



**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

**(Mark One)**

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

For the quarterly period ended June 30, 2017

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-33072

**Leidos Holdings, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**20-3562868**

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

**11951 Freedom Drive, Reston, Virginia**

(Address of principal executive office)

**20190**

(Zip Code)

**(571) 526-6000**

(Registrant's telephone number, including area code)

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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.

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Emerging growth company

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

The number of shares issued and outstanding of each issuer's classes of common stock as of July 25, 2017, was 151,209,095 shares of common stock (\$.0001 par value per share).

---

**LEIDOS HOLDINGS, INC.**  
**FORM 10-Q**  
**TABLE OF CONTENTS**

	<b>Page</b>
<b>Part I</b>	
Item 1. Unaudited Condensed Consolidated Financial Statements and Notes to Condensed Consolidated Financial Statements	1
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3. Quantitative and Qualitative Disclosures About Market Risk	27
Item 4. Controls and Procedures	28
<b>Part II</b>	
Item 1. Legal Proceedings	29
Item 1A. Risk Factors	29
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	29
Item 3. Defaults Upon Senior Securities	29
Item 4. Mine Safety Disclosures	29
Item 5. Other Information	29
Item 6. Exhibits	30
<b>Signatures</b>	<b>31</b>

---

## PART I—FINANCIAL INFORMATION

Item 1. *Financial Statements.*LEIDOS HOLDINGS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 30, 2017	December 30, 2016
	(in millions)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 262	\$ 376
Receivables, net	1,832	1,657
Inventory, prepaid expenses and other current assets	340	348
Total current assets	2,434	2,381
Property, plant and equipment, net	215	259
Intangible assets, net	1,006	1,589
Goodwill	4,922	4,622
Deferred tax assets	13	16
Other assets	292	265
	<u>\$ 8,882</u>	<u>\$ 9,132</u>
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,330	\$ 1,427
Accrued payroll and employee benefits	475	483
Dividends payable	17	23
Income taxes payable	4	21
Long-term debt, current portion	84	62
Total current liabilities	1,910	2,016
Long-term debt, net of current portion	3,147	3,225
Deferred tax liabilities	362	540
Other long-term liabilities	222	204
Commitments and contingencies (Notes 15 and 16)		
Stockholders' equity:		
Common stock, \$.0001 par value, 500 million shares authorized, 151 million and 150 million shares issued and outstanding at June 30, 2017 and December 30, 2016, respectively	—	—
Additional paid-in capital	3,321	3,316
Accumulated deficit	(105)	(177)
Accumulated other comprehensive income (loss)	8	(4)
Total Leidos stockholders' equity	3,224	3,135
Non-controlling interest	17	12
Total equity	3,241	3,147
	<u>\$ 8,882</u>	<u>\$ 9,132</u>

See accompanying notes to condensed consolidated financial statements.

**LEIDOS HOLDINGS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

	Three Months Ended		Six Months Ended	
	June 30, 2017	July 1, 2016	June 30, 2017	July 1, 2016
	(in millions, except per share amounts)			
Revenues	\$ 2,571	\$ 1,288	\$ 5,151	\$ 2,600
Cost of revenues	2,233	1,141	4,503	2,295
Selling, general and administrative expenses	143	56	287	116
Acquisition and integration costs	16	15	35	24
Restructuring expenses	6	1	19	1
Equity losses of non-consolidated subsidiaries	7	—	—	—
Operating income	166	75	307	164
Interest income	2	2	4	5
Interest expense	(36)	(15)	(74)	(29)
Other income (expense), net	3	(2)	6	(2)
Income from continuing operations before income taxes	135	60	243	138
Income tax expense	(37)	(19)	(71)	(44)
Net income	98	41	172	94
Less: