little or no prior notice, for convenience or for default based on performance. In the event of termination of a contract for the U.S. Government's convenience, a contractor is normally able to recover costs already incurred on the contract and receive profit on those costs up to the amount authorized under the contract, but not the anticipated profit that would have been earned had the contract been completed. Such a termination could also result in the cancellation of future work on the related program. Termination resulting from our default can expose us to various liabilities, including excess re-procurement costs, and could negatively affect our ability to compete for future contracts. Any contract termination could have a material adverse effect on our financial condition, results of operations, or cash flows.

***Cost growth on flexibly priced contracts that cannot be justified as increases in contract value due from customers exposes us to reduced profitability and to the potential loss of future business.***

Our operating income is adversely affected when we incur certain contract costs or certain increases in contract costs that cannot be billed to customers. Cost growth can occur if expenses to complete a contract increase due to technical challenges, manufacturing difficulties, delays, workforce-related issues, or inaccurate estimates used to calculate contract costs initially. Reasons may include unavailability or reduced productivity of labor, the nature and complexity of the work performed, the timeliness and availability of materials, major subcontractor performance or product quality issues, performance delays, availability and timing of funding from the customer, and natural disasters. The process of estimating contract costs requires significant judgment and expertise. A significant increase in contract costs from our original cost estimates on one or more contracts could have a material adverse effect on our financial position, results of operations, or cash flows.

Our ability to recover the costs we incur and realize profits on contracts with our U.S. government customers depends on the type of contract under which we are performing. Our U.S. Government business is currently performed under firm fixed price ("FFP"), fixed price incentive ("FPI"), cost plus incentive fee ("CPIF"), cost plus fixed fee ("CPFF"), and cost plus award fee ("CPAF") contracts. Under FFP contracts, we retain all cost savings on completed contracts but are responsible for the full amount of all expenditures in excess of the contract price. FPI contracts, on the other hand, are flexibly priced agreements under which cost overruns and underruns to an agreed target cost are shared between the U.S. Government and us. The U.S. Government is liable for its share of allowable costs up to a ceiling price, and we are responsible for all costs incurred in excess of such ceiling price, typically 125-135% of target cost. Our profit on FPI contracts varies according to a contract formula that generally compares the amount of costs incurred to the contract target cost. Under CPIF, CPFF, and CPAF contracts, we are generally required to perform the contract only to the extent the U.S. Government makes funds available, and we recover all allowable costs incurred in the performance of the contract. Under CPIF contracts, our profit is determined by a contractually specified formula that compares allowable incurred costs to the contract target cost, subject in some instances to a maximum or minimum fee percentage. Under CPFF contracts, the dollar amount of profit received is the same without regard to the amount of costs incurred. Under CPAF contracts, the dollar amount of profit received is determined by the award fee provisions in the contract.

Of Ingalls' revenues in 2017, approximately 89% were generated from FPI contracts, approximately 5% were generated from CPAF contracts, approximately 3% were generated from CPFF contracts, and approximately 3% were generated from FFP contracts. Of Newport News' 2017 revenues, approximately 50% were generated from CPFF contracts, approximately 41% were generated from FPI contracts, and approximately 9% were generated from CPIF contracts. Of Technical Solutions' revenues in 2017, approximately 33% were generated from time and material contracts, approximately 28% were generated from CPFF contracts, approximately 29% were generated from FFP contracts, approximately 7% were generated from CPAF contracts, approximately 1% were generated from FPI contracts, and approximately 2% were generated from CPIF contracts. To the extent our mix of contract types changes in the future, our ability to recover our costs and realize profits on our contracts could be negatively affected.

***Our earnings and profitability depend upon our ability to perform our contracts.***

When agreeing to contract terms, we make assumptions and projections about future conditions and events, many of which extend over long periods. Our assumptions and projections are based, among other matters, upon our assessments of the productivity and availability of labor, the complexity of the work to be performed, the cost and availability of materials, the impact of delayed performance, and the timing of product deliveries. We may experience significant variances from our assumptions and projections, delays in our contract performance, and variances in the timing of our product deliveries. If our actual experience differs significantly from our assumptions or projections or we incur unanticipated contract costs, the profitability of the related contracts may be adversely affected.

***Our earnings and profitability depend, in part, upon subcontractor performance and raw material and component availability and pricing.***

We rely on third parties to provide raw materials, major components and sub-systems, hardware elements, and sub-assemblies for our products and to perform certain services we provide to our customers, and to do so in compliance with applicable laws and regulations. Disruptions and performance problems caused by our suppliers and subcontractors, or a misalignment between our contractual obligations to our customers and our agreements with our subcontractors and suppliers, could have an adverse effect on our ability to meet our commitments to customers. Our ability to perform our obligations on a timely basis could be adversely affected if one or more of our suppliers or subcontractors are unable to provide the agreed-upon products or materials or perform the agreed-upon services in a timely, compliant and cost-effective manner or otherwise fail to satisfy contractual requirements. The inability of our suppliers or subcontractors to perform could also result in the need for us to transition to alternate parties, which could result in significant incremental cost and delay, or the need for us to provide other supplemental means to support our existing suppliers and subcontractors.

Our costs to manufacture our products can increase over the terms of our contracts, including as a result of increases in material costs. We may be protected from increases in material costs through cost escalation provisions in some of our contracts, to the extent that such increases are consistent with industry indices. Even with these provisions, however, the difference in basis between our actual material costs and these indices may expose us to cost uncertainty. In addition, significant delays in deliveries of key raw materials, which may occur as a result of availability or price, could have a material adverse effect on our financial position, results of operations, or cash flows.

In some cases, only one supplier may exist for certain components and parts required to manufacture our products. The inability of a sole source supplier to provide a necessary component or part in a timely, compliant, or cost-effective manner could increase our contract cost and affect our ability to perform our contract.

Our procurement practices are intended to provide quality materials and services to support our programs and to reduce the likelihood of our procurement of unauthorized, non-compliant, or deficient materials and services. We rely on our subcontractors and suppliers to comply with applicable laws, regulations, and the expectations set forth in the HII Supplier Code of Conduct regarding the materials and services we procure from them. In some circumstances, we rely on representations and certifications from our subcontractors and suppliers regarding their compliance. We also work with subcontractors and suppliers to conduct technical assessments, inspections, and audits, as necessary. Notwithstanding the actions we take to mitigate the risk of receiving materials and services that fail to meet specifications or requirements, subcontractors and suppliers have in the past provided us with unauthorized, non-compliant, or deficient materials and services.

Our inability to procure, or a significant delay in acquiring, necessary raw materials, components, or parts, the failure of our subcontractors or suppliers to comply with applicable laws and regulations, inaccurate certifications from our subcontractors and suppliers regarding their compliance, or noncompliant materials, components, or parts we acquire from our subcontractors and suppliers could have a material adverse effect on our financial position, results of operations, or cash flows.

***Changes to Department of Defense business practices could have a material effect on DoD's procurement process and adversely impact our current programs and potential new awards.***

The defense industry has experienced, and we expect will continue to experience, significant changes to business practices resulting from an increased focus by DoD on affordability, efficiencies, business systems, recovery of costs, and a reprioritization of available defense funds to key areas for future defense spending. The DoD continues to adjust its procurement practices, requirements criteria, and source selection methodology in an ongoing effort to reduce costs, gain efficiencies, and enhance program management and control. We expect DoD's focus on business practices to impact the contracting environment in which we operate as we and others in the industry adjust our practices to address the DoD's initiatives and the reduced level of spending by the DoD. Depending on how these initiatives are implemented, they could have an impact on our current programs, as well as new business opportunities with the DoD. In addition to DoD's business practice initiatives, the DCMA and DCAA have implemented cost recovery/cost savings initiatives to prioritize efforts to recover costs. As a result of certain of these initiatives, we have experienced and may continue to experience a higher number of audits and/or lengthened periods of time required to close open audits. In addition, the thresholds for certain allowable costs, including compensation costs, have been significantly reduced, and other thresholds are being challenged, debated, and, in certain cases, modified. Significant changes to the thresholds for allowable costs could adversely affect our financial position, results of operations, or cash flows.

***Our future success depends, in part, on our ability to deliver our products and services at an affordable life cycle cost, requiring us to develop and maintain technologies, facilities, equipment, and a qualified workforce to meet the needs of current and future customers.***

Shipbuilding is a long cycle business, and our success depends on quality, cost, and schedule performance on our contracts. Our success depends upon our ability to develop and maintain the workforce, technologies, facilities, equipment, and financial capacity needed to deliver our products and services at an affordable life cycle cost. If we fail to maintain our competitive position in these areas, we could lose future contracts to our competitors, which could have a material adverse effect on our financial position, results of operations, or cash flows.

Our operating results are heavily dependent upon our ability to attract and retain at competitive costs a sufficient number of engineers and workers with the necessary skills and security clearances. At the same time, stable future revenues and costs are important for us to maintain a qualified workforce. Development and maintenance of the necessary nuclear expertise and the challenges of hiring and training a qualified workforce can be a limitation on our business. If qualified personnel become scarce, we could experience higher labor, recruiting, or training costs to attract and retain qualified employees, or, if we fail to attract and retain qualified personnel, we could incur difficulties performing our contracts and attracting new contract awards.

***Competition within our markets or an increase in bid protests may reduce our revenues and market share.***

U.S. defense spending levels are uncertain and difficult to predict. The reduction in shipbuilding activity by the U.S. Navy, evidenced by the reduction in fleet size from 566 ships in 1989 to 280 ships as of December 31, 2017, has resulted in workforce reductions in the industry but little infrastructure consolidation. The general result has been fewer contracts awarded to the same fixed number of shipyards. Six major private United States shipyards, three of which we own, plus many other smaller private shipyards compete for contracts to construct, overhaul, repair, and convert naval vessels. Additionally, our products, such as aircraft carriers, submarines, amphibious assault ships, surface combatants, and other ships, compete for funding with each other, as well as with other defense products and services. We expect competition for future shipbuilding programs to be intense.

We compete with another large defense contractor for construction contracts to build surface combatants, submarines, and large deck amphibious ships. We may in the future compete with the same and other defense contractors to build other ships for which we are currently the sole source, including expeditionary warfare and other amphibious assault ships. Moreover, reductions in U.S. defense spending that reduce the demand for the types of ships we build and services we provide increase our risk exposure to market competition. If we are unable to continue to compete successfully against our current or future competitors, we may experience lower revenues and market share, which could negatively impact our financial condition, results of operations, or cash flows.

Although we are the only company currently capable of refueling nuclear-powered aircraft carriers, two existing U.S. Government-owned shipyards may be able to refuel nuclear-powered aircraft carriers if substantial investments in facilities, personnel, and training were made. U.S. Government-owned shipyards currently engage in the refueling, overhaul, and inactivation of *Los Angeles* class (SSN 688) submarines and are capable of repairing and overhauling non-nuclear ships. If a U.S. Government-owned shipyard became capable and engaged in the refueling of nuclear-powered aircraft carriers, our financial position, results of operations, or cash flows could be adversely affected.

We also compete in the shipbuilding engineering, planning, and design market with other companies that provide engineering support services. Such competition increases the risk we may not be the successful bidder on future U.S. Navy engineering proposals, including aircraft carrier research and development, submarine design, and surface combatant and amphibious assault ship program contracts.

Our competitive environment is also affected by bid protests from unsuccessful bidders on new program awards. As the competitive environment intensifies, the number of bid protests may increase. Bid protests can result in an award decision being overturned, requiring a re-bid of the contract. Even when a bid protest does not result in a re-bid, resolution of the matter typically extends the time until contract performance can begin, which may reduce our earnings in the period in which the contract would otherwise be performed.

***As a U.S. Government contractor, we are heavily regulated and could be adversely affected by changes in regulations or negative findings from a U.S. Government audit or investigation.***

As a U.S. Government contractor, we must comply with significant regulatory requirements, including those relating to procurement, cyber security, and nuclear operations. Government contracting requirements increase our contract performance and compliance costs and risks and change on a routine basis. In addition, our nuclear operations are subject to an enhanced regulatory environment, which results in increased performance and compliance efforts and costs. New laws, regulations, or procurement requirements, or changes to existing ones (including, for example, regulations related to recovery of compensation costs, cyber security, counterfeit parts, specialty metals, and conflict minerals), can increase our performance and compliance costs and risks and reduce our profitability.

We are routinely audited and reviewed by the U.S. Government and its various agencies, including the U.S. Navy's Supervisor of Shipbuilding, the DCAA, and the DCMA. These agencies review our contract performance, cost structures, and compliance with applicable laws, regulations, and standards, as well as the adequacy of our business systems and processes relative to U.S. Government requirements. If an audit uncovers improper or illegal activities, we may be subject to administrative, civil, or criminal proceedings, which could result in fines, penalties, repayments, or compensatory, treble, or other damages. Certain U.S. Government findings against a contractor can also lead to suspension or debarment from future U.S. Government contracts or the loss of export privileges. Allegations of impropriety can also cause us significant reputational harm.

Whether or not illegal activities are alleged, the U.S. Government has the ability to decrease or withhold contract payments if it determines significant deficiencies exist in business systems subject to its review. In the past the U.S. Government has, in certain instances, withheld contract payments upon its assessment that deficiencies existed with one or more of our business systems. When appropriate, we must modify our affected business systems to address the U.S. Government's determinations.

The U.S. Government has, from time to time, recommended that certain of our contract prices be reduced, or that certain costs allocated to our contracts be disallowed. These recommendations sometimes involve substantial dollar amounts. In response to U.S. Government audits, investigations, and inquiries, we have also in the past made adjustments to our contract prices and the costs allocated to our government contracts. Such audits, investigations, and inquiries may result in future reductions of our contract prices. Any costs we incur that are determined to be unallowable or improperly allocated to a specific contract will not be recovered or must be refunded if previously reimbursed.

We must comply with a variety of federal laws and regulations, including the FAR, the Truth in Negotiations Act, the False Claims Act, the Procurement Integrity Act, the International Traffic in Arms Regulations promulgated under the Arms Export Control Act, the Close the Contractor Fraud Loophole Act, the Foreign Corrupt Practices Act, and Cost Accounting Standards. If a determination is made that we engaged in illegal activities or did not act responsibly, as defined by the law, we may be subject to reductions in contract values, contract modifications or terminations,

penalties, fines, repayments, compensatory, treble, or other damages, or suspension or debarment, any of which could have a material adverse effect on our financial position, results of operations, or cash flows.

***Many of our contracts contain performance obligations that require innovative design capabilities or state-of-the-art manufacturing expertise, include technological complexity, or are dependent upon factors not wholly within our control, and failure to meet these obligations could adversely affect our profitability and future prospects.***

We design, develop, and manufacture products and provide services applied by our customers in a variety of environments. Problems and delays in product development or with delivery of subcontractor components or services as a result of issues with respect to design, technology, licensing and intellectual property rights, labor, learning curve assumptions, or materials and parts could prevent us from satisfying contractual requirements.

First-in-class ships, also known as lead ships, usually include new technology that is supplied by the U.S. Navy, other contractors, or us. Problems developing these new technologies or design changes in the construction process can lead to delays in the design schedule for construction. The risks associated with new technology or mid-construction design changes can both increase the cost of a ship and delay delivery. Late delivery of information can also cause inefficiencies in the construction process, increase costs, and put the delivery schedule at risk, which could adversely affect our profitability and future prospects.

Our products cannot always be tested and proven and are otherwise subject to unforeseen problems, including premature failure of products that cannot be accessed for repair or replacement, substandard quality or workmanship, and unplanned degradation of product performance. These failures could result in loss of life or property and could negatively affect our results of operations by causing unanticipated expenses not covered by insurance or indemnification from the customer, diversion of management focus to respond to unforeseen problems, loss of follow-on work, and, in the case of certain contracts, repayment to the customer of contract costs and fee payments previously received.

We periodically experience quality issues with respect to products and services that we sell to our U.S. Government customers. These issues can and have required significant resources to analyze the source of the deficiencies and implement corrective actions. We may discover quality issues in the future related to our products and services that require analysis and corrective action. Such issues and our responses and corrective actions could have a material adverse effect on our financial position, results of operations, or cash flows.

***We use estimates when accounting for contracts. Changes in estimates could affect our profitability and our overall financial position.***

Contract accounting requires judgment relative to assessing risks, estimating contract revenues and costs, and making assumptions regarding schedule and technical issues. The size and nature of many of our contracts make the estimation of total revenues and costs at completion complicated and subject to many variables. For new shipbuilding programs, we estimate, negotiate, and contract for construction of ships that are not completely designed, which subjects our risk assessments, revenue and cost estimates, and assumptions regarding schedule and technical issues to the variability of the final ship design and evolving scope of work. Our judgment, estimation, and assumption processes are significant to our contract accounting, and materially different amounts can be generated if different assumptions are used or if actual events differ from our assumptions. Future changes in underlying assumptions, circumstances, or estimates may have a material adverse effect on our future financial position, results of operations, or cash flows. See Critical Accounting Policies, Estimates, and Judgments in Item 7.

***Our business is subject to disruption caused by natural disasters, environmental disasters, and other events that could have a material adverse effect on our financial position, results of operations, or cash flows.***

We have significant operations located in regions of the United States that have been and may in the future be exposed to damaging storms, such as hurricanes and floods, and environmental disasters, such as oil spills. Natural disasters can disrupt our workforce, electrical and other power distribution networks, computer and internet operations and accessibility, and the critical industrial infrastructure needed for normal business operations, which could adversely affect our contract performance and financial results. Environmental disasters, particularly oil spills in waterways and bodies of water used for the transport and testing of our ships, can disrupt the timing of performance under our contracts with the U.S. Navy and the U.S. Coast Guard.

Damage and disruption resulting from natural and environmental disasters may be significant. Should insurance or other risk transfer mechanisms be unavailable or insufficient to recover material costs associated with natural or environmental disasters or other events, we could experience a material adverse effect on our financial position, results of operations, or cash flows. See *Our insurance coverage may be inadequate to cover all of our significant risks or our insurers may deny coverage of material losses we incur, which could adversely affect our profitability and financial position.*

Our suppliers and subcontractors are also subject to natural and environmental disasters that could affect their ability to deliver products or services or otherwise perform their contracts. Performance failures by our subcontractors due to natural or environmental disasters may adversely affect our ability to perform our contracts, which could reduce our profitability in the event damages or other costs are not recoverable from the subcontractor, the customer, or insurers. Such events could also result in a termination of the prime contract and have an adverse effect on our ability to compete for future contracts.

In addition to the types of events described above, operation of our facilities may be disrupted by civil unrest, acts of sabotage or terrorism, and other local security concerns. Such events may require us to incur greater costs for security or to shut down operations for a period of time.

***Our insurance coverage may be inadequate to cover all of our significant risks or our insurers may deny coverage of material losses we incur, which could adversely affect our profitability and financial position.***

We seek to negotiate and enter into insurance agreements to cover our significant risks and potential liabilities, including, among others, property loss from natural disasters, product liability, and business interruption resulting from an insured property loss. In some circumstances, we may be indemnified for losses by the U.S. Government, subject to the availability of appropriated funds. Not every risk or liability can be protected by insurance, and, for insurable risks, the limits of coverage reasonably obtainable in the market may not be sufficient to cover the full amount of actual losses or liabilities incurred, including, for example, in the case of a catastrophic hurricane. In addition, the nature of our business makes it difficult to quantify the disruptive impact of such events. Limitations on the availability of insurance coverage may result in us bearing substantial costs for uninsured losses, which could have a material adverse effect on our financial position, results of operations, or cash flows. Even in cases where we have insurance coverage, disputes with insurance carriers over coverage may affect the timing of cash flows, and, in the event of litigation with an insurance carrier, an outcome unfavorable to us may have a material adverse effect on our financial position, results of operations, or cash flows.

***Our business could suffer if we are unsuccessful in negotiating new collective bargaining agreements.***

Approximately 50% of our employees are covered by a total of nine collective bargaining agreements and two DoE site stabilization agreements. Newport News has four collective bargaining agreements covering represented employees, one of which covers approximately 50% of Newport News employees and was renewed in July 2017. The remaining collective bargaining agreements at Newport News expire in August 2018, December 2018, and November 2020. Newport News craft workers employed at the Kesselring Site near Saratoga Springs, New York are represented under an indefinite DoE site agreement. Ingalls has five collective bargaining agreements covering represented employees, all of which expire in March 2022. Approximately 35 Technical Solutions craft employees at the Hanford Site near Richland, Washington are represented under an indefinite DoE site stabilization agreement.

Collective bargaining agreements generally expire after three to five years, and we negotiate successor agreements as each of our collective bargaining agreements expires. While we believe we maintain good relationships with our represented workers, it is possible we may experience difficulties renegotiating expiring collective bargaining agreements. We have, in the past, experienced work stoppages, strikes, and other labor disruptions associated with the collective bargaining of new labor agreements. If we experience such events in the future, we could incur additional expenses or work delays that could adversely affect programs served by employees who are covered by collective bargaining agreements.



***Changes in key estimates and assumptions, such as discount rates and assumed long-term returns on assets, actual investment returns on our pension plan assets, and legislative and regulatory actions could significantly affect our earnings, financial condition, and contributions to our defined benefit pension and other postretirement benefit plans in future periods.***

Our pension and retiree health care costs are dependent upon significant judgment regarding various estimates and assumptions, particularly with respect to the discount rate and expected long-term rates of return on plan assets. Changes to these estimates and assumptions could have a material adverse effect on our financial position, results of operations, or cash flows. Differences between actual investment returns and our assumed long-term returns on assets will result in future changes in pension expense and the funded status of our plans, and could increase future funding of the plans.

***Unforeseen environmental costs could have a material adverse effect on our financial position, results of operations, or cash flows.***

Our operations are subject to and affected by a variety of existing federal, state, and local environmental protection laws and regulations. In addition, we could be affected by future laws or regulations, including those imposed in response to concerns over climate change, other aspects of the environment, or natural resources. We expect to incur future capital and operating costs to comply with current and future environmental laws and regulations, and such costs could be substantial, depending on the future proliferation of environmental rules and regulations and the extent to which we discover currently unknown environmental conditions.

Shipbuilding operations require the use of hazardous materials. Our shipyards also generate significant quantities of wastewater, which we treat before discharging pursuant to various permits. To handle these materials, our shipyards have an extensive network of aboveground and underground storage tanks, some of which have leaked and required remediation in the past. In addition, our handling of hazardous materials has sometimes resulted in spills in our shipyards and occasionally in adjacent rivers and waterways in which we operate. Our shipyards maintain extensive waste handling programs that we periodically modify, consistent with changes in applicable laws and regulations. See Environmental, Health and Safety in Item 1.

Various federal, state, and local environmental laws and regulations impose restrictions on the discharge of pollutants into the environment and establish standards for the transportation, storage, and disposal of toxic and hazardous wastes. Substantial fines, penalties, and criminal sanctions may be imposed for noncompliance, and certain environmental laws impose joint and several "strict liability" for remediation of spills and releases of oil and hazardous substances. Such laws and regulations render a party liable for environmental cleanup and remediation costs and damage without regard to negligence or fault on the part of such party and could expose us to liability for the conduct of or conditions caused by third parties.

In addition to fines, penalties, and criminal sanctions, environmental laws and regulations may require the installation of costly pollution control equipment or operational changes to limit pollution emissions or discharges and/or to decrease the likelihood of accidental hazardous material releases. We expect to continue to incur costs to comply with federal and state environmental laws and regulations related to the cleanup of pollutants released into the environment. In addition, if we are found to be in violation of the Clean Air Act or the Clean Water Act, the facility or facilities involved in the violation could be placed by the EPA on the "Excluded Parties List" maintained by the General Services Administration, which would continue until the EPA concluded that the cause of the violation was cured. Facilities on the "Excluded Parties List" are prohibited from working on any U.S. Government contract.

The adoption of new environmental laws and regulations, stricter enforcement of existing laws and regulations, imposition of new cleanup requirements, discovery of previously unknown or more extensive contamination, litigation involving environmental impacts, our inability to recover related costs under our government contracts, or the financial insolvency of other responsible parties could cause us to incur costs that could have a material adverse effect on our financial position, results of operations, or cash flows.

We ceased shipbuilding construction at our Avondale, Louisiana shipyard in 2014. Our wind down of operations at this shipyard may result in environmental costs, the amount of which we cannot currently estimate. Such costs could be significant and could have a material adverse effect on our financial position, results of operations, or cash flows.

***Market volatility and adverse capital market conditions may affect our ability to access cost-effective sources of funding and may expose us to risks associated with the financial viability of suppliers and subcontractors.***

The financial markets can experience high levels of volatility and disruption, reducing the availability of credit for certain issuers. We may access these markets from time to time to support certain business activities, including funding acquisitions and capital expansion projects and refinancing existing indebtedness. We also access these markets to obtain credit support for our workers' compensation self-insurance program and arrange for letters of credit. A number of factors could cause us to incur higher borrowing costs and to have greater difficulty accessing public and private markets for debt. These factors include disruptions or declines in the global capital markets and/or a decline in our financial performance, outlook, or credit ratings. The occurrence of any or all of these events may adversely affect our ability to fund our operations, meet contractual commitments, make future investments or desirable acquisitions, or respond to competitive challenges.

Tightening capital markets could also adversely affect our suppliers' and subcontractors' ability to obtain financing. Delays in suppliers' or subcontractors' ability to obtain financing, or the unavailability of financing, could negatively affect their ability to perform their contracts with us and cause our inability to perform our contracts. The inability of our suppliers and subcontractors to obtain financing could also result in the need for us to transition to alternate suppliers and subcontractors, which could result in significant incremental costs and delays.

***Our reputation and our ability to do business may be impacted by the improper conduct of employees, agents, or business partners.***

Our compliance program includes detailed compliance plans and related compliance controls, policies, procedures, and training designed to prevent and detect misconduct by employees, agents, business partners, and others working on our behalf, including suppliers and subcontractors, that would violate the laws of the jurisdictions in which we operate, including laws governing payments to government officials, the protection of export controlled or classified information, cost accounting and billing, competition, and data privacy. Our business has been impacted in the past by the improper misconduct of employees and business partners, and we may not prevent all such misconduct in the future by our employees, agents, business partners, and others working on our behalf, including suppliers and subcontractors. Moreover, the risk of improper conduct may be expected to increase as we expand into commercial markets and foreign jurisdictions. Any improper actions by our employees, agents, business partners, and others working on our behalf, including suppliers and subcontractors, could subject us to administrative, civil, or criminal investigations and monetary and non-monetary penalties, including suspension or debarment, which could have a material adverse effect on our financial position, results of operations, or cash flows. Any such improper actions could also cause us significant reputational damage.

***Our business could be negatively impacted by security threats, including cyber security threats, and related disruptions.***

As a defense contractor, we rely on our information technology infrastructure to process, transmit, and store electronic information, including classified and other sensitive information of the U.S. Government. While we maintain stringent information security policies and protocols, we face cyber security and other security threats to our information technology infrastructure, including threats to our and the U.S. Government's proprietary and classified information. We face unauthorized and unlawful attempts to gain access to our information technology infrastructure, including coordinated attacks from groups of hackers, and we could also face attempts to gain physical access to classified and other sensitive information located at our facilities. Our information technology infrastructure is critical to the efficient operation of our business and essential to our ability to perform day-to-day operations. Breaches of our information technology infrastructure or physical facilities could cause us to incur significant recovery and restoration expenses; degrade performance on existing contracts; and expose us to reputational damage, potential liability, or the loss of current or future contracts, including work on sensitive or classified systems for the U.S. Government, which could have a material adverse effect on our operations, financial position, results of operations, or cash flows.

In addition, our suppliers, subcontractors, and other business partners face cyber security and other security threats. Although we work cooperatively with our customers, suppliers, subcontractors, and other business partners to seek to minimize the impact of cyber threats, other security threats, and business disruptions, we must rely on the safeguards put in place by these entities, which may affect the security of our information. These entities have

varying levels of cyber security expertise and safeguards, and their relationships with U.S. Government contractors may increase the likelihood that they are targeted by the same cyber security threats we face.

***Our nuclear operations subject us to various environmental, regulatory, financial, and other risks.***

The design, construction, refueling and overhaul, repair, and inactivation of nuclear-powered aircraft carriers and nuclear-powered submarines, our nuclear facilities used to support such activities, our nuclear operations at DoE sites, and our activities in the commercial nuclear market subject us to various risks, including:

- Potential liabilities relating to harmful effects on the environment and human health resulting from nuclear operations and the storage, handling, and disposal of radioactive materials, including nuclear assemblies and their components;
- Unplanned expenditures relating to maintenance, operation, security, and repair, including repairs required by the U.S. Navy, the Nuclear Regulatory Commission, or the DoE;
- Reputational harm;
- Potential liabilities arising out of a nuclear incident whether or not it is within our control; and
- Regulatory noncompliance and loss of authorizations or indemnifications necessary for our operations.

Failure to properly handle nuclear materials could pose a health risk to humans or wildlife and could cause personal injury and property damage, including environmental contamination. If a nuclear accident were to occur, its severity could be significantly affected by the volume of the materials and the speed of corrective action taken by us and emergency response personnel, as well as other factors beyond our control, such as weather and wind conditions. Actions we might take in response to an accident could result in significant costs.

Our nuclear operations are subject to various safety related requirements imposed by the U.S. Navy, DoE, and Nuclear Regulatory Commission. In the event of noncompliance, these agencies may increase regulatory oversight, impose fines, or shut down our operations, depending on their assessment of the severity of the noncompliance. In addition, new or revised security and safety requirements imposed by the U.S. Navy, DoE, and Nuclear Regulatory Commission could necessitate substantial capital and other expenditures.

Subject to certain requirements and limitations, our contracts with the U.S. Navy and DoE generally provide for indemnity by the U.S. Government for costs arising out of or resulting from our nuclear operations. We may not, however, be indemnified for all liabilities we may incur in connection with our nuclear operations. To mitigate risks related to our commercial nuclear operations, we rely primarily on insurance carried by nuclear facility operators and our own limited insurance for losses in excess of the coverage of facility operators. Such insurance, however, may not be sufficient to cover our costs in the event of an accident or business interruption relating to our commercial nuclear operations, which could have a material adverse effect on our financial position, results of operations, or cash flows.

***Changes in future business conditions could cause business investments, recorded goodwill, and/or purchased intangible assets to become impaired, resulting in substantial losses and write-downs that would reduce our operating income.***

As part of our business strategy, we acquire non-controlling and controlling interests in businesses. We make acquisitions and investments following careful analysis and due diligence processes designed to achieve a desired return or strategic objective. Business acquisitions generally involve estimates, assumptions, and judgments to determine acquisition prices, which prices are allocated among acquired assets, including goodwill, based upon fair market values. Notwithstanding our analyses, due diligence processes, and business integration efforts, actual operating results of acquired businesses may vary significantly from initial estimates. In such events, we may be required to write down our carrying value of the related goodwill and/or purchased intangible assets. In addition, declines in the trading price of our common stock or the market as a whole can result in goodwill and/or purchased intangible asset impairment charges.

As of December 31, 2017, goodwill and purchased intangible assets generated from prior business acquisitions accounted for approximately 19% and 8%, respectively, of our total assets. We evaluate goodwill values for impairment annually on November 30, or when evidence of potential impairment exists. We also evaluate the values of purchased intangible assets when evidence of potential impairment exists. The impairment tests are

based on several factors requiring judgment. As a general matter, a significant decrease in expected cash flows or changes in market conditions may indicate potential impairment of recorded goodwill or purchased intangible assets.

In 2015, we recorded goodwill impairment charges of \$75 million at our Technical Solutions segment within the oil and gas reporting unit. The oil and gas reporting unit is sensitive to developments in the oil and gas industry. The goodwill impairment charges were primarily driven by continuing declines in oil prices and the resulting decreases in industry market multiples. In 2015, we also recorded an intangible asset impairment charge of \$27 million at our Technical Solutions segment as a result of declining market conditions and updated expectations.

Adverse equity market conditions that result in a decline in market multiples and the trading price of our common stock, or other events, such as reductions in future contract awards or significant adverse changes in our operating margins or the operating results of acquired businesses that vary significantly from projected results on which purchase prices are based, could result in an impairment of goodwill or other intangible assets. Any such impairments that result in us recording additional goodwill or intangible asset impairment charges could have a material adverse effect on our financial position or results of operations.

***Unanticipated changes in our tax provisions or exposure to additional income tax liabilities could affect our profitability and cash flow.***

We are subject to income taxes in various jurisdictions. Significant judgment is required in determining our provision for income taxes. In the ordinary course of business, the ultimate tax determination of many of our transactions and calculations is uncertain. In addition, timing differences in the recognition of contract income for financial statement purposes and for income tax purposes can cause uncertainty with respect to the timing of income tax payments, which can have a significant impact on cash flow in a particular period.

Changes in applicable income tax laws and regulations, or their interpretation, could result in higher or lower income tax rates or changes in the taxability of certain transactions or the deductibility of certain expenses, thereby affecting our income tax expense and profitability. On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was signed into law. The Tax Act provides for significant changes to the U.S. Internal Revenue Code of 1986, as amended, that impact corporations, including a reduction of the statutory federal corporate income tax rate from 35% to 21% and changes or limitations to certain deductions. While our accounting for elements of the Tax Act is incomplete, we were able to make reasonable estimates of the effects of certain provisions of the Tax Act and recorded corresponding provisional adjustments. There remain certain elements for which we cannot yet make reasonable estimates, however, and we cannot determine at this time the full effects in future years of the Tax Act on our financial position, results of operations, or cash flows. See Note 13: Income Taxes in Item 8.

In addition, the final results of any tax audits or related litigation could be materially different from our related historical income tax provisions and accruals. Changes in our tax rate as a result of changes in our overall profitability, changes in tax legislation, changes in the valuation of deferred tax assets and liabilities, changes in differences between financial statement income and taxable income, the examination of previously filed tax returns by taxing authorities, and continuing assessments of our tax exposures can also impact our tax liabilities and affect our income tax expense, profitability, and cash flow.

***We conduct a portion of our operations through joint ventures and strategic alliances. We may have limited control over such arrangements and experience returns that are not proportional to the risks and resources we contribute.***

We conduct a portion of our operations through joint ventures with business partners. In any joint venture arrangement, differences in views among the joint venture participants may result in delayed decisions or in failures to reach agreement on major issues. We and our joint venture partners may, in certain instances, fail to reach agreement on significant decisions on a timely basis, or at all. We also cannot control the actions of our joint venture partners, including any non-performance, default, or bankruptcy of our joint venture partners, and we typically share liability or have joint and/or several liability with our joint venture partners for joint venture matters. Any of these factors could potentially have a material adverse effect on our joint venture operations and the profitability of our joint ventures.

In joint ventures in which we hold a minority interest, we have limited control over many decisions relating to joint venture operations and internal controls relating to operations. These joint ventures may not be subject to the same

requirements regarding internal controls and internal control reporting that apply to us. As a result, internal control issues may arise that could have a material adverse effect on the joint venture. In addition, in order to establish or preserve relationships with our joint venture partners, we may agree to assume risks and contribute resources that are proportionately greater than the returns we expect to receive in the related joint venture. Such agreements may reduce our income and returns on these investments compared to what we would have received if our assumed risks and contributed resources were proportionate to our returns.

***Strategic acquisitions and investments we pursue involve risks and uncertainties.***

As part of our business strategy, we review, evaluate, and consider potential acquisitions and investments. In evaluating such transactions, we make difficult judgments regarding the value of business opportunities, technologies, and other assets, the risks and costs of potential liabilities, and the future prospects of business opportunities. In addition, acquisitions and investments involve other risks and uncertainties, including the difficulty of integrating acquired businesses, challenges achieving strategic objectives and other benefits anticipated from acquisitions or investments, the diversion of management attention and resources from our existing operations and other initiatives, the potential impairment of acquired assets, and the potential loss of key employees of acquired businesses. Our financial results, business, and future prospects could be adversely affected by unanticipated performance issues at acquired businesses, transaction-related charges, unexpected liabilities, amortization of expenses related to purchased intangible assets, and charges for impairments of goodwill and purchased intangible assets.

***We are subject to claims and litigation that could ultimately be resolved against us, requiring future material cash payments and/or future material charges against our operating income, materially impairing our financial position or cash flows.***

The size, nature, and complexity of our business make it highly susceptible to claims and litigation. We are subject to various administrative, civil, and criminal litigation, environmental claims, income tax matters, compliance matters, claims, and investigations, which could divert financial and management resources and result in fines, penalties, compensatory, treble or other damages, or nonmonetary relief. Government regulations also provide that certain allegations against a contractor may lead to suspension or debarment from government contracts or suspension of export privileges. Suspension or debarment could have a material adverse effect on us because of our reliance on government contracts and authorizations. Litigation, claims, or investigations, if ultimately resolved against us, could have a material adverse effect on our financial position, results of operations, or cash flows. Any litigation, claim, or investigation, even if fully indemnified or insured, could negatively impact our reputation among our customers and the public and make it more difficult for us to compete effectively or obtain adequate insurance in the future.

***We may be unable to adequately protect our intellectual property rights, which could affect our ability to compete.***

We own patents, trademarks, copyrights, and other forms of intellectual property related to our business, and we license intellectual property rights to and from third parties. The U.S. Government generally receives non-exclusive licenses to certain intellectual property we develop in the performance of U.S. Government contracts, and the U.S. Government may use or authorize others to use such intellectual property. The U.S. Government has begun asserting or seeking to obtain more extensive rights in intellectual property associated with its contracts. The U.S. Government's efforts could reduce our ability to control the use of certain of our intellectual property rights in a government contracting environment. Our intellectual property is also subject to challenge, invalidation, misappropriation, or circumvention by third parties.

We also rely upon proprietary technology, information, processes, and know-how that are not protected by patents. We seek to protect this information through trade secret or confidentiality agreements with our employees, consultants, subcontractors, and other parties, as well as through other measures. These agreements and other measures may not, however, provide meaningful protection for our unpatented proprietary information.

In the event of infringement of our intellectual property rights, breach of a confidentiality agreement, or unauthorized disclosure of proprietary information, we may not have adequate legal remedies to maintain our rights in our intellectual property. Litigation to determine the scope of our rights, even if successful, could be costly and a diversion of management's attention from other aspects of our business. In addition, trade secrets may otherwise

become known or be independently developed by competitors. If we are unable adequately to protect our intellectual property rights, our business could be adversely affected.

We have the right to use certain intellectual property licensed to us by third parties. In instances where third parties have licensed to us the right to use their intellectual property, we may be unable in the future to secure the necessary licenses to use such intellectual property on commercially reasonable terms.

***There can be no assurance we will continue to increase our dividends or to repurchase shares of our common stock at current levels.***

The payment of cash dividends and repurchases of our common stock are subject to limitations under applicable law and the discretion of our board of directors, considered in the context of then current conditions, including our earnings, other operating results and capital requirements. Declines in asset values or increases in liabilities, including liabilities associated with benefit plans and assets and liabilities associated with taxes, can reduce stockholders' equity. A deficit in stockholders' equity could limit our ability under Delaware law to pay dividends and repurchase shares in the future. In addition, the timing and amount of share repurchases under board approved share repurchase programs is within the discretion of management and will depend upon many factors, including results of operations and capital requirements, as well as applicable law.

***Our debt exposes us to certain risks.***

As of December 31, 2017, we had \$1,279 million of debt under our senior notes and \$1,235 million of additional borrowing capacity under our Credit Agreement (the "Credit Facility"). Our Credit Facility also allows us to solicit lenders to provide incremental financing in an aggregate amount not to exceed \$1,000 million, and the indentures governing our senior notes do not limit our incurrence of debt. The amount of our existing debt, combined with our ability to incur significant amounts of debt in the future, could have important consequences, including:

- Increasing our vulnerability to adverse economic or industry conditions;
- Requiring us to dedicate a portion of our cash flow from operations to payments on our debt, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, strategic initiatives, and general corporate purposes;
- Increasing our vulnerability to, and limiting our flexibility in planning for, or reacting to, changes in our business or the industries in which we operate;
- Exposing us to the risk of higher interest rates on borrowings under our Credit Facility, which are subject to variable rates of interest;
- Placing us at a competitive disadvantage compared to our competitors that have less debt; and
- Limiting our ability to borrow additional funds.

To the extent new debt is added to our current debt levels, the related risks that we face could be increased.

***Anti-takeover provisions in our organizational documents and Delaware law, as well as regulatory requirements, could delay or prevent a change in control.***

Certain provisions of our Restated Certificate of Incorporation and Restated Bylaws may delay or prevent a merger or acquisition that stockholders may consider favorable. For example, our Restated Certificate of Incorporation and Restated Bylaws currently require advance notice for stockholder proposals and director nominations, and authorize our board of directors to issue one or more series of preferred stock. These provisions may discourage acquisition proposals or delay or prevent a change in control, which could harm our stock price. Delaware law also imposes restrictions on mergers and other business combinations between any holder of 15% or more of our outstanding common stock and us.

Our nuclear shipbuilding operations are considered vitally important to the U.S. Navy. Consequently, the U.S. Navy requires us to include in our contracts with the Navy provisions regarding notice and approval rights for the Navy in the event of a change of control of our nuclear shipbuilding operations and regarding the Navy's obligations to indemnify us for losses relating to our nuclear operations for the Navy. Such provisions require us to provide the U.S. Navy with notice of any potential change of control of our nuclear shipbuilding operations and obtain the Navy's consent for transferring certain related licenses in order to facilitate the Navy's ability to ensure that a potential buyer would continue to conduct our operations in a satisfactory manner. We have included such

provisions in solicitations for future U.S. Navy nuclear work, and we expect them to be included in future contracts with the Navy for nuclear work.

Provisions of our Restated Certificate of Incorporation and our Restated Bylaws and our existing contracts with the U.S. Navy may have the effect of discouraging, delaying, or preventing a change of control of our company that may be beneficial to our stockholders.

## **ITEM 1B. UNRESOLVED STAFF COMMENTS**

There were no unresolved staff comments.

## **ITEM 2. PROPERTIES**

Our principal properties are located in Huntsville, Alabama; San Diego, California; Broomfield, Colorado; Avondale (New Orleans), Louisiana; Pascagoula, Mississippi; Houston, Texas; Fairfax, Hampton, Newport News, Suffolk, and Virginia Beach, Virginia; and Washington, D.C.

*Ingalls* - The properties comprising our Ingalls operating segment are located in Pascagoula, Mississippi, and Avondale, Louisiana.

Our Pascagoula shipyard is a primary builder of major surface warships for the U.S. Navy and has modernized dozens of other naval ships. It is the only U.S. shipyard in recent years to develop and build six different classes of ships for the U.S. Navy and U.S. Coast Guard. Our facilities in Pascagoula are located on approximately 800 acres on the banks of the Pascagoula River where it flows into the Mississippi Sound. We lease the west bank of our Pascagoula shipyard from the State of Mississippi pursuant to a 99-year lease, consisting of a 40-year base term plus six optional terms. We anticipate continued use of this facility for the remaining 49 years of the lease and beyond.

In October 2014, we ceased shipbuilding construction operations at the Avondale facility. Our Avondale shipyard is located on approximately 268 acres on the banks of the Mississippi River, approximately 12 miles upriver from downtown New Orleans. Approximately 20% of the Avondale shipyard is leased from several third parties. The leases have varying expiration dates and typically contain renewal rights. Effective July 31, 2017, we entered into a Purchase and Sale Agreement with a potential buyer of the Avondale facility. After conducting due diligence on the property, the potential buyer has the right to determine whether or not to proceed to closing.

*Newport News* - The primary properties comprising our Newport News operating segment are located in Newport News, Virginia.

Our Newport News facilities are located on approximately 550 acres we own near the mouth of the James River, which adjoins the Chesapeake Bay, the premier deep-water harbor on the east coast of the United States. Our Newport News shipyard is one of the largest in the United States. It is the sole designer, builder, and refueler of nuclear-powered aircraft carriers and one of only two shipyards capable of designing and building nuclear-powered submarines for the U.S. Navy. The shipyard also provides services for naval and commercial vessels.

Our Newport News shipyard includes seven graving docks, a floating dry dock, two outfitting berths, five outfitting piers, and various other shops. It also has a variety of other facilities, including an 18-acre all-weather steel fabrication shop, accessible by both rail and transporter, module outfitting facilities that enable us to assemble a ship's basic structural modules indoors and on land, machine shops totaling 300,000 square feet, and an apprentice school, which provides a four-year accredited apprenticeship program to train shipbuilders.

*Technical Solutions* - The properties comprising our Technical Solutions operating segment are located throughout the United States. Our properties located in Virginia Beach, Virginia; Mayport and Panama City, Florida; San Diego, California; Bremerton, Washington; and Honolulu, Hawaii, primarily provide fleet support services. Properties located in Huntsville, Alabama; Fairfax, Virginia; Orlando, Florida; San Antonio, Texas; and Aberdeen, Maryland, primarily provide integrated missions solutions services. Properties located in Broomfield, Colorado, and Newport News, Virginia, primarily provide nuclear and environmental services. A property located in Houston, Texas provides oil and gas services.

We believe our physical facilities and equipment are generally well maintained, in good operating condition, and satisfactory for our current needs. While our physical facilities and equipment are adequate for our current needs, we have initiated capital expenditure programs at our Ingalls and Newport News segments that will make us more competitive and enable us to meet future obligations under our shipbuilding programs.

### ITEM 3. LEGAL PROCEEDINGS

*U.S. Government Investigations and Claims* - Departments and agencies of the U.S. Government have the authority to investigate various transactions and operations of our company, and the results of such investigations may lead to administrative, civil, or criminal proceedings, the ultimate outcome of which could be fines, penalties, repayments, or compensatory, treble, or other damages. U.S. Government regulations provide that certain findings against a contractor may also lead to suspension or debarment from future U.S. Government contracts or the loss of export privileges. Any suspension or debarment would likely have a material adverse effect on us because of our reliance on government contracts.

In January 2013, we disclosed to the DoD, including the U.S. Navy, and the U.S. Department of Homeland Security, including the U.S. Coast Guard, pursuant to the FAR, that we had initiated an internal investigation regarding whether certain employees at Ingalls mischarged time or misstated progress on Navy and Coast Guard contracts. We conducted an internal investigation, led by external counsel, and took remedial actions, including the termination of employees in instances where we believed grounds for termination existed. We provided information regarding our investigation to the relevant government agencies, and agreed with the U.S. Navy and U.S. Coast Guard that they would initially withhold \$24 million in payments on existing contracts pending receipt of additional information from our internal investigation. The U.S. Navy subsequently reduced its portion of the withhold from \$18.2 million to \$4.7 million, and the U.S. Coast Guard reduced its withhold from \$5.8 million to \$3.6 million. In September 2017, the U.S. Navy and the U.S. Coast Guard paid us the respective remaining amounts they were withholding.

In June 2015, the U.S. Department of Justice ("DoJ") informed us that it was investigating the matters we disclosed to the DoD in January 2013. In August 2017, we settled the matters with the DoJ. The settlement did not have a material effect on our consolidated financial position, results of operations, or cash flows.

*Litigation* - In 2015, we received a Civil Investigative Demand from the DoJ relating to an investigation of certain allegedly non-conforming parts we purchased from one of our suppliers for use in connection with U.S. Government contracts. We have cooperated with the DoJ in connection with its investigation. In 2016, we were made aware that we are a defendant in a False Claims Act lawsuit filed under seal in the U.S. District Court for the Middle District of Florida related to our purchase of the allegedly non-conforming parts from the supplier. Depending upon the outcome of this matter, we could be subject to civil penalties, damages, and/or suspension or debarment from future U.S. Government contracts, which could have a material adverse effect on our consolidated financial position, results of operations, or cash flows. The matter remains sealed and given the current posture of the matter, we are unable to estimate an amount or range of reasonably possible loss or to express an opinion regarding the ultimate outcome.

We and our predecessors-in-interest are defendants in a longstanding series of cases that have been and continue to be filed in various jurisdictions around the country, in which former and current employees and various third parties allege exposure to asbestos-containing materials while on, or associated with, our premises or while working on vessels constructed or repaired by us. The cases allege various injuries, including those associated with pleural plaque disease, asbestosis, cancer, mesothelioma and other alleged asbestos-related conditions. In some cases, several of our former executive officers are also named as defendants. In some instances, partial or full insurance coverage is available to us for our liability and that of our former executive officers. Although we believe the ultimate resolution of current cases will not have a material effect on our consolidated financial position, results of operations, or cash flows, we cannot predict what new or revised claims or litigation might be asserted or what information might come to light and can, therefore, give no assurances regarding the ultimate outcome of asbestos related litigation.

We and our predecessor-in-interest have been in litigation with the Bolivarian Republic of Venezuela (the "Republic") since 2002 over a contract for the repair, refurbishment, and modernization at Ingalls of two foreign-built frigates. The case proceeded towards arbitration, then appeared to settle favorably, but the settlement was overturned in court and the matter returned to litigation. In March 2014, we filed an arbitral statement of claim asserting breaches of the contract and \$173 million in damages plus substantial interest and litigation expenses. In



July 2014, the Republic filed in the arbitration a statement of defense denying all our allegations and a counterclaim alleging late redelivery of the frigates, unfinished work, and breach of warranty and asserting damages of \$61 million plus interest. An arbitration hearing was held in January 2015, and we cannot predict when the arbitration panel will render a decision. No assurances can be provided regarding the ultimate outcome of this matter.

We are party to various other claims and legal proceedings that arise in the ordinary course of business. Although we believe that the resolution of these other claims and legal proceedings will not have a material effect on our consolidated financial position, results of operations, or cash flows, we cannot predict what new or revised claims or litigation might be asserted or what information might come to light and can, therefore, give no assurances regarding the ultimate outcome of these matters.

#### ITEM 4. MINE SAFETY DISCLOSURES

None.

#### ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth certain information as of February 9, 2018, concerning our executive officers, including a five-year employment history.

Name	Age	Position(s)
C. Michael Petters	58	President and Chief Executive Officer
Jennifer R. Boykin	53	Executive Vice President and President, Newport News Shipbuilding
Brian J. Cuccias	61	Executive Vice President and President, Ingalls Shipbuilding
Jerri F. Dickseski	55	Executive Vice President, Communications
William R. Ermatinger	54	Executive Vice President and Chief Human Resources Officer
Edgar A. Green III	52	Executive Vice President and President, Technical Solutions
Christopher D. Kastner	54	Executive Vice President, Business Management and Chief Financial Officer
Nicolas G. Schuck	44	Corporate Vice President, Controller and Chief Accounting Officer
Michael S. Smith	44	Executive Vice President, Strategy and Development
Mitchell B. Waldman	57	Executive Vice President, Government and Customer Relations
Kellye L. Walker	51	Executive Vice President and General Counsel
D. R. Wyatt	59	Corporate Vice President and Treasurer

*C. Michael Petters, President and Chief Executive Officer* - Mr. Petters has been our President and Chief Executive Officer since March 2011. Prior to that and from 2008, Mr. Petters was President of Northrop Grumman Shipbuilding ("NGSB"). Before that and from 2004, he was President of Northrop Grumman Newport News. Since joining Newport News Shipbuilding and Dry Dock Company in 1987, Mr. Petters' responsibilities have included oversight of the *Virginia*-class submarine program, the nuclear-powered aircraft carrier programs, aircraft carrier refueling and overhaul, submarine fleet maintenance, commercial and naval ship repair, human resources and business and technology development. Mr. Petters holds a B.S. in Physics from the U.S. Naval Academy and an M.B.A. from the College of William and Mary.

*Jennifer R. Boykin, Executive Vice President and President, Newport News Shipbuilding* - Ms. Boykin was elected Executive Vice President and President, Newport News Shipbuilding effective July 2017. From 2012 until she assumed her current position, Ms. Boykin was Vice President, Engineering and Design for Newport News Shipbuilding. Since joining Newport News Shipbuilding in the Nuclear Division in 1987, Ms. Boykin has had a variety of responsibilities, including serving as Vice President of Quality and Process Excellence, Director of Facilities and Waterfront Support, and program manager for the Nuclear Engineering Division. Ms. Boykin also served as a construction superintendent for the aircraft carrier program during construction of USS *John C. Stennis* and USS *Harry S. Truman*. Ms. Boykin holds a B.S. in Marine Engineering from the U.S. Merchant Marine Academy and a Master's Degree in Engineering Management from The George Washington University.

*Brian J. Cuccias, Executive Vice President and President, Ingalls Shipbuilding* - Mr. Cuccias has been Executive Vice President and President, Ingalls Shipbuilding, since April 2014. Prior to that and from February 2011, he served in several different positions at our Ingalls Shipbuilding segment, including Vice President, Program Management, Vice President, Amphibious Ship Programs, and Vice President, Large Deck Amphibious Ships. From 2008 to February 2011, Mr. Cuccias was Vice President, Surface Combatants for NGSB. After joining a predecessor of Northrop Grumman in 1979, he held a variety of positions, including assistant to the group vice president of Avondale Industries, sector vice president, material for Northrop Grumman Ship Systems, and DDG(X) and DDG 1000 program manager and vice president. Mr. Cuccias holds a B.S. in Accounting from the University of South Alabama.

*Jerri F. Dickeski, Executive Vice President, Communications* - Ms. Dickeski has been Executive Vice President, Communications since March 2011. In this position, she is responsible for our communications strategy and execution. From 2008 to 2011, Ms. Dickeski served as Sector Vice President of Communications for NGSB. From 2001 to 2008, she was Director of Communications at Northrop Grumman Newport News. She joined Newport News Shipbuilding Inc. in 1991. Ms. Dickeski holds both a B.A. and an M.A. in English from Old Dominion University.

*William R. Ermatinger, Executive Vice President and Chief Human Resources Officer* - Mr. Ermatinger has been Executive Vice President and Chief Human Resources Officer since March 2011. Prior to that and from 2008, Mr. Ermatinger was Sector Vice President of Human Resources and Administration for NGSB. In that position, he was responsible for all NGSB human resources and administration activities. Since joining a predecessor of Northrop Grumman in 1987, Mr. Ermatinger has held several human resources management positions with increasing responsibility, including Vice President of Human Resources and Administration of Northrop Grumman Newport News. Mr. Ermatinger holds a B.A. in Political Science from the University of Maryland Baltimore County.

*Edgar A. Green III, Executive Vice President and President, Technical Solutions* - Mr. Green was appointed Executive Vice President and President, Technical Solutions in December 2016. Prior to that and from January 2015, he served as Corporate Vice President, Corporate Development. From January 2013 to January 2015, Mr. Green served as Vice President, Component Manufacturing, for Newport News Shipbuilding, and, from March 2011 to January 2013, he served as Corporate Vice President, Investor Relations, of HII. Prior to joining HII in 2011, Mr. Green served as Vice President of Investor Relations at Celanese Corp. Before that he was an investment banker and research analyst at Wells Fargo, where he covered the defense and aerospace industry, and a manufacturing plant engineer and maintenance manager at Eaton Corp.'s Truck Components Division. Mr. Green also served as a U.S. Navy nuclear submarine officer. He holds a B.S. in Systems Engineering from the U.S. Naval Academy and an M.B.A. from Duke University.

*Christopher D. Kastner, Executive Vice President, Business Management and Chief Financial Officer* - Mr. Kastner was elected Executive Vice President, Business Management and Chief Financial Officer effective March 2016. From August 2012 until he assumed his current position, Mr. Kastner served as Corporate Vice President and General Manager, Corporate Development. Prior to that and from March 2011, he served as Vice President and Chief Financial Officer of our Ingalls Shipbuilding segment. Before that and from 2008, Mr. Kastner served as Vice President, Business Management and Chief Financial Officer of NGSB, Gulf Coast, and served as Vice President, Contracts and Risk Management of Northrop Grumman Ship Systems from 2006 to 2008. Prior to that, he held several positions at other Northrop Grumman businesses, including Corporate Director of Strategic Transactions. Mr. Kastner holds a B.A. in Political Science from the University of California at Santa Barbara and an M.B.A. from Pepperdine University.

*Nicolas G. Schuck, Corporate Vice President, Controller and Chief Accounting Officer* - Mr. Schuck was appointed Corporate Vice President, Controller and Chief Accounting Officer effective August 2015. Prior to that, he was Assistant Controller at our Newport News Shipbuilding division. Prior to that and since joining us in January 2012, he served as Corporate Assistant Controller. From December 2009 until December 2011, Mr. Schuck served as Director, Finance at ManTech International Corporation, a provider of technologies and solutions for national security programs for the intelligence community and other U.S. federal government customers. Prior to that, he worked for PricewaterhouseCoopers and Arthur Andersen. Mr. Schuck attended the National Institute of Economics and Accounting in Paris. He holds a Bachelor's Degree and a Master's Degree in Accounting and Finance and is a certified public accountant.

*Michael S. Smith, Executive Vice President, Strategy and Development* - Mr. Smith was appointed Executive Vice President, Strategy and Development, effective March 2016. Prior to that and since joining HII in 2014, he served

as Corporate Vice President, Business Growth, and, more recently, as Corporate Vice President, Corporate Development-Nuclear and Environmental Services. Prior to joining us, Mr. Smith worked ten years at BAE Systems, most recently as Sector Vice President, Business Development, Strategy and Planning, for the Support Solutions sector. Prior to BAE, he worked at Marsh USA, Inc. as a leader of the company's nuclear risk practice and then as vice president for insurance services. Mr. Smith also served five years as a surface warfare officer in the U.S. Navy. He holds a B.S. in Industrial Engineering and a Master's Degree in Engineering Management from Stanford University.

*Mitchell B. Waldman, Executive Vice President, Government and Customer Relations* - Mr. Waldman has been Executive Vice President, Government and Customer Relations since March 2011. In this position, he is responsible for the development and management of our government and customer affairs programs. From 2009 to 2011, Mr. Waldman served as Vice President of Business Development of Advanced Programs and Technology for Northrop Grumman's Aerospace Systems sector. Prior to that position, he served as Northrop Grumman's Corporate Director for Acquisition Policy from 2008. From 2003 to 2008, Mr. Waldman served as National Security Advisor for former Sen. Trent Lott. Prior to that, he held various senior executive positions within the Department of the Navy, including Deputy Assistant Secretary of the Navy (Ships). He holds a B.S. in Mechanical Engineering from the University of Florida and a J.D. from Catholic University.

*Kellye L. Walker, Executive Vice President and General Counsel* - Ms. Walker was elected Executive Vice President and General Counsel effective January 2015. In this position, she has overall leadership responsibility for our law department and outside counsel. Prior to joining us, Ms. Walker was with American Water Works Company, Inc., serving as Chief Administrative Officer, General Counsel and Secretary from September 2010 through May 2014. She served as their Senior Vice President, General Counsel and Secretary from January 2010 through January 2015. From February 2007 to June 2009, Ms. Walker served as Senior Vice President and General Counsel of Diageo North America, Inc., the largest operating company of Diageo plc. From February 2003 to December 2006, she served as Senior Vice President, General Counsel and Secretary of BJ's Wholesale Club, Inc., a leading warehouse club operator. Ms. Walker also served as a partner with the law firm of Hill & Barlow in Boston, Massachusetts, and as a partner and/or associate with the law firms of Chaffe, McCall, Phillips, Toler & Sarpy in New Orleans, Louisiana, and Boulton, Cummings, Connors & Berry in Nashville, Tennessee. Ms. Walker holds a B.S. in Business Administration, Marketing from Louisiana Tech University and a J.D. from Emory University School of Law.

*D. R. Wyatt, Corporate Vice President and Treasurer* - Mr. Wyatt has been Corporate Vice President and Treasurer since March 2011. Prior to that, he was Director of Business Management at NGSB where he was responsible for aircraft carriers, carrier fleet support, and energy business. Prior to his appointment as Director of Business Management, Mr. Wyatt served as Treasurer of Newport News Shipbuilding Inc., Assistant Treasurer and Manager of Finance, and has held various positions in the financial area, including cost estimating, cost control, accounting, financial analysis, and government accounting. He has extensive Treasury experience, including responsibility for corporate finance, cash management, risk management and all financings, capital structure, capital market interface, rating agency relationships, cash and financial forecasting, working capital management, short term investments, strategic transactions, pension asset management, and insurance and loss control. Mr. Wyatt holds a B.S. in Economics from Hampden-Sydney College and an M.B.A. from Old Dominion University.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### *Market Information*

Our common stock is listed on the New York Stock Exchange under the symbol "HII".

The following table sets forth, for the periods indicated, the high and low closing sale prices of our common stock as reported in the consolidated reporting system for the New York Stock Exchange Composite Transactions:

	2017		2016	
	High	Low	High	Low
January through March	\$ 219.47	\$ 189.05	\$ 138.52	\$ 121.41
April through June	\$ 205.62	\$ 185.22	\$ 168.03	\$ 137.35
July through September	\$ 226.44	\$ 191.38	\$ 174.09	\$ 149.11
October through December	\$ 251.96	\$ 229.93	\$ 187.96	\$ 146.75

#### *Stockholders*

The approximate number of common stockholders was 17,120 as of February 9, 2018.

#### *Dividends*

Quarterly cash dividends per common share for the most recent two years were as follows:

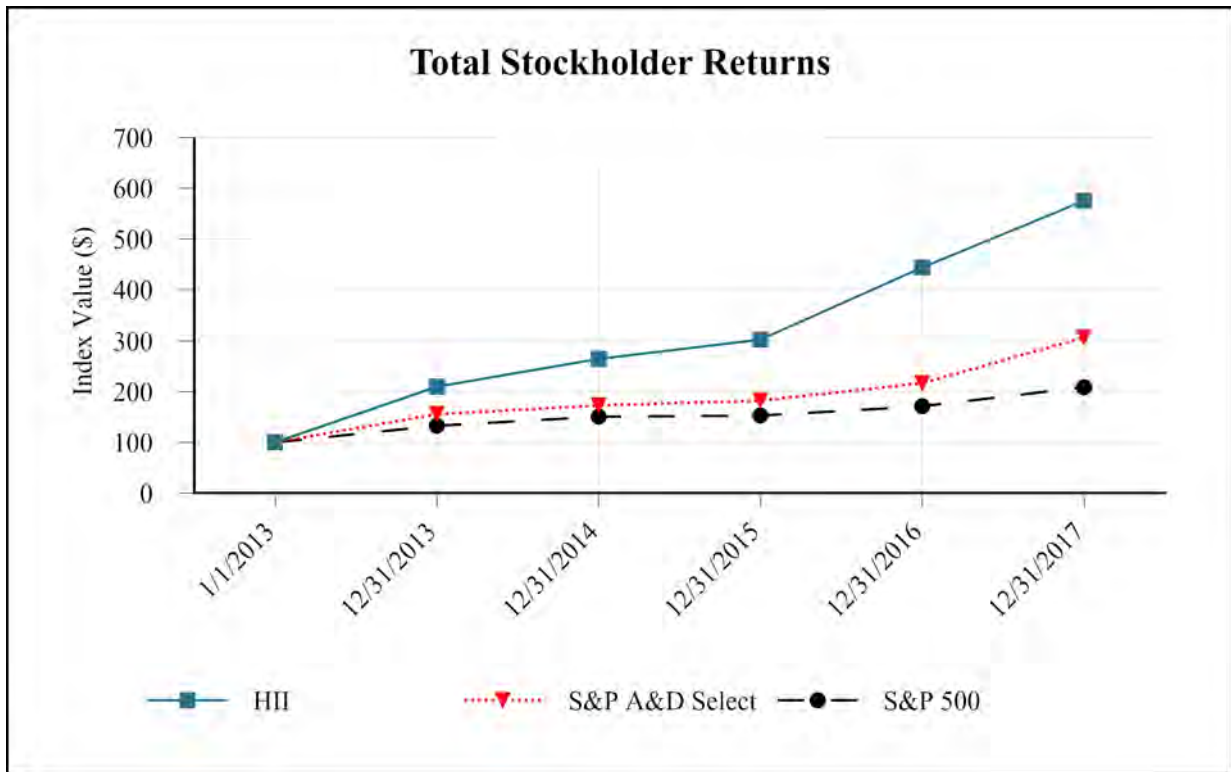
	2017	2016
	\$ 0.60	\$ 0.50
January through March	\$ 0.60	\$ 0.50
April through June	\$ 0.60	\$ 0.50
July through September	\$ 0.60	\$ 0.50
October through December	\$ 0.72	\$ 0.60

#### *Annual Meeting of Stockholders*

Our Annual Meeting of Stockholders will be held on May 2, 2018, in Newport News, Virginia.

## Stock Performance Graph

The following graph compares the total return on a cumulative basis of \$100 invested in our common stock on January 1, 2013, to the Standard & Poor's ("S&P") 500 Index and the S&P Aerospace and Defense Select Index.



- (1) The cumulative total return assumes reinvestment of dividends.
- (2) The total return is weighted according to market capitalization of each company at the beginning of each year.
- (3) The S&P Aerospace & Defense Select Index is comprised of Arconic, Inc., The Boeing Company, General Dynamics Corporation, Huntington Ingalls Industries, Inc., L-3 Technologies, Inc., Lockheed Martin Corporation, Northrop Grumman Corporation, Raytheon Company, Rockwell Collins, Inc., Textron, Inc., TransDigm Group Incorporated, and United Technologies Corporation, among other companies.

### *Purchases of Equity Securities by the Issuer and Affiliated Purchasers*

In November 2017, our board of directors authorized an increase in our stock repurchase program from \$1.2 billion to \$2.2 billion and an extension of the term of the program from October 31, 2019, to October 31, 2022.

Repurchases are made from time to time at management's discretion in accordance with applicable federal securities laws. All repurchases of HII common stock have been recorded as treasury stock. The following table summarizes information by month relating to purchases made by or on behalf of the Company of shares of the Company's common stock during the quarter ended December 31, 2017.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (in millions)
October 1, 2017 through October 31, 2017	26,833	\$ 234.05	26,833	\$ 1,263.0
November 1, 2017 through November 30, 2017	28,271	235.30	28,271	1,256.3
December 1, 2017 through December 31, 2017	118,599	236.86	118,599	1,228.3
Total	<u>173,703</u>	<u>\$ 236.17</u>	<u>173,703</u>	<u>\$ 1,228.3</u>

### *Securities Authorized for Issuance Under Equity Compensation Plans*

For information regarding securities authorized for issuance under our equity compensation plans, see Note 19: Stock Compensation Plans in Item 8 and Equity Compensation Plan Information in Item 12.

### *Unregistered Sales of Equity Securities and Use of Proceeds*

The Huntington Ingalls Industries Savings Plan, Huntington Ingalls Industries Financial Security and Savings Program, and Huntington Ingalls Industries, Inc. Newport News Operations Savings (401(k)) Plan for Union Eligible Employees (collectively, the "Plans") include shares of our common stock as an investment choice for participants. The trustees of the Plans manage HII stock funds, which purchase shares of our common stock on the open market, and interests in the stock funds are allocated to participant Plan accounts at the election of participants. In 2017, we became aware that participants in the Plans purchased more shares of our common stock than were registered under the Securities Act of 1933, as amended. We did not receive any consideration in connection with such purchases, which were funded with participant and employer contributions to the Plan.

## ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected financial data. The table should be read in conjunction with Item 7 and Item 8 of this Annual Report on Form 10-K.

(\$ in millions, except per share amounts)	Year Ended December 31				
	2017	2016	2015	2014	2013
Sales and service revenues	\$ 7,441	\$ 7,068	\$ 7,020	\$ 6,957	\$ 6,820
Goodwill impairment	—	—	75	47	—
Operating income (loss)	865	858	769	655	512
Net earnings (loss)	479	573	404	338	261
Total assets	6,374	6,352	6,024	6,239	6,190
Long-term debt <sup>(1)</sup>	1,279	1,278	1,273	1,562	1,665
Total long-term obligations	3,225	3,356	3,260	3,562	3,277
Net cash provided by (used in) operating activities	814	822	861	755	260
Free cash flow <sup>(2)</sup>	453	537	673	590	121
Dividends declared per share	\$ 2.52	\$ 2.10	\$ 1.70	\$ 1.00	\$ 0.50
Basic earnings (loss) per share	\$ 10.48	\$ 12.24	\$ 8.43	\$ 6.93	\$ 5.25
Diluted earnings (loss) per share	\$ 10.46	\$ 12.14	\$ 8.36	\$ 6.86	\$ 5.18

<sup>(1)</sup> Long-term debt does not include the current portion of long-term debt, which is included in current liabilities.

<sup>(2)</sup> Free cash flow is a non-GAAP financial measure and represents cash from operating activities less capital expenditures net of related grant proceeds. See Liquidity and Capital Resources in Item 7 for more information on this measure.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **OVERVIEW**

#### **Our Business**

Huntington Ingalls Industries, Inc. is America's largest military shipbuilding company and a provider of professional services to partners in government and industry. For more than a century, our Ingalls segment in Mississippi and Newport News segment in Virginia have built more ships in more ship classes than any other U.S. naval shipbuilder. We also provide a range of services to the governmental, energy, and oil and gas markets through our Technical Solutions segment. Headquartered in Newport News, Virginia, HII employs approximately 38,000 people operating both domestically and internationally.

We conduct most of our business with the U.S. Government, primarily the DoD. As prime contractor, principal subcontractor, team member, or partner, we participate in many high-priority U.S. defense technology programs. Ingalls includes our non-nuclear ship design, construction, repair, and maintenance businesses. Newport News includes all of our nuclear ship design, construction, overhaul, refueling, and repair and maintenance businesses. Our Technical Solutions segment provides a wide range of professional services, including fleet support, integrated missions solutions, nuclear and environmental, and oil and gas services.

The following discussion should be read along with the audited consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

#### **Business Environment**

In August 2011, the BCA established limits on U.S. Government discretionary spending, including a reduction of defense spending by approximately \$487 billion for fiscal years 2012 through 2021. The BCA also provided that the defense budget would face "sequestration" cuts of up to an additional \$500 billion during that same period, to the extent that discretionary spending limits are exceeded, and \$500 billion for non-defense discretionary spending, including the U.S. Coast Guard.

The BBA 2018 provided sequestration relief for fiscal years 2018 and 2019 and raised the budget topline for defense and non-defense discretionary spending. However, sequestration remains in effect for fiscal years 2020 and 2021. Long-term uncertainty remains with respect to overall levels of defense spending across the future years defense plan, and it is likely that U.S. Government discretionary spending levels will continue to be subject to significant pressure.

We cannot predict the impact that sequestration cuts or reprioritization of readiness and modernization investment may have on funding for our individual programs. Long-term funding for certain programs in which we participate may be reduced, delayed, or canceled. In addition, spending cuts and/or reprioritization of defense investment could adversely affect the viability of our suppliers, subcontractors, and employee base. Our contracts or subcontracts under programs in which we participate may be terminated or adjusted by the U.S. Government or the prime contractor as a result of lack of government funding or reductions or delays in government funding. Significant reductions in the number of ships procured by the U.S. Navy or significant delays in funding our ship programs would have a material effect on our financial position, results of operations, or cash flows.

The budget environment, including sequestration as currently mandated, remains a significant long-term risk. Considerable uncertainty exists regarding how future budget and program decisions will develop and what challenges budget changes will present for the defense industry. We believe continued budget pressures that result from sequestration and other budget priorities will have serious implications for defense discretionary spending, the defense industrial base, including us, and the customers, employees, suppliers, subcontractors, investors, and communities that rely on companies in the defense industrial base. Although it is difficult to determine specific impacts, we expect that over the longer term, the budget environment may result in fewer contract awards and lower revenues, profits, and cash flows from our U.S. Government contracts. Congress and the new Administration continue to discuss various options to address sequestration in future budget planning, but we cannot predict the outcome of these efforts. It is likely budget and program decisions made in this environment will have long-term impacts on us and the entire defense industry.



## Defense Industry Overview

The United States faces a complex, uncertain, and rapidly changing national security environment. The 2018 National Defense Strategy acknowledges an increasingly complex global security environment, characterized by overt challenges to the free and open international order and the re-emergence of long-term, strategic competition between nations. America also faces an ever more lethal and disruptive battlefield, combined across domains, and conducted at increasing speed and reach. The security environment is also affected by rapid technological advancements and the changing character of war. The drive to develop new technologies is relentless, expanding to more actors with lower barriers of entry, and moving at accelerating speed. New technologies include advanced computing, "big data" analytics, artificial intelligence, autonomy, robotics, directed energy, hypersonics, and biotechnology.

States are the principal actors on the global stage, but non-state actors also threaten the security environment with increasingly sophisticated capabilities. Terrorists, trans-national criminal organizations, cyber hackers, and other malicious non-state actors have increased capabilities of mass disruption. Terrorism remains a persistent condition driven by ideology and unstable political and economic structures.

We expect that the DoD execution of its strategy will require an affordable balance between investments in restoring the readiness of the current force with investments in new capabilities, technologies, and capacity to meet future challenges. The DoD faces the additional challenge of recapitalizing equipment and rebuilding readiness at a time when the DoD is pursuing modernization of its capabilities, while still facing additional budget cuts from sequestration. While the BBA 2018 provided relief for fiscal years 2018 and 2019, it is unclear how sequestration could impact programs for 2020 and beyond. BCA spending caps, coupled with other budget priorities, could have a significant impact on future spending plans for defense and non-defense discretionary programs. Decreases in the proposed funding levels for our programs could negatively impact our financial position, results of operations, or cash flows, including revenues, goodwill, and long-lived assets.

In December 2016, the U.S. Navy released the findings of a year-long Force Structure Assessment, developed to determine the right balance of existing forces, the ships currently under construction, and the future procurement plans needed to address the ever-evolving and increasingly complex threats that the Navy is required to counter. Notably, the Force Structure Assessment did not present a desired force size the U.S. Navy would pursue if resources were not constrained; it reflected a force level that balances warfighting risk to equipment and personnel against available resources and recommends a force size that can reasonably achieve success. Accordingly, the Force Structure Assessment reflects an objective force of 355 ships, comprised of 12 aircraft carriers, 104 large surface combatants, 52 small surface combatants, 38 amphibious warfare ships, 66 attack submarines, 12 ballistic missile submarines, 32 combat logistics ships, 10 expeditionary/high speed transports, 6 expeditionary support bases, and 23 command and support ships. Additionally, the 2018 National Defense Authorization Act included the SHIPS Act, which made it the policy of our nation to achieve a fleet size of 355 ships. It remains unclear, however, whether the 2016 Force Structure Assessment or the requirements of the SHIPS Act will have any bearing on budget outcomes for fiscal year 2019 and beyond.

The shipbuilding defense industry, as characterized by its competitors, customers, suppliers, potential entrants, and substitutes, is unique in many ways. It is heavily capital and skilled labor intensive. The U.S. Navy, a large single customer with many needs and requirements, dominates the industry's customer base and is served by a supplier base that has trended toward exclusive providers. Smaller shipyards, however, have entered the market to build the U.S. Navy's littoral combat ship. The U.S. Navy must compete with other national priorities, including other defense activities, non-defense discretionary spending, and entitlement programs, for a share of federal budget funding.

The Administration has focused on regulatory reform in order to manage the costs associated with the governmental imposition of private expenditures required to comply with federal regulations. Additionally, an Executive Order issued in February 2017 requires that for every new regulation issued, at least two prior regulations must be identified for elimination, and that the cost of planned regulations be prudently managed and controlled through a budgeting process. The DoD continues to adjust its procurement practices and streamline acquisition organizations and processes in an ongoing effort to reduce costs, gain efficiencies, and enhance program management and control. While the impact to our business resulting from these initiatives remains uncertain, they could have a material impact on current programs, as well as new business opportunities with the DoD. See Risk Factors in Item 1A.

## Program Descriptions

For convenience, a brief description of certain programs discussed in this Annual Report on Form 10-K is included in the Glossary of Programs.

## CONTRACTS

We generate most of our revenues from long-term U.S. Government contracts for design, production, and support activities. Government contracts typically include the following cost elements: direct material, labor and subcontracting costs, and certain indirect costs, including allowable general and administrative expenses. Unless otherwise specified in a contract, costs billed to contracts with the U.S. Government are treated as allowable and allocable costs under the FAR and CAS regulations. Examples of costs incurred by us that are not allowable under the FAR and CAS regulations include certain legal costs, lobbying costs, charitable donations, interest expense, and advertising costs.

We monitor our policies and procedures with respect to our contracts on a regular basis to ensure consistent application under similar terms and conditions, as well as compliance with all applicable government regulations. In addition, the DCAA routinely audits the costs we incur that are allocated to contracts with the U.S. Government.

Our long-term contracts typically fall into one of two broad categories:

- *Flexibly-Priced Contracts* - Includes both cost-type and fixed-price incentive contracts. Cost-type contracts provide for reimbursement of the contractor's allowable costs plus a fee that represents profit. Cost-type contracts generally require that the contractor use its reasonable efforts to accomplish the scope of the work within some specified time and some stated dollar limitation. Fixed-price incentive contracts also provide for reimbursement of the contractor's allowable costs, but are subject to a cost-share limit that affects profitability. Fixed-price incentive contracts effectively become firm fixed-price contracts once the cost-share limit is reached. Approximately 92%, 94%, and 95% of our revenues for the years ended December 31, 2017, 2016, and 2015, respectively, were generated from flexibly-priced contracts, including certain fixed-price incentive contracts that have exceeded their cost-share limit.
- *Firm Fixed-Price Contracts* - A firm fixed-price contract is a contract in which the specified scope of work is agreed to for a price that is predetermined by bid or negotiation and not generally subject to adjustment regardless of costs incurred by the contractor. Time and materials contracts, which specify a fixed hourly rate for each labor hour charged, are considered firm fixed-price contracts. Approximately 8%, 6%, and 5% of our revenues for the years ended December 31, 2017, 2016, and 2015, respectively, were generated from firm fixed-price arrangements.

*Contract Fees* - Negotiated contract fee structures for both flexibly-priced and firm fixed-price contracts include: fixed fee amounts, cost sharing arrangements to reward or penalize contractors for under or over cost target performance, respectively, positive award fees, and negative penalty arrangements. Profit margins may vary materially depending on the negotiated contract fee arrangements, percentage-of-completion of the contract, the achievement of performance objectives, and the stage of performance at which the right to receive fees, particularly under incentive and award fee contracts, is finally determined.

*Award Fees* - Certain contracts contain award fees based on performance criteria such as cost, schedule, quality, and technical performance. Award fees are determined and earned based on an evaluation by the customer of our performance against such negotiated criteria. Fees that we are reasonably assured of collecting and can be reasonably estimated are recorded over the performance period of the contract.

## CRITICAL ACCOUNTING POLICIES, ESTIMATES, AND JUDGMENTS

Our consolidated financial statements are prepared in accordance with GAAP, which requires management to make estimates, judgments, and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Management considers an accounting policy to be critical if it is important to our financial condition and results of operations and requires significant judgment and estimates by management in its application. The development and selection of these critical accounting policies have been determined by our management. We have reviewed our critical accounting policies and estimates with the audit committee of our board of directors. Due to the significant judgment involved in selecting certain of the assumptions used in these

policies, it is possible that different parties could choose different assumptions and reach different conclusions. We consider the policies relating to the following matters to be critical accounting policies:

- Revenue recognition;
- Purchase accounting, goodwill, and intangible assets;
- Litigation, commitments, and contingencies;
- Retirement related benefit plans; and
- Workers' compensation.

## **Revenue Recognition**

*Overview* - Most of our revenues are derived from long-term contracts for the production of goods and services provided to the federal government, which are accounted for in conformity with GAAP for construction-type and production-type contracts and federal government contractors. We have other types of contracts, such as services and commercial arrangements, for which revenues are recognized upon delivery or as services are rendered once persuasive evidence of an arrangement exists, the price is fixed or determinable, and collectibility is reasonably assured. Costs related to these contracts are expensed as incurred. We classify contract revenues as product sales or service revenues depending on the predominant attributes of the relevant underlying contracts. We consider the nature of these contracts and the types of products and services provided when determining the proper accounting method for a particular contract.

*Percentage-of-Completion Accounting* - We generally recognize revenues from our long-term contracts under the cost-to-cost measure of the percentage-of-completion method of accounting. The percentage-of-completion method recognizes income as work on a contract progresses. For most contracts, we calculate sales based on the percentage of costs incurred in relation to total Estimated Costs at Completion of the contract ("EAC"). For certain contracts with large up-front purchases of material, sales are calculated based on the percentage that direct labor costs incurred bear to total estimated direct labor costs at completion. For certain contracts that provide for deliveries of a substantial number of similar units, sales are accounted for using units of delivery as the basis to measure progress toward completion.

The use of the percentage-of-completion method depends on our ability to make reasonably dependable cost estimates for the design, manufacture, and delivery of our products and services. Such costs are typically incurred over a period of several years, and estimation of these costs requires the use of judgment. We record sales under cost-type contracts as costs are incurred.

Many contracts contain positive and negative profit incentives based upon performance relative to predetermined targets that may occur during or subsequent to delivery of the product. These incentives take the form of potential additional fees to be earned or penalties to be incurred. Incentives and award fees that we are reasonably assured of collecting and can be reasonably estimated are recorded over the performance period of the contract. Incentives and award fees that we are not reasonably assured of collecting or cannot be reasonably estimated are recorded when awarded or at such time as a reasonable estimate can be made.

At the start of each contract, we estimate an initial profit-booking rate that considers risks related to technical requirements and feasibility, schedule, and contract costs. Management then performs periodic reviews of our contracts in order to evaluate technical matters, schedule, and contract costs. During the life of a contract, the profit-booking rate may increase as we are able to retire risks in connection with technical matters, schedule, and contract costs. Conversely, if we are not able to retire these risks, our EAC may increase, resulting in a lower profit-booking rate.

Changes in estimates of contract sales, costs, and profits are recognized using the cumulative catch-up method of accounting. This method recognizes in the current period the cumulative effect of the changes in current and prior periods. Hence, the effect of the changes in future periods of contract performance is recognized as if the revised estimate had been the original estimate. A significant change in an estimate on one or more contracts in a period could have a material effect on our consolidated financial position or results of operations for that period.

For the years ended December 31, 2017, 2016, and 2015, favorable and unfavorable cumulative catch-up adjustments were as follows:

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
Gross favorable adjustments	\$ 309	\$ 297	\$ 304
Gross unfavorable adjustments	(105)	(73)	(65)
Net adjustments	\$ 204	\$ 224	\$ 239

For the year ended December 31, 2017, favorable cumulative catch-up adjustments were primarily related to risk retirement on the *Legend* class NSC program, *Tripoli* (LHA 7), *Portland* (LPD 27), and the delivered USS *John Finn* (DDG 113), the resolution of outstanding contract changes on the inactivation of the decommissioned *Enterprise* (CVN 65) and the RCOH of the redelivered USS *Abraham Lincoln* (CVN 72), and other individually insignificant adjustments. During the same period, none of the unfavorable cumulative catch-up adjustments were individually significant.

For the year ended December 31, 2016, favorable cumulative catch-up adjustments were primarily related to risk retirement on USS *John P. Murtha* (LPD 26), the *Virginia* class (SSN 774) submarine program, *Portland* (LPD 27), the *Legend* class NSC program, and the *Arleigh Burke* class (DDG 51) destroyer program. During the same period, unfavorable cumulative catch-up adjustments included lower performance on the RCOH of USS *Abraham Lincoln* (CVN 72) and construction of *Gerald R. Ford* (CVN 78), as well as other individually insignificant adjustments.

For the year ended December 31, 2015, favorable cumulative catch-up adjustments were primarily related to risk retirement on the *Virginia* class (SSN 774) submarine program, the *Legend* class NSC program, and the *San Antonio* class (LPD 17) program, including delivered ships, the resolution of outstanding contract changes on the *America* class (LHA 6) program and the RCOH of USS *Theodore Roosevelt* (CVN 71), and contract impacts of the Aon litigation settlement. During the same period, unfavorable cumulative catch-up adjustments included lower performance on *Gerald R. Ford* (CVN 78), as well as other individually insignificant adjustments.

*Cost Estimation* - The cost estimation process requires significant judgment and is based upon the professional knowledge and experience of our engineers, program managers, and financial professionals. Factors we consider in estimating the work to be completed and ultimate contract recovery include the availability, productivity, and cost of labor, the nature and complexity of the work to be performed, the effect of change orders, the availability of materials, the effect of any delays in performance, the availability and timing of funding from the customer, and the recoverability of any claims included in the estimates to complete. A significant change in an estimate on one or more contracts in a period could have a material effect on our consolidated financial position or results of operations for that period, and, where such changes occur, separate disclosure is made of the nature, underlying conditions, and financial impact of the change. We update our contract cost estimates at least annually and more frequently as determined by events or circumstances. We review and assess our cost and revenue estimates for each significant contract on a quarterly basis.

We record a provision for the entire loss on a contract in the period the loss is determined when estimates of total costs to be incurred on the contract exceed estimates of total revenues to be earned. We offset loss provisions first against costs that are included in unbilled accounts receivable or inventoried costs, with any remaining amount reflected in other current liabilities.

### Purchase Accounting, Goodwill, and Intangible Assets

*Goodwill* - Goodwill represents the purchase price paid in excess of the fair value of identifiable net tangible and intangible assets acquired in a business combination. The amount of our goodwill as of December 31, 2017 and 2016, was \$1,217 million and \$1,234 million, respectively. During the year ended December 31, 2017, we recorded a goodwill adjustment of \$17 million in the Technical Solutions segment, primarily driven by the finalization of fair value calculations for certain assets and liabilities, as well as the net working capital adjustment, related to the acquisition of Camber.

*Tests for Impairment* - We perform impairment tests for goodwill as of November 30 of each year, or when evidence of potential impairment exists. When testing goodwill, we compare the fair value of the reporting unit to its carrying

value. If the fair value of the reporting unit is determined to be less than the carrying value, we record a charge to operations.

We estimate the fair value of each reporting unit using a combination of discounted cash flow analysis and market based valuation methodologies. Determining fair value requires the exercise of significant judgment, including judgments about projected revenues, operating expenses, working capital investment, capital expenditures, and cash flows over a multi-year period. The discount rate applied to our forecasts of future cash flows is based on our estimated weighted average cost of capital. In assessing the reasonableness of our determined fair values, we evaluate our results against our market capitalization. Changes in these estimates and assumptions could materially affect the determination of fair value and/or goodwill impairment for each reporting unit.

*November 30, 2017 Impairment Test* - In connection with our annual goodwill impairment test, we tested goodwill for each of our four reporting units. As a result of our annual goodwill impairment test, we determined that the estimated fair value of each reporting unit exceeded by more than 10% its corresponding carrying value as of November 30, 2017.

*November 30, 2016 Impairment Test* - In connection with our annual goodwill impairment test, we tested goodwill for each of our four reporting units. As a result of our annual goodwill impairment test, we determined that the estimated fair value of each reporting unit exceeded by more than 10% its corresponding carrying value as of November 30, 2016.

In conjunction with the realignment of our operations on December 1, 2016, we allocated goodwill among new and realigned reporting units based on the relative fair values of the reporting units being realigned. As a result, during the fourth quarter of 2016, we performed a quantitative assessment of goodwill immediately after the realignment for each of the reporting units impacted by our realignment. Based on this quantitative assessment, no impairment charge was necessary as a result of the realignment.

*November 30, 2015 and December 31, 2015 Impairment Tests* - We performed our annual goodwill impairment test as of November 30, 2015, and, while the annual impairment test did not result in an impairment, considering the limited excess fair value of goodwill over its carrying value in our oil and gas reporting unit and the continued decline in oil prices and related industry activity levels, we performed an interim assessment of goodwill as of December 31, 2015. Our determination of fair value as of December 31, 2015, considered industry events that occurred in the period since our annual goodwill impairment test, as well as the updated long term outlook for this reporting unit. Those events included continued deterioration in the oil and gas markets, numerous industry-wide project deferrals, and capital spending cuts announced by industry leaders. The analysis concluded the fair value of this reporting unit was less than its carrying value as of December 31, 2015, and we recorded a goodwill impairment charge of \$16 million at our oil and gas reporting unit in our Technical Solutions segment in the fourth quarter of 2015. We determined that the estimated fair values of our remaining reporting units significantly exceeded their corresponding carrying values as of November 30, 2015.

*May 31, 2015 Impairment Test* - We continuously monitor industry events and changes in circumstances in the industries in which our reporting units conduct business. In consideration of the oil and gas reporting unit's sensitivity to developments within its industry, the continued decline in crude oil prices, significant reductions in its customer capital spending plans, and project delays, we concluded an interim goodwill impairment test was necessary to determine whether it was more likely than not that the fair value of our oil and gas reporting unit was still higher than its carrying value as of May 31, 2015. Our assessment considered the aforementioned changes to expectations that were considered as part of our annual goodwill impairment test as of November 30, 2014. As a result of our analysis, we recorded a \$59 million goodwill impairment charge at our Oil and Gas reporting unit in our Technical Solutions segment in the second quarter of 2015.

*Other Intangible Assets* - We perform tests for impairment of amortizable intangible assets whenever events or circumstances suggest that amortizable intangible assets may be impaired.

*December 31, 2015 Impairment Test* - We performed an impairment test as of December 31, 2015, on the amortizable intangible assets that arose from the UPI acquisition, which reside in our oil and gas reporting unit within our Technical Solutions segment. The oil and gas asset group's long-lived intangible assets consist primarily of customer relationships and, to a lesser degree, trade name and developed technology. We performed our impairment test considering the latest market conditions and expectations, as well as lower anticipated revenue and profitability. Based on the nature of UPI's intangible assets, we performed the recoverability test at the reporting unit

level. In connection with the recoverability test, we reevaluated the remaining useful lives of the intangible assets and determined the total undiscounted pretax cash flows generated by the reporting unit over the remaining useful life of the primary asset, customer relationships. The carrying amount of the reporting unit was greater than the total undiscounted pretax cash flows, and, as a result, the intangible assets were written down by \$27 million, charged against cost of sales and service revenues within income from operations at our oil and gas reporting unit in our Technical Solutions segment.

## **Litigation, Commitments and Contingencies**

*Overview* - We are subject to a range of legal proceedings before various courts and administrative agencies and are periodically subject to government examinations, inquiries, and investigations that arise in the ordinary course of business. Estimating liabilities and costs associated with these matters requires judgment and assessment based upon professional knowledge and the experience of management and our internal and external legal counsel. In accordance with our practices relating to accounting for contingencies, we record amounts as charges to earnings when we determine, after taking into consideration the facts and circumstances of each matter, including any settlement offers, that it is probable a liability has been incurred and the amount of the loss can be reasonably estimated. The ultimate resolution of any such exposure may vary from earlier estimates as further facts and circumstances become known.

*Environmental Accruals* - We are subject to the environmental laws and regulations of the jurisdictions in which we conduct operations. We record a liability for the costs of expected environmental remediation obligations when we determine that it is probable we will incur such costs and the amount of the liability can be reasonably estimated. When a range of costs is possible and no amount within that range is a better estimate than another, we record the minimum amount of the range.

Factors that could result in changes to the assessment of probability, range of estimated costs, and environmental liability accruals include: modification of planned remedial actions, increase or decrease in the estimated time required to remediate, discovery of more extensive contamination than anticipated, results of efforts to involve other legally responsible parties, financial insolvency of other responsible parties, changes in laws and regulations or contractual obligations affecting remediation requirements, and improvements in remediation technology. Although we cannot predict whether new information gained as remediation projects progress will materially affect the accrued liability, we do not believe that future remediation expenditures will have a material effect on our financial position, results of operations, or cash flows.

*Asset Retirement Obligations* - We record all known asset retirement obligations for which the liability's fair value can be reasonably estimated, including certain asbestos removal, asset decommissioning, and contractual lease restoration obligations. Recorded amounts as of each of December 31, 2017 and 2016, were \$19 million and consist primarily of obligations associated with the wind down of shipbuilding operations at our Avondale facility. See Note 2: Summary of Significant Accounting Policies in Item 8.

We also have known conditional asset retirement obligations related to assets currently in use, such as certain asbestos remediation and asset decommissioning activities to be performed in the future, that were not reasonably estimable as of December 31, 2017, due to insufficient information about the timing and method of settlement of the obligation. Accordingly, the fair value of these obligations has not been recorded in the consolidated financial statements. Environmental remediation and/or asset decommissioning of these facilities may be required when we cease to utilize these facilities. In addition, there may be conditional environmental asset retirement obligations that we have not yet discovered (for example, asbestos of which we have not become aware through normal business operations may exist in certain buildings), and these obligations have therefore not been included in our consolidated financial statements.

*Litigation Accruals* - Litigation accruals are recorded as charges to earnings when management has determined, after taking into consideration the facts and circumstances of each matter, including any settlement offers, that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The ultimate resolution of any exposure may vary from earlier estimates as further facts and circumstances become known. Based upon the information available, we believe that the resolution of any of these various legal proceedings will not have a material effect on our consolidated financial position, results of operations, or cash flows.

*Uncertain Tax Positions* - Uncertain tax positions meeting the more-likely-than-not recognition threshold, based on the merits of the position, are recognized in the financial statements. We recognize the amount of tax benefit that is

greater than 50% likely to be realized upon ultimate settlement with the related tax authority. If a tax position does not meet the minimum statutory threshold to avoid payment of penalties, we recognize an expense for the amount of the penalty in the period the tax position is claimed or expected to be claimed in our tax return. Penalties and accrued interest related to uncertain tax positions are recognized as a component of income tax expense. See Note 13: Income Taxes in Item 8. Changes in accruals associated with uncertain tax positions are recorded in earnings in the period they are determined.

### **Retirement Related Benefit Plans**

We recognize, on a plan-by-plan basis, the funded status of our retirement related benefit plans as an asset or liability on our balance sheet, with corresponding adjustments to after-tax accumulated other comprehensive income and deferred tax assets or liabilities. The funded status represents the difference between the benefit obligation and the fair value of plan assets. See Note 18: Employee Pension and Other Postretirement Benefits in Item 8.

We calculate our retirement related benefit plan costs under both CAS and U.S. GAAP Financial Accounting Standards ("FAS"). The calculations under CAS and FAS require significant judgment. CAS prescribes the determination, allocation, and recovery of retirement related benefit plan costs on U.S. Government contracts through the pricing of products and services. FAS prescribes the methodology used to determine retirement related benefit plan expense or income, as well as the liability, for financial reporting purposes. The CAS requirements for these costs and their calculation methodologies differ from FAS. As a result, while both CAS and FAS use assumptions in their calculation methodologies, each method results in different calculated amounts of retirement related benefit plan costs.

Retirement related benefit plan costs are allocated to our U.S. Government contracts as allowable costs based upon CAS. We recover our CAS costs through the pricing of products and services on U.S. Government contracts so that the CAS cost is recognized in segment product sales and service revenues and in the costs of those product sales and service revenues. In order to present our consolidated financial statements in accordance with FAS, we record the difference between our FAS expense and CAS cost ("FAS/CAS Adjustment") as operating income (loss) within general and administrative expenses. For the years ended December 31, 2017, 2016, and 2015, our CAS costs in excess of FAS expenses were \$189 million, \$145 million, and \$104 million, respectively.

The minimum funding requirements for our qualified pension plans are determined under the Employee Retirement Income Security Act of 1974 ("ERISA"), which is primarily based on the year's expected service cost and amortization of other previously unfunded liabilities. Effective January 1, 2011, we were subject to the funding requirements under the Pension Protection Act of 2006 ("PPA"), which amended ERISA. Under the PPA, we are required to fully fund our pension plans over a rolling seven-year period as determined annually based upon the funded status at the beginning of each year. PPA also introduced a variety of benefit restrictions that apply if a plan falls below certain funded percentages, as defined by the Internal Revenue Code. In funding our plans, we consider various factors, including the minimum funding requirements, maintaining the funded status needed to avoid potential benefit restrictions and other adverse consequences, maintaining minimum CAS funding requirements, and the current and anticipated funding levels of each plan.

During 2012, the Moving Ahead for Progress in the 21st Century Act ("MAP-21") was enacted. MAP-21 included provisions for potential pension relief to plan sponsors in the form of higher interest rate assumptions that were used to determine minimum funding requirements. The relief derived from these provisions was to be phased out to lower levels over the next few years. The enactment of the Highway and Transportation Funding Act ("HATFA") in 2014 and BBA 2015 successively provided for the continuation of pension relief and higher interest rate assumptions used to determine minimum funding requirements and extended the pension relief phase-out period. We consider the effects of pension relief legislation in the context of current year and future projected funded status levels in deciding the level of contributions to make to our plans each year.

Due to the differences in requirements and calculation methodologies between FAS and CAS, our FAS pension expense is not necessarily indicative of the funding requirements under PPA or the amounts we recover from the U.S. Government under CAS.

When PPA was enacted, it was anticipated that the amounts required to be funded would exceed government contractors' recovery of those costs under CAS. To remedy this cash flow misalignment, on December 27, 2011, the U.S. Cost Accounting Standards Board issued its final CAS Harmonization Rule ("Harmonization"). Harmonization

was intended to improve the alignment of the pension cost recovered through contract pricing under CAS and the pension funding requirements under the PPA. Harmonization became effective for forward pricing purposes for contracts negotiated on or after February 27, 2012. Under Harmonization, only contracts entered into before the effective date qualified for an equitable adjustment. Price proposals for CAS covered contracts awarded on or after the effective date of February 27, 2012, reflected the effects of the rule. Harmonization affected pension costs on contracts over a phase-in period that ended in 2017. Our CAS pension cost recoveries are expected to remain unaffected by the pension relief provisions noted above because of the method permitted under Harmonization we use to determine the CAS interest rate, which is a current market rate.

*Assumptions* - We account for our retirement related benefit plans on the accrual basis under FAS. The measurements of obligations, costs, assets, and liabilities require significant judgment. We annually review our assumptions, which are set at each year end and are generally not changed during the following year unless there is a major plan event, such as an amendment, curtailment, or settlement that would trigger a remeasurement. The key assumptions in these measurements are the interest rate used to discount future benefit payments and the expected long-term rate of return on plan assets.

*Discount Rate* - The assumed discount rate under FAS is used to determine the retirement related benefit plan obligations and expense, and represents the hypothetical rate at which the plans' benefit obligations could be effectively settled at the measurement date. Consequently, the discount rate can be volatile from year to year. The discount rate assumption is determined for each plan by constructing a hypothetical portfolio of high quality bonds with cash flows that match the estimated outflows for future benefit payments to determine a single equivalent discount rate. Benefit payments are not only contingent on the terms of a plan, but also on the underlying participant demographics, including current age and assumed mortality. We use only bonds that are denominated in U.S. Dollars, are rated Aa or better by nationally recognized statistical rating agencies, have a minimum outstanding issue of \$100 million as of the measurement date, and are not callable, convertible, or index-linked.

Taking into consideration the factors noted above, our weighted average discount rate for pensions was 3.82% and 4.47% as of December 31, 2017 and 2016, respectively. Our weighted average discount rate for other postretirement benefits was 3.85% and 4.38% as of December 31, 2017 and 2016, respectively.

*Expected Long-Term Rate of Return* - The expected long-term rate of return on assets is used to calculate net periodic expense, and is based on such factors as historical returns, targeted asset allocations, investment policy, duration, expected future long-term performance of individual asset classes, interest rates, inflation, portfolio volatility, investment management and administrative fees, and risk management strategies. Historical plan asset performance alone has inherent limitations in predicting future returns. While studies are helpful in understanding past and current trends and performance, the assumption is based more on long-term prospective views to avoid short-term market influences. Unless plan assets and benefit obligations are subject to remeasurement during the year, the expected return on pension assets is based on the fair value of plan assets at the beginning of the year. We used a 7.25% expected long-term rate of return assumption to record 2017 pension expense, and we anticipate retaining that assumption throughout 2018.

*Mortality* - Mortality assumptions are used to determine the retirement related benefit obligations and expense, and represent the likelihood and duration of benefit payments to plan participants based on historical experience and projected longevity. We periodically update our mortality assumptions as circumstances warrant.

Differences arising from actual experience or changes in assumptions might materially affect retirement related benefit plan obligations and the funded status. Actuarial gains and losses arising from differences between assumptions and actual experience or changes in assumptions are deferred in accumulated other comprehensive income. This unrecognized amount is amortized as a component of net expense to the extent it exceeds 10% of the greater of the plan's benefit obligation or plan assets. The amortization period for actuarial gains and losses is the estimated average remaining service life of the plan participants. In 2017, the actual return on assets was approximately 17.0%, which was greater than the expected return assumption of 7.25%. For the year ended December 31, 2017, the weighted average discount rates for our pension and other postretirement benefit plans decreased by 65 and 53 basis points, respectively. These differences in asset returns, updated mortality assumptions, and discount rates resulted in actuarial gains of \$473 million and \$68 million and an actuarial loss of \$625 million, respectively, as of December 31, 2017.



An increase or decrease of 25 basis points in the discount rate and the expected long-term rate of return assumptions would have had the following approximate impacts on pensions:

(\$ in millions)	Increase (Decrease) in 2018 Expense	Increase (Decrease) in December 31, 2017 Obligations
25 basis point decrease in discount rate	\$ 23	\$ 261
25 basis point increase in discount rate	(22)	(246)
25 basis point decrease in expected return on assets	15	
25 basis point increase in expected return on assets	(15)	

Assuming a 7.25% expected return on asset assumption, a \$50 million pension contribution is generally expected to favorably impact the current year expected return on assets by approximately \$1 million, depending on the timing of the contribution.

Sensitivities to assumptions are not necessarily linear and are specific to the time periods noted.

*CAS Cost* - In addition to providing the methodology for calculating retirement related benefit plan costs, CAS also prescribes the method for assigning those costs to specific periods. While the ultimate liability for such costs under FAS and CAS is similar, the pattern of cost recognition is different. The key drivers of CAS pension cost include the funded status and the method used to calculate CAS reimbursement for each of our plans. A plan's CAS pension cost can only be allocated until the plan is fully funded as defined under the CAS requirements.

Through 2013, CAS required the pension interest rate to be consistent with the expected long-term rate of return on assets assumption, which changed infrequently given its long-term nature. As a result, short-term changes in bond yields or other interest rates generally did not impact CAS costs. Under Harmonization the liability used to determine CAS cost is developed by comparing the liability under the previous CAS methodology and assumptions to a liability based on a discount rate derived from yields on high quality corporate bonds. Since Harmonization became fully phased in during 2017, the greater of the two liabilities is used for CAS cost calculations. Generally, liabilities based on a discount rate of high quality corporate bonds will be higher than liabilities calculated prior to Harmonization. Prior to the full phasing in of Harmonization the use of a blend of the pre and post Harmonization liabilities was required.

*Other FAS and CAS Pension Considerations* - A key driver of the difference between FAS expense and CAS cost (and consequently the FAS/CAS Adjustment) is the pattern of earnings and expense recognition for actuarial gains and losses that arise when our asset and liability experiences differ from our assumptions under each set of requirements. Under FAS, our net actuarial gains and losses exceeding the 10% corridor are amortized over the estimated average remaining service life of the plan participants. Under CAS Harmonization, the amortization period changed from 15 to 10 years for actuarial gains and losses beginning in 2013. Both FAS and CAS use a "market-related value" of plan assets approach to calculate the amount of deferred asset gains or losses to be amortized. Under CAS actual asset gains and losses are systematically smoothed over five years, subject to certain limitations. For FAS, we do not use this smoothing method, and instead use fair value in determining our FAS expense. Accordingly, FAS expense generally reflects recent asset gains and losses sooner than CAS.

Additionally, CAS cost is only recognized for plans that are not fully funded as defined under CAS. If a plan becomes or ceases to be fully funded due to our asset or liability experience, our CAS cost will change accordingly.

The FAS/CAS Adjustment in 2017 and 2016 was a net benefit of \$189 million and \$145 million, respectively. The favorable change from 2016 to 2017 was primarily driven by the continued phase-in of Harmonization. The FAS/CAS Adjustment in 2015 was a net benefit of \$104 million. The favorable change from 2015 to 2016 was driven by the continued phase-in of Harmonization. Our projected 2018 FAS/CAS Adjustment is discussed in Consolidated Operating Results - Operating Income.

*Retirement Plan Assets* - Retirement plan assets are stated at fair value. Investments in equity securities (common and preferred) are valued at the last reported sales price when an active market exists. Investments in fixed-income securities are generally valued based on market transactions for comparable securities and various relationships between securities that are generally recognized by institutional traders. Investments in hedge funds, real estate

investment funds, private partnerships, collective trust funds, and commingled funds are generally valued at their Net Asset Values ("NAV") or equivalent, which are based on the current fair value of the fund's underlying assets.

Management reviews independently appraised values, audited financial statements, and additional pricing information to evaluate the NAV or its equivalent. For the limited group of investments for which market quotations are not readily available or for which the above valuation procedures are deemed not to reflect fair value, additional information is obtained from the investment manager and evaluated internally to determine whether any adjustments are required to reflect fair value. See Note 18: Employee Pension and Other Postretirement Benefits, in Item 8.

*Accumulated Other Comprehensive Income* - Changes in assumptions and changes to plan assets and benefit obligations due to differences between actuarial assumptions and actual results are reported as actuarial gains and losses and recorded in accumulated other comprehensive income along with unrecognized prior service costs arising from plan amendments. As disclosed in Note 18: Employee Pension and Other Postretirement Benefits in Item 8, net pre-tax unrecognized actuarial losses as of December 31, 2017 and 2016 were \$1,459 million and \$1,583 million, respectively. The decrease in these actuarial losses in 2017 was primarily driven by actual asset returns which were \$473 million above expected returns, \$93 million of amortization of previously unrecognized actuarial losses, \$68 million actuarial gain from updated mortality assumptions, and a \$625 million actuarial loss due to the decrease in the discount rates used to determine benefit obligations.

Net pre-tax unrecognized prior service costs (credits) as of December 31, 2017 and 2016 were \$47 million and \$(18) million, respectively. These net deferred costs (credits) primarily originated from plan amendments, including those resulting from collective bargaining agreements. The change in unrecognized prior service costs (credits) in 2017 primarily resulted from amendments within a collective bargaining agreement, offset by the amortization of previously accumulated prior service costs (credits).

### **Workers' Compensation**

Our operations are subject to federal and state workers' compensation laws. We maintain self-insured workers' compensation plans and participate in federally administered second injury workers' compensation funds. We estimate the liability for such claims and funding requirements on a discounted basis utilizing actuarial methods based on various assumptions, which include our historical loss experience and projected loss development factors. We periodically, and at least annually, update our assumptions based on an actuarial analysis. Related self-insurance accruals include the liability for reported claims and an estimated accrual for claims incurred but not reported. Our workers' compensation liability was discounted at 2.35% and 2.54% as of December 31, 2017 and 2016, respectively, based on future payment streams and a risk-free rate. We estimate a 100 basis points increase or decrease in the discount rate would change our workers' compensation liability by \$(48) million and \$58 million, respectively. The workers' compensation benefit obligation on an undiscounted basis was \$925 million and \$835 million as of December 31, 2017 and 2016, respectively.

### **Accounting Standards Updates**

See Note 3: Accounting Standards Updates in Item 8 for further information.

## CONSOLIDATED OPERATING RESULTS

Selected financial highlights are presented in the following table:

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
Sales and service revenues	\$ 7,441	\$ 7,068	\$ 7,020	\$ 373	5 %	\$ 48	1 %
Cost of product sales and service revenues	6,018	5,608	5,517	410	7 %	91	2 %
Income (loss) from operating investments, net	12	6	10	6	100 %	(4)	(40)%
Other income and gains	—	15	—	(15)	(100)%	15	— %
General and administrative expenses	570	623	669	(53)	(9)%	(46)	(7)%
Goodwill impairment	—	—	75	—	— %	(75)	(100)%
Operating income (loss)	865	858	769	7	1 %	89	12 %
Interest expense	94	74	137	20	27 %	(63)	(46)%
Federal and foreign income taxes	293	211	228	82	39 %	(17)	(7)%
Net earnings (loss)	\$ 479	\$ 573	\$ 404	\$ (94)	(16)%	\$ 169	42 %

### Operating Performance Assessment and Reporting

We manage and assess the performance of our business based on our performance on individual contracts and programs using the financial measures referred to below, with consideration given to the Critical Accounting Policies, Estimates, and Judgments referred to in this section. Our portfolio of long-term contracts is largely flexibly-priced. Therefore, sales tend to fluctuate in concert with costs across our large portfolio of active contracts, with operating income being a critical measure of operating performance. Under FAR rules that govern our business with the U.S. Government, most types of costs are allowable, and we do not focus on individual cost groupings, such as cost of sales or general and administrative expenses, as much as we do on total contract costs, which are a key factor in determining contract operating income. As a result, in evaluating our operating performance, we look primarily at changes in sales and service revenues, as well as operating income, including the effects of significant changes in operating income as a result of changes in contract estimates and the use of the cumulative catch-up method of accounting in accordance with GAAP. This approach is consistent with the long-term life cycle of our contracts, as management assesses the bidding of each contract by focusing on net sales and operating profit and monitors performance in a similar manner through contract completion. Consequently, our discussion of business segment performance focuses on net sales and operating profit, consistent with our approach for managing our business.

Cost of sales for both product sales and service revenues consists of materials, labor, and subcontracting costs, as well as an allocation of indirect costs for overhead. We manage the type and amount of costs at the contract level, which is the basis for estimating our total costs at completion of our contracts. Unusual fluctuations in operating performance driven by changes in a specific cost element across multiple contracts are described in our analysis.

### Sales and Service Revenues

Sales and service revenues were comprised as follows:

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
Product sales	\$ 5,573	\$ 5,631	\$ 5,665	\$ (58)	(1)%	\$ (34)	(1)%
Service revenues	1,868	1,437	1,355	431	30 %	82	6 %
Sales and service revenues	\$ 7,441	\$ 7,068	\$ 7,020	\$ 373	5 %	\$ 48	1 %

2017 - Product sales in 2017 decreased \$58 million, or 1%, from 2016. Product sales at our Ingalls segment decreased \$10 million in 2017, primarily as a result of lower volumes in surface combatants, partially offset by higher volumes in amphibious assault ships. Newport News product sales increased \$20 million in 2017, primarily as a result of higher volumes in aircraft carriers, partially offset by lower volumes in submarines. Technical Solutions

product sales decreased \$68 million in 2017, primarily as a result of higher volumes in 2016 from the resolution of outstanding contract changes on a nuclear and environmental commercial contract.

Service revenues in 2017 increased \$431 million, or 30%, from 2016. Service revenues at our Ingalls segment increased \$41 million in 2017, as a result of higher volumes in surface combatants services. Service revenues at our Newport News segment increased \$57 million in 2017, primarily as a result of higher volumes in naval nuclear support services and submarines services, partially offset by lower volumes in aircraft carriers services. Service revenues at our Technical Solutions segment increased \$333 million in 2017, primarily as a result of higher volumes in integrated missions solutions services following the December 2016 acquisition of Camber and higher volumes in fleet support and oil and gas services.

2016 - Product sales in 2016 decreased \$34 million, or 1%, from 2015. Product sales at our Ingalls segment increased \$138 million in 2016, primarily as a result of higher volumes in surface combatants, partially offset by lower volumes in the *Legend* class NSC program. Newport News product sales decreased \$275 million in 2016, primarily as a result of lower volumes in aircraft carriers. Technical Solutions product sales increased \$103 million in 2016, primarily as a result of higher volumes in nuclear and environmental products.

Service revenues in 2016 increased \$82 million, or 6%, from 2015. Service revenues at our Ingalls segment increased \$63 million in 2016, as a result of higher volumes in surface combatants and amphibious assault ships services. Service revenues at our Newport News segment increased \$65 million in 2016, primarily as a result of higher volumes in submarines and naval nuclear support services. Service revenues at our Technical Solutions segment decreased \$46 million in 2016, primarily due to lower volumes in nuclear and environmental, fleet support, and oil and gas services, partially offset by higher volumes in integrated missions solutions services following the acquisition of Camber.

### Cost of Sales and Service Revenues

Cost of product sales, cost of service revenues, income from operating investments, net, and general and administrative expenses were as follows:

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
Cost of product sales	\$ 4,444	\$ 4,380	\$ 4,319	\$ 64	1 %	\$ 61	1 %
% of product sales	79.7%	77.8%	76.2%	—		—	
Cost of service revenues	1,574	1,228	1,198	346	28 %	30	3 %
% of service revenues	84.3%	85.5%	88.4%	—		—	
Income (loss) from operating investments, net	12	6	10	6	100 %	(4)	(40)%
Other income and gains	—	15	—	(15)	(100)%	15	— %
General and administrative expenses	570	623	669	(53)	(9)%	(46)	(7)%
% of total sales and service revenues	7.7%	8.8%	9.5%	—		—	
Goodwill impairment	—	—	75	—	— %	(75)	(100)%
Cost of sales and service revenues	<u>\$ 6,576</u>	<u>\$ 6,210</u>	<u>\$ 6,251</u>	<u>\$ 366</u>	<u>6 %</u>	<u>\$ (41)</u>	<u>(1)%</u>

### Cost of Product Sales

2017 - Cost of product sales in 2017 increased \$64 million, or 1%, compared to 2016. Cost of product sales at our Ingalls segment increased \$64 million in 2017, primarily as a result of lower risk retirement in the *San Antonio* class (LPD 17) program, following delivery of USS *John P. Murtha* (LPD 26) in 2016, as well as the volume changes described above, partially offset by higher risk retirement on *Tripoli* (LHA 7). Cost of product sales at our Newport News segment increased \$56 million in 2017, primarily as a result of the volume changes described above and the resolution of outstanding contract changes on the RCOH of the redelivered USS *Abraham Lincoln* (CVN 72), partially offset by lower risk retirement in the *Virginia* class (SSN 774) submarine program. Cost of product sales at our Technical Solutions segment decreased \$56 million in 2017, primarily due to the resolution in 2016 of outstanding contract changes on a nuclear and environmental commercial contract, partially offset by the establishment of an allowance for accounts receivable on a nuclear and environmental commercial contract in 2017. Cost of product sales as a percentage of product sales increased from 77.8% in 2016 to 79.7% in 2017,

primarily driven by lower risk retirement in the *San Antonio* class (LPD 17) program, following delivery of USS *John P. Murtha* (LPD 26) in 2016, the *Virginia* class (SSN 774) submarine program, and *Arleigh Burke* class (DDG 51) destroyers, as well as the establishment of an allowance for accounts receivable on a nuclear and environmental commercial contract, partially offset by higher risk retirement on *Tripoli* (LHA 7) and the resolution of outstanding contract changes on the RCOH of the redelivered USS *Abraham Lincoln* (CVN 72).

2016 - Cost of product sales in 2016 increased \$61 million, or 1%, compared to 2015. Cost of product sales at our Ingalls segment increased \$194 million in 2016, primarily as a result of the impact in 2015 of the settlement of the Aon litigation and the volume changes described above, partially offset by higher risk retirement in the *San Antonio* class (LPD 17) program. Cost of product sales at our Newport News segment decreased \$220 million in 2016, primarily as a result of the volume changes described above, partially offset by lower risk retirement in the *Virginia* class (SSN 774) submarine program. Cost of product sales at our Technical Solutions segment increased \$87 million in 2016, primarily due to the higher volumes described above. Cost of product sales as a percentage of product sales increased from 76.2% in 2015 to 77.8% in 2016, primarily driven by the impact in 2015 of the settlement of the Aon litigation and lower risk retirement in the *Virginia* class (SSN 774) submarine program, partially offset by higher risk retirement in the *San Antonio* class (LPD 17) program.

#### *Cost of Service Revenues*

2017 - Cost of service revenues in 2017 increased \$346 million, or 28%, compared to 2016. Cost of service revenues at our Ingalls segment increased \$23 million in 2017, primarily as a result of the higher sales volumes described above. Cost of service revenues at our Newport News segment increased \$30 million in 2017, primarily as a result of the higher sales volumes described above. Cost of service revenues at our Technical Solutions segment increased \$293 million in 2017, primarily as a result of the higher volumes described above. Cost of service revenues as a percentage of service revenues declined from 85.5% in 2016 to 84.3% in 2017, primarily driven by the resolution of outstanding contract changes on the inactivation of the decommissioned *Enterprise* (CVN 65), improved performance in oil and gas services, and year-to-year variances in contract mix.

2016 - Cost of service revenues in 2016 increased \$30 million, or 3%, compared to 2015. Cost of service revenues at our Ingalls segment increased \$66 million in 2016, primarily as a result of the higher sales volumes described above. Cost of service revenues at our Newport News segment increased \$32 million in 2016, primarily as a result of the higher sales volumes described above. Cost of service revenues at our Technical Solutions segment decreased \$68 million in 2016, as a result of the intangible asset impairment charge in 2015 and lower sales volumes described above. Cost of service revenues as a percentage of service revenues decreased from 88.4% in 2015 to 85.5% in 2016, primarily driven by the intangible asset impairment charge in 2015, improved performance in fleet support services in 2016, and year-to-year variances in contract mix.

#### *Income (Loss) from Operating Investments, Net*

The activities of our operating investments are closely aligned with the operations of the segments holding the investments. We therefore record income related to earnings from equity method investments in our operating income.

2017 - Income from operating investments, net increased \$6 million, or 100%, to \$12 million in 2017 from \$6 million in 2016. The increase resulted from higher equity income from our Savannah River Nuclear Solutions, LLC investment.

2016 - Income from operating investments, net decreased \$4 million, or 40%, to \$6 million in 2016 from \$10 million in 2015. The decrease resulted from lower equity income from our Savannah River Nuclear Solutions, LLC investment.

#### *Other Income and Gains*

2017 - Other income and gains decreased \$15 million in 2017 compared to 2016. The decrease resulted from state and local government grants at our Newport News segment in 2016.

## General and Administrative Expenses

In accordance with industry practice and the regulations that govern the cost accounting requirements for government contracts, most general and administrative expenses are considered allowable and allocable costs on government contracts. These costs are allocated to contracts in progress on a systematic basis, and contract performance factors include this cost component as an element of cost.

2017 - General and administrative expenses in 2017 decreased \$53 million, or 9%, compared to 2016. This decrease was primarily driven by favorable changes in the FAS/CAS Adjustment.

2016 - General and administrative expenses in 2016 decreased \$46 million, or 7%, compared to 2015. This decrease was primarily driven by favorable changes in the FAS/CAS Adjustment and lower current state tax expense.

## Impairment of Goodwill

As discussed above under Critical Accounting Policies, Estimates and Judgments, we perform impairment tests for goodwill as of November 30 each year, or when evidence of potential impairment exists. We record a charge to operations when we determine that an impairment has occurred.

We recorded goodwill impairment charges in 2015 of \$75 million in our Technical Solutions segment. See Note 12: Goodwill and Other Purchased Intangible Assets in Item 8.

## Operating Income

We consider operating income to be an important measure for evaluating our operating performance, and, as is typical in the industry, we define operating income as revenues less the related cost of producing the revenues and general and administrative expenses.

We internally manage our operations by reference to "segment operating income," which is defined as operating income before the FAS/CAS Adjustment and non-current state income taxes, neither of which affects segment performance. Segment operating income is not a recognized measure under GAAP. When analyzing our operating performance, investors should use segment operating income in addition to, and not as an alternative for, operating income or any other performance measure presented in accordance with GAAP. It is a measure we use to evaluate our core operating performance. We believe segment operating income reflects an additional way of viewing aspects of our operations that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our business. We believe the measure is used by investors and is a useful indicator to measure our performance. Because not all companies use identical calculations, our presentation of segment operating income may not be comparable to similarly titled measures of other companies.

The following table reconciles segment operating income to operating income:

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
Segment operating income (loss)	\$ 688	\$ 715	\$ 667	\$ (27)	(4)%	\$ 48	7%
FAS/CAS Adjustment	189	145	104	44	30 %	41	39%
Non-current state income taxes	(12)	(2)	(2)	(10)	(500)%	—	—%
Operating income (loss)	<u>\$ 865</u>	<u>\$ 858</u>	<u>\$ 769</u>	<u>\$ 7</u>	1 %	<u>\$ 89</u>	12%

## Segment Operating Income

2017 - Segment operating income in 2017 was \$688 million, compared to \$715 million in 2016. The decrease was primarily due to lower risk retirement on the delivered USS *John P. Murtha* (LPD 26), lower volume and risk retirement in the *Virginia* class (SSN 774) submarine program and *Arleigh Burke* class (DDG 51) destroyers, favorable changes in overhead costs in 2016, the receipt in 2016 of a local government incentive grant, and the establishment of an allowance for accounts receivable on a nuclear and environmental commercial contract in 2017, partially offset by higher risk retirement on *Tripoli* (LHA 7) and *Portland* (LPD 27), the resolution of

outstanding contract changes on the inactivation of the decommissioned *Enterprise* (CVN 65) and the RCOH of the redelivered USS *Abraham Lincoln* (CVN 72), and improved performance in oil and gas services.

2016 - Segment operating income in 2016 was \$715 million, compared to \$667 million in 2015. The increase was primarily due to the goodwill and intangible asset impairment charges in the Technical Solutions segment in 2015, higher risk retirement on the *San Antonio* class (LPD 17) program, favorable changes in overhead cost, and the receipt of a local government incentive grant, partially offset by the impact in 2015 of the settlement of the Aon litigation, lower risk retirement in the *Virginia* class (SSN 774) submarine program, and lower volume and lower risk retirement on the execution contract for the RCOH of USS *Abraham Lincoln* (CVN 72).

Activity within each segment is discussed under Segment Operating Results below.

#### FAS/CAS Adjustment

The FAS/CAS Adjustment represents the difference between our pension and postretirement plan expense under FAS and under CAS.

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
FAS expense	\$ (172)	\$ (161)	\$ (168)	\$ (11)	(7)%	\$ 7	4%
CAS cost	361	306	272	55	18 %	34	13%
FAS/CAS Adjustment	\$ 189	\$ 145	\$ 104	\$ 44	30 %	\$ 41	39%

2017 - The FAS/CAS Adjustment in 2017 was a net benefit of \$189 million, compared to a net benefit of \$145 million in 2016. The favorable change was primarily driven by the continued phase-in of Harmonization.

2016 - The FAS/CAS Adjustment in 2016 was a net benefit of \$145 million, compared to a net benefit of \$104 million in 2015. The favorable change was primarily driven by the continued phase-in of Harmonization.

We expect the FAS/CAS Adjustment in 2018 to be a net benefit of approximately \$369 million (\$91 million FAS and \$460 million CAS), primarily driven by the more immediate recognition of the 2017 asset gains under FAS and the impacts of lower discount and interest rates and other experience gains and losses and assumption changes (e.g., mortality). The expected FAS/CAS Adjustment is subject to change during 2018, when we remeasure our actuarial estimate of the unfunded benefit obligation for CAS with updated census data and other items later in the year.

#### Non-current State Income Taxes

Non-current state income taxes include deferred state income taxes, which reflect the change in deferred state tax assets and liabilities, and the tax expense or benefit associated with changes in state uncertain tax positions in the relevant period. These amounts are recorded within operating income. Current period state income tax expense is charged to contract costs and included in cost of sales and service revenues in segment operating income.

2017 - Non-current state income tax expense in 2017 was \$12 million, compared to \$2 million in 2016. Deferred state income tax expense in 2017 was \$12 million, compared to deferred state income tax expense of \$8 million in 2016. The increase in deferred state income tax expense was primarily attributable to changes in pension related adjustments. In 2017, the decrease in state uncertain tax positions resulted in a net tax benefit of less than \$1 million, compared to a tax benefit of \$6 million in 2016. In 2016, a state uncertain tax position was settled through agreement with the applicable taxing authority and was partially offset by the recognition of a non-current state tax expense in a different jurisdiction impacted by the results of the settlement. See Note 13: Income Taxes in Item 8.

2016 - Non-current state income tax expense remained constant at \$2 million in 2016 and 2015. Deferred state income tax expense in 2016 was \$8 million as compared to deferred state income tax expense of less than \$1 million in 2015. The increase in deferred state income tax expense was primarily attributable to changes in the timing of contract taxable income and pension related adjustments. In 2016, the decrease in state uncertain tax positions resulted in a net tax benefit of \$6 million, as compared to \$2 million of tax expense in 2015. The state uncertain tax position was settled through agreement with the applicable taxing authority and was partially offset by

the recognition of a non-current state tax expense in a different jurisdiction impacted by the results of the settlement. See Note 13: Income Taxes in Item 8.

## **Interest Expense**

2017 - Interest expense in 2017 was \$94 million, compared to \$74 million in 2016. The increase was primarily a result of a loss on the early extinguishment of debt in the fourth quarter of 2017. See Note 14: Debt in Item 8.

2016 - Interest expense in 2016 was \$74 million, compared to \$137 million in 2015. The decrease was primarily a result of refinancing \$600 million principal amount of 7.125% senior notes with 5.000% senior notes and repayment in 2015 of credit facility term loans, as well as the loss on early extinguishment of debt in 2015. See Note 14: Debt in Item 8.

## **Federal and Foreign Income Taxes**

2017 - Our effective tax rate on earnings from continuing operations was 38.0% in 2017, compared to 26.9% in 2016. The increase in our effective tax rate for 2017 was primarily attributable to the revaluation of net deferred tax assets resulting from the decrease in the federal tax rate included in the Tax Act and a decrease in the domestic manufacturing deduction primarily resulting from an increase in the Company's 2018 expected discretionary pre-tax pension contributions. See Note 13: Income Taxes in Item 8.

2016 - Our effective tax rate on earnings from continuing operations was 26.9% in 2016, compared to 36.1% in 2015. The decrease in our effective tax rate for 2016 was primarily attributable to the adoption of ASU 2016-09, which reduced income tax expense by the income tax benefits resulting from stock award settlement activity, a re-measurement of uncertain tax positions that resulted in a decrease in cumulative unrecognized tax benefits, and the goodwill impairment that was recorded in 2015. See Note 13: Income Taxes in Item 8.

In December 2017, the U.S. enacted the Tax Act, which made significant changes to U.S. federal income tax law, including a reduction of the statutory federal corporate income tax rate from 35.0% to 21.0% and changes or limitations to certain deductions. As a result of the corporate income tax reduction effective January 1, 2018, we revalued our net deferred tax assets as of December 31, 2017. This reduced our net deferred tax assets by \$56 million, which was recorded as additional income tax expense for the year ended December 31, 2017. In future periods, we expect that Tax Act changes will positively impact our after-tax earnings primarily due to the lower corporate income tax rate.

## **SEGMENT OPERATING RESULTS**

### **Basis of Presentation**

We are aligned into three reportable segments: Ingalls, Newport News, and Technical Solutions. We established the Technical Solutions segment in the fourth quarter of 2016 in conjunction with our acquisition of Camber and realignment of management oversight of operations to enhance strategic and operational alignment among our services businesses. As a result of this realignment, our non-nuclear fleet support and nuclear and environmental services were transferred from our Newport News segment to our Technical Solutions segment. Our oil and gas services were transferred from our Other segment to our Technical Solutions segment, and our Other segment was dissolved.

In December 2016, we completed the acquisition of Camber, and, in 2015, we completed the acquisition of USC. We report the post-acquisition results of operations, financial position, and cash flows of Camber and USC as part of our Technical Solutions segment.



Segment operating results are presented in the following table:

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
<b>Sales and Service Revenues</b>							
Ingalls	\$ 2,420	\$ 2,389	\$ 2,188	\$ 31	1 %	\$ 201	9 %
Newport News	4,164	4,089	4,298	75	2 %	(209)	(5)%
Technical Solutions	952	691	616	261	38 %	75	12 %
Intersegment eliminations	(95)	(101)	(82)	6	6 %	(19)	(23)%
Sales and service revenues	<u>\$ 7,441</u>	<u>\$ 7,068</u>	<u>\$ 7,020</u>	<u>\$ 373</u>	5 %	<u>\$ 48</u>	1 %
<b>Operating Income (Loss)</b>							
Ingalls	\$ 313	\$ 321	\$ 379	\$ (8)	(2)%	\$ (58)	(15)%
Newport News	354	386	401	(32)	(8)%	(15)	(4)%
Technical Solutions	21	8	(113)	13	163 %	121	107 %
Segment operating income (loss)	<u>688</u>	<u>715</u>	<u>667</u>	<u>(27)</u>	(4)%	<u>48</u>	7 %
<b>Non-segment factors affecting operating income (loss)</b>							
FAS/CAS Adjustment	189	145	104	44	30 %	41	39 %
Non-current state income taxes	(12)	(2)	(2)	(10)	(500)%	—	— %
Operating income (loss)	<u>\$ 865</u>	<u>\$ 858</u>	<u>\$ 769</u>	<u>\$ 7</u>	1 %	<u>\$ 89</u>	12 %

## KEY SEGMENT FINANCIAL MEASURES

### Sales and Service Revenues

Period-to-period revenues reflect performance under new and ongoing contracts. Changes in sales and service revenues are typically expressed in terms of volume. Unless otherwise described, volume generally refers to increases (or decreases) in reported revenues due to varying production activity levels, delivery rates, or service levels on individual contracts. Volume changes will typically carry a corresponding income change based on the margin rate for a particular contract.

### Segment Operating Income

Segment operating income reflects the aggregate performance results of contracts within a segment. Excluded from this measure are certain costs not directly associated with contract performance, such as the FAS/CAS Adjustment and non-current state income taxes. Changes in segment operating income are typically expressed in terms of volume, as discussed above, or performance. Performance refers to changes in contract margin rates. These changes typically relate to profit recognition associated with revisions to EAC that reflect improved or deteriorated operating performance on that contract. Operating income changes are accounted for on a cumulative to date basis at the time an EAC change is recorded. Segment operating income may also be affected by, among other things, contract performance, the effects of workforce stoppages, the effects of natural disasters such as hurricanes, resolution of disputed items with the customer, recovery of insurance proceeds, and other discrete events. At the completion of a long-term contract, any originally estimated costs not incurred or reserves not fully utilized, such as warranty reserves, could also impact contract earnings. Where such items have occurred and the effects are material, a separate description is provided.

### Ingalls

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
Sales and service revenues	\$ 2,420	\$ 2,389	\$ 2,188	\$ 31	1 %	\$ 201	9 %
Segment operating income (loss)	313	321	379	(8)	(2)%	(58)	(15)%
<i>As a percentage of segment sales</i>	12.9%	13.4%	17.3%				

## Sales and Service Revenues

2017 - Ingalls revenues, including intersegment sales, increased \$31 million, or 1%, in 2017 compared to 2016, primarily driven by higher revenues in amphibious assault ships, partially offset by lower revenues in surface combatants and the *Legend* class NSC program. Amphibious assault ships revenues increased as a result of higher volumes on *Bougainville* (LHA 8) and *Fort Lauderdale* (LPD 28), partially offset by lower volume on the delivered USS *John P. Murtha* (LPD 26) and *Portland* (LPD 27). Surface combatants revenues decreased due to lower volumes on the delivered USS *John Finn* (DDG 113), *Ralph Johnson* (DDG 114), *Frank E. Petersen Jr.* (DDG 121), *Paul Ignatius* (DDG 117), and *Delbert D. Black* (DDG 119), partially offset by higher volumes on *Lenah H. Sutcliffe Higbee* (DDG 123), *Jack H. Lucas* (DDG 125), and the extended selected restricted availability contract for USS *Ramage* (DDG 61). Revenues on the *Legend* class NSC program decreased due to lower volume on the delivered USCGC *Munro* (NSC 6), partially offset by higher volumes on *Stone* (NSC 9) and *Midgett* (NSC 8).

2016 - Ingalls revenues, including intersegment sales, increased \$201 million, or 9%, in 2016 compared to 2015, primarily driven by higher revenues in surface combatants and amphibious assault ships, partially offset by lower revenues in the *Legend* class NSC program. Surface combatants revenues increased due to higher volumes on *Frank E. Petersen Jr.* (DDG 121), *Lenah H. Sutcliffe Higbee* (DDG 123), and planning yard services, partially offset by lower volume on *John Finn* (DDG 113) in connection with its delivery in 2016. The increase in amphibious assault ships revenues was due to higher volumes on *Fort Lauderdale* (LPD 28), *Tripoli* (LHA 7), and *Bougainville* (LHA 8), partially offset by lower volumes on *Portland* (LPD 27) and USS *John P. Murtha* (LPD 26) following its delivery in 2016. Revenues on the *Legend* class NSC program decreased due to delivery of USCGC *James* (NSC 5) in 2015 and lower volume on *Munro* (NSC 6), partially offset by higher volume on *Midgett* (NSC 8).

## Segment Operating Income

2017 - Ingalls operating income in 2017 was \$313 million, compared to income of \$321 million in 2016. The decrease was primarily due to lower risk retirement on the delivered USS *John P. Murtha* (LPD 26) and *Arleigh Burke* class (DDG 51) destroyers, partially offset by higher risk retirement on *Tripoli* (LHA 7) and *Portland* (LPD 27).

2016 - Ingalls operating income in 2016 was \$321 million, compared to income of \$379 million in 2015. The decrease was primarily due to the impact in 2015 of the settlement of the Aon litigation and lower risk retirement on the *America* class (LHA 6) program, partially offset by higher risk retirement on USS *John P. Murtha* (LPD 26), *Portland* (LPD 27), and *Ralph Johnson* (DDG 114).

## Newport News

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
Sales and service revenues	\$ 4,164	\$ 4,089	\$ 4,298	\$ 75	2 %	\$ (209)	(5)%
Segment operating income (loss)	354	386	401	(32)	(8)%	(15)	(4)%
<i>As a percentage of segment sales</i>	8.5%	9.4%	9.3%				

## Sales and Service Revenues

2017 - Newport News revenues, including intersegment sales, increased \$75 million, or 2%, in 2017 compared to 2016, primarily driven by higher revenues in aircraft carriers and naval nuclear support services, partially offset by lower revenues in submarines. Aircraft carriers revenues increased primarily as a result of higher volumes on the advance planning and execution contract for the RCOH of USS *George Washington* (CVN 73), the construction contract for *John F. Kennedy* (CVN 79), and the advance planning contract for *Enterprise* (CVN 80), partially offset by lower volumes on the execution contract for the RCOH of the redelivered USS *Abraham Lincoln* (CVN 72), the construction contract for the delivered USS *Gerald R. Ford* (CVN 78), and the inactivation of the decommissioned *Enterprise* (CVN 65). Naval nuclear support services revenues increased primarily as a result of higher volumes in submarine support and facility maintenance services, partially offset by lower volumes in aircraft carrier support services. Submarines revenues related to the *Virginia* class (SSN 774) submarine program decreased due to lower volumes on Block III boats, partially offset by higher volumes on Block IV boats.

2016 - Newport News revenues, including intersegment sales, decreased \$209 million, or 5%, in 2016 compared to 2015, primarily driven by lower revenues in aircraft carriers. Aircraft carriers revenues decreased primarily as a

result of lower volumes on USS *Gerald R. Ford* (CVN 78) and the execution contract for the RCOH of USS *Abraham Lincoln* (CVN 72), partially offset by higher volumes on *John F. Kennedy* (CVN 79) and the advance planning contract for the RCOH of USS *George Washington* (CVN 73). Submarines revenues related to the *Virginia* class (SSN 774) submarine program were relatively constant in 2016 compared to 2015 due to higher volumes on Block IV boats and USS *John Warner* (SSN 785) post-shakedown availability services, offset by lower volumes on Block III boats.

### Segment Operating Income

2017 - Newport News operating income in 2017 was \$354 million, compared to income of \$386 million in 2016. The decrease was primarily due to lower volume and risk retirement in the *Virginia* class (SSN 774) submarine program, favorable changes in overhead costs in 2016, and the receipt in 2016 of a local government incentive grant, partially offset by the resolution of outstanding contract changes on the inactivation of the decommissioned *Enterprise* (CVN 65) and the RCOH of the redelivered USS *Abraham Lincoln* (CVN 72).

2016 - Newport News operating income in 2016 was \$386 million, compared to income of \$401 million in 2015. The decrease was primarily due to lower risk retirement in the *Virginia* class (SSN 774) submarine program, lower volume and lower risk retirement on the execution contract for the RCOH of USS *Abraham Lincoln* (CVN 72) and lower volume on USS *Gerald R. Ford* (CVN 78), partially offset by favorable changes in overhead cost, and higher volumes on *John F. Kennedy* (CVN 79) and the RCOH of USS *George Washington* (CVN 73), as well as the receipt of a local government incentive grant.

### Technical Solutions

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
Sales and service revenues	\$ 952	\$ 691	\$ 616	\$ 261	38%	\$ 75	12%
Segment operating income (loss)	21	8	(113)	13	163%	121	107%
<i>As a percentage of segment sales</i>	2.2%	1.2%	(18.3)%				

### Sales and Service Revenues

2017 - Technical Solutions revenues, including intersegment sales, for the year ended December 31, 2017, increased \$261 million, or 38%, compared to 2016, primarily due to higher volume in integrated missions solutions services following the December 2016 acquisition of Camber and higher volumes in fleet support and oil and gas services, partially offset by lower nuclear and environmental volumes due to the resolution in 2016 of outstanding contract changes on a nuclear and environmental commercial contract.

2016 - Technical Solutions revenues, including intersegment sales, for the year ended December 31, 2016, increased \$75 million, or 12%, compared to 2015, primarily due to higher nuclear and environmental and fleet support revenues, as well as the acquisition of Camber, partially offset by lower revenues in oil and gas services. Nuclear and environmental revenues increased due to higher volumes and the resolution of outstanding contract changes on a commercial contract, partially offset by lower volumes associated with environmental remediation programs.

### Segment Operating Income

2017 - Operating income in the Technical Solutions segment for the year ended December 31, 2017, was \$21 million, compared to operating income of \$8 million in 2016. The increase was primarily due to improved performance in oil and gas services and higher volume in integrated missions solutions services following the December 2016 acquisition of Camber, partially offset by the establishment of an allowance for accounts receivable on a nuclear and environmental commercial contract in 2017 and the resolution in 2016 of outstanding contract changes on a nuclear and environmental commercial contract.

2016 - Operating income in the Technical Solutions segment for the year ended December 31, 2016, was \$8 million, compared to an operating loss of \$113 million in 2015. The increase was primarily due to goodwill and

intangible asset impairment charges in 2015 and the resolution of outstanding contract changes on a nuclear and environmental commercial contract.

## BACKLOG

Total backlog as of December 31, 2017, was approximately \$21 billion. Total backlog includes both funded backlog (firm orders for which funding is contractually obligated by the customer) and unfunded backlog (firm orders for which funding is not currently contractually obligated by the customer). Backlog excludes unexercised contract options and unfunded Indefinite Delivery/Indefinite Quantity orders. For contracts having no stated contract values, backlog includes only the amounts committed by the customer.

The following table presents funded and unfunded backlog by segment as of December 31, 2017 and 2016:

(\$ in millions)	December 31, 2017			December 31, 2016		
	Funded	Unfunded	Total Backlog	Funded	Unfunded	Total Backlog
Ingalls	\$ 5,920	\$ 2,071	\$ 7,991	\$ 6,033	\$ 692	\$ 6,725
Newport News	6,976	5,608	12,584	5,799	7,127	12,926
Technical Solutions	478	314	792	712	372	1,084
Total backlog	<u>\$ 13,374</u>	<u>\$ 7,993</u>	<u>\$ 21,367</u>	<u>\$ 12,544</u>	<u>\$ 8,191</u>	<u>\$ 20,735</u>

As a result of integration efforts following the acquisition of Camber, the Company corrected the Technical Solutions segment's total backlog and unfunded backlog as of December 31, 2016, reducing the balances by \$289 million.

We expect approximately 31% of the \$21 billion total backlog as of December 31, 2017, to be converted into sales in 2018. U.S. Government orders comprised substantially all of the backlog as of December 31, 2017 and 2016.

## Awards

2017 - The value of new contract awards during the year ended December 31, 2017, was approximately \$8.1 billion. Significant new awards during this period included the detailed design and construction contract for *Bougainville* (LHA 8) and the execution contract for the RCOH of USS *George Washington* (CVN 73).

2016 - The value of new contract awards during the year ended December 31, 2016, was approximately \$5.2 billion. Significant new awards during this period included contracts for the detail design and construction of *Fort Lauderdale* (LPD 28), the construction of NSC 9 (unnamed), planning, advanced engineering, and procurement of long-lead material for *Bougainville* (LHA 8), and additional advance planning for the RCOH of USS *George Washington* (CVN 73).

## LIQUIDITY AND CAPITAL RESOURCES

We endeavor to ensure the most efficient conversion of operating results into cash for deployment in operating our businesses, implementing our business strategy, and maximizing stockholder value. We use various financial measures to assist in capital deployment decision making, including net cash provided by operating activities and free cash flow. We believe these measures are useful to investors in assessing our financial performance.

The following table summarizes key components of cash flow provided by (used in) operating activities:

(\$ in millions)	Year Ended December 31			2017 over 2016		2016 over 2015	
	2017	2016	2015	Dollars	Percent	Dollars	Percent
Net earnings (loss)	\$ 479	\$ 573	\$ 404	\$ (94)	(16)%	\$ 169	42 %
Depreciation and amortization	211	191	188	20	10 %	3	2 %
Provision for doubtful accounts	10	—	—	10	— %	—	— %
Stock-based compensation	34	36	43	(2)	(6)%	(7)	(16)%
Deferred income taxes	184	85	(15)	99	116 %	100	667 %
Retiree benefit funding less than (in excess of) expense	(163)	(44)	32	(119)	(270)%	(76)	(238)%
Insurance proceeds for investing purposes	—	—	(21)	—	— %	21	100 %
Impairment of goodwill and intangible assets	—	—	102	—	— %	(102)	(100)%
Loss on early extinguishment of debt	22	—	44	22	— %	(44)	(100)%
Trade working capital decrease (increase)	37	(19)	84	56	295 %	(103)	(123)%
Net cash provided by (used in) operating activities	<u>\$ 814</u>	<u>\$ 822</u>	<u>\$ 861</u>	<u>\$ (8)</u>	(1)%	<u>\$ (39)</u>	(5)%

## Cash Flows

We discuss below our major operating, investing, and financing activities for each of the three years in the period ended December 31, 2017, as classified in our consolidated statements of cash flows.

### Operating Activities

2017 - Cash provided by operating activities was \$814 million in 2017, compared to \$822 million in 2016. The decrease of \$8 million in operating cash flow was primarily due to increased funding of retiree benefit plans and the change in deferred income taxes, partially offset by a change in trade working capital. The change in trade working capital was primarily driven by the timing of payments of accounts payable.

We expect cash generated from operations in 2018, in combination with our current cash and cash equivalents, as well as existing credit facilities, to be sufficient to service debt and retiree benefit plans, meet contractual obligations, and finance capital expenditures for at least the next 12 months.

2016 - Cash provided by operating activities was \$822 million in 2016, compared to \$861 million in 2015. The decrease of \$39 million in operating cash flow was primarily due to higher funding of retiree benefit plans, a change in trade working capital, and the impact in 2015 of the settlement of the Aon litigation. The change in trade working capital was primarily driven by accounts receivable and accounts payable due to timing of receipts and payments, respectively.

### Investing Activities

2017 - Cash used in investing activities was \$349 million in 2017, a decrease of \$304 million from 2016. The change in investing cash flow was driven by the acquisition of Camber in 2016, partially offset by higher capital expenditures in 2017.

For 2018, we expect our capital expenditures for maintenance and sustainment to be approximately 2.0% to 2.5% of annual revenues and our discretionary capital expenditures to be approximately 3.0% to 3.5% of annual revenues.

2016 - Cash used in investing activities was \$653 million in 2016, an increase of \$512 million from 2015. The change in investing cash flow was driven by the acquisition of Camber in 2016, higher capital expenditures in 2016, the sale of the Gulfport Composite Center of Excellence in March 2015, and proceeds in 2015 from the Aon litigation settlement.

## Financing Activities

2017 - Cash used in financing activities in 2017 was \$484 million, compared to \$343 million used in 2016. The change was primarily due to increases of \$92 million of common stock repurchases, \$27 million of debt related expenditures, \$17 million of cash dividend payments, and \$5 million in employee tax withholdings on share-based payment arrangements.

2016 - Cash used in financing activities in 2016 was \$343 million, compared to \$816 million used in 2015. The change was primarily due to decreases of \$449 million of debt related expenditures, \$38 million of common stock repurchases, and \$3 million in employee tax withholdings on share-based payment arrangements, partially offset by an additional \$17 million of cash dividend payments in 2016 compared to 2015.

## Free Cash Flow

Free cash flow represents cash provided by (used in) operating activities less capital expenditures net of related grant proceeds. Free cash flow is not a measure recognized under GAAP. Free cash flow has limitations as an analytical tool and should not be considered in isolation from, or as a substitute for, analysis of our results as reported under GAAP. We believe free cash flow is an important liquidity measure for our investors because it provides them insight into our current and period-to-period performance and our ability to generate cash from continuing operations. We also use free cash flow as a key operating metric in assessing the performance of our business and as a key performance measure in evaluating management performance and determining incentive compensation. Free cash flow may not be comparable to similarly titled measures of other companies.

The following table reconciles net cash provided by operating activities to free cash flow:

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
Net cash provided by (used in) operating activities	\$ 814	\$ 822	\$ 861
Less capital expenditures:			
Capital expenditure additions	(382)	(285)	(188)
Grant proceeds for capital expenditures	21	—	—
Free cash flow	<u>\$ 453</u>	<u>\$ 537</u>	<u>\$ 673</u>

2017 - Free cash flow decreased \$84 million from 2016, primarily due to increased funding of retiree benefit plans, higher capital expenditures, and a change in trade working capital.

2016 - Free cash flow decreased \$136 million from 2015, primarily due to capital expenditures, higher funding of retiree benefit plans, a change in trade working capital, and the impact in 2015 of the settlement of the Aon litigation.

## Retirement Related Benefit Plan Contributions

ERISA, including amendments under pension relief, defines the minimum amount that must be contributed to our qualified defined benefit pension plans. In determining whether to make discretionary contributions to these plans above the minimum required amounts, we consider various factors, including maintaining the funded status needed to avoid potential benefit restrictions and other adverse consequences, maintaining minimum CAS funding requirements, and the current and anticipated future funding levels of each plan. The contributions to our qualified defined benefit pension plans are affected by a number of factors, including published IRS interest rates, the actual return on plan assets, actuarial assumptions, and demographic experience. These factors and our resulting contributions also impact the plans' funded statuses. We made the following minimum and discretionary contributions to our pension and other postretirement plans in the years ended December 31, 2017, 2016 and 2015:

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
Pension plans			
Discretionary			
Qualified	\$ 294	\$ 167	\$ 99
Non-qualified	7	6	4
Other benefit plans	34	32	33
Total contributions	<u>\$ 335</u>	<u>\$ 205</u>	<u>\$ 136</u>

We made discretionary contributions to our qualified defined benefit pension plans totaling \$294 million, \$167 million, and \$99 million in the years ended December 31, 2017, 2016, and 2015, respectively.

As of December 31, 2017 and 2016, our qualified pension plans were funded 89% and 83%, respectively, on a FAS basis. As of December 31, 2017 and 2016, these plans were sufficiently funded on an ERISA basis so as not to be subject to benefit payment restrictions. The funded percentages under ERISA and FAS vary due to inherent differences in the assumptions and methodologies used to calculate the respective obligations. We expect our 2018 cash contributions to our qualified defined benefit pension plans to be \$508 million, all of which we anticipate will be discretionary and which are exclusive of CAS cost recoveries in our contracts. Due to the differences in calculation methodologies, our FAS expense is not necessarily representative of our funding requirements or CAS cost recoveries.

Other postretirement benefit contributions were \$34 million, \$32 million, and \$33 million in 2017, 2016, and 2015, respectively. We expect our 2018 contributions to our other postretirement benefit plans to be approximately \$35 million, which are exclusive of CAS cost recoveries in our contracts. Contributions for postretirement benefits are not required to be funded in advance and are paid on an as-incurred basis.

### Other Sources and Uses of Capital

*Stockholder Distributions* - In November 2017, our board of directors authorized an increase in our quarterly cash dividend to \$0.72 per share. The board previously increased the quarterly cash dividend to \$0.60 per share in November 2016 and \$0.50 per share in October 2015. We paid cash dividends totaling \$115 million (\$2.52 per share), \$98 million (\$2.10 per share), and \$81 million (\$1.70 per share) in the years ended December 31, 2017, 2016, and 2015, respectively.

In November 2017, our board of directors authorized an increase in our stock repurchase program from \$1.2 billion to \$2.2 billion and an extension of the term of the program from October 31, 2019, to October 31, 2022. Repurchases are made from time to time at management's discretion in accordance with applicable federal securities laws. For the year ended December 31, 2017, we repurchased 1,417,808 shares at an aggregate cost of \$288 million, of which \$2 million was not yet settled for cash as of December 31, 2017. For the years ended December 31, 2016 and 2015, we repurchased 1,266,192 and 1,987,550 shares, respectively, at aggregate costs of \$192 million and \$234 million, respectively, of which \$2 million was not yet settled for cash as of December 31, 2015.

*Additional Capital* - In December 2017, we issued \$600 million aggregate principal amount of unregistered 3.483% senior notes with registration rights due December 2027, the net proceeds of which were used to repurchase our 5.000% senior notes due in 2021. In November 2015, we issued \$600 million aggregate principal amount of unregistered 5.000% senior notes due November 2025, the net proceeds of which were used to repurchase our 7.125% senior notes due in 2021. Interest on our senior notes is payable semi-annually.

In November 2017, we terminated our Second Amended and Restated Credit Agreement with third-party lenders and entered into a new Credit Agreement (the "Credit Facility") with third-party lenders. The Credit Facility includes a revolving credit facility of \$1,250 million, which may be drawn upon during a period of five years from November 22, 2017. The revolving credit facility includes a letter of credit subfacility of \$500 million. The revolving credit facility has a variable interest rate on outstanding borrowings based on the London Interbank Offered Rate ("LIBOR") plus a spread based upon our credit rating, which may vary between 1.125% and 1.500%. The revolving credit facility

also has a commitment fee rate on the unutilized balance based on our leverage ratio. The commitment fee rate as of December 31, 2017 was 0.25% and may vary between 0.20% and 0.30%.

We made term loan payments of \$395 million during the year ended December 31, 2015, using cash generated from operations.

We were in compliance with all debt-related covenants as of and during the year ended December 31, 2017. For a description of our outstanding debt amounts and related restrictive covenants, see Note 14: Debt in Item 8.

## CONTRACTUAL OBLIGATIONS

As of December 31, 2017, our total outstanding long-term debt was \$1,279 million, consisting of senior notes and other third-party debt. For a description of our outstanding debt amounts and related restrictive covenants, see Note 14: Debt in Item 8.

In connection with the spin-off from Northrop Grumman, we entered into a Tax Matters Agreement with Northrop Grumman (the "Tax Matters Agreement"), which governs the respective rights, responsibilities, and obligations of Northrop Grumman and us after the spin-off with respect to tax liabilities and benefits, tax attributes, tax contests, and other tax sharing regarding U.S. federal, state, local, and foreign income taxes, other taxes, and related tax returns. We have several liabilities with Northrop Grumman to the Internal Revenue Service ("IRS") for the consolidated U.S. federal income taxes of the Northrop Grumman consolidated group relating to the taxable periods in which we were part of that group. The Tax Matters Agreement specifies the portion of this tax liability for which we will bear responsibility, and Northrop Grumman has agreed to indemnify us against any amounts for which we are not responsible.

The following table presents our contractual obligations as of December 31, 2017, and the estimated timing of related future cash payments:

(\$ in millions)	Total	2018	2019 - 2020	2021 - 2022	2023 and beyond
Long-term debt	\$ 1,305	\$ —	\$ —	\$ —	\$ 1,305
Interest payments on long-term debt	523	62	124	124	213
Operating leases	194	39	63	41	51
Purchase obligations <sup>(1)</sup>	2,728	1,494	1,005	161	68
Other long-term liabilities <sup>(2)</sup>	860	126	143	82	509
Total contractual obligations	<u>\$ 5,610</u>	<u>\$ 1,721</u>	<u>\$ 1,335</u>	<u>\$ 408</u>	<u>\$ 2,146</u>

(1) A "purchase obligation" is defined as an agreement to purchase goods or services that is enforceable and legally binding on us and that specifies all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum, or variable price provisions; and the approximate timing of the transaction. These amounts are primarily comprised of open purchase order commitments to vendors and subcontractors pertaining to funded contracts.

(2) Other long-term liabilities primarily consist of total accrued workers' compensation reserves, deferred compensation, and other miscellaneous liabilities, of which \$250 million is the current portion of workers' compensation liabilities. It excludes obligations for uncertain tax positions of less than \$1 million, for which the timing of the payments, if any, cannot be reasonably estimated.

The above table excludes retirement related contributions. Amounts for retirement related contributions depend on plan provisions, actuarial assumptions, actual plan asset performance, and other factors described above under Retirement Related Benefit Plans under Critical Accounting Policies, Estimates and Judgments and under Liquidity and Capital Resources.

Further details regarding long-term debt and operating leases can be found in Note 14: Debt and Note 16: Commitments and Contingencies in Item 8.



## **Off-Balance Sheet Arrangements**

In the ordinary course of business, we use standby letters of credit issued by commercial banks and surety bonds issued by insurance companies principally to support our self-insured workers' compensation plans. As of December 31, 2017, \$15 million in standby letters of credit were issued but undrawn and \$258 million of surety bonds were outstanding.

As of December 31, 2017, we had no other significant off-balance sheet arrangements other than operating leases. For a description of our operating leases, see Note 2: Summary of Significant Accounting Policies and Note 16: Commitments and Contingencies in Item 8.

## GLOSSARY OF PROGRAMS

Included below are brief descriptions of some of the programs discussed in this Annual Report on Form 10-K.

<u>Program Name</u>	<u>Program Description</u>
<i>America</i> class (LHA 6) amphibious assault ships	Design and build large deck amphibious assault ships that provide forward presence and power projection as an integral part of joint, interagency and multinational maritime expeditionary forces. The <i>America</i> class (LHA 6) ships, together with the <i>Wasp</i> class (LHD 1) ships, are the successors to the decommissioned <i>Tarawa</i> class (LHA 1) ships. The <i>America</i> class (LHA 6) ships optimize aviation operations and support capabilities. We delivered USS <i>America</i> (LHA 6) in April 2014, <i>Tripoli</i> (LHA 7) is scheduled for delivery in fourth quarter 2018, and we were awarded a construction contract for <i>Bougainville</i> (LHA 8) in 2017.
<i>Arleigh Burke</i> class (DDG 51) destroyers	Build guided missile destroyers designed for conducting anti-air, anti-submarine, anti-surface, and strike operations. The Aegis-equipped <i>Arleigh Burke</i> class (DDG 51) destroyers are the U.S. Navy's primary surface combatant, and have been constructed in variants, allowing technological advances during construction. In 2016 we delivered USS <i>John Finn</i> (DDG 113), and in 2017 we delivered <i>Ralph Johnson</i> (DDG 114). In June 2013, we were awarded a multi-year contract for construction of five additional <i>Arleigh Burke</i> class (DDG 51) destroyers: <i>Paul Ignatius</i> (DDG 117), <i>Delbert D. Black</i> (DDG 119), <i>Frank E. Petersen Jr.</i> (DDG 121), <i>Lenah H. Sutcliffe Higbee</i> (DDG 123), and <i>Jack H. Lucas</i> (DDG 125).
Carrier RCOH	Perform refueling and complex overhaul ("RCOH") of nuclear-powered aircraft carriers, which is required at the mid-point of their 50-year life cycle. USS <i>Abraham Lincoln</i> (CVN 72) was redelivered to the U.S. Navy in the second quarter of 2017 and USS <i>George Washington</i> (CVN 73) arrived at Newport News for the start of its RCOH in August 2017.
<i>Columbia</i> class (SSBN 826) submarines	Newport News is participating in designing the <i>Columbia</i> class submarine as a replacement for the current aging <i>Ohio</i> class nuclear ballistic missile submarines, which were first introduced into service in 1981. The <i>Ohio</i> class SSBN includes 14 nuclear ballistic missile submarines and four nuclear cruise missile submarines. The <i>Columbia</i> class program plan of record is to construct 12 new ballistic missile submarines. The U.S. Navy has initiated the design process for the new class of submarines, and, in early 2017, the DOD signed the acquisition decision memorandum approving the <i>Columbia</i> class program's Milestone B, which formally authorizes the program's entry into the engineering and manufacturing development phase. We continue to perform design work as a subcontractor to Electric Boat, and we have entered into a teaming agreement with Electric Boat to build modules for the entire <i>Columbia</i> class submarine program that leverages our <i>Virginia</i> class (SSN 774) experience. The teaming agreement is subject to the U.S. Navy's concurrence. Newport News was awarded a contract from Electric Boat in 2017 to begin integrated product and process development for the <i>Columbia</i> class. Construction of the first <i>Columbia</i> class submarine is expected to begin in 2021, with procurement of long-lead-time materials and advance construction beginning prior to that time.

Fleet support services	Provide comprehensive life-cycle sustainment services to the U.S. Navy fleet and other DoD and commercial maritime customers. We provide services including maintenance, modernization, and repair on all ship classes; naval architecture, marine engineering, and design; integrated logistics support; technical documentation development; warehousing, asset management, and material readiness; operational and maintenance training development and delivery; software design and development; IT infrastructure support and data delivery and management; and cyber security and information assurance. We provide undersea vehicle and specialized craft development and prototyping services.
<i>Gerald R. Ford</i> class (CVN 78) aircraft carriers	Design and construction for the <i>Ford</i> class program, which is the aircraft carrier replacement program for the decommissioned <i>Enterprise</i> (CVN 65) and <i>Nimitz</i> class (CVN 68) aircraft carriers. USS <i>Gerald R. Ford</i> (CVN 78), the first ship of the <i>Ford</i> class, was delivered to the U.S. Navy in the second quarter of 2017. In June 2015, we were awarded a contract for the detail design and construction of <i>John F. Kennedy</i> (CVN 79), following several years of engineering, advance construction, and purchase of long-lead time components and material. In February 2017, we were awarded a contract for advance planning of <i>Enterprise</i> (CVN 80), the third <i>Ford</i> class aircraft carrier. This category also includes the class' non-recurring engineering. The class is expected to bring improved warfighting capability, quality of life improvements for sailors, and reduced life cycle costs.
Integrated missions solutions services	Provide services including high-end information technology and mission-based solutions to DoD, intelligence, and federal civilian customers. Services include agile software engineering, development, and integration; Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance ("C4ISR") engineering and software integration; mobile application development and network engineering; modeling, simulation, and training; force protection and emergency management training and exercises; unmanned systems development, integration, operations, and maintenance; and mission-oriented intelligence, surveillance, and reconnaissance analytics.
<i>Legend</i> class National Security Cutter	Design and build the U.S. Coast Guard's National Security Cutters ("NSCs"), the largest and most technically advanced class of cutter in the U.S. Coast Guard. The NSC is equipped to carry out maritime homeland security, maritime safety, protection of natural resources, maritime mobility, and national defense missions. The plan is for a total of nine ships, of which the first six ships have been delivered. <i>Kimball</i> (NSC 7), <i>Midgett</i> (NSC 8), and <i>Stone</i> (NSC 9) are currently under construction.
Naval nuclear support services	Provide services to and in support of the U.S. Navy, ranging from services supporting the Navy's carrier and submarine fleets to maintenance services at U.S. Navy training facilities. Naval nuclear support services include design, construction, maintenance, and disposal activities for in service U.S. Navy nuclear ships worldwide through mobile and in-house capabilities. Services include maintenance services on nuclear reactor prototypes.

Nuclear and environmental services	Provide services in nuclear management and operations, and nuclear and non-nuclear fabrication and repair. We provide site management, nuclear and industrial facilities operations and maintenance, decontamination and decommissioning, and radiological and hazardous waste management services. We provide services, including fabrication, equipment repair, and technical engineering services. We participate in several joint ventures, including N3B, MSTS, and SRNS. N3B was awarded the Los Alamos Legacy Cleanup Contract at the DoE/National Nuclear Security Administration's Los Alamos National Laboratory. MSTS was awarded a contract for site management and operations at the Nevada National Security Site. SRNS provides site management and operations at the DoE's Savannah River Site near Aiken, South Carolina.
Oil and gas services	Deliver engineering, procurement, and construction management services to the oil and gas industry for major pipeline, production, and treatment facilities. These services include full life-cycle services for domestic and international projects, from concept identification through detail design, execution and construction, and decommissioning. Related field services include survey, inspection, commissioning and start-up, operations and maintenance, and optimization and debottlenecking.
<i>San Antonio</i> class (LPD 17) amphibious transport dock ships	Design and build amphibious transport dock ships, which are warships that embark, transport, and land elements of a landing force for a variety of expeditionary warfare missions, and also serve as the secondary aviation platform for Amphibious Readiness Groups. The <i>San Antonio</i> class (LPD 17) is the newest addition to the U.S. Navy's 21st century amphibious assault force, and these ships are a key element of the U.S. Navy's seabase transformation. In 2013, we delivered USS <i>Somerset</i> (LPD 25), in 2016, we delivered USS <i>John P. Murtha</i> (LPD 26), and, in 2017, we delivered <i>Portland</i> (LPD 27). We are currently constructing <i>Fort Lauderdale</i> (LPD 28). The <i>San Antonio</i> class (LPD 17) currently includes a total of 11 ships.
The decommissioned <i>Enterprise</i> (CVN 65)	Defuel and inactivate the world's first nuclear-powered aircraft carrier, which began in 2013.
<i>Virginia</i> class (SSN 774) fast attack submarines	Construct attack submarines as the principal subcontractor to Electric Boat. The <i>Virginia</i> class (SSN 774) is a post-Cold War design tailored to excel in a wide range of warfighting missions, including anti-submarine and surface ship warfare; special operation forces; strike; intelligence, surveillance, and reconnaissance; carrier and expeditionary strike group support; and mine warfare.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to certain market risks, primarily related to interest rates and foreign currency exchange rates.

*Interest Rates* - Our financial instruments potentially subject to interest rate risk include floating rate borrowings under our Credit Facility. Our \$1,250 million revolving facility under our Credit Facility was undrawn as of December 31, 2017.

*Foreign Currency* - We currently have, and in the future may enter into, foreign currency forward contracts to manage foreign currency exchange rate risk related to payments to suppliers denominated in foreign currencies. As of December 31, 2017, the fair values of our outstanding foreign currency forward contracts were not significant.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

### **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the shareholders and the Board of Directors of  
Huntington Ingalls Industries, Inc.  
Newport News, Virginia

#### **Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of Huntington Ingalls Industries, Inc. and subsidiaries (the "Company") as of December 31, 2017 and 2016, the related consolidated statements of operations and comprehensive income (loss), changes in equity, and cash flows for each of the three years in the period ended December 31, 2017, the related notes and the financial statement schedule listed in the Index at Item 15 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with the accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 15, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

#### **Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ DELOITTE & TOUCHE LLP

Richmond, Virginia  
February 15, 2018  
We have served as the Company's auditor since 2011

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the shareholders and the Board of Directors of  
Huntington Ingalls Industries, Inc.  
Newport News, Virginia

### **Opinion on Internal Control over Financial Reporting**

We have audited the internal control over financial reporting of Huntington Ingalls Industries, Inc. and subsidiaries (the "Company") as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended December 31, 2017, of the Company and our report dated February 15, 2018, expressed an unqualified opinion on those financial statements.

### **Basis for Opinion**

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### **Definition and Limitations of Internal Control over Financial Reporting**

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

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

/s/ DELOITTE & TOUCHE LLP

Richmond, Virginia  
February 15, 2018

**HUNTINGTON INGALLS INDUSTRIES, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)**

(in millions, except per share amounts)	Year Ended December 31		
	2017	2016	2015
Sales and service revenues			
Product sales	\$ 5,573	\$ 5,631	\$ 5,665
Service revenues	1,868	1,437	1,355
Sales and service revenues	<u>7,441</u>	<u>7,068</u>	<u>7,020</u>
Cost of sales and service revenues			
Cost of product sales	4,444	4,380	4,319
Cost of service revenues	1,574	1,228	1,198
Income (loss) from operating investments, net	12	6	10
Other income and gains	—	15	—
General and administrative expenses	570	623	669
Goodwill impairment	—	—	75
Operating income (loss)	<u>865</u>	<u>858</u>	<u>769</u>
Other income (expense)			
Interest expense	(94)	(74)	(137)
Other, net	1	—	—
Earnings (loss) before income taxes	<u>772</u>	<u>784</u>	<u>632</u>
Federal and foreign income taxes	293	211	228
Net earnings (loss)	<u>\$ 479</u>	<u>\$ 573</u>	<u>\$ 404</u>
Basic earnings (loss) per share	\$ 10.48	\$ 12.24	\$ 8.43
Weighted-average common shares outstanding	45.7	46.8	47.9
Diluted earnings (loss) per share	\$ 10.46	\$ 12.14	\$ 8.36
Weighted-average diluted shares outstanding	45.8	47.2	48.3
Net earnings (loss) from above	\$ 479	\$ 573	\$ 404
Other comprehensive income (loss)			
Change in unamortized benefit plan costs	59	(172)	34
Other	14	(1)	(5)
Tax benefit (expense) for items of other comprehensive income	(22)	67	(12)
Other comprehensive income (loss), net of tax	<u>51</u>	<u>(106)</u>	<u>17</u>
Comprehensive income (loss)	<u>\$ 530</u>	<u>\$ 467</u>	<u>\$ 421</u>

*The accompanying notes are an integral part of these consolidated financial statements.*

**HUNTINGTON INGALLS INDUSTRIES, INC.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

(\$ in millions)	December 31	
	2017	2016
<b>Assets</b>		
Current Assets		
Cash and cash equivalents	\$ 701	\$ 720
Accounts receivable, net of allowance for doubtful accounts of \$15 million as of 2017 and \$4 million as of 2016	1,188	1,164
Inventoried costs, net	183	210
Prepaid expenses and other current assets	123	48
Total current assets	<u>2,195</u>	<u>2,142</u>
Property, Plant, and Equipment		
Land and land improvements	292	252
Buildings and leasehold improvements	1,923	1,752
Machinery and other equipment	1,559	1,410
Capitalized software costs	211	199
	<u>3,985</u>	<u>3,613</u>
Accumulated depreciation and amortization	<u>(1,770)</u>	<u>(1,627)</u>
Property, plant, and equipment, net	2,215	1,986
Other Assets		
Goodwill	1,217	1,234
Other intangible assets, net of accumulated amortization of \$528 million as of 2017 and \$488 million as of 2016	508	548
Long-term deferred tax assets	114	314
Miscellaneous other assets	125	128
Total other assets	<u>1,964</u>	<u>2,224</u>
Total assets	<u>\$ 6,374</u>	<u>\$ 6,352</u>

*The accompanying notes are an integral part of these consolidated financial statements.*



**HUNTINGTON INGALLS INDUSTRIES, INC.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION - CONTINUED**

(\$ in millions)	December 31	
	2017	2016
<i>Liabilities and Stockholders' Equity</i>		
Current Liabilities		
Trade accounts payable	\$ 375	\$ 316
Accrued employees' compensation	245	241
Current portion of postretirement plan liabilities	139	147
Current portion of workers' compensation liabilities	250	217
Advance payments and billings in excess of revenues	146	166
Other current liabilities	236	256
Total current liabilities	1,391	1,343
Long-term debt	1,279	1,278
Pension plan liabilities	922	1,116
Other postretirement plan liabilities	414	431
Workers' compensation liabilities	509	441
Other long-term liabilities	101	90
Total liabilities	4,616	4,699
Commitments and Contingencies (Note 16)		
Stockholders' Equity		
Common stock, \$0.01 par value; 150 million shares authorized; 53.0 million issued and 45.1 million outstanding as of December 31, 2017, and 52.6 million issued and 46.2 million outstanding as of December 31, 2016	1	1
Additional paid-in capital	1,942	1,964
Retained earnings (deficit)	1,687	1,323
Treasury stock	(972)	(684)
Accumulated other comprehensive income (loss)	(900)	(951)
Total stockholders' equity	1,758	1,653
Total liabilities and stockholders' equity	\$ 6,374	\$ 6,352

*The accompanying notes are an integral part of these consolidated financial statements.*

**HUNTINGTON INGALLS INDUSTRIES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
<b>Operating Activities</b>			
Net earnings (loss)	\$ 479	\$ 573	\$ 404
Adjustments to reconcile to net cash provided by (used in) operating activities			
Depreciation	165	163	154
Amortization of purchased intangibles	40	23	26
Amortization of debt issuance costs	6	5	8
Provision for doubtful accounts	10	—	—
Stock-based compensation	34	36	43
Deferred income taxes	184	85	(15)
Proceeds from insurance settlement related to investing activities	—	—	(21)
Impairment of goodwill and intangible assets	—	—	102
Loss on early extinguishment of debt	22	—	44
Change in			
Accounts receivable	(35)	(22)	(41)
Inventoried costs	18	75	54
Prepaid expenses and other assets	(52)	(17)	(31)
Accounts payable and accruals	102	(41)	97
Retiree benefits	(163)	(44)	32
Other non-cash transactions, net	4	(14)	5
Net cash provided by (used in) operating activities	814	822	861
<b>Investing Activities</b>			
Capital expenditures			
Capital expenditure additions	(382)	(285)	(188)
Grant proceeds for capital expenditures	21	—	—
Proceeds from disposition of assets	9	4	32
Acquisitions of businesses, net of cash received	3	(372)	(6)
Proceeds from insurance settlement related to investing activities	—	—	21
Net cash provided by (used in) investing activities	(349)	(653)	(141)
<b>Financing Activities</b>			
Proceeds from issuance of long-term debt	600	—	600
Repayment of long-term debt	(600)	—	(995)
Debt issuance costs	(12)	—	(21)
Premiums and fees related to early extinguishment of debt	(15)	—	(33)
Dividends paid	(115)	(98)	(81)
Repurchases of common stock	(286)	(194)	(232)
Employee taxes on certain share-based payment arrangements	(56)	(51)	(54)
Net cash provided by (used in) financing activities	(484)	(343)	(816)
Change in cash and cash equivalents	(19)	(174)	(96)
Cash and cash equivalents, beginning of period	720	894	990
Cash and cash equivalents, end of period	\$ 701	\$ 720	\$ 894
<b>Supplemental Cash Flow Disclosure</b>			
Cash paid for income taxes	\$ 223	\$ 229	\$ 242
Cash paid for interest	\$ 72	\$ 71	\$ 96
<b>Non-Cash Investing and Financing Activities</b>			
Capital expenditures accrued in accounts payable	\$ 33	\$ 24	\$ 17
Capital assets received from government grants	\$ —	\$ 30	\$ —

*The accompanying notes are an integral part of these consolidated financial statements.*

**HUNTINGTON INGALLS INDUSTRIES, INC.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

(\$ in millions)	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance as of December 31, 2014	\$ 1	\$ 1,959	\$ 525	\$ (258)	\$ (862)	\$ 1,365
Net earnings (loss)	—	—	404	—	—	404
Dividends declared (\$1.70 per share)	—	—	(81)	—	—	(81)
Additional paid-in capital	—	19	—	—	—	19
Other comprehensive income (loss), net of tax	—	—	—	—	17	17
Treasury stock activity	—	—	—	(234)	—	(234)
Balance as of December 31, 2015	1	1,978	848	(492)	(845)	1,490
Net earnings (loss)	—	—	573	—	—	573
Dividends declared (\$2.10 per share)	—	—	(98)	—	—	(98)
Additional paid-in capital	—	(14)	—	—	—	(14)
Other comprehensive income (loss), net of tax	—	—	—	—	(106)	(106)
Treasury stock activity	—	—	—	(192)	—	(192)
Balance as of December 31, 2016	1	1,964	1,323	(684)	(951)	1,653
Net earnings (loss)	—	—	479	—	—	479
Dividends declared (\$2.52 per share)	—	—	(115)	—	—	(115)
Additional paid-in capital	—	(22)	—	—	—	(22)
Other comprehensive income (loss), net of tax	—	—	—	—	51	51
Treasury stock activity	—	—	—	(288)	—	(288)
Balance as of December 31, 2017	\$ 1	\$ 1,942	\$ 1,687	\$ (972)	\$ (900)	\$ 1,758

*The accompanying notes are an integral part of these consolidated financial statements.*

## HUNTINGTON INGALLS INDUSTRIES, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. DESCRIPTION OF BUSINESS

Huntington Ingalls Industries, Inc. ("HII" or the "Company") is one of America's largest military shipbuilding companies and a provider of professional services to partners in government and industry. HII is organized into three reportable segments: Ingalls Shipbuilding ("Ingalls"), Newport News Shipbuilding ("Newport News"), and Technical Solutions. For more than a century, the Company's Ingalls segment in Mississippi and Newport News segment in Virginia have built more ships in more ship classes than any other U.S. naval shipbuilder. The Technical Solutions segment, established in the fourth quarter of 2016, provides a range of services to the governmental, energy, and oil and gas markets.

HII conducts most of its business with the U.S. Government, principally the Department of Defense ("DoD"). As prime contractor, principal subcontractor, team member, or partner, the Company participates in many high-priority U.S. defense technology programs. Through its Ingalls segment, HII is a builder of amphibious assault and expeditionary ships for the U.S. Navy, the sole builder of National Security Cutters for the U.S. Coast Guard, and one of only two companies that builds the Navy's current fleet of *Arleigh Burke* class (DDG 51) destroyers. Through its Newport News segment, HII is the nation's sole designer, builder and refueler of nuclear-powered aircraft carriers, and one of only two companies currently designing and building nuclear-powered submarines for the U.S. Navy. The Technical Solutions segment provides a wide range of professional services, including fleet support, integrated missions solutions, nuclear and environmental, and oil and gas services.

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Principles of Consolidation* - The consolidated financial statements of HII and its subsidiaries have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and the instructions to Form 10-K promulgated by the Securities and Exchange Commission ("SEC"). All intercompany transactions and balances are eliminated in consolidation. For classification of current assets and liabilities related to its long-term production contracts, the Company uses the duration of these contracts as its operating cycle, which is generally longer than one year.

*Accounting Estimates* - The preparation of the Company's consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Estimates have been prepared on the basis of the most current and best available information, and actual results could differ materially from those estimates.

The Bipartisan Budget Act of 2015 established limits on U.S. Government discretionary spending, including defense spending, and provided sequestration relief for 2016 and 2017. Sequestration remains in effect for 2018 through 2021 and could result in significant decreases in DoD spending that could negatively impact the Company's revenues and its estimated recovery of goodwill and other long-lived assets.

*Revenue Recognition* - The majority of the Company's business is derived from long-term contracts for the construction of naval vessels, production of goods, and provision of services, primarily to the U.S. Government. In accounting for these contracts, the Company extensively utilizes the cost-to-cost measure of the percentage-of-completion method of accounting, primarily based upon total costs incurred. Under this method, sales, including estimated earned fees or profits, are recorded as costs are incurred, generally based on the percentage that total costs incurred bear to total estimated costs at completion. Certain contracts contain provisions for price redetermination or for cost and/or performance incentives. Such redetermined amounts or incentives are included in sales when the amounts can reasonably be determined and estimated. Amounts representing contract change orders, claims, requests for equitable adjustment, or limitations in funding are included in sales only when they can be reliably estimated and realization is probable. The Company estimates profit as the difference between total estimated revenues and total estimated cost of a contract and recognizes that profit over the life of the contract based on progress toward completion. If the Company estimates a contract will result in a loss, the full amount of the estimated loss is recognized against income in the period in which the loss is identified.

The Company classifies contract revenues as product sales or service revenues depending upon the predominant attributes of the relevant underlying contracts. The Company recognizes changes in estimates of contract sales, costs, and profits using the cumulative catch-up method of accounting. This method recognizes in the current period the cumulative effect of the changes on current and prior periods. Accordingly, the effect of the changes on future periods of contract performance is recognized as if the revised estimate had been the original estimate. For the years ended December 31, 2017, 2016, and 2015, net cumulative catch-up adjustments increased operating income by \$204 million, \$224 million, and \$239 million, respectively, and increased diluted earnings per share by \$2.90, \$3.08, and \$3.21, respectively. Cumulative catch-up adjustments for the year ended December 31, 2016, included favorable adjustments of \$74 million on a contract at the Ingalls segment, which increased diluted earnings per share by \$1.02. No individual adjustment was material to the Company's consolidated statements of operations and comprehensive income (loss) for the years ended December 31, 2017 and 2015.

For services contracts not associated with the design, development, manufacture, or modification of complex equipment, revenues are recognized upon delivery or as services are rendered once persuasive evidence of an arrangement exists, the price is fixed or determinable, and collectibility is reasonably assured. Costs related to these contracts are expensed as incurred.

*Government Grants* - The Company recognizes incentive grants, inclusive of transfers of depreciable assets, from federal, state, and local governments at fair value upon compliance with the conditions of their receipt and reasonable assurance that the grants will be received or the depreciable assets will be transferred. Grants in recognition of specific expenses are recognized in the same period as an offset to those related expenses. Grants related to depreciable assets are recognized over the periods and in the proportions in which depreciation expense on those assets is recognized.

For the year ended December 31, 2017, the Company recognized cash grant benefits of approximately \$21 million in other long-term liabilities in the consolidated statements of financial position. For the year ended December 31, 2016, the Company recognized grant benefits of approximately \$30 million in depreciable assets. The Company recognized approximately \$15 million in other income and gains within the consolidated statements of operations and comprehensive income (loss), and approximately \$15 million in grant benefits in other long-term liabilities in the consolidated statements of financial position. For the year ended December 31, 2015, the Company recognized no grant benefits.

*General and Administrative Expenses* - In accordance with industry practice and regulations that govern the cost accounting requirements for government contracts, most general corporate expenses incurred at both the segment and corporate locations are allowable and allocable costs on government contracts. These costs are allocated to contracts in progress on a systematic basis, and contract performance factors include this as an element of cost.

General and administrative expenses also include certain other costs that do not affect segment operating income, primarily consisting of the FAS/CAS Adjustment and the provision for non-current state income taxes. The FAS/CAS Adjustment reflects the difference between pension and postretirement benefits expenses determined in accordance with U.S. Financial Accounting Standards ("FAS") and pension and postretirement benefit expenses allocated to individual contracts in accordance with U.S. Cost Accounting Standards ("CAS"). Non-current state income taxes include deferred state income taxes, which reflect the change in deferred state tax assets and liabilities, and the tax expense or benefit associated with changes in state uncertain tax positions in the relevant period.

*Research and Development* - Company-sponsored research and development activities primarily include independent research and development ("IR&D") related to experimentation, design, development, and test activities for government programs. IR&D expenses are included in general and administrative expenses and are generally allocable to government contracts. Company-sponsored IR&D expenses totaled \$17 million, \$19 million, and \$19 million for the years ended December 31, 2017, 2016, and 2015, respectively. Expenses for research and development sponsored by the customer are charged directly to the related contracts.

*Product Warranty Costs* - The Company provides certain product warranties that require repair or replacement of non-conforming items for a specified period of time often subject to a specified monetary coverage limit. The Company's product warranties are provided under government contracts, the costs of which are immaterial and are included in contract costs for purposes of using the percentage-of-completion method of accounting.

*Environmental Costs* - Environmental liabilities are accrued when the Company determines remediation costs are probable and such amounts are reasonably estimable. When only a range of amounts is established and no amount within the range is more probable than another, the minimum amount in the range is recorded. Environmental liabilities are recorded on an undiscounted basis and are not material. Environmental expenditures are expensed or capitalized as appropriate. Capitalized expenditures, if any, relate to long-lived improvements in currently operating facilities. The Company does not record insurance recoveries before collection is probable and, as of December 31, 2017 and 2016, did not have any accrued receivables related to insurance reimbursements or recoveries for environmental matters.

*Fair Value of Financial Instruments* - The accounting standard for fair value measurements provides a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The accounting standard provides a fair value hierarchy, which requires an entity to maximize the use of observable inputs, where available. The three levels of inputs consist of:

Level 1: Quoted prices in active markets for identical assets and liabilities.

Level 2: Observable inputs, other than Level 1 prices, such as: quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or that the Company corroborates with observable market data for substantially the full term of the related assets or liabilities.

Level 3: Unobservable inputs supported by little or no market activity that are significant to the fair value of the assets and liabilities.

Except for the Company's long-term debt, the carrying amounts of the Company's financial instruments recorded at historical cost approximate fair value due to the short-term nature of the instruments and low credit risk associated with the respective counterparties.

The Company maintains multiple grantor trusts to fund certain non-qualified pension plans. These trusts were valued at \$94 million and \$82 million as of December 31, 2017 and 2016, respectively, and are presented within miscellaneous other assets within the consolidated statements of financial position. These trusts consist primarily of available-for-sale investments in marketable securities, which are held at fair value within Level 1 of the fair value hierarchy.

*Foreign Currency Translation* - The Company's international subsidiaries that do not have the U.S. dollar as their functional currency translate assets and liabilities at current rates of exchange in effect at the balance sheet date. Revenues and expenses from these international subsidiaries are translated using the monthly average exchange rates in effect for the periods in which the items occur. The cumulative foreign currency translation gains and losses are included as a component of accumulated other comprehensive income (loss) in stockholders' equity. Gains and losses from foreign currency transactions are included in other income (expense) in the consolidated statements of operations and comprehensive income (loss). Such amounts are not material.

*Asset Retirement Obligations* - Environmental remediation and/or asset decommissioning may be required when the Company ceases to utilize certain facilities. The Company records, within other current liabilities or other long-term liabilities as appropriate, all known asset retirement obligations for which the liability's fair value can be reasonably estimated, including certain asbestos removal, asset decommissioning, and lease restoration obligations.

The changes in the asset retirement obligation carrying amounts for the years ended December 31, 2017, 2016, and 2015, were as follows:

(\$ in millions)	Asset Retirement Obligations
Balance as of December 31, 2014	\$ 22
Liabilities settled	(4)
Revision of estimate	(1)
Accretion expense	1
Balance as of December 31, 2015	<u>18</u>
Accretion expense	1
Balance as of December 31, 2016	<u>19</u>
Liabilities settled	(1)
Accretion expense	1
Balance as of December 31, 2017	<u><u>\$ 19</u></u>

The Company also has known conditional asset retirement obligations related to assets currently in use, including certain asbestos remediation and asset decommissioning activities to be performed in the future, that were not reasonably estimable as of December 31, 2017, due to insufficient information about the timing and method of settlement of the obligation. Accordingly, the fair value of these obligations has not been recorded in the consolidated financial statements. A liability for these obligations is recorded in the period in which sufficient information regarding timing and method of settlement becomes available to make a reasonable estimate of the liability's fair value. In addition, there may be conditional environmental asset retirement obligations that the Company has not yet discovered.

*Income Taxes* - Income tax expense and other related information are based on the prevailing statutory rates for U.S. federal income taxes and the composite state income tax rate for the Company for each period presented. Non-current state income taxes include deferred state income taxes, which reflect the change in deferred state tax assets and liabilities, and the tax expense or benefit associated with changes in state uncertain tax positions in the relevant period. These amounts are recorded within operating income, while the current period state income tax expense, which is generally considered allowable and allocable, is charged to contract costs and included in cost of sales and service revenues in segment operating income.

Deferred income taxes are recorded when revenues and expenses are recognized in different periods for financial statement purposes and for tax return purposes. Deferred tax asset or liability account balances are calculated at the balance sheet date using current tax laws and rates expected to be in effect when the deferred tax items reverse in future periods. As a result of the reduction in the corporate income tax rate from 35% to 21% effective January 1, 2018, under the Tax Cuts and Jobs Act (the "Tax Act"), the Company revalued its net deferred tax assets as of December 31, 2017. This reduced the Company's net deferred tax assets by \$56 million, which was recorded as additional income tax expense for the year ended December 31, 2017.

The Company recognizes deferred tax assets to the extent it believes these assets are more likely than not to be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. Based on the Company's evaluation of these deferred tax assets, valuation allowances of \$12 million and \$11 million were deemed necessary as of December 31, 2017 and 2016, respectively.

Uncertain tax positions meeting the more-likely-than-not recognition threshold, based on the merits of the position, are recognized in the financial statements. The Company recognizes the amount of tax benefit that is greater than 50% likely to be realized upon ultimate settlement with the related tax authority. If a tax position does not meet the minimum statutory threshold to avoid payment of penalties, the Company recognizes an expense for the amount of the penalty in the period the tax position is claimed or expected to be claimed in its tax return. Penalties and accrued interest related to uncertain tax positions are recognized as a component of income tax expense. Changes in accruals associated with uncertain tax positions are recorded in earnings in the period in which they are determined.

*Cash and Cash Equivalents* - The carrying amounts of cash and cash equivalents approximate fair value due to the short-term nature of these assets, which have original maturity dates of 90 days or less.

*Concentration Risk* - The Company's assets that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents. The Company places its cash and cash equivalents with reputable financial institutions and limits the amount of credit exposure with any one of them. The Company regularly evaluates the creditworthiness of these financial institutions and minimizes this credit risk by entering into transactions with high-quality counterparties, limiting the exposure to each counterparty, and monitoring the financial condition of its counterparties.

In connection with its U.S. Government contracts, the Company is required to procure certain raw materials, components, and parts from supply sources approved by the U.S. Government. Only one supplier may exist for certain components and parts required to manufacture the Company's products.

*Accounts Receivable* - Accounts receivable include amounts billed and currently due from customers, amounts currently due but unbilled, certain estimated contract change amounts, claims or requests for equitable adjustment in negotiation that are probable of recovery, and amounts retained by the customer pending contract completion.

*Inventoried Costs* - Inventoried costs primarily relate to production costs of contracts in process and company owned raw materials, which are stated at the lower of cost or net realizable value, generally using the average cost method. Under the Company's U.S. Government contracts, the customer asserts title to, or a security interest in, inventories related to such contracts as a result of contract advances, performance-based payments, and progress payments. In accordance with industry practice, inventoried costs are classified as a current asset and include amounts related to contracts having production cycles longer than one year. Inventoried costs also include work in process under contracts that recognize revenues using labor dollars as the basis of the percentage-of-completion calculation. These costs represent accumulated contract costs less cost of sales as calculated using the percentage-of-completion method, not in excess of recoverable value.

*Advance Payments and Billings in Excess of Revenues* - Payments received in excess of inventoried costs and revenues are recorded as advance payment liabilities.

*Property, Plant, and Equipment* - Depreciable properties owned by the Company are recorded at cost and depreciated over the estimated useful lives of individual assets. Major improvements are capitalized while expenditures for maintenance, repairs, and minor improvements are expensed. Costs incurred for computer software developed or obtained for internal use are capitalized and amortized over the expected useful life of the software, not to exceed nine years. Leasehold improvements are amortized over the shorter of their useful lives or the term of the lease.

The remaining assets are depreciated using the straight-line method, with the following lives:

	Years
Land improvements	2 - 40
Buildings and improvements	2 - 60
Capitalized software costs	2 - 9
Machinery and other equipment	2 - 45

The Company evaluates the recoverability of its property, plant, and equipment when there are changes in economic circumstances or business objectives that indicate the carrying value may not be recoverable. The Company's evaluations include estimated future cash flows, profitability, and other factors affecting fair value. As these assumptions and estimates may change over time, it may or may not be necessary to record impairment charges.

*Leases* - The Company uses its incremental borrowing rate in the assessment of lease classification as capital or operating and defines the initial lease term to include renewal options determined to be reasonably assured. The Company conducts operations primarily under operating leases.



Many of the Company's real property lease agreements contain incentives for tenant improvements, rent holidays, or rent escalation clauses. For incentives for tenant improvements, the Company records a deferred rent liability and amortizes the deferred rent over the term of the lease as a reduction to rent expense. For rent holidays and rent escalation clauses during the lease term, the Company records minimum rental expenses on a straight-line basis over the term of the lease. For purposes of recognizing lease incentives, the Company uses the date of initial possession as the commencement date, which is generally the date on which the Company is given the right of access to the space and begins to make improvements in preparation for the intended use.

*Goodwill and Other Intangible Assets* - The Company performs impairment tests for goodwill as of November 30 of each year and between annual impairment tests if evidence of potential impairment exists, by comparing the carrying value of net assets to the fair value of the reporting unit. If the fair value is determined to be less than the carrying value, the Company records an impairment charge to the reporting unit. Purchased intangible assets are amortized on a straight-line basis or a method based on the pattern of benefits over their estimated useful lives, and the carrying value of these assets is reviewed for impairment when events indicate that a potential impairment may have occurred.

*Equity Method Investments* - Investments in which the Company has the ability to exercise significant influence over the investee but does not own a majority interest or otherwise control are accounted for under the equity method of accounting and included in other assets in its consolidated statements of financial position. The Company's equity investments align strategically and are integrated with the Company's operations. Accordingly, the Company's share of the net earnings or losses of the investee is included in operating income (loss). The Company evaluates its equity investments for other than temporary impairment whenever events or changes in business circumstances indicate that the carrying amounts of such investments may not be fully recoverable. If a decline in the value of an equity method investment is determined to be other than temporary, a loss is recorded in earnings in the current period.

*Self-Insured Group Medical Insurance* - The Company maintains a self-insured group medical insurance plan. The plan is designed to provide a specified level of coverage for employees and their dependents. Estimated liabilities for incurred but not paid claims utilize actuarial methods based on various assumptions, which include, but are not limited to, Hill's historical loss experience and projected loss development factors. These liabilities are recorded in other current liabilities and account for less than 5% of the total current liabilities balance.

*Self-Insured Workers' Compensation Plan* - The operations of the Company are subject to federal and state workers' compensation laws. The Company maintains self-insured workers' compensation plans and participates in federally administered second injury workers' compensation funds. The Company estimates the liability for claims and funding requirements on a discounted basis utilizing actuarial methods based on various assumptions, which include, but are not limited to, the Company's historical loss experience and projected loss development factors as compiled in an annual actuarial study. Self-insurance accruals include amounts related to the liability for reported claims and an estimated accrual for claims incurred but not reported. The Company's workers' compensation liability was discounted at 2.35% and 2.54% as of December 31, 2017 and 2016, respectively. These discount rates were determined using a risk-free rate based on future payment streams. Workers' compensation benefit obligations on an undiscounted basis were \$925 million and \$835 million as of December 31, 2017 and 2016, respectively.

*Litigation, Commitments, and Contingencies* - Amounts associated with litigation, commitments, and contingencies are recorded as charges to earnings when management, after taking into consideration the facts and circumstances of each matter, including any settlement offers and projected loss or claim development factors, has determined it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

*Restructuring* - The Company has recorded accruals for restructuring activities in other current liabilities. These accruals include estimates primarily related to facility consolidations and closures, asset retirement obligations, long-lived asset write-downs, employment reductions, and contract termination costs. Actual costs may vary from these estimates. Restructuring related accruals are reviewed and adjusted when circumstances require such a change.

*Retirement Related Benefit Costs* - The Company accounts for its retirement related benefit plans on the accrual basis. The measurements of obligations, costs, assets, and liabilities require significant judgment. The costs of benefits provided by defined benefit pension plans are recorded in the period participating employees provide service. The costs of benefits provided by other postretirement benefit plans are recorded in the period participating

employees attain full eligibility. The discount rate assumption is defined under GAAP as the rate at which a plan's obligation could be effectively settled. The discount rate is established for each of the retirement related benefit plans at its respective measurement date.

The expected return on plan assets component of retirement related costs is used to calculate net periodic expense. Unless plan assets and benefit obligations are subject to remeasurement during the year, the expected return on assets is based on the fair value of plan assets at the beginning of the year. The costs of plan amendments that provide benefits already earned by plan participants (prior service costs and credits) are deferred in accumulated other comprehensive income and amortized over the expected future service period of active participants as of the date of amendment. Actuarial gains and losses arising from differences between assumptions and actual experience or changes in assumptions are deferred in accumulated other comprehensive income. This unrecognized amount is amortized to the extent it exceeds 10% of the greater of the plan's benefit obligation or plan assets. The amortization period for actuarial gains and losses is the estimated remaining service life of the plan participants.

The Company recognizes the funded status of each retirement related benefit plan as an asset or liability in its consolidated statements of financial position. The funded status represents the difference between the plan's benefit obligation and the fair value of the plan's assets. Unrecognized deferred amounts, such as demographic or asset gains or losses and the impacts of plan amendments, are included in accumulated other comprehensive income and amortized as described above.

*Stock Compensation* - Stock-based compensation value is determined based on the closing market price of the Company's common stock on grant date, and the expense is recognized over the vesting period. At each reporting date, the number of shares is adjusted to equal the number ultimately expected to vest based on the Company's expectations regarding the relevant performance and service criteria.

*Related Party Transactions* - On March 29, 2011, HII entered into a Separation and Distribution Agreement (the "Separation Agreement") with its former parent company, Northrop Grumman Corporation ("Northrop Grumman"), and Northrop Grumman's subsidiaries (Northrop Grumman Shipbuilding, Inc. and Northrop Grumman Systems Corporation), pursuant to which HII was legally and structurally separated from Northrop Grumman. In connection with the spin-off, HII also entered into a Tax Matters Agreement with Northrop Grumman related to taxes prior to the spin-off as described in Note 13: Income Taxes. Under all spin-off related agreements, the Company was due \$8 million and \$33 million from Northrop Grumman as of December 31, 2017 and 2016, respectively. As of December 31, 2017 and 2016, the Company had \$84 million outstanding under Industrial Revenue Bonds issued by the Mississippi Business Finance Corporation. Prior to the spin-off, repayment of principal and interest was guaranteed by Northrop Grumman Systems Corporation. The guaranty remains in effect, and the Company has agreed to indemnify Northrop Grumman Systems Corporation for any losses related to the guaranty.

### **3. ACCOUNTING STANDARDS UPDATES**

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers (Topic 606)", which will replace existing requirements in U.S. GAAP, including industry-specific requirements, significantly expand the disclosure requirements, and provide companies with a single revenue recognition model for recognizing revenue from contracts with customers. The core principle of the new standard is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. In July 2015, the FASB approved the deferral of the new standard's effective date by one year. The new standard is effective for annual reporting periods beginning after December 15, 2017. The FASB permitted companies to adopt the new standard early, but not before the original effective date of annual reporting periods beginning after December 15, 2016.

As part of the Company's corporate governance structure, the Company established an implementation team comprised of key stakeholders across the Company's businesses. The Company developed a plan to identify and implement applicable changes to its business processes, systems, and controls. These changes are necessary to support recognition and disclosure under the new standard. In the first quarter of 2017, the Company reached a point in its assessment to support a transition decision based on information obtained to date. Based on its

evaluation, the Company will adopt the requirements of the new standard in the first quarter of 2018 utilizing the modified retrospective method. As a result, the Company will present the cumulative effect of applying the standard at the date of initial application, January 1, 2018.

The Company has completed its evaluation of the impact of the accounting and disclosure changes on its business processes, controls, and systems and, as a result, has redefined its accounting policies affected by this standard and enhanced internal controls over financial reporting related to the standard. The assessment of the majority of the Company's contracts under the new standard supports the recognition of revenue over time using the cost-to-cost measurement under the percentage of completion method, which is consistent with the Company's current revenue recognition practices. As such, the revenue on the majority of the Company's contracts will continue to be recognized over time considering the continuous transfer of control to the customer. Under U.S. Government contracts, this continuous transfer of control to the customer is supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay the Company for costs incurred plus a reasonable profit, and take control of any work in process. ASU 2014-09 also requires expanded disclosures regarding the nature, timing, and uncertainty of revenue and customer contract balances, including how and when the Company satisfies its performance obligations and the relationship between revenue recognized and changes in contract balances during a reporting period. The Company has evaluated these disclosure requirements and is incorporating the collection of relevant data into its business processes. The Company does not expect the new standard to have a material effect on its consolidated financial position, results of operations, or cash flows.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)", which establishes a right-of-use model that requires a lessee to record the right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of operations and comprehensive income. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those reporting periods. Early adoption is permitted and should be applied using a modified retrospective approach. The Company is in the process of evaluating the potential impacts of ASU 2016-02 on its consolidated financial statements and disclosures, contracting and accounting processes, internal controls, and information technology systems.

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment", which eliminates the performance of Step 2 from the goodwill impairment test. In performing its annual or interim impairment testing, an entity will instead compare the fair value of the reporting unit with its carrying amount and recognize any impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss. The Company elected to adopt ASU 2017-04 as of November 30, 2017. The adoption of ASU 2017-04 did not have a material impact on the Company's consolidated financial statements and disclosures, accounting processes, or internal controls.

In March 2017, the FASB issued ASU 2017-07, "Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost". The update requires employers to present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. The other components of net benefit cost, including interest cost, expected return on plan assets, amortization of prior service cost/credit and actuarial gain/loss, and settlement and curtailment effects, are to be presented outside of any subtotal of operating income. Employers will have to disclose the line(s) used to present the other components of net periodic benefit cost, if the components are not presented separately in the income statement. ASU 2017-07 is effective for fiscal years and interim periods beginning after December 15, 2017, and early adoption is permitted.

The Company expects the adoption of ASU 2017-07 will change the net FAS/CAS pension adjustment within operating income, which will be offset by a corresponding change in Other income (expense), as a result of reclassifying interest cost, expected return on plan assets, amortization of prior service cost/credit and actuarial gain/loss, and settlement and curtailment effects of net periodic benefit expense from operating income to Other income (expense). Additionally, the remaining FAS/CAS Adjustment within operating income will be reclassified from General and administrative expenses to Cost of product sales and service revenues. The Company adopted ASU 2017-07 on January 1, 2018 using the retrospective method and does not expect the impact to 2017 and 2016 operating income to be material when it is recast to reflect the new standard. The Company does not expect ASU 2017-07 to have a material impact on its consolidated statements of financial position, cash flows, accounting processes, or internal controls.

In May 2017, the FASB issued ASU 2017-10, "Service Concession Arrangements (Topic 853): Determining the Customer of the Operation Services", which addresses how an operating entity should determine the customer for operations under a service concession arrangement. The update clarifies that the grantor is the customer of the operation services in all cases for these arrangements. This standard is effective for annual reporting periods beginning after December 15, 2017. The FASB permitted companies to adopt the new standard early, but not before the original effective date of annual reporting periods beginning after December 15, 2016. The Company is currently evaluating the impact of ASU 2017-10 on its consolidated financial statements and disclosures, accounting processes, or internal controls.

Other pronouncements issued but not effective until after December 31, 2017, are not expected to have a material impact on the Company's consolidated financial position, results of operations, or cash flows.

#### **4. AVONDALE**

In 2010, plans were announced to consolidate the Company's Ingalls shipbuilding operations by winding down shipbuilding at the Avondale, Louisiana facility in 2013 after completion of LPD-class ships that were under construction at this facility. In October 2014, the Company ceased shipbuilding construction operations at the Avondale facility.

In connection with and as a result of the decision to wind down shipbuilding at the Avondale facility, the Company began incurring and paying related costs, including, but not limited to, severance expense, relocation expense, and asset write-downs related to the Avondale facilities. Pursuant to applicable provisions of the Federal Acquisition Regulation ("FAR") and Cost Accounting Standards for the treatment of restructuring and shutdown related costs, the Company has been amortizing the deferred costs over a five year period since 2014, when the Company ceased shipbuilding construction operations at the Avondale facility.

The Company engaged in communications and negotiations with the U.S. Government beginning in 2010 regarding the amount and recovery of the Company's restructuring and shutdown costs. On November 16, 2017, the U.S. Government and the Company reached a settlement of the Company's claim for restructuring costs. Under the terms of the settlement, \$251 million is being treated as allowable costs. Any future gain or loss associated with disposition of the land, facilities, and capital assets located at Avondale was excluded from the settlement and will be recorded by the Company at the time of disposition. The settlement was consistent with management's cost recovery expectations and did not have a material effect on the Company's consolidated financial position or results of operations. The Company anticipates that a majority of these restructuring and shutdown related costs will be billed to the U.S. Government and collected by the end of 2018.

Effective July 31, 2017, the Company entered into a Purchase and Sale Agreement with a potential buyer of the Avondale facility. After conducting due diligence on the property, the potential buyer has the right to determine whether or not to proceed to closing. As of December 31, 2017, the assets related to the Avondale facility were recorded at \$23 million in land within property, plant, and equipment, net and \$124 million in contract working capital within inventoried costs, accounts receivable and advance payments and billings in excess of revenues in the consolidated statements of financial position.

#### **5. GULFPORT**

In September 2013, the Company announced the closure of its Gulfport Composite Center of Excellence in Gulfport, Mississippi, part of the Ingalls reportable segment, which it completed in August 2014. In connection with this closure, the Company incurred total costs of \$54 million, consisting of \$52 million in accelerated depreciation of fixed assets and \$2 million in personnel, facility shutdown, and other related costs. In March 2015, the Company sold the Gulfport Composite Center of Excellence to the Mississippi State Port Authority for \$32 million, resulting in a gain on disposition of \$9 million, recorded as a reduction to contract costs in accordance with the terms of the Company's contracts with the U.S. Government.

The Company has received communications from the Supervisor of Shipbuilding questioning the Company's treatment and proposed allocation of the Gulfport closure costs. The Company has responded to such communications with the position that its proposed accounting and allocation of the closure costs complies with applicable law, and the Company and the U.S. Government remain in discussions about the proper accounting and allocation of such costs. While the Company anticipates a resolution that is substantially in accordance with

management's cost recovery expectations, any inability to recover such costs substantially in accordance with the Company's cost recovery expectations could result in a material effect on the Company's consolidated financial position, results of operations, or cash flows.

## 6. ACQUISITIONS

On December 1, 2016, the Company acquired, for approximately \$369 million in cash, net of \$27 million of cash acquired, Camber Holding Corporation ("Camber"), a provider of mission-based and information technology solutions to the U.S. Government. The acquisition was consistent with the Company's strategy to optimize and expand its services portfolio. For the year ended December 31, 2017, Camber contributed revenues of \$309 million and operating income of \$8 million. In connection with this acquisition, the Company recorded \$261 million of goodwill, all of which was allocated to its Technical Solutions segment, primarily related to the value of Camber's workforce, and \$76 million of intangible assets related to existing contract backlog. See Note 11: Goodwill and Other Intangible Assets. For the year ended December 31, 2017, the Company recorded a goodwill adjustment of \$17 million, primarily driven by the finalization of fair value calculations for certain assets and liabilities, as well as the net working capital adjustment. The assets, liabilities, and results of operations of Camber are not material to the Company's consolidated financial position, results of operations, or cash flows.

On January 30, 2015, the Company acquired, for approximately \$6 million in cash, the assets of the Engineering Solutions Division ("ESD") of The Columbia Group. ESD, a leading designer and builder of unmanned underwater vehicles for domestic and international customers, is operating as the Undersea Solutions Corporation ("USC"). As the U.S. Navy increases employment of unmanned vehicles in both the surface and undersea domains, this acquisition enhances the Company's ability to compete in these markets. In connection with this acquisition, the Company recorded \$4 million of goodwill, all of which was allocated to its Newport News segment, primarily attributed to USC's specialized and skilled employees, and \$1 million of intangible assets, primarily related to technology. See Note 12: Goodwill and Other Intangible Assets. The assets, liabilities, and results of operations of USC are not material to the Company's consolidated financial position, results of operations, or cash flows.

The Company funded each of these acquisitions using cash on hand. The acquisition costs incurred in connection with these acquisitions were not material. The operating results of these businesses have been included in the Company's consolidated results as of the respective closing dates of the acquisitions. In allocating the purchase prices of these businesses, the Company considered the estimated fair value of net tangible and intangible assets acquired, with any excess purchase price recorded as goodwill. The total amount of goodwill resulting from these acquisitions expected to be deductible for tax purposes was \$155 million. These acquisitions are not material either individually or in the aggregate, and pro forma revenues and results of operations have therefore not been provided.

## 7. STOCKHOLDERS' EQUITY

*Common Stock* - Changes in the Company's number of outstanding shares for the year ended December 31, 2017, resulted from shares purchased in the open market under the Company's stock repurchase program and share activity under its stock compensation plans. See Note 19: Stock Compensation Plans.

*Treasury Stock* - In October 2015, the Company's board of directors authorized an increase in the stock repurchase program from \$600 million to \$1.2 billion. In November 2017, the Company's board of directors authorized an increase in the Company's stock repurchase program from \$1.2 billion to \$2.2 billion and an extension of the term of the program from October 31, 2019, to October 31, 2022. Repurchases are made from time to time at management's discretion in accordance with applicable federal securities laws. For the year ended December 31, 2017, the Company repurchased 1,417,808 shares at an aggregate cost of \$288 million, of which \$2 million was not yet settled for cash as of December 31, 2017. For the years ended December 31, 2016 and 2015, the Company repurchased 1,266,192 and 1,987,550 shares, respectively, at aggregate costs of \$192 million and \$234 million, respectively, of which \$2 million was not yet settled for cash as of December 31, 2015. The cost of purchased shares is recorded as treasury stock in the consolidated statements of financial position.

*Dividends* - In November 2017, the Company's board of directors authorized an increase in the Company's quarterly cash dividend from \$0.60 per share to \$0.72 per share. In November 2016, the Company's board of directors authorized an increase in the Company's quarterly cash dividend from \$0.50 per share to \$0.60 per share. In October 2015, the Company's board of directors authorized an increase in the Company's quarterly cash dividend from \$0.40 per share to \$0.50 per share. The Company paid cash dividends totaling \$115 million (\$2.52

per share), \$98 million (\$2.10 per share), and \$81 million (\$1.70 per share) in the years ended December 31, 2017, 2016, and 2015, respectively.

*Accumulated Other Comprehensive Income* - Other comprehensive income (loss) refers to gains and losses recorded as an element of stockholders' equity but excluded from net earnings (loss). The accumulated other comprehensive loss as of December 31, 2017 and 2016, was comprised of unamortized benefit plan costs of \$906 million and \$948 million, respectively, and other comprehensive income (loss) items of \$6 million and \$(3) million, respectively.

The changes in accumulated other comprehensive income (loss) by component for the years ended December 31, 2017, 2016, and 2015, were as follows:

(\$ in millions)	Benefit Plans	Other	Total
Balance as of December 31, 2014	\$ (864)	\$ 2	\$ (862)
Other comprehensive income (loss) before reclassifications	(53)	(5)	(58)
Amounts reclassified from accumulated other comprehensive income (loss)			
Amortization of prior service cost (credit) <sup>1</sup>	(1)	—	(1)
Amortization of net actuarial loss (gain) <sup>1</sup>	88	—	88
Tax benefit (expense) for items of other comprehensive income	(13)	1	(12)
Net current period other comprehensive income (loss)	21	(4)	17
Balance as of December 31, 2015	(843)	(2)	(845)
Other comprehensive income (loss) before reclassifications	(249)	(1)	(250)
Amounts reclassified from accumulated other comprehensive income (loss)			
Amortization of prior service cost (credit) <sup>1</sup>	(1)	—	(1)
Amortization of net actuarial loss (gain) <sup>1</sup>	78	—	78
Tax benefit (expense) for items of other comprehensive income	67	—	67
Net current period other comprehensive income (loss)	(105)	(1)	(106)
Balance as of December 31, 2016	(948)	(3)	(951)
Other comprehensive income (loss) before reclassifications	(34)	14	(20)
Amounts reclassified from accumulated other comprehensive income (loss)			
Amortization of net actuarial loss (gain) <sup>1</sup>	93	—	93
Tax benefit (expense) for items of other comprehensive income	(17)	(5)	(22)
Net current period other comprehensive income (loss)	42	9	51
Balance as of December 31, 2017	\$ (906)	\$ 6	\$ (900)

<sup>1</sup> These accumulated comprehensive income (loss) components are included in the computation of net periodic benefit cost. See Note 18: Employee Pension and Other Postretirement Benefits. The tax expense associated with amounts reclassified from accumulated other comprehensive income (loss) for the years ended December 31, 2017, 2016, and 2015, was \$36 million, \$27 million, and \$30 million, respectively.

## 8. EARNINGS PER SHARE

Basic and diluted earnings per common share were calculated as follows:

(in millions, except per share amounts)	Year Ended December 31		
	2017	2016	2015
Net earnings (loss)	\$ 479	\$ 573	\$ 404
Weighted-average common shares outstanding	45.7	46.8	47.9
Net effect of dilutive stock options and awards	0.1	0.4	0.4
Dilutive weighted-average common shares outstanding	<u>45.8</u>	<u>47.2</u>	<u>48.3</u>
Earnings (loss) per share - basic	\$ 10.48	\$ 12.24	\$ 8.43
Earnings (loss) per share - diluted	<u>\$ 10.46</u>	<u>\$ 12.14</u>	<u>\$ 8.36</u>

The Company's calculation of diluted earnings per common share includes the dilutive effects of the assumed exercise of stock options and vesting of restricted stock based on the treasury stock method. Under the treasury stock method, the Company has excluded from the diluted share amounts presented above the effects 0.3 million Restricted Performance Stock Rights ("RPSRs") for the year ended December 31, 2017. The amounts presented above for the year ended December 31, 2016, exclude the impact of 0.1 million stock options and 0.3 million RPSRs under the treasury stock method. The amounts presented above for the year ended December 31, 2015, exclude the impact of 0.3 million stock options and 0.7 million RPSRs under the treasury stock method.

## 9. SEGMENT INFORMATION

The Company is organized into three reportable segments: Ingalls, Newport News, and Technical Solutions, consistent with how management makes operating decisions and assesses performance. The Technical Solutions segment was established in the fourth quarter of 2016 in conjunction with the Company's acquisition of Camber and realignment of management oversight of operations to enhance strategic and operational alignment among its services businesses. As a result of this realignment, the Company's non-nuclear fleet support and nuclear and environmental services were transferred from its Newport News segment to its Technical Solutions segment. The Company's oil and gas services were transferred from its Other segment to its Technical Solutions segment, and its Other segment was dissolved. The Company has reflected the 2016 segment realignment in prior reporting periods on a retrospective basis. None of these changes impacted the Company's previously reported consolidated financial position, results of operations, or cash flows.

*U.S. Government Sales* - Revenues from the U.S. Government include revenues from contracts for which HII is the prime contractor, as well as contracts for which the Company is a subcontractor and the ultimate customer is the U.S. Government. The Company derived over 95% of its revenues from the U.S. Government for each of the years ended December 31, 2017, 2016, and 2015, respectively.

*Assets* - Substantially all of the Company's assets are located or maintained in the United States.

## Results of Operations by Segment

The following table presents the Company's operating results by segment.

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
<b>Sales and Service Revenues</b>			
Ingalls	\$ 2,420	\$ 2,389	\$ 2,188
Newport News	4,164	4,089	4,298
Technical Solutions	952	691	616
Intersegment eliminations	(95)	(101)	(82)
Total sales and service revenues	<u>\$ 7,441</u>	<u>\$ 7,068</u>	<u>\$ 7,020</u>
<b>Operating Income (Loss)</b>			
Ingalls	\$ 313	\$ 321	\$ 379
Newport News	354	386	401
Technical Solutions	21	8	(113)
Total segment operating income (loss)	<u>688</u>	<u>715</u>	<u>667</u>
<b>Non-segment factors affecting operating income (loss)</b>			
FAS/CAS Adjustment	189	145	104
Non-current state income taxes	(12)	(2)	(2)
Total operating income (loss)	<u>\$ 865</u>	<u>\$ 858</u>	<u>\$ 769</u>

Sales transactions between segments are generally recorded at cost.

*Goodwill and Intangible Asset Impairment Charges* - The operating loss at the Technical Solutions segment for the year ended December 31, 2015, reflects goodwill impairment charges of \$75 million and intangible asset impairment charges of \$27 million.

## Other Financial Information

The following tables present the Company's assets, capital expenditures, and depreciation and amortization by segment.

(\$ in millions)	December 31		
	2017	2016	2015
<b>Assets</b>			
Ingalls	\$ 1,385	\$ 1,362	1,324
Newport News	3,350	3,169	3,061
Technical Solutions	642	692	303
Corporate	997	1,129	1,336
Total assets	<u>\$ 6,374</u>	<u>\$ 6,352</u>	<u>\$ 6,024</u>



(\$ in millions)	Year Ended December 31		
	2017	2016	2015
Capital Expenditures <sup>(1)</sup>			
Ingalls	\$ 131	\$ 97	\$ 53
Newport News	224	176	130
Technical Solutions	6	8	5
Corporate	—	4	—
Total capital expenditures	<u>\$ 361</u>	<u>\$ 285</u>	<u>\$ 188</u>

<sup>(1)</sup> Net of grant proceeds for capital expenditures

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
Depreciation and Amortization <sup>(1)</sup>			
Ingalls	\$ 73	\$ 68	\$ 65
Newport News	107	109	102
Technical Solutions	25	9	13
Total depreciation and amortization	<u>\$ 205</u>	<u>\$ 186</u>	<u>\$ 180</u>

<sup>(1)</sup> Excluding amortization of debt issuance costs

## 10. ACCOUNTS RECEIVABLE, NET

Accounts receivable includes unbilled amounts that represent sales for which billings have not been presented to customers at year-end. These amounts are usually billed and collected within one year. Accounts receivable billed but not paid by customers under retainage provisions in long-term contracts were \$64 million and \$46 million as of December 31, 2017 and 2016, respectively, substantially all of which were under U.S. Government contracts. Accounts receivable at December 31, 2017, are expected to be collected in 2018, except for approximately \$77 million due in 2019 and \$65 million due in or after 2020.

Because the Company's accounts receivable are primarily with the U.S. Government or with companies acting as a contractor to the U.S. Government, the Company does not have material exposure to accounts receivable credit risk.

Accounts receivable were comprised of the following:

(\$ in millions)	December 31	
	2017	2016
Due From U.S. Government		
Amounts billed	\$ 277	\$ 249
Recoverable costs and accrued profit on progress completed - unbilled	733	830
	<u>1,010</u>	<u>1,079</u>
Due From Other Customers		
Amounts billed	167	69
Recoverable costs and accrued profit on progress completed - unbilled	26	20
	<u>193</u>	<u>89</u>
Total accounts receivable	1,203	1,168
Allowances for doubtful accounts	(15)	(4)
Total accounts receivable, net	<u>\$ 1,188</u>	<u>\$ 1,164</u>

The Company has limited exposure to credit losses and maintains an allowance for anticipated losses considered necessary under the circumstances based on historical experience with uncollected customer accounts and a review of its currently outstanding accounts receivable. For the three months ended March 31, 2017, the Company

recorded a \$29 million allowance for doubtful accounts within the Technical Solutions segment related to a commercial customer's petition for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. For the three months ended June 30, 2017, and September 30, 2017, the Company released \$7 million and \$13 million, respectively, of the allowance for doubtful accounts following its receipt of bankruptcy related payments from its commercial customer. Additionally, certain payments totaling \$28 million received from this customer may be reclaimed by the bankruptcy trustee if any such payments are determined to have been a preferential payment or similar transaction under applicable bankruptcy laws.

## 11. INVENTORIED COSTS, NET

Inventoried costs were comprised of the following:

(\$ in millions)	December 31	
	2017	2016
Production costs of contracts in process	\$ 90	\$ 116
Raw material inventory	93	94
Total inventoried costs, net	<u>\$ 183</u>	<u>\$ 210</u>

## 12. GOODWILL AND OTHER INTANGIBLE ASSETS

### Goodwill

HII performs impairment tests for goodwill as of November 30 of each year and between annual impairment tests if an event occurs or circumstances change that would more likely than not reduce the fair values of the Company's reporting units below their carrying values. Reporting units are aligned with the Company's businesses. The Company's testing approach utilizes a combination of discounted cash flow analysis and comparative market multiples to determine the fair values of its businesses for comparison to their corresponding book values.

In connection with the Company's annual goodwill impairment test as of November 30, 2017, management tested goodwill for each of its four reporting units. As a result of its annual goodwill impairment test, the Company determined that the estimated fair value of each reporting unit exceeded by more than 10% its corresponding carrying value as of November 30, 2017.

In connection with the Company's annual goodwill impairment test as of November 30, 2016, management tested goodwill for each of its four reporting units. As a result of its annual goodwill impairment test, the Company determined that the estimated fair value of each reporting unit exceeded by more than 10% its corresponding carrying value as of November 30, 2016.

In conjunction with the Company's realignment of its operations on December 1, 2016, the Company allocated goodwill among new and realigned reporting units based on the relative fair values of the reporting units being realigned. As a result, during the fourth quarter of 2016, the Company performed a quantitative assessment of goodwill immediately after the realignment for each of the reporting units impacted by the Company's realignment. Based on this quantitative assessment, no impairment charge was necessary as a result of the realignment.

While the November 30, 2015, annual impairment test did not result in an impairment, considering the limited excess fair value of goodwill over its carrying value in the Oil and Gas reporting unit and the continued decline in oil prices and related industry activity levels, the Company performed an interim assessment of goodwill as of December 31, 2015. The Company's determination of fair value as of December 31, 2015, considered industry events that occurred in the period since its annual goodwill impairment test, as well as the updated long term outlook for this reporting unit. Those events included continued deterioration in the oil and gas markets, numerous industry-wide project deferrals, and capital spending cuts announced by industry leaders. The analysis concluded the fair value of this reporting unit was less than its carrying value as of December 31, 2015, and the Company recorded a goodwill impairment charge of \$16 million at the Oil and Gas reporting unit in the Technical Solutions segment in the fourth quarter of 2015.

The Company continuously monitors industry events and changes in circumstances in the industries in which its reporting units conduct business. In consideration of the Oil and Gas reporting unit's sensitivity to developments within its industry, the continued decline in crude oil prices, significant reductions in its customer capital spending

plans, and project delays, management concluded that an interim goodwill impairment test was necessary to determine whether it was more likely than not that the fair value of its Oil and Gas reporting unit was still higher than its carrying value as of May 31, 2015. As a result of its analysis, the Company recorded a \$59 million goodwill impairment charge in the Oil and Gas reporting unit at its Technical Solutions segment in the second quarter of 2015.

Accumulated goodwill impairment losses as of each of December 31, 2017 and 2016, were \$2,877 million. The accumulated goodwill impairment losses for Ingalls as of each of December 31, 2017, and 2016, were \$1,568 million. The accumulated goodwill impairment losses for Newport News as of each of December 31, 2017, and 2016, were \$1,187 million. The accumulated goodwill impairment losses for the Technical Solutions segment as of each of December 31, 2017 and 2016, were \$122 million.

During the year ended December 31, 2017, the Company recorded a goodwill adjustment of \$17 million in the Technical Solutions segment, primarily driven by the finalization of fair value calculations for certain assets and liabilities, as well as the net working capital adjustment, related to the acquisition of Camber. For the year ended December 31, 2016, the Company recorded \$278 million of goodwill related to its acquisition of Camber.

For the years ended December 31, 2017 and 2016, the carrying amounts of goodwill changed as follows:

(\$ in millions)	Ingalls	Newport News	Technical Solutions	Total
Balance as of December 31, 2015	\$ 175	\$ 721	\$ 60	\$ 956
Acquisitions	—	—	278	278
Balance as of December 31, 2016	175	721	338	1,234
Adjustments	—	—	(17)	(17)
Balance as of December 31, 2017	<u>\$ 175</u>	<u>\$ 721</u>	<u>\$ 321</u>	<u>\$ 1,217</u>

### Other Intangible Assets

The Company performs tests for impairment of long-lived assets whenever events or circumstances suggest that long-lived assets may be impaired. In December 2015, the Company performed an impairment test on the amortizable intangible assets that arose from the UPI acquisition, which reside in the Company's Oil and Gas reporting unit within the Technical Solutions segment. The Oil and Gas asset group's long lived intangible assets consist primarily of customer relationships and, to a lesser degree, trade name and developed technology. The Company performed its impairment test considering the latest market conditions and expectations, as well as lower anticipated revenue and profitability. Based on the nature of UPI's intangible assets, the Company performed the recoverability test at the reporting unit level. In connection with the recoverability test, the Company reevaluated the remaining useful lives of the intangible assets and determined the total undiscounted pretax cash flows generated by the reporting unit over the remaining useful life of the primary asset, customer relationships. The carrying amount of the reporting unit was greater than the total undiscounted pretax cash flows, and, as a result, the intangible assets were written down by \$27 million, charged against cost of sales and service revenues within income from operations at the Technical Solutions segment, and the new carrying value was adjusted to be amortized using the pattern of benefits method over a weighted-average life of seven years.

In connection with the Camber purchase in 2016, the Company recorded \$76 million of intangible assets pertaining to existing contract backlog and customer relationships, to be amortized using the pattern of benefits method over a weighted-average life of 10 years. In connection with the USC purchase in 2015, the Company recorded \$1 million of intangible assets pertaining to technology, to be amortized using the pattern of benefits method over a weighted-average life of 19 years.

The Company's purchased intangible assets are being amortized on a straight-line basis or a method based on the pattern of benefits over their estimated useful lives. Net intangible assets consist primarily of amounts pertaining to nuclear-powered aircraft carrier and submarine program intangible assets, with an aggregate weighted-average useful life of 40 years based on the long life cycle of the related programs. Aggregate amortization expense for the years ended December 31, 2017, 2016, and 2015, was \$40 million, \$23 million, and \$26 million, respectively.

The Company expects amortization for purchased intangible assets of \$36 million in 2018, \$32 million in 2019, \$28 million in 2020, \$26 million in 2021, and \$24 million in 2022.

### 13. INCOME TAXES

*Tax Reform* - The Tax Act, signed into law on December 22, 2017, provides for significant changes to U.S. federal income tax law, including a provision that allows for full expensing of certain qualified property, reduction of the federal corporate income tax rate from 35.0% to 21.0%, repeal of the manufacturing deduction, and further limitations on the deductibility of certain executive compensation. The Tax Act contains other provisions that are not expected to materially affect the Company, including requiring a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries that is payable over eight years, limitations on the deductibility of interest expense, and the creation of the base erosion anti-abuse tax.

The SEC staff issued Staff Accounting Bulletin ("SAB") 118, which provides guidance on accounting for the tax effects of the Tax Act, including a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under Accounting Standards Codification ("ASC") 740, *Income Taxes*. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Act for which the accounting under ASC 740 is complete. Provisional estimates for the income tax effects of the Tax Act can be recorded where a company's accounting is incomplete but a reasonable estimate can be determined. If a company cannot determine a provisional estimate for the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax law that were in effect immediately before enactment of the Tax Act.

There are no material elements of the Tax Act for which the Company's accounting is complete. While the Company's accounting for the following elements of the Tax Act is incomplete, the Company was able to make reasonable estimates of certain effects of such elements. Accordingly, the Company recorded provisional adjustments for the following significant items:

*Reduction of the U.S. federal corporate income tax rate:* Beginning January 1, 2018, the Company's income will be taxed at a 21.0% federal rate, in contrast to the previous rate of 35.0%. Under ASC 740, *Income Taxes*, deferred tax assets or liabilities must be recalculated as of the enactment date using current tax laws and rates expected to be in effect when the deferred tax items reverse in future periods. Consequently, the Company has recorded provisional decreases in its deferred tax assets and deferred tax liabilities of \$252 million and \$196 million, respectively, with a corresponding net adjustment to deferred income tax expense of \$56 million for the year ended December 31, 2017. While the Company is able to make a reasonable estimate of the impact of the reduction in the U.S. federal rate, it may be affected by other analyses related to the Tax Act, including, but not limited to, accounting method changes for tax purposes that could result in adjustments to federal temporary differences.

*Acceleration of Depreciation:* While the Company has not completed its determination of all capital expenditures that qualify for immediate expensing, for the year ended December 31, 2017, the Company recorded a provisional benefit of \$8 million based on its current intent to fully expense all qualifying expenditures. This resulted in a decrease of approximately \$8 million to the Company's current income taxes payable and a corresponding decrease in its net deferred tax asset excluding the effect of the reduction in the U.S. federal corporate tax rate.

The Company's accounting for the following element of the Tax Act is incomplete and the Company is not yet able to make a reasonable estimate of the effect. Accordingly, no provisional adjustment was recorded.

*Executive Compensation:* Effective January 1, 2018, the performance-based compensation exception to the \$1 million deduction limitation of Internal Revenue Code Section 162(m) is repealed and the employees subject to the \$1 million deduction limitation are revised to include the chief executive officer, the chief financial officer, and the next three most highly compensated employees required to be reported in the Company's proxy statement. The only exception to this rule is for compensation that is paid pursuant to a binding contract in effect on November 2, 2017 that would have otherwise been deductible under prior Section 162(m) rules. Accordingly, any compensation paid in the future pursuant to new compensation arrangements entered into after November 2, 2017, even if performance based, will count toward the \$1 million annual deduction limit if paid to an executive subject to Section 162(m). The Company has not yet completed an analysis of the binding contract requirement on the Company's various compensation plans to determine the impact of the law change.

The Company's earnings are primarily domestic and its effective tax rate on earnings from operations for the year ended December 31, 2017, was 38.0%, compared with 26.9% and 36.1% for 2016 and 2015, respectively.

For the year ended December 31, 2017, the Company's effective tax rate differed from the federal statutory rate primarily as a result of the increase in deferred federal tax expense attributable to the recalculation of the Company's net deferred tax asset to reflect the impact of the federal tax rate decrease included in the Tax Act, partially offset by the income tax benefits resulting from stock award settlement activity and the domestic manufacturing deduction. For the year ended December 31, 2016, the Company's effective tax rate differed from the federal statutory rate primarily as a result of the adoption of ASU 2016-09, which reduced income tax expense by the income tax benefits resulting from stock award settlement activity, a remeasurement of uncertain tax positions that resulted in a decrease in cumulative unrecognized tax benefits, and the domestic manufacturing deduction. The Company's effective tax rate for the year ended December 31, 2015, differed from the federal statutory rate primarily as a result of the amount of the goodwill impairment that is not amortizable for tax purposes and other non-deductible expenses, partially offset by the domestic manufacturing deduction.

Non-current state income taxes include deferred state income taxes, which reflect the change in deferred state tax assets and liabilities, and the tax expense or benefit associated with changes in state uncertain tax positions in the relevant period. These amounts are recorded within operating income. Current period state income tax expense is charged to contract costs and included in cost of sales and service revenues in segment operating income.

In connection with the spin-off from Northrop Grumman, HII entered into a Tax Matters Agreement with Northrop Grumman, which governs the respective rights, responsibilities, and obligations of Northrop Grumman and the Company with respect to tax liabilities and benefits, tax attributes, tax contests, and other tax sharing regarding U.S. federal, state, local, and foreign income taxes, other taxes, and related tax returns. The Company is severally liable with Northrop Grumman for its income taxes for periods before the spin-off. HII is obligated to indemnify Northrop Grumman for tax adjustments that increase the Company's taxable income for periods before the spin-off and are of a nature that could result in a correlative reduction in HII's taxable income for periods after the spin-off. Northrop Grumman is obligated to indemnify HII for tax adjustments that decrease the Company's taxable income for periods before the spin-off and are of a nature that could result in a correlative increase in HII's taxable income for periods after the spin-off. These payment obligations only apply once the aggregate tax liability related to tax adjustments exceeds \$5 million. Once the aggregate amount is exceeded, only the amount in excess of \$5 million is ultimately required to be paid. In 2016 and prior years, HII incurred non-cash federal and state tax adjustments for items governed by the Tax Matters Agreement. The federal tax expense (benefit) adjustment is reported as a component of tax expense, while the state tax expense (benefit) adjustment is treated as an allowable cost in the applicable period under the terms of the Company's existing contracts and is included in general and administrative expenses. In 2016, Northrop Grumman settled with the IRS for the years 2007 through the date of the spin-off, during which HII was part of its consolidated tax returns. Northrop Grumman's 2007 through 2011 federal tax returns are currently subject to examination due to the filing of refund claims for those years.

Federal and foreign income tax expense for the years ended December 31, 2017, 2016, and 2015, consisted of the following:

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
Income Taxes on Operations			
Federal and foreign income taxes currently payable	\$ 121	\$ 134	\$ 242
Change in deferred federal and foreign income taxes	172	77	(14)
Total federal and foreign income taxes	<u>\$ 293</u>	<u>\$ 211</u>	<u>\$ 228</u>

Earnings and income tax from foreign operations are not material for all periods presented.

Income tax expense differed from the amount based on the statutory federal income tax rate applied to earnings (loss) before income taxes due to the following:

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
Income tax expense (benefit) on operations at statutory rate	\$ 270	\$ 274	\$ 221
Provisional deferred tax asset revaluation - Tax Act	56	—	—
Goodwill impairment	—	—	11
Stock compensation - net excess tax benefits	(25)	(29)	—
Manufacturing deduction	(12)	(21)	(10)
Uncertain tax positions	—	(15)	—
Other, Net	4	2	6
Total federal and foreign income taxes	<u>\$ 293</u>	<u>\$ 211</u>	<u>\$ 228</u>

*Unrecognized Tax Benefits* - Unrecognized tax benefits represent the gross value of the Company's uncertain tax positions that have not been reflected in the consolidated statements of operations. If the income tax benefits from federal tax positions are ultimately realized, such realization would affect the Company's income tax expense, while the realization of state tax benefits would be recorded in general and administrative expenses.

The changes in unrecognized tax benefits (exclusive of interest and penalties) for the years ended December 31, 2017, 2016, and 2015 are summarized in the following table:

(\$ in millions)	December 31		
	2017	2016	2015
Unrecognized tax benefits at beginning of the year	\$ 2	\$ 27	\$ 19
Additions based on tax positions related to the current year	—	1	8
Additions based on tax positions of prior years	—	2	3
Reductions based on tax positions of prior years	—	(15)	—
Settlements	—	(11)	(1)
Statute of limitation expirations	(2)	(2)	(2)
Net change in unrecognized tax benefits	<u>(2)</u>	<u>(25)</u>	<u>8</u>
Unrecognized tax benefits at end of the year	<u>\$ —</u>	<u>\$ 2</u>	<u>\$ 27</u>

As of December 31, 2017 and 2016, the estimated amounts of the Company's uncertain tax positions, excluding interest and penalties, were liabilities of less than \$1 million and \$2 million, respectively. Assuming sustainment of these positions, as of December 31, 2017 and 2016, the reversal of less than \$1 million and \$2 million, respectively, of the amounts accrued would favorably affect the Company's effective federal income tax rate in future periods.

In 2016, the Company settled a state uncertain tax position through agreement with the applicable taxing authority. The net impact of the settlement was not material to HII's consolidated financial position, results of operations, or cash flows.

The Company recognizes interest and penalties related to unrecognized tax benefits as income tax expense. Related to the unrecognized tax benefits noted above, there was a net decrease in income tax expense of \$1 million in 2017 for interest and penalties, resulting in no material liability for interest and penalties as of December 31, 2017. The 2017 changes in interest and penalties related to statute of limitation expirations. In 2016, there was a net decrease in income tax expense of \$2 million for interest and penalties, resulting in a total liability of \$1 million for interest and penalties as of December 31, 2016. The 2016 changes in interest and penalties related to reductions in prior year tax positions and settlement with a taxing authority. There were no material changes to accrued interest or penalties during 2015, and, as of December 31, 2015, the Company's liability for interest and penalties was \$3 million.

The following table summarizes the tax years that are either currently under examination or remain open under the applicable statute of limitations and subject to examination by the major tax jurisdictions in which the Company operates:

Jurisdiction	Years
United States	2011 - 2016
Connecticut	2016 - 2016
Mississippi	2012 - 2016
Virginia	2012 - 2016

Although the Company believes it has adequately provided for all uncertain tax positions, amounts asserted by taxing authorities could be greater than the Company's accrued position. Accordingly, additional provisions for federal and state income tax related matters could be recorded in the future as revised estimates are made or the underlying matters are effectively settled or otherwise resolved. Conversely, the Company could settle positions with the tax authorities for amounts lower than have been accrued. The Company believes that it is reasonably possible that during the next 12 months the Company's liability for uncertain tax positions may decrease by less than \$1 million due to resolution of a federal uncertain tax position.

During 2013 the Company entered into the pre-Compliance Assurance Process with the IRS for years 2011 and 2012. The Company is part of the IRS Compliance Assurance Process program for the 2014 through 2018 tax years. Open tax years related to state jurisdictions remain subject to examination.

*Deferred Income Taxes* - Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and for income tax purposes. As described above, deferred tax assets and liabilities are calculated as of the balance sheet date using current tax laws and rates expected to be in effect when the deferred tax items reverse in future periods. As a result of the reduction in the corporate income tax rate from 35.0% to 21.0% under the Tax Act, the Company revalued its net deferred tax assets as of December 31, 2017. Net deferred tax assets are classified as long-term deferred tax assets in the consolidated statements of financial position.

The tax effects of significant temporary differences and carry-forwards that gave rise to year-end deferred tax balances, as presented in the consolidated statements of financial position, were as follows:

(\$ in millions)	December 31	
	2017	2016
Deferred Tax Assets		
Retirement benefits	\$ 263	\$ 568
Workers' compensation	167	251
Reserves not currently deductible for tax purposes	44	56
Stock-based compensation	11	16
Net operating losses and tax credit carry-forwards	21	22
Other	—	7
	506	920
Gross deferred tax assets		
Less valuation allowance	12	11
Net deferred tax assets	494	909
Deferred Tax Liabilities		
Depreciation and amortization	223	320
Contract accounting differences	51	108
Purchased intangibles	106	167
	380	595
Gross deferred tax liabilities		
Total net deferred tax assets	\$ 114	\$ 314

As of December 31, 2017, the Company had gross state income tax credit carry-forwards of approximately \$20 million, which expire from 2018 through 2020. A deferred tax asset of approximately \$16 million (net of federal benefit) has been established related to these state income tax credit carry-forwards, with a valuation allowance of \$7 million against such deferred tax asset as of December 31, 2017. The Company had a gross state net operating loss carry-forward of \$39 million, which expires in 2027. A deferred tax asset of approximately \$3 million (net of federal benefit) has been established for the net operating loss carry-forward, with a full valuation allowance as of December 31, 2017. Other state and foreign net operating loss carry-forwards are separately and cumulatively immaterial to the Company's deferred tax balances and expire between 2026 and 2036.

#### 14. DEBT

Long-term debt consisted of the following:

(\$ in millions)	December 31	
	2017	2016
Senior notes due December 15, 2021, 5.000%	—	600
Senior notes due November 15, 2025, 5.000%	600	600
Senior notes due December 1, 2027, 3.483%	600	—
Mississippi economic development revenue bonds due May 1, 2024, 7.81%	84	84
Gulf opportunity zone industrial development revenue bonds due December 1, 2028, 4.55%	21	21
Less unamortized debt issuance costs	(26)	(27)
Total long-term debt	1,279	1,278

*Credit Facility* - In November 2017, the Company terminated its Second Amended and Restated Credit Agreement and entered into a new Credit Agreement (the "Credit Facility") with third-party lenders. The Credit Facility includes a revolving credit facility of \$1,250 million, which may be drawn upon during a period of five years from November 22, 2017. The revolving credit facility includes a letter of credit subfacility of \$500 million. The revolving credit facility has a variable interest rate on outstanding borrowings based on the London Interbank Offered Rate ("LIBOR") plus a spread based upon the Company's credit rating, which may vary between 1.125% and 1.500%. The revolving credit facility also has a commitment fee rate on the unutilized balance based on the Company's leverage ratio. The commitment fee rate as of December 31, 2017 was 0.25% and may vary between 0.20% and 0.30%.

The Credit Facility contains customary affirmative and negative covenants, as well as a financial covenant based on a maximum total leverage ratio. Each of the Company's existing and future material wholly owned domestic subsidiaries, except those that are specifically designated as unrestricted subsidiaries, are and will be guarantors under the Credit Facility.

In July 2015, the Company used cash on hand to repay all amounts outstanding under a prior credit facility, including \$345 million in principal amount of outstanding term loans.

As of December 31, 2017, \$15 million in letters of credit were issued but undrawn, and the remaining \$1,235 million of the revolving credit facility was unutilized. The Company had unamortized debt issuance costs associated with its credit facilities of \$11 million and \$8 million as of December 31, 2017 and 2016, respectively.

*Senior Notes* - In December 2017, the Company issued \$600 million aggregate principal amount of unregistered 3.483% senior notes with registration rights due December 2027, the net proceeds of which were used to repurchase the Company's 5.000% senior notes due in 2021 in connection with the 2017 redemption described below. In November 2015, the Company issued \$600 million aggregate principal amount of unregistered 5.000% senior notes due November 2025, the net proceeds of which were used to repurchase the Company's 7.125% senior notes due in 2021 in connection with the 2015 tender offer and redemption described below. Interest on the Company's senior notes is payable semi-annually.

The terms of the 5.000% and 3.483% senior notes limit the Company's ability and the ability of certain of its subsidiaries to create liens, enter into sale and leaseback transactions, sell assets, and effect consolidations or mergers. The Company had unamortized debt issuance costs associated with the senior notes of \$15 million and \$19 million as of December 31, 2017 and 2016, respectively.



*Tender Offers and Redemptions* - During the fourth quarter of 2017, the Company completed a redemption of \$600 million aggregate principal amount of its 5.000% senior notes due in 2021.

During the fourth quarter of 2015, the Company completed a tender offer, followed by a redemption of untendered notes, to purchase for cash an aggregate principal amount of \$600 million of its 7.125% senior notes due in 2021.

*Early Extinguishment of Debt* - Details of the loss on early extinguishment of debt related to the Company's prior credit facility and refinancing of senior notes, which was included in interest expense, were as follows:

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
Redemption and tender premiums and fees	\$ 15	\$ —	\$ 33
Write-off of unamortized debt issuance costs	7	—	11
Total loss on early extinguishment of debt	\$ 22	\$ —	\$ 44

*Mississippi Economic Development Revenue Bonds* - As of each of December 31, 2017 and 2016, the Company had \$84 million outstanding under Industrial Revenue Bonds issued by the Mississippi Business Finance Corporation. These bonds accrue interest at a fixed rate of 7.81% per annum (payable semi-annually) and mature in 2024. While repayment of principal and interest is guaranteed by Northrop Grumman Systems Corporation, HII has agreed to indemnify Northrop Grumman Systems Corporation for any losses related to the guaranty. In accordance with the terms of the bonds, the proceeds were used to finance the construction, reconstruction, and renovation of the Company's interest in certain ship manufacturing and repair facilities, or portions thereof, located in the state of Mississippi.

*Gulf Opportunity Zone Industrial Development Revenue Bonds* - As of each of December 31, 2017 and 2016, the Company had \$21 million outstanding under Gulf Opportunity Zone Industrial Development Revenue Bonds ("GO Zone IRBs") issued by the Mississippi Business Finance Corporation. These bonds accrue interest at a fixed rate of 4.55% per annum (payable semi-annually) and mature in 2028. In accordance with the terms of the bonds, the proceeds were used to finance the construction, reconstruction, and renovation of the Company's interest in certain ship manufacturing and repair facilities, or portions thereof, located in the state of Mississippi.

The Company's debt arrangements contain customary affirmative and negative covenants, including a maximum leverage ratio. The Company was in compliance with all debt covenants during the year ended December 31, 2017.

The estimated fair values of the Company's total long-term debt, including current portions, as of December 31, 2017 and December 31, 2016, were \$1,361 million and \$1,372 million, respectively. The fair values of the Company's long-term debt were calculated based on either recent trades of the Company's debt instruments in inactive markets or yields available on debt with substantially similar risks, terms, and maturities, which fall within Level 2 under the fair value hierarchy.

The Company does not have any principal payments due on long-term debt within the next five years.

## 15. INVESTIGATIONS, CLAIMS, AND LITIGATION

The Company is involved in legal proceedings before various courts and administrative agencies, and is periodically subject to government examinations, inquiries and investigations. Pursuant to FASB Accounting Standards Codification 450 *Contingencies*, the Company has accrued for losses associated with investigations, claims, and litigation when, and to the extent that, loss amounts related to the investigations, claims, and litigation are probable and can be reasonably estimated. The actual losses that might be incurred to resolve such investigations, claims, and litigation may be higher or lower than the amounts accrued. For matters where a material loss is probable or reasonably possible and the amount of loss cannot be reasonably estimated, but the Company is able to reasonably estimate a range of possible losses, the Company will disclose such estimated range in these notes. This estimated range is based on information currently available to the Company and involves elements of judgment and significant uncertainties. Any estimated range of possible loss does not represent the Company's maximum possible loss exposure. For matters as to which the Company is not able to reasonably estimate a possible loss or range of loss, the Company will indicate the reasons why it is unable to estimate the possible loss or range of loss. For matters not specifically described in these notes, the Company does not believe, based on

information currently available to it, that it is reasonably possible that the liabilities, if any, arising from such investigations, claims, and litigation will have a material effect on its consolidated financial position, results of operations, or cash flows. The Company has, in certain cases, provided disclosure regarding certain matters for which the Company believes at this time that the likelihood of material loss is remote.

*False Claims Act Complaints* - In 2015, the Company received a Civil Investigative Demand from the Department of Justice ("DoJ") relating to an investigation of certain allegedly non-conforming parts the Company purchased from one of its suppliers for use in connection with U.S. Government contracts. The Company has cooperated with the DoJ in connection with its investigation. In 2016, the Company was made aware that it is a defendant in a False Claims Act lawsuit filed under seal in the U.S. District Court for the Middle District of Florida related to the Company's purchases of the allegedly non-conforming parts from the supplier. Depending upon the outcome of this matter, the Company could be subject to civil penalties, damages, and/or suspension or debarment from future U.S. Government contracts, which could have a material adverse effect on its consolidated financial position, results of operations, or cash flows. The matter remains sealed and given the current posture of the matter, the Company is unable to estimate an amount or range of reasonably possible loss or to express an opinion regarding the ultimate outcome.

*U.S. Government Investigations and Claims* - Departments and agencies of the U.S. Government have the authority to investigate various transactions and operations of the Company, and the results of such investigations may lead to administrative, civil or criminal proceedings, the ultimate outcome of which could be fines, penalties, repayments or compensatory, treble, or other damages. U.S. Government regulations provide that certain findings against a contractor may also lead to suspension or debarment from future U.S. Government contracts or the loss of export privileges. Any suspension or debarment would have a material effect on the Company because of its reliance on government contracts.

In January 2013, the Company disclosed to the DoD, including the U.S. Navy, and the U.S. Department of Homeland Security, including the U.S. Coast Guard, pursuant to the FAR, that it had initiated an internal investigation regarding whether certain employees at Ingalls mischarged time or misstated progress on Navy and Coast Guard contracts. The Company conducted an internal investigation, led by external counsel, and took remedial actions, including the termination of employees in instances where the Company believed grounds for termination existed. The Company provided information regarding its investigation to the relevant government agencies, and agreed with the U.S. Navy and U.S. Coast Guard that they would initially withhold \$24 million in payments on existing contracts pending receipt of additional information from the Company's internal investigation. The U.S. Navy subsequently reduced its portion of the withhold from \$18.2 million to \$4.7 million, and the U.S. Coast Guard reduced its withhold from \$5.8 million to \$3.6 million. In September 2017, the U.S. Navy and the U.S. Coast Guard paid the Company the respective remaining amounts they were withholding.

In June 2015, the DoJ informed the Company that it was investigating the matters disclosed by the Company to the DoD in January 2013. In August 2017, the Company settled the matters with the DoJ. The settlement did not have a material effect on the Company's consolidated financial position, results of operations, or cash flows.

*Asbestos Related Claims* - HII and its predecessors-in-interest are defendants in a longstanding series of cases that have been and continue to be filed in various jurisdictions around the country, wherein former and current employees and various third parties allege exposure to asbestos containing materials while on or associated with HII premises or while working on vessels constructed or repaired by HII. The cases allege various injuries, including those associated with pleural plaque disease, asbestosis, cancer, mesothelioma, and other alleged asbestos related conditions. In some cases, several of HII's former executive officers are also named as defendants. In some instances, partial or full insurance coverage is available to the Company for its liability and that of its former executive officers. The average cost per case to resolve cases during the years ended December 31, 2017, 2016, and 2015 was immaterial individually and in the aggregate. The Company's estimate of asbestos-related liabilities is subject to uncertainty because liabilities are influenced by numerous variables that are inherently difficult to predict. Key variables include the number and type of new claims, the litigation process from jurisdiction to jurisdiction and from case to case, reforms made by state and federal courts, and the passage of state or federal tort reform legislation. Although the Company believes the ultimate resolution of current cases will not have a material effect on its consolidated financial position, results of operations, or cash flows, it cannot predict what new or revised claims or litigation might be asserted or what information might come to light and can, therefore, give no assurances regarding the ultimate outcome of asbestos related litigation.

*Other Litigation* - The Company and its predecessor-in-interest have been in litigation with the Bolivarian Republic of Venezuela (the "Republic") since 2002 over a contract for the repair, refurbishment, and modernization at Ingalls of two foreign-built frigates. The case proceeded towards arbitration, then appeared to settle favorably, but the settlement was overturned in court and the matter returned to litigation. In March 2014, the Company filed an arbitral statement of claim asserting breaches of the contract and \$173 million in damages plus substantial interest and litigation expenses. In July 2014, the Republic filed in the arbitration a statement of defense denying all the Company's allegations and a counterclaim alleging late redelivery of the frigates, unfinished work, and breach of warranty and asserting damages of \$61 million plus interest. An arbitration hearing was held in January 2015, and the Company cannot predict when the arbitration panel will render a decision. No assurances can be provided regarding the ultimate outcome of this matter.

The Company is party to various other claims and legal proceedings that arise in the ordinary course of business. Although the Company believes that the resolution of these other claims and legal proceedings will not have a material effect on its consolidated financial position, results of operations, or cash flows, it cannot predict what new or revised claims or litigation might be asserted or what information might come to light and can, therefore, give no assurances regarding the ultimate outcome of these matters.

## **16. COMMITMENTS AND CONTINGENCIES**

*Contract Performance Contingencies* - Contract profit margins may include estimates of revenues for matters on which the customer and the Company have not reached agreement, such as settlements in the process of negotiation, contract changes, claims, and requests for equitable adjustment for previously unanticipated contract costs. These estimates are based upon management's best assessment of the underlying causal events and circumstances, and are included in determining contract profit margins to the extent of expected recovery based on contractual entitlements and the probability of successful negotiation with the customer. As of December 31, 2017, recognized amounts related to claims and requests for equitable adjustment were not material individually or in aggregate.

*Guarantees of Performance Obligations* - From time to time in the ordinary course of business, HII may enter into joint ventures, teaming, and other business arrangements to support the Company's products and services. The Company generally strives to limit its exposure under these arrangements to its investment or the extent of obligations under the applicable contract. In some cases, however, HII may be required to guarantee performance of the arrangement's obligations and, in such cases, generally obtains cross-indemnification from the other members of the arrangement.

In the ordinary course of business, the Company may guarantee obligations of its subsidiaries under certain contracts. Generally, the Company is liable under such an arrangement only if its subsidiary is unable to perform its obligations. Historically, the Company has not incurred any substantial liabilities resulting from these guarantees. As of December 31, 2017, the Company was not aware of any existing event of default that would require it to satisfy any of these guarantees.

*Environmental Matters* - The estimated cost to complete environmental remediation has been accrued where it is probable that the Company will incur such costs in the future to address environmental conditions at currently or formerly owned or leased operating facilities, or at sites where it has been named a Potentially Responsible Party ("PRP") by the Environmental Protection Agency or similarly designated by another environmental agency, and the related costs can be estimated by management. These accruals do not include any litigation costs related to environmental matters, nor do they include amounts recorded as asset retirement obligations. To assess the potential impact on the Company's consolidated financial statements, management estimates the range of reasonably possible remediation costs that could be incurred by the Company, taking into account currently available facts on each site, as well as the current state of technology and prior experience in remediating contaminated sites. These estimates are reviewed periodically and adjusted to reflect changes in facts and technical and legal circumstances. Management estimates that as of December 31, 2017, the probable future cost for environmental remediation was \$1 million, which is accrued in other current liabilities. Factors that could result in changes to the Company's estimates include: modification of planned remedial actions, increases or decreases in the estimated time required to remediate, changes to the determination of legally responsible parties, discovery of more extensive contamination than anticipated, changes in laws and regulations affecting remediation requirements, and improvements in remediation technology. Should other PRPs not pay their allocable shares of remediation costs, the Company may incur costs exceeding those already estimated and accrued. Although management cannot predict whether new information gained as projects progress will materially affect the

estimated liability accrued, management does not believe that future remediation expenditures will have a material effect on the Company's consolidated financial position, results of operations, or cash flows. In addition, there are certain potential remediation sites where the costs of remediation cannot be reasonably estimated.

*Financial Arrangements* - In the ordinary course of business, HII uses standby letters of credit issued by commercial banks and surety bonds issued by insurance companies primarily to support the Company's self-insured workers' compensation plans. As of December 31, 2017, the Company had \$15 million in standby letters of credit issued but undrawn, as indicated in Note 14: Debt, and \$258 million of surety bonds outstanding.

*U.S. Government Claims* - From time to time, the U.S. Government communicates to the Company potential claims, disallowed costs, and penalties concerning prior costs incurred by the Company with which the U.S. Government disagrees. When such preliminary findings are presented, the Company and U.S. Government representatives engage in discussions, from which HII evaluates the merits of the claims and assesses the amounts being questioned. Although the Company believes that the resolution of any of these matters will not have a material effect on its consolidated financial position, results of operations, or cash flows, it cannot predict the ultimate outcome of these matters.

*Collective Bargaining Agreements* - Of the Company's approximately 38,000 employees, approximately 50% are covered by a total of nine collective bargaining agreements and two site stabilization agreements. Newport News has four collective bargaining agreements covering represented employees, one of which covers approximately 50% of Newport News employees and was renewed July 2017. The remaining collective bargaining agreements at Newport News expire August 2018, December 2018, and November 2020. Newport News craft workers employed at the Kesselring Site near Saratoga Springs, New York are represented under an indefinite Department of Energy ("DoE") site agreement. Ingalls has five collective bargaining agreements covering represented employees, all of which expire in March 2022. Approximately 35 Technical Solutions craft employees at the Hanford Site near Richland, Washington are represented under an indefinite DoE site stabilization agreement. The Company believes its relationship with its employees is satisfactory.

Collective bargaining agreements generally expire after three to five years and are subject to renegotiation at that time. The Company does not expect the results of these negotiations, either individually or in the aggregate, to have a material effect on the Company's consolidated results of operations.

*Purchase Obligations* - Periodically the Company enters into agreements to purchase goods or services that are enforceable and legally binding on the Company and specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum, or variable price provisions; and the approximate timing of the transaction. These obligations are primarily comprised of open purchase order commitments to vendors and subcontractors pertaining to funded contracts.

*Operating Leases* - Rental expense for operating leases for the years ended December 31, 2017, 2016, and 2015, was \$63 million, \$69 million, and \$62 million, respectively. These amounts are net of immaterial amounts of sublease rental income. The amounts of minimum rental commitments under long-term non-cancellable operating leases for each of the years 2018 through 2022 and thereafter are:

(\$ in millions)	
2018	\$ 39
2019	35
2020	28
2021	24
2022	17
Thereafter	51
Total	<u>\$ 194</u>

## 17. IMPACTS FROM HURRICANES

In August 2005, the Company's Ingalls operations were significantly impacted by Hurricane Katrina, and the Company's shipyards in Louisiana and Mississippi sustained significant windstorm damage from the hurricane. As a result of the storm, the Company incurred costs to replace or repair destroyed or damaged assets, suffered losses

under its contracts, and incurred substantial costs to clean up and recover its operations. At the time of the storm, the Company had an insurance program that provided coverage for, among other things, property damage, business interruption impact on net profitability, and costs associated with clean-up and recovery. The Company recovered \$677.5 million of its Hurricane Katrina claim from participating program insurers, which included \$180 million from Factory Mutual Insurance Company ("FM Global") in settlement of litigation arising from a disagreement concerning the coverage of certain losses related to Hurricane Katrina.

In January 2011, the Company, through a predecessor-in-interest, filed suit in Superior Court in California against Aon Risk Insurance Services West, Inc. ("Aon"), which acted as broker to the predecessor-in-interest in connection with the policy with FM Global, seeking damages for breach of contract, professional negligence and negligent misrepresentation, as well as declaratory relief. Those included damages unrecovered from FM Global plus costs, legal fees, and expenses incurred in the lawsuit against FM Global, as well as interest. In January 2014, the Company amended its complaint to allege fraud and seek punitive damages.

In May 2015, the Company and Aon entered into a settlement agreement, pursuant to which Aon made a cash payment of \$150 million to the Company and the Company released its claims against Aon. In the second quarter of 2015, the \$150 million settlement was recorded as a gain in operating income and the Company recorded a credit to the U.S. Government, which resulted in a reduction in operating income of \$14 million. Should the U.S. Government disagree with the Company's allocation of proceeds, the Company may be required to allocate additional amounts to the U.S. Government. The \$150 million gain and allowable cost credit resulted in a net favorable impact to operating income for the year ended December 31, 2015, of \$136 million.

## **18. EMPLOYEE PENSION AND OTHER POSTRETIREMENT BENEFITS**

The Company provides defined benefit pension plans and postretirement benefit plans to eligible employees. Non-collectively bargained defined benefit pension benefits accruing under the traditional years of service and compensation formula were amended in 2009 to freeze future service accruals and have been replaced with a cash balance benefit for all current non-collectively bargained employees. Except for the major collectively bargained plan at Ingalls, the Company's qualified defined benefit pension plans are frozen to new entrants. The Company's policy is to fund its qualified defined benefit pension plans at least to the minimum amounts required under U.S. Government regulations.

Plan obligations are measured based on the present value of projected future benefit payments to participants for services rendered to date. The measurement of projected future benefits is dependent on the terms of each individual plan, demographics, and valuation assumptions. No assumption is made regarding any potential changes to the benefit provisions beyond those to which the Company is currently committed, for example under existing collective bargaining agreements.

The Company also sponsors 401(k) defined contribution pension plans in which most employees, including certain hourly employees, are eligible to participate. Company contributions for most defined contribution pension plans are based on the matching of employee contributions up to 4% of eligible compensation. Certain hourly employees are covered under a target benefit plan. In addition to the 401(k) defined contribution pension benefit formula, non-collectively bargained employees hired after June 30, 2008, are eligible to participate in a defined contribution benefit program in lieu of a defined benefit pension plan. The Company's contributions to the qualified defined contribution pension plans for the years ended December 31, 2017, 2016, and 2015, were \$78 million, \$71 million, and \$73 million, respectively.

The Company also sponsors defined benefit and defined contribution pension plans to provide benefits in excess of the qualified limits. The liabilities related to these plans as of December 31, 2017, were \$182 million and \$32 million, respectively, and as of December 31, 2016, were \$154 million and \$29 million, respectively. Assets, primarily in the form of Level 1 marketable securities held in grantor trusts, are intended to fund certain of these obligations. The trusts' fair values supporting these liabilities as of December 31, 2017 and 2016, were \$94 million and \$82 million, respectively, of which \$61 million and \$51 million, respectively, were related to the non-qualified defined benefit pension plans.

The Company provides contributory postretirement health care and life insurance benefits to a dominantly closed group of eligible employees, retirees, and their qualifying dependents. Covered employees achieve eligibility to participate in these contributory plans upon retirement from active service if they meet specified age, years of service, and grandfathered requirements. Benefits are not guaranteed, and the Company reserves the right to

amend or terminate coverage at any time. The Company's contributions for retiree health care benefits are subject to caps, which limit Company contributions when spending thresholds are reached.

The measurement date for all of the Company's retirement related plans is December 31. The costs of the Company's defined benefit pension plans and other postretirement benefit plans for the years ended December 31, 2017, 2016, and 2015, were as follows:

(\$ in millions)	Pension Benefits			Other Benefits		
	Year Ended December 31			Year Ended December 31		
	2017	2016	2015	2017	2016	2015
Components of Net Periodic Benefit Cost						
Service cost	\$ 146	\$ 133	\$ 150	\$ 10	\$ 10	\$ 13
Interest cost	266	262	242	24	25	27
Expected return on plan assets	(367)	(346)	(351)	—	—	—
Amortization of prior service cost (credit)	20	18	19	(20)	(19)	(20)
Amortization of net actuarial loss (gain)	97	84	86	(4)	(6)	2
Net periodic benefit cost	<u>\$ 162</u>	<u>\$ 151</u>	<u>\$ 146</u>	<u>\$ 10</u>	<u>\$ 10</u>	<u>\$ 22</u>

The funded status of the Company's pension and other postretirement plans as of December 31, 2017 and 2016, was as follows:

(\$ in millions)	Pension Benefits		Other Benefits	
	December 31		December 31	
	2017	2016	2017	2016
Change in Benefit Obligation				
Benefit obligation at beginning of year	\$ 6,050	\$ 5,635	\$ 578	\$ 566
Service cost	146	133	10	10
Interest cost	266	262	24	25
Plan participants' contributions	4	8	8	8
Plan amendments	74	—	(10)	—
Actuarial loss (gain)	457	216	(15)	9
Benefits paid	(219)	(204)	(42)	(40)
Benefit obligation at end of year	<u>6,778</u>	<u>6,050</u>	<u>553</u>	<u>578</u>
Change in Plan Assets				
Fair value of plan assets at beginning of year	4,911	4,613	—	—
Actual return on plan assets	840	321	—	—
Employer contributions	301	173	34	32
Plan participants' contributions	4	8	8	8
Benefits paid	(219)	(204)	(42)	(40)
Fair value of plan assets at end of year	<u>5,837</u>	<u>4,911</u>	<u>—</u>	<u>—</u>
Funded status	<u>\$ (941)</u>	<u>\$ (1,139)</u>	<u>\$ (553)</u>	<u>\$ (578)</u>

Amounts Recognized in the Consolidated Statements of Financial Position:

Pension plan assets <sup>(1)</sup>	\$ 6	\$ —	\$ —	\$ —
Current liability <sup>(2)</sup>	(25)	(23)	(139)	(147)
Non-current liability <sup>(3)</sup>	(922)	(1,116)	(414)	(431)
Accumulated other comprehensive loss (income) (pre-tax) related to:				
Prior service costs (credits)	122	68	(75)	(86)
Net actuarial loss (gain)	1,477	1,589	(18)	(6)

<sup>(1)</sup> Included in miscellaneous other assets.

(2) Included in other current liabilities and current portion of postretirement plan liabilities, respectively.

(3) Included in pension plan liabilities and other postretirement plan liabilities, respectively.

The Projected Benefit Obligation ("PBO"), Accumulated Benefit Obligation ("ABO"), and asset values for the Company's qualified pension plans were \$6,596 million, \$6,202 million, and \$5,837 million, respectively, as of December 31, 2017, and \$5,896 million, \$5,530 million, and \$4,911 million, respectively, as of December 31, 2016. The PBO represents the present value of pension benefits earned through the end of the year, with allowance for future salary increases. The ABO is similar to the PBO, but does not provide for future salary increases.

The PBO and fair value of plan assets for all qualified and non-qualified pension plans with PBOs in excess of plan assets were \$5,386 million and \$4,440 million, respectively, as of December 31, 2017, and \$6,050 million and \$4,911 million, respectively, as of December 31, 2016.

The ABO and fair value of plan assets for all qualified and non-qualified pension plans with ABOs in excess of plan assets were \$5,001 million and \$4,440 million, respectively, as of December 31, 2017, and \$5,672 million and \$4,911 million, respectively, as of December 31, 2016. The ABO for all pension plans was \$6,367 million and \$5,672 million as of December 31, 2017 and 2016, respectively.

The changes in amounts recorded in accumulated other comprehensive income (loss) were as follows:

(\$ in millions)	Pension Benefits			Other Benefits		
	Year Ended December 31			Year Ended December 31		
	2017	2016	2015	2017	2016	2015
Prior service cost (credit)	\$ (74)	\$ —	\$ —	\$ 10	\$ —	\$ —
Amortization of prior service cost (credit)	20	18	19	(20)	(19)	(20)
Net actuarial loss (gain)	16	(241)	(144)	15	(9)	91
Amortization of net actuarial loss (gain)	97	84	86	(4)	(6)	2
Other	(1)	1	(1)	—	—	1
Total changes in accumulated other comprehensive income (loss)	\$ 58	\$ (138)	\$ (40)	\$ 1	\$ (34)	\$ 74

The amounts included in accumulated other comprehensive income (loss) as of December 31, 2017, expected to be recognized as components of net periodic expense in 2018 were as follows:

(\$ in millions)	Pension Benefits	Other Benefits
Prior service cost (credit)	\$ 23	\$ (22)
Net loss	82	(3)
Total	\$ 105	\$ (25)

The weighted average assumptions used to determine the net periodic benefit costs for each year ended December 31 were as follows:

	Pension Benefits		
	2017	2016	2015
Discount rate	4.47%	4.73%	4.34%
Expected long-term rate on plan assets	7.25%	7.50%	7.50%
Rate of compensation increase	3.68%	3.66%	3.64%
	Other Benefits		
	2017	2016	2015
Discount rate	4.38%	4.58%	4.22%
Initial health care cost trend rate assumed for next year	6.50%	7.00%	7.00%
Gradually declining to a rate of	5.00%	5.00%	5.00%
Year in which the rate reaches the ultimate rate	2025	2024	2023

The weighted average assumptions used to determine the benefit obligations as of December 31 of each year were as follows:

	Pension Benefits December 31		Other Benefits December 31	
	2017	2016	2017	2016
Discount rate	3.82%	4.47%	3.85%	4.38%
Rate of compensation increase	3.71%	3.68%		
Initial health care cost trend rate assumed for next year			6.00%	6.50%
Gradually declining to a rate of			4.50%	5.00%
Year in which the rate reaches the ultimate rate			2025	2025

**Health Care Cost Trend Rate** - The health care cost trend rate represents the annual rates of change in the cost of health care benefits based on estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, government mandated benefits, and other considerations. Using a combination of market expectations and economic projections on December 31, 2017, the Company selected an expected initial health care cost trend rate of 6.00% and an ultimate health care cost trend rate of 4.50% to be reached in 2025. On December 31, 2016, the Company assumed an expected initial health care cost trend rate of 6.50% and an ultimate health care cost trend rate of 5.00% to be reached in 2025.

A one percent change in the assumed health care cost trend rates would have the following effects on 2017 results:

(\$ in millions)	1 Percentage Point	
	Increase	Decrease
Effect on postretirement benefit expense	\$ 2	\$ (2)
Effect on postretirement benefit obligations	26	(25)

The Employee Retirement Income Security Act of 1974 ("ERISA"), including amendments under pension relief, defines the minimum amount that must be contributed to the Company's qualified defined benefit pension plans. In determining whether to make discretionary contributions to these plans above the minimum required amounts, the Company considers various factors, including attainment of the funded percentage needed to avoid benefit restrictions and other adverse consequences, minimum CAS funding requirements, and the current and anticipated future funding levels of each plan. The Company's contributions to its qualified defined benefit pension plans are affected by a number of factors, including published IRS interest rates, the actual return on plan assets, actuarial assumptions, and demographic experience. These factors and the Company's resulting contributions also impact the funded status of each plan. The Company made the following contributions to its pension and other postretirement plans for the years ended December 31, 2017, 2016, and 2015:

(\$ in millions)	Year Ended December 31		
	2017	2016	2015
Pension plans			
Discretionary			
Qualified	\$ 294	\$ 167	\$ 99
Non-qualified	7	6	4
Other benefit plans	34	32	33
Total contributions	\$ 335	\$ 205	\$ 136

In the third quarter of 2017, the Company concluded negotiations on one of its collective bargaining agreements, which required an amendment to one of its pension plans. As a result of the amendment, the remeasurement of the plan increased the pension liability and pre-tax accumulated other comprehensive loss by approximately \$76 million.



For the year ending December 31, 2018, the Company expects its cash contributions to its qualified defined benefit pension plans to be \$508 million, all of which will be discretionary. For the year ending December 31, 2017, the Company expects its cash contributions to its postretirement benefit plans to be approximately \$35 million.

The following table presents estimated future benefit payments, using the same assumptions used in determining the Company's benefit obligations as of December 31, 2017. Benefit payments depend on future employment and compensation levels, years of service, and mortality. Changes in any of these factors could significantly affect these estimated amounts.

(\$ in millions)	Pension Benefits	Other Benefits	
		Benefit Payments	Subsidy Receipts
2018	\$ 233	\$ 35	\$ —
2019	249	36	—
2020	266	38	—
2021	285	40	—
2022	306	41	—
Years 2023 to 2027	\$ 1,830	\$ 201	\$ 2

### Pension Plan Assets

Pension assets include public equities, government and corporate bonds, cash and cash equivalents, private real estate funds, private partnerships, hedge funds, and other assets. Plan assets are held in a master trust and overseen by the Company's Investment Committee. All assets are externally managed through a combination of active and passive strategies. Managers may only invest in the asset classes for which they have been appointed.

The Investment Committee is responsible for setting the policy that provides the framework for management of the plan assets. The Investment Committee has set the minimum and maximum permitted values for each asset class in the Company's pension plan master trust for the year ended December 31, 2017, as follows:

	Range
U.S. equities	15 - 37%
International equities	10 - 28%
Fixed income securities	25 - 50%
Alternative investments	10 - 25%

The general objectives of the Company's pension asset strategy are to earn a rate of return over time to satisfy the benefit obligations of the plans, meet minimum ERISA funding requirements, and maintain sufficient liquidity to pay benefits and address other cash requirements within the master trust. Specific investment objectives include reducing the volatility of pension assets relative to benefit obligations, achieving a competitive, total investment return, achieving diversification between and within asset classes, and managing other risks. Investment objectives for each asset class are determined based on specific risks and investment opportunities identified. Decisions regarding investment policies and asset allocation are made with the understanding of the historical and prospective return and risk characteristics of various asset classes, the effect of asset allocations on funded status, future Company contributions, and projected expenditures, including benefits. The Company updates its asset allocations periodically. The Company uses various analytics to determine the optimal asset mix and considers plan obligation characteristics, duration, liquidity characteristics, funding requirements, expected rates of return, regular rebalancing, and the distribution of returns. Actual allocations to each asset class could vary from target allocations due to periodic investment strategy changes, short-term market value fluctuations, the length of time it takes to fully implement investment allocation positions, such as real estate and other alternative investments, and the timing of benefit payments and Company contributions.

Taking into account the asset allocation ranges, the Company determines the specific allocation of the master trust's investments within various asset classes. The master trust utilizes select investment strategies, which are executed through separate account or fund structures with external investment managers who demonstrate experience and expertise in the appropriate asset classes and styles. The selection of investment managers is

done with careful evaluation of all aspects of performance and risk, demonstrated fiduciary responsibility, investment management experience, and a review of the investment managers' policies and processes. Investment performance is monitored frequently against appropriate benchmarks and tracked to compliance guidelines with the assistance of third party consultants and performance evaluation tools and metrics.

Plan assets are stated at fair value. The Company employs a variety of pricing sources to estimate the fair value of its pension plan assets, including independent pricing vendors, dealer or counterparty-supplied valuations, third-party appraisals, and appraisals prepared by the Company's investment managers or other experts.

Investments in equity securities, common and preferred, are valued at the last reported sales price when an active market exists. Securities for which official or last trade pricing on an active exchange is available are classified as Level 1. If closing prices are not available, securities are valued at the last trade price, if deemed reasonable, or a broker's quote in a non-active market, and are typically categorized as Level 2.

Investments in fixed-income securities are generally valued by independent pricing services or dealers who make markets in such securities. Pricing methods are based upon market transactions for comparable securities and various relationships between securities that are generally recognized by institutional traders, and fixed-income securities typically are categorized as Level 2.

Investments in collective trust funds and commingled funds based on the use of Net Asset Values ("NAV") are valued based on the redemption price of units owned by the master trust, which is based on the current fair values of the funds' underlying assets, as reported by the investment manager.

Investments in hedge funds generally do not have readily available market quotations and are estimated at fair value, which primarily utilizes NAV or the equivalent, as a practical expedient, as reported by the investment manager. Hedge funds usually have restrictions on redemptions that might affect the ability to sell the investment at NAV in the short term.

Real estate funds are typically valued through updated independent third-party appraisals, which are adjusted for changes in cash flows, market conditions, property performance, and leasing status. Since real estate funds do not have readily available market quotations, they are generally valued at NAV or its equivalent, as a practical expedient, as reported by the asset manager. Redemptions from real estate funds are also subject to various restrictions.

Private partnership interests include debt and equity investments. These investments are valued based on NAVs or their equivalents, adjusted for capital calls and distributions, from the respective general partners. The terms of the partnerships range from seven to ten or more years, and investors do not have the option to redeem their interests in these partnerships. As of December 31, 2017, unfunded commitments to private partnerships were \$112 million.

Management reviews independently appraised values, audited financial statements, and additional pricing information to evaluate the net asset values. For the very limited group of investments for which market quotations are not readily available or for which the above valuation procedures are deemed not to reflect fair value, additional information is obtained from the investment manager and evaluated internally to determine whether any adjustments are required to reflect fair value.

The Company might be unable to quickly liquidate some assets at amounts close or equal to fair value in order to meet the plans' liquidity requirements or respond to specific events, such as the creditworthiness of any particular issuer or counterparty. Illiquid assets are generally long-term investments that complement the long-term nature of the Company's pension obligations and are generally not used to fund benefit payments in the short term. Management monitors liquidity risk on an ongoing basis and has procedures designed to maintain adequate liquidity for plan requirements.

The master trust has considerable investments in fixed income securities for which changes in the relevant interest rate of a particular instrument might result in the inability to secure similar returns upon the maturity or sale. Changes in prevailing interest rates might result in an increase or decrease in fair value of the instrument. Investment managers are permitted to use interest rate swaps and other financial derivatives to manage interest rate and credit risks.

Counterparty risk is the risk that a counterparty to a financial instrument held by the master trust will default on its commitment. Counterparty risk is generally related to over-the-counter derivative instruments used to manage risk exposure to interest rates on long-term debt securities. Certain agreements with counterparties employ set-off agreements, collateral support arrangements, and other risk mitigation practices designed to reduce the net credit risk exposure in the event of a counterparty default. Credit policies and processes are in place to manage concentrations of risk by seeking to undertake transactions with large well-capitalized counterparties and by monitoring the creditworthiness of these counterparties.

Certain investments that are measured at fair value using NAV per share (or its equivalent) as a practical expedient are not required to be categorized in the fair value hierarchy table. The total fair value of these investments is included in the table below to permit reconciliation of the fair value hierarchy to amounts presented in the funded status table above.

(\$ in millions)	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Plan assets subject to leveling				
U.S. and international equities	\$ 1,270	\$ 1,270	\$ —	\$ —
Government and agency debt securities	409	—	409	—
Corporate and other debt securities	1,287	—	1,287	—
Group annuity contract	3	—	3	—
Cash and cash equivalents	—	—	—	—
Net plan assets subject to leveling	<u>\$ 2,969</u>	<u>\$ 1,270</u>	<u>\$ 1,699</u>	<u>\$ —</u>
Plan assets not subject to leveling				
U.S. and international equities (a)	2,012			
Corporate and other debt securities	165			
Real estate investments	279			
Private partnerships	16			
Hedge funds	281			
Cash and cash equivalents, net (b)	115			
Total plan assets not subject to leveling	<u>2,868</u>			
Net plan assets	<u>\$ 5,837</u>			

(a) U.S. and international equity securities include investments in small, medium, and large capitalization stocks of public companies held in commingled trust funds.

(b) Cash and cash equivalents are liquid short-term investment funds and include net receivables and payables of the trust. These funds are available for immediate use to fund daily operations, execute investment policies, and serve as a temporary investment vehicle.

(\$ in millions)	December 31, 2016			
	Total	Level 1	Level 2	Level 3
Plan assets subject to leveling				
U.S. and international equities	\$ 988	\$ 988	\$ —	\$ —
Government and agency debt securities	391	—	391	—
Corporate and other debt securities	1,126	—	1,126	—
Group annuity contract	3	—	3	—
Cash and cash equivalents	16	16	—	—
Net plan assets subject to leveling	<u>\$ 2,524</u>	<u>\$ 1,004</u>	<u>\$ 1,520</u>	<u>\$ —</u>
Plan assets not subject to leveling				
U.S. and international equities (a)	1,653			
Corporate and other debt securities	119			
Real estate investments	309			
Hedge funds	262			
Cash and cash equivalents, net (b)	44			
Total plan assets not subject to leveling	<u>2,387</u>			
Net plan assets	<u>\$ 4,911</u>			

(a) U.S. and international equity securities include investments in small, medium, and large capitalization stocks of public companies held in commingled trust funds.

(b) Cash and cash equivalents are liquid short-term investment funds and include net receivables and payables of the trust. These funds are available for immediate use to fund daily operations, execute investment policies, and serve as a temporary investment vehicle.

The master trust limits the use of derivatives through direct or separate account investments, such that the derivatives used are liquid and able to be readily valued in the market. Derivative usage in separate account structures is primarily for gaining market exposure in an unlevered manner or hedging investment risks. The fair market value of the pension master trust's derivatives through direct or separate account investments resulted in a net liability of approximately \$1 million and \$2 million as of December 31, 2017 and 2016, respectively.

There was no activity attributable to Level 3 retirement plan assets during the years ended December 31, 2017 and 2016.

## 19. STOCK COMPENSATION PLANS

As of December 31, 2017, HII had stock-based compensation awards outstanding under the following plans: the Huntington Ingalls Industries, Inc. 2011 Long-Term Incentive Stock Plan (the "2011 Plan") and the Huntington Ingalls Industries, Inc. 2012 Long-Term Incentive Stock Plan (the "2012 Plan").

### Stock Compensation Plans

On March 23, 2012, the Company's board of directors adopted the 2012 Plan, subject to stockholder approval, and the Company's stockholders approved the 2012 Plan on May 2, 2012. Award grants made on or after May 2, 2012, were made under the 2012 Plan. Award grants made prior to May 2, 2012, were made under the 2011 Plan. No future grants will be made under the 2011 Plan.

The 2012 Plan permits awards of stock options, stock appreciation rights, and other stock awards. Each stock option grant is made with an exercise price of not less than 100% of the closing price of HII's common stock on the date of grant. Stock awards, in the form of RPSRs, restricted stock rights ("RSRs"), and stock rights, are granted to key employees and members of the board of directors without payment to the Company. The 2012 Plan authorized (i) 3.4 million new shares; plus (ii) any shares subject to outstanding awards under the 2011 Plan that were subsequently forfeited to the Company; plus (iii) any shares subject to outstanding awards under the 2011 Plan that were subsequently exchanged by the participant as full or partial payment to the Company in connection with any such award or exchanged by a participant or withheld by the Company to satisfy the tax withholding obligations related to any such award. As of December 31, 2017, the remaining aggregate number of shares of the Company's common stock authorized for issuance under the 2012 Plan was 4.1 million.

The 2011 Plan permitted the awards of stock options and other stock awards. Each stock option grant was made with an exercise price of not less than 100% of the closing price of HII's common stock on the date of grant, with the exception of stock options issued at the time of the spin-off in exchange for Northrop Grumman stock options. Stock awards, in the form of stock rights, were granted to members of the board of directors without payment to the Company.

### **Stock Awards**

Stock awards include RPSRs, RSRs, and stock rights. The fair value of stock awards is determined based on the closing market price of the Company's common stock on the grant date. Compensation expense for stock awards is measured based on the grant date fair value and recognized over the vesting period, generally three years.

For purposes of measuring compensation expense, the amount of shares ultimately expected to vest is estimated at each reporting date based on management's expectations regarding the relevant service or performance criteria.

The Company issued the following stock awards in the years ended December 31, 2017, 2016, and 2015:

*Restricted Performance Stock Rights* - For the year ended December 31, 2017, the Company granted approximately 0.1 million RPSRs at a weighted average share price of \$218.54. These rights are subject to cliff vesting on December 31, 2019. For the year ended December 31, 2016, the Company granted approximately 0.2 million RPSRs at a weighted average share price of \$134.53. These rights are subject to cliff vesting on December 31, 2018. For the year ended December 31, 2015, the Company granted approximately 0.2 million RPSRs at a weighted average share price of \$142.02. These rights were fully vested as of December 31, 2017. All of the RPSRs are subject to the achievement of performance-based targets at the end of the respective vesting periods and will ultimately vest between 0% and 200% of grant date value.

*Restricted Stock Rights* - Retention stock awards are granted to key employees primarily to ensure business continuity. In 2017 the Company granted approximately 3,100 RSRs at a weighted average share price of \$188.13, with cliff vesting two years from the grant date. In 2015, the Company granted approximately 3,000 RSRs at a weighted average share price of \$115.50, with cliff vesting one year from the grant date. As of December 31, 2017, approximately 3,100 of these RSRs were outstanding.

For the year ended December 31, 2017, 0.4 million stock awards vested, of which approximately 0.2 million were transferred to the Company from employees in satisfaction of minimum tax withholding obligations. For the year ended December 31, 2016, 0.8 million stock awards vested, of which approximately 0.3 million were transferred to the Company from employees in satisfaction of minimum tax withholding obligations. For the year ended December 31, 2015, 0.9 million stock awards vested, of which approximately 0.4 million were transferred to the Company from employees in satisfaction of minimum tax withholding obligations.

*Stock Rights and Stock Issuances* - The Company granted stock rights to its non-employee directors on a quarterly basis in 2017, with each grant less than 10,000 shares. All stock rights granted to non-employee directors are fully vested on the grant date. If a non-employee director has met certain ownership guidelines, the non-employee director may elect under the terms of the Directors' Compensation Policy and Board Deferred Compensation Policy to receive their annual equity award for the following calendar year in the form of either shares of the Company's common stock or stock units that are payable in the fifth calendar year after the year in which the annual equity award is earned, or, if earlier, upon termination of the director's board service.

The stock award activity for the years ended December 31, 2017, 2016, and 2015, was as follows:

	Stock Awards (in thousands)	Weighted-Average Grant Date Fair Value	Weighted Average Remaining Contractual Term
Outstanding as of December 31, 2014	1,311	\$ 51.23	0.7 years
Granted	163	140.48	
Adjustment due to performance	315	36.36	
Vested	(865)	36.36	
Forfeited	(33)	83.44	
Outstanding as of December 31, 2015	891	75.73	0.6 years
Granted	169	134.78	
Adjustment due to performance	326	46.75	
Vested	(783)	46.75	
Forfeited	(25)	127.45	
Outstanding as of December 31, 2016	578	113.95	0.8 years
Granted	109	217.02	
Adjustment due to performance	163	97.00	
Vested	(387)	97.00	
Forfeited	(14)	154.75	
Outstanding as of December 31, 2017	449	\$ 147.13	0.8 years

Vested awards include stock awards that fully vested during the year based on the level of achievement of the relevant performance goals. The performance goals for outstanding RPSRs granted in 2017, 2016, and 2015 are based on two metrics as defined in the grant agreements: earnings before interest, taxes, depreciation, amortization, and pension, weighted at 50%, and pension-adjusted return on invested capital, weighted at 50%.

## Stock Options

*Effect of the Spin-Off* - Prior to the spin-off, HII's current and former employees received stock options under Northrop Grumman's stock-based award plans (the "Northrop Grumman Plan"). As of the date of the spin-off, the stock options under the Northrop Grumman Plan were converted to stock options under the 2011 Plan. The conversion was effected so that the outstanding stock options held by the Company's current and former employees on the distribution date were adjusted to reflect the value of the distribution, such that the intrinsic value of the stock options was not diluted at the time of, and due to, the separation. This was achieved using the conversion rate included in the spin-off agreement. Unless otherwise stated, share amounts and share prices detailed below were retroactively adjusted to reflect the impact of the conversion. The Company measured the fair value of the stock options immediately before and after the conversion, and there was no incremental compensation expense associated with the conversion.

The following is a description of the Northrop Grumman Plan stock options, which were converted into stock options under the 2011 Plan.

*Converted Stock Options* - As of the date of the spin-off, outstanding stock options held by HII's current and former employees under the Northrop Grumman Plan were converted to stock options of HII under the 2011 Plan. Based on the conversion factor of 1.65, included in the spin-off agreement, approximately 1.0 million stock options under the Northrop Grumman Plan were converted into approximately 1.6 million stock options under the 2011 Plan, approximately 1.4 million of which were fully vested at the time of conversion. Outstanding stock options granted prior to 2008 generally vested in 25% increments over four years from the grant date and expire ten years after the grant date. Stock options granted in 2008 and later vested in 33% increments over three years from the grant date and expire seven years after the grant date. The cumulative intrinsic value of the stock options at conversion was maintained in the conversion, and totaled \$15 million at March 31, 2011.

Compensation expense for the outstanding converted stock options was determined at the time of grant by Northrop Grumman. No stock options were granted during the years ended December 31, 2017, 2016, and 2015. The fair value of the stock options was expensed on a straight-line basis over the vesting period of the options. The fair value of each of the stock options was estimated on the date of grant using a Black-Scholes option pricing model.

The stock option activity for the years ended December 31, 2017, 2016, and 2015, was as follows:

	Shares Under Option (in thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (\$ in millions)
Outstanding as of December 31, 2014	644	\$ 36.06	1.4 years	\$ 49
Exercised	(111)	46.46		
Outstanding as of December 31, 2015	533	33.90	0.6 years	50
Exercised	(271)	30.20		
Outstanding as of December 31, 2016	262	37.73	0.1 years	38
Exercised	(262)	37.73		
Outstanding as of December 31, 2017	—	\$ —		\$ —
Vested as of December 31, 2017	—	\$ —		\$ —

Intrinsic value is measured using the fair market value at the date of exercise for stock options exercised or at period end for outstanding stock options, in each case less the applicable exercise price. The intrinsic value of stock options exercised during the years ended December 31, 2017, 2016, and 2015, was \$43 million, \$26 million, and \$11 million, respectively. The Company issued new shares to satisfy exercised stock options.

### Compensation Expense

The Company recorded \$34 million, \$36 million, and \$43 million of expense related to stock awards for the years ended December 31, 2017, 2016, and 2015, respectively. The Company recorded \$9 million (net of impact of reduction in statutory federal corporate income tax rate), \$14 million, and \$17 million as tax benefits related to stock awards and stock options for the years ended December 31, 2017, 2016, and 2015, respectively.

The Company recognized tax benefits for the years ended December 31, 2017, 2016, and 2015, of \$28 million, \$39 million, and \$41 million, respectively, from the issuance of stock in settlement of stock awards, and \$17 million, \$10 million, and \$4 million for the years ended December 31, 2017, 2016, and 2015, respectively, from the exercise of stock options.

### Unrecognized Compensation Expense

As of December 31, 2017, the Company had less than \$1 million of unrecognized compensation expense associated with RSRs granted in 2017, which will be recognized over a weighted average period of 1.4 years, and \$25 million of unrecognized expense associated with RPSRs granted in 2017 and 2016, which will be recognized over a weighted average period of 0.9 years. As of December 31, 2017, the Company had no unrecognized compensation expense related to stock options. Compensation expense for stock options was fully recognized as of December 31, 2013.

## 20. UNAUDITED SELECTED QUARTERLY DATA

Unaudited quarterly financial results for the years ended December 31, 2017 and 2016, are set forth in the following tables:

(\$ in millions, except per share amounts)	Year Ended December 31, 2017			
	1st Qtr	2nd Qtr <sup>(1)</sup>	3rd Qtr	4th Qtr <sup>(2)</sup>
Sales and service revenues	\$ 1,724	\$ 1,858	\$ 1,863	\$ 1,996
Operating income (loss)	164	237	237	227
Earnings (loss) before income taxes	147	218	220	187
Net earnings (loss)	119	147	149	64
Dividends declared per share	\$ 0.60	\$ 0.60	\$ 0.60	\$ 0.72
Basic earnings (loss) per share	\$ 2.57	\$ 3.22	\$ 3.28	\$ 1.41
Diluted earnings (loss) per share	\$ 2.56	\$ 3.21	\$ 3.27	\$ 1.41

(\$ in millions, except per share amounts)	Year Ended December 31, 2016			
	1st Qtr <sup>(3)</sup>	2nd Qtr <sup>(4)</sup>	3rd Qtr	4th Qtr
Sales and service revenues	\$ 1,763	\$ 1,700	\$ 1,683	\$ 1,922
Operating income (loss)	198	217	175	268
Earnings (loss) before income taxes	177	199	157	251
Net earnings (loss)	136	133	107	197
Dividends declared per share	\$ 0.50	\$ 0.50	\$ 0.50	\$ 0.60
Basic earnings (loss) per share	\$ 2.89	\$ 2.83	\$ 2.28	\$ 4.26
Diluted earnings (loss) per share	\$ 2.87	\$ 2.80	\$ 2.27	\$ 4.20

<sup>(1)</sup> In the second quarter of 2017, the Company recorded a \$30 million favorable cumulative adjustment on a contract at the Ingalls segment.

<sup>(2)</sup> In the fourth quarter of 2017, the Tax Act resulted in an increase of \$56 million to the Company's income tax expense.

<sup>(3)</sup> In the first quarter of 2016, the Company recorded a \$22 million favorable cumulative adjustment on a contract at the Ingalls segment.

<sup>(4)</sup> In the second quarter of 2016, the Company recorded a \$38 million favorable cumulative adjustment on a contract at the Ingalls segment and a \$23 million favorable cumulative adjustment on a contract at the Newport News segment.

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

### ITEM 9A. CONTROLS AND PROCEDURES

#### Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of December 31, 2017. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2017, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed in reports the Company files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) accumulated and communicated to management to allow their timely decisions regarding required disclosure.



## **Changes in Internal Control over Financial Reporting**

During the three months ended December 31, 2017, no change occurred in the Company's internal control over financial reporting that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act, management has conducted an assessment, including testing, using the criteria in *Internal Control – Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Company's system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on its assessment, management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2017, based on criteria in *Internal Control – Integrated Framework (2013)*, issued by the COSO. The effectiveness of the Company's internal control over financial reporting as of December 31, 2017, has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report, which is included in Item 8.

/s/ C. Michael Petters

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C. Michael Petters

President and Chief Executive Officer

/s/ Christopher D. Kastner

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Christopher D. Kastner

Executive Vice President, Business  
Management and Chief Financial Officer

## ITEM 9B. OTHER INFORMATION

None.

## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

#### Directors

Information regarding our directors will be incorporated herein by reference to the Proxy Statement for our 2018 Annual Meeting of Stockholders, to be filed with the SEC within 120 days after the end of the Company's fiscal year.

#### Executive Officers

Information regarding our executive officers may be found under Item 4A.

#### Audit Committee Financial Expert

Information as to the Audit Committee and the Audit Committee Financial Expert will be incorporated herein by reference to the Proxy Statement for our 2018 Annual Meeting of Stockholders, to be filed within 120 days after the end of the Company's fiscal year.

#### Code of Ethics

We have adopted a Code of Ethics and Business Conduct for all of our employees, including the principal executive officer, principal financial officer, and principal accounting officer. The Code of Ethics and Business Conduct can be found on our internet website at [www.huntingtoningalls.com](http://www.huntingtoningalls.com) under "Investor Relations—Company Information—Leadership and Governance." A copy of the Code of Ethics and Business Conduct is available to any stockholder who requests it by writing to: Huntington Ingalls Industries, Inc., c/o Office of the Secretary, 4101 Washington Avenue, Newport News, VA 23607. If we make any substantive amendments to the Code of Ethics and Business Conduct or grant any waivers, including any implicit waiver, from a provision of the Code of Ethics and Business Conduct to our Chief Executive Officer, Chief Financial Officer, or Chief Accounting Officer, we will disclose the nature of the amendment or waiver on our website.

Our website and information contained on our website or incorporated into our website are not intended to be incorporated into this report on Form 10-K or other filings with the SEC.

#### Other Disclosures

Other disclosures required by this Item will be incorporated herein by reference to the Proxy Statement for our 2018 Annual Meeting of Stockholders, to be filed within 120 days after the end of the Company's fiscal year.

### ITEM 11. EXECUTIVE COMPENSATION

Information concerning executive compensation, including information concerning compensation committee interlocks, insider participation, and the compensation committee report, will be incorporated herein by reference to the Proxy Statement for our 2018 Annual Meeting of Stockholders, to be filed within 120 days after the end of the Company's fiscal year.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information as to security ownership of certain beneficial owners and management and related stockholder matters will be incorporated herein by reference to the Proxy Statement for our 2018 Annual Meeting of Stockholders, to be filed within 120 days after the end of the Company's fiscal year.

## Equity Compensation Plan Information

The following table presents the equity securities available for issuance under our equity compensation plans as of December 31, 2017.

Equity Compensation Plan Information

Plan category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights <sup>(1)</sup>	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	448,859	\$0.00	4,087,587
Equity compensation plans not approved by security holders <sup>(2)</sup>	—	—	—
Total	448,859	\$0.00	4,087,587

<sup>(1)</sup> Includes grants made under the Huntington Ingalls Industries, Inc. 2012 Long-Term Incentive Stock Plan (the "2012 Plan"), which was approved by our stockholders on May 2, 2012, and the Huntington Ingalls Industries, Inc. 2011 Long-Term Incentive Stock Plan (the "2011 Plan"), which was approved by the sole stockholder of HII prior to its spin-off from Northrop Grumman Corporation. Of these shares, 27,123 were stock rights granted under the 2011 Plan. In addition, this number includes 28,763 stock rights, 3,075 restricted stock rights, and 389,898 restricted performance stock rights granted under the 2012 Plan, assuming target performance achievement.

<sup>(2)</sup> There are no awards made under plans not approved by security holders.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information as to certain relationships and related transactions and director independence will be incorporated herein by reference to the Proxy Statement for our 2018 Annual Meeting of Stockholders, to be filed within 120 days after the end of the Company's fiscal year.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information as to principal accountant fees and services will be incorporated herein by reference to the Proxy Statement for our 2018 Annual Meeting of Stockholders, to be filed within 120 days after the end of the Company's fiscal year.

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) 1. Report of Independent Registered Public Accounting Firm

Financial Statements

Consolidated Statements of Operations and Comprehensive Income (Loss)

Consolidated Statements of Financial Position

Consolidated Statements of Cash Flows

Consolidated Statements of Changes in Equity

Notes to Consolidated Financial Statements

2. Financial Statement Schedules

Schedule II - Valuation and Qualifying Accounts

All other schedules have been omitted because they are not applicable, not required, or the information has been otherwise supplied in the financial statements or notes to the financial statements.

#### SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

	Balance at Beginning of Period	(Benefits)/Charges to Income	Other	Balance at End of Period
Year Ended December 31, 2015				
Valuation allowance for deferred tax assets	\$ 14	\$ (3)	\$ —	\$ 11
Year Ended December 31, 2016				
Valuation allowance for deferred tax assets	11	—	—	11
Year Ended December 31, 2017				
Valuation allowance for deferred tax assets	\$ 11	\$ 1	\$ —	\$ 12

3. Exhibits

- 2.1 Separation and Distribution Agreement, dated as of March 29, 2011, among Titan II Inc. (formerly Northrop Grumman Corporation), Northrop Grumman Corporation (formerly New P, Inc.), Huntington Ingalls Industries, Inc., Northrop Grumman Shipbuilding, Inc. and Northrop Grumman Systems Corporation (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 4, 2011).
- 3.1 Restated Certificate of Incorporation of Huntington Ingalls Industries, Inc., filed March 30, 2011 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on April 4, 2011).
- 3.2 Certificate of Amendment to the Restated Certificate of Incorporation of Huntington Ingalls Industries, Inc., dated May 28, 2014 (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q filed on August 7, 2014).
- 3.3 Certificate of Amendment to the Restated Certificate of Incorporation of Huntington Ingalls Industries, Inc., dated May 21, 2015 (incorporated by reference to Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2015).
- 3.4 Restated Bylaws of Huntington Ingalls Industries, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on February 1, 2016).
- 4.1 Indenture, dated as of November 17, 2015, by and among Huntington Ingalls Industries, Inc., the guarantors party thereto, and The Bank of New York Mellon, as trustee (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on November 17, 2015).

- 4.2 First supplemental indenture, dated as of February 17, 2017, to the indenture, dated as of November 17, 2015, among Huntington Ingalls Industries, Inc., the guarantors party thereto, and The Bank of New York Mellon, as trustee (incorporated by reference to Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q filed November 8, 2017).
- 4.3 Indenture, dated as of December 1, 2017, by and among Huntington Ingalls Industries, Inc., the guarantors party thereto, and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on December 4, 2017).
- 10.1 Credit Agreement, dated as of November 22, 2017, among Huntington Ingalls Industries, Inc., as borrower, the lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent and an issuing bank, and certain other issuing banks (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 27, 2017).
- 10.2 Form of Amended and Restated Indemnification Agreement and Schedule of directors and officers who have entered into such agreement (incorporated by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K filed on February 19, 2015).
- 10.3 Intellectual Property License Agreement, dated as of March 29, 2011, between Northrop Grumman Systems Corporation and Northrop Grumman Shipbuilding, Inc. (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on April 4, 2011).
- 10.4 Tax Matters Agreement, dated as of March 29, 2011, among Northrop Grumman Corporation (formerly New P, Inc.), Huntington Ingalls Industries, Inc. and Titan II Inc. (formerly Northrop Grumman Corporation) (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on April 4, 2011).
- 10.5 Loan Agreement, dated as of May 1, 1999, between Ingalls Shipbuilding, Inc. and the Mississippi Business Finance Corporation relating to the Economic Development Revenue Bonds (Ingalls Shipbuilding, Inc. Project) Taxable Series 1999A due 2024 (incorporated by reference to Exhibit 10.6 to the Company's Amendment No. 1 to Registration Statement on Form 10 filed on November 24, 2010).
- 10.6 Indenture of Trust, dated as of May 1, 1999, between the Mississippi Business Finance Corporation and the First National Bank of Chicago, as Trustee, relating to the Economic Development Revenue Bonds (Ingalls Shipbuilding, Inc. Project) Taxable Series 1999A due 2024 (incorporated by reference to Exhibit 10.7 to the Company's Amendment No. 1 to Registration Statement on Form 10 filed on November 24, 2010).
- 10.7 Loan Agreement, dated as of December 1, 2006, between Northrop Grumman Ship Systems, Inc. and the Mississippi Business Finance Corporation relating to the Gulf Opportunity Zone Industrial Development Revenue Bonds (Northrop Grumman Ship Systems, Inc. Project), Series 2006 due 2028 (incorporated by reference to Exhibit 10.8 to the Company's Amendment No. 1 to Registration Statement on Form 10 filed on November 24, 2010).
- 10.8 Trust Indenture, dated as of December 1, 2006, between the Mississippi Business Finance Corporation and The Bank of New York Trust Company, N.A., as Trustee, relating to the Gulf Opportunity Zone Industrial Development Revenue Bonds (Northrop Grumman Ship Systems, Inc. Project), Series 2006 due 2028 (incorporated by reference to Exhibit 10.9 to the Company's Amendment No. 1 to Registration Statement on Form 10 filed on November 24, 2010).
- 10.9 Guaranty Agreement, dated as of May 1, 1999, between Litton Industries, Inc. and The First National Bank of Chicago, as Trustee (incorporated by reference to Exhibit 10.10 to the Company's Amendment No. 2 to Registration Statement on Form 10 filed on December 21, 2010).
- 10.10 Assumption of Guaranty of Litton Industries, Inc., dated as of January 1, 2003, by Northrop Grumman Systems Corporation (incorporated by reference to Exhibit 10.11 to the Company's Amendment No. 2 to Registration Statement on Form 10 filed on December 21, 2010).

- 10.11 Guaranty Agreement, dated as of December 1, 2006, between Northrop Grumman Corporation and The Bank of New York Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 10.12 to the Company's Amendment No. 2 to Registration Statement on Form 10 filed on December 21, 2010).
- 10.12 Performance and Indemnity Agreement, dated as of March 30, 2011, between Huntington Ingalls Industries, Inc. and Titan II Inc. (formerly Northrop Grumman Corporation) relating to the Gulf Opportunity Zone Industrial Development Revenue Bonds (incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q filed on May 11, 2011).
- 10.13 Performance and Indemnity Agreement, dated as of March 30, 2011, between Huntington Ingalls Industries, Inc. and Titan II Inc. (formerly Northrop Grumman Corporation) relating to certain performance guarantees associated with certain U.S. Navy shipbuilding contracts (incorporated by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q filed on May 11, 2011).
- 10.14 Ingalls Guaranty Performance, Indemnity and Termination Agreement, dated as of March 29, 2011, among Huntington Ingalls Industries, Inc., Northrop Grumman Systems Corporation and Northrop Grumman Shipbuilding, Inc. (incorporated by reference to Exhibit 10.8 to the Company's Quarterly Report on Form 10-Q filed on May 11, 2011).
- 10.15 Registration Rights Agreement, dated as of December 1, 2017, by and among the Company, certain subsidiaries of the Company and J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Mizuho Securities USA LLC and Wells Fargo Securities, LLC, as representatives of the initial purchasers (incorporated by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K filed on December 4, 2017).
- 10.16\* Huntington Ingalls Industries Supplemental Plan 2 (incorporated by reference to Exhibit 10.16 to the Company's Amendment No. 4 to Registration Statement on Form 10 filed on January 18, 2011) and Amendment to Appendix G to the plan.
- 10.17\* Huntington Ingalls Industries ERISA Supplemental Plan (incorporated by reference to Exhibit 10.17 to the Company's Amendment No. 4 to Registration Statement on Form 10 filed on January 18, 2011).
- 10.18\* Severance Plan for Elected and Appointed Officers of Huntington Ingalls Industries (incorporated by reference to Exhibit 10.18 to the Company's Quarterly Report on Form 10-Q filed on May 9, 2012).
- 10.19\* First Amendment to Severance Plan for Elected and Appointed Officers of Huntington Ingalls Industries As Amended and Restated (effective March 31, 2012) (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on November 8, 2012).
- 10.20\* Huntington Ingalls Industries Deferred Compensation Plan (incorporated by reference to Exhibit 10.19 to the Company's Amendment No. 4 to Registration Statement on Form 10 filed on January 18, 2011).
- 10.21\* Huntington Ingalls Industries Savings Excess Plan (incorporated by reference to Exhibit 10.20 to the Company's Amendment No. 4 to Registration Statement on Form 10 filed on January 18, 2011).
- 10.22\* First Amendment to the Huntington Ingalls Industries Savings Excess Plan (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on August 3, 2017).
- 10.23\* Huntington Ingalls Industries Officers Retirement Account Contribution Plan (incorporated by reference to Exhibit 10.21 to the Company's Amendment No. 4 to Registration Statement on Form 10 filed on January 18, 2011).
- 10.24\* HII Newport News Shipbuilding Inc. Retirement Benefit Restoration Plan (incorporated by reference to Exhibit 10.22 to the Company's Amendment No. 4 to Registration Statement on Form 10 filed on January 18, 2011).
- 10.25\* Huntington Ingalls Industries Electronic Systems Executive Pension Plan (incorporated by reference to Exhibit 10.23 to the Company's Amendment No. 4 to Registration Statement on Form 10 filed on January 18, 2011).

- 10.26\* Huntington Ingalls Industries, Inc. Special Officer Retiree Medical Plan (incorporated by reference to Exhibit 10.24 to the Company's Amendment No. 4 to Registration Statement on Form 10 filed on January 18, 2011).
- 10.27\* Huntington Ingalls Industries, Inc. 2011 Long-Term Incentive Stock Plan (incorporated by reference to Exhibit 10.25 to the Company's Amendment No. 8 to Registration Statement on Form 10 filed on March 15, 2011).
- 10.28\* Huntington Ingalls Industries, Inc. Annual Incentive Plan, as amended and restated December 10, 2015 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on May 5, 2016).
- 10.29\* Form of Award Certificate applicable to Non-Employee Director Stock Units Granted Under the 2011 and 2012 Long-Term Incentive Stock Plans (incorporated by reference to Exhibit 10.30 to the Company's Annual Report on Form 10-K filed on February 27, 2013).
- 10.30\* Form of Award Certificate applicable to Restricted Performance Stock Rights Granted Under the 2011 and 2012 Long-Term Incentive Stock Plans (incorporated by reference to Exhibit 10.31 to the Company's Annual Report on Form 10-K filed on February 27, 2014).
- 10.31\* Form of Award Certificate applicable to Restricted Stock Rights Granted Under the 2011 and 2012 Long-Term Incentive Stock Plans (incorporated by reference to Exhibit 10.32 to the Company's Annual Report on Form 10-K filed on February 27, 2014).
- 10.32\* Form of Award Certificate applicable to Stock Options Granted Under the 2011 and 2012 Long-Term Incentive Stock Plans (incorporated by reference to Exhibit 10.33 to the Company's Annual Report on Form 10-K filed on February 27, 2014).
- 10.33\* Amendment to Terms and Conditions Applicable to 2012, 2013 and 2014 Restricted Performance Stock Rights of Irwin F. Edenzon (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 17, 2013).
- 10.34\* Huntington Ingalls Industries, Inc. 2012 Long-Term Incentive Stock Plan (incorporated by reference to Annex A to the Proxy Statement filed on April 3, 2012).
- 10.35\* Performance-Based Compensation Policy of Huntington Ingalls Industries, Inc (incorporated by reference to Annex B to the Proxy Statement filed on April 3, 2012).
- 10.36\* Huntington Ingalls Industries, Inc. Amended and Restated Directors' Compensation Policy
- 10.37\* Huntington Ingalls Industries, Inc. Directors Compensation Policy--Board Deferred Compensation Policy
- 11 Computation of Per Share Earnings (provided in Note 8 of the Notes to Consolidated Financial Statements under the caption "Earnings Per Share").
- 12.1 Ratio of Earnings to Fixed Charges.
- 21.1 List of subsidiaries of Huntington Ingalls Industries, Inc.
- 23.1 Consent of Deloitte & Touche LLP.
- 31.1 Certification of the Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.



- 32.1 Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 The following financial information for the company, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Operations and Comprehensive Income (Loss), (ii) the Consolidated Statements of Financial Position, (iii) the Consolidated Statements of Cash Flows, (iv) the Consolidated Statements of Changes in Equity, and (v) the Notes to Consolidated Financial Statements.

\*Indicates management contract or compensatory plan or arrangement.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 15th day of February, 2018.

Huntington Ingalls Industries, Inc.

/s/ C. Michael Petters

C. Michael Petters

President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
<u>/s/ C. Michael Petters</u> C. Michael Petters	President, Chief Executive Officer and Director (Principal Executive Officer)	February 15, 2018
<u>/s/ Christopher D. Kastner</u> Christopher D. Kastner	Executive Vice President, Business Management and Chief Financial Officer (Principal Financial Officer)	February 15, 2018
<u>/s/ Nicolas Schuck</u> Nicolas Schuck	Corporate Vice President, Controller and Chief Accounting Officer (Principal Accounting Officer)	February 15, 2018
<u>/s/ Thomas B. Fargo</u> Thomas B. Fargo	Chairman	February 15, 2018
<u>/s/ Philip M. Bilden</u> Philip M. Bilden	Director	February 15, 2018
<u>/s/ Augustus L. Collins</u> Augustus L. Collins	Director	February 15, 2018
<u>/s/ Kirkland H. Donald</u> Kirkland H. Donald	Director	February 15, 2018
<u>/s/ Victoria D. Harker</u> Victoria D. Harker	Director	February 15, 2018
<u>/s/ Anastasia D. Kelly</u> Anastasia D. Kelly	Director	February 15, 2018
<u>/s/ Thomas C. Schievelbein</u> Thomas C. Schievelbein	Director	February 15, 2018
<u>/s/ John K. Welch</u> John K. Welch	Director	February 15, 2018
<u>/s/ Stephen R. Wilson</u> Stephen R. Wilson	Director	February 15, 2018

# CORPORATE INFORMATION

## Corporate Headquarters

Huntington Ingalls Industries, Inc.  
4101 Washington Avenue  
Newport News, VA 23607  
Tel: 757-380-2000

## Stock Exchange Listing

Huntington Ingalls Industries Common Stock is listed on the New York Stock Exchange  
Ticker Symbol: HII

## Transfer Agent/Shareholder Inquiries

Computershare Trust Company  
P.O. Box 505000  
Louisville, KY 40233  
Tel: 888-665-9610  
www.computershare.com/investor

## Investor Relations

757-380-2104 or 757-380-7911  
e-mail: investor.relations@hii-co.com

## Independent Registered Public

### Accounting Firm

Deloitte & Touche LLP  
901 East Byrd Street  
Suite 820  
Richmond, VA 23219  
Tel: 804-697-1500  
Fax: 804-697-1825

For reporting complaints about Huntington Ingalls Industries accounting, internal accounting controls or auditing matters or any other concerns to the Board of Directors or the Audit Committee, you may write to:

## Board of Directors

Huntington Ingalls Industries, Inc.  
c/o Charles R. Monroe, Jr., Corporate Secretary  
4101 Washington Avenue  
Newport News, VA 23607  
e-mail: OfficeoftheGeneralCounsel@hii-co.com

Adjusted Segment Operating Income, Adjusted Segment Operating Margin and Adjusted Diluted EPS Reconciliation

(\$ in millions, except per share amounts)	Year Ended December 31				
	2017	2016	2015	2014	2013
<b>Sales and Service Revenues</b>	<b>\$7,441</b>	\$7,068	\$7,020	\$6,957	\$6,820
<b>Operating Income</b>	<b>865</b>	858	769	655	512
<b>Operating Margin</b>	<b>11.6%</b>	12.1%	11.0%	9.4%	7.5%
Non-segment factors affecting operating income:					
FAS/CAS Adjustment	(189)	(145)	(104)	(72)	61
Non-current state income taxes	12	2	2	2	(6)
<b>Segment Operating Income</b>	<b>688</b>	715	667	585	567
Adjustment for non-cash goodwill impairment <sup>1</sup>	—	—	75	47	—
Adjustment for non-cash purchased intangibles impairment <sup>2</sup>	—	—	27	—	—
<b>Adjusted Segment Operating Income</b>	<b>688</b>	715	769	632	567
<b>Adjusted Segment Operating Margin</b>	<b>9.2%</b>	10.1%	11.0%	9.1%	8.3%
<b>Net Earnings</b>	<b>479</b>	573	404	338	261
Adjustment for non-cash goodwill impairment <sup>1,3,4</sup>	—	—	59	37	—
Adjustment for non-cash purchased intangibles impairment <sup>2,3,5</sup>	—	—	18	—	—
Adjustment for loss on early extinguishment of debt <sup>6</sup>	14	—	29	—	—
Adjustment for tax expense related to the 2017 Tax Act	56	—	—	—	—
Adjustment for tax expense related to discretionary pension contributions	7	—	—	—	—
<b>Adjusted Net Earnings</b>	<b>556</b>	573	510	375	261
<b>Diluted Earnings Per Share</b>	<b>10.46</b>	12.14	8.36	6.86	5.18
Non-cash goodwill impairment per share <sup>1,3,7</sup>	—	—	1.22	0.75	—
Non-cash purchased intangibles impairment per share <sup>2,3,7</sup>	—	—	0.37	—	—
Non-cash loss on early extinguishment of debt per share	0.31	—	0.60	—	—
Tax expense related to the 2017 Tax Act per share	1.22	—	—	—	—
Tax expense related to discretionary pension contributions per share	0.15	—	—	—	—
<b>Adjusted Diluted Earnings Per Share</b>	<b>12.14</b>	12.14	10.55	7.61	5.18

<sup>1</sup> Non-cash goodwill impairment charges recorded at the Technical Solutions segment in 2014 and 2015.

<sup>2</sup> Non-cash purchased intangibles impairment charge recorded at the Technical Solutions segment in 2015.

<sup>3</sup> The income tax impact is calculated using the tax rate in effect for the relevant non-GAAP adjustment.

<sup>4</sup> The income tax impact, calculated using the tax rate in effect for the relevant non-GAAP adjustment, was equal to \$16 million and \$10 million in 2015 and 2014, respectively.

<sup>5</sup> The income tax impact, calculated using the tax rate in effect for the relevant non-GAAP adjustment, was equal to \$9 million in 2015.

<sup>6</sup> The income tax impact, calculated using the tax rate in effect for the relevant non-GAAP adjustment, was equal to \$8 million in 2017 and \$15 million in 2015.

<sup>7</sup> The weighted-average diluted shares outstanding were 45.8 million, 47.2 million, 48.3 million, 49.3 million and 50.4 million in 2017, 2016, 2015, 2014 and 2013, respectively.

Adjusted Segment Operating Income, Adjusted Segment Operating Margin and Adjusted Diluted EPS are not measures recognized under GAAP. They should be considered supplemental to and not a substitute for financial information prepared in accordance with GAAP. We believe these measures are useful to investors because they exclude items that do not reflect our core operating performance. They may not be comparable to similarly titled measures of other companies.

## Forward-Looking Statements

Statements in this annual report to stockholders, other than statements of historical fact, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those expressed in these statements. Factors that may cause such differences include: changes in government and customer priorities and requirements (including government budgetary constraints, shifts in defense spending, and changes in customer short-range and long-range plans); our ability to estimate our future contract costs and perform our contracts effectively; changes in procurement processes and government regulations and our ability to comply with such requirements; our ability to deliver our products and services at an affordable life cycle cost and compete within our markets; natural and environmental disasters and political instability; adverse economic conditions in the United States and globally; changes in key estimates and assumptions regarding our pension and retiree health costs; security threats, including cyber security threats, and related disruptions; and other risk factors discussed in our other filings with the SEC. There may be other risks and uncertainties that we are unable to predict at this time or that we currently do not expect to have a material adverse effect on our business, and we undertake no obligation to update any forward-looking statements. You should not place undue reliance on any forward-looking statements that we may make.

Our Annual Report on Form 10-K for the year ended December 31, 2017 forms a part of this 2017 Annual Report. If you would like an additional copy of our Form 10-K, you can access it through the Investor Relations page of our website (www.huntingtoningalls.com) or at the Securities and Exchange Commission website (www.sec.gov). The Form 10-K is also available free of charge by writing to us at: Corporate Secretary, Huntington Ingalls Industries, Inc., 4101 Washington Avenue, Newport News, Virginia 23607. Exhibits to the Form 10-K are also available if requested.

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# BOARD OF DIRECTORS



**Front Row (L to R):** *Anastasia D. Kelly, Co-Managing Partner, DLA Piper Americas, Chair of Governance and Policy Committee; Thomas B. Fargo, Chairman of the Board, Huntington Ingalls Industries, Admiral, U.S. Navy (Ret.); C. Michael Petters, President and CEO, Huntington Ingalls Industries; Victoria D. Harker, Executive Officer and Chief Financial Officer, Tegna, Inc., Chair of Compensation Committee*

**Rear (L to R):** *John K. Welch, Retired President and CEO, Centrus Energy Corp.; Stephen R. Wilson, Independent Business Consultant, Retired Executive Vice President and Chief Financial Officer, RJR Nabisco, Inc., Chair of Audit Committee; Kirkland H. Donald, Independent Business Consultant, Admiral, U.S. Navy (Ret.); Augustus L. Collins, CEO, MINACT, Inc., Major General, U.S. Army (Ret.); Philip M. Bilden, Private Equity Investor and Retired Co-founding Member, HarbourVest Partners; Thomas C. Schievelbein, Retired Chairman and CEO, The Brink's Company, Chair of Finance Committee*

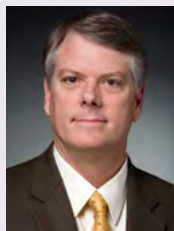
# SENIOR EXECUTIVE TEAM



**C. Michael Petters**  
President and CEO



**Jennifer R. Boykin**  
Executive Vice President and President, Newport News Shipbuilding



**Brian J. Cuccias**  
Executive Vice President and President, Ingalls Shipbuilding



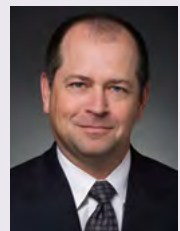
**Andy Green**  
Executive Vice President and President, Technical Solutions



**Jerri Fuller Dickseski**  
Executive Vice President, Communications



**William R. Ermatinger**  
Executive Vice President and Chief Human Resources Officer



**Christopher D. Kastner**  
Executive Vice President, Business Management, and Chief Financial Officer



**Scott Stabler**  
Executive Vice President and Chief Transformation Officer



**Mitchell B. Waldman**  
Executive Vice President, Government and Customer Relations



**Kellye L. Walker**  
Executive Vice President and General Counsel



**Charles R. Monroe, Jr.**  
Corporate Vice President, Associate General Counsel and Secretary



**Nicolas G. Schuck**  
Corporate Vice President, Controller and Chief Accounting Officer



**D.R. Wyatt**  
Corporate Vice President and Treasurer



**HUNTINGTON INGALLS INDUSTRIES**  
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757.380.2000 | HUNTINGTONINGALLS.COM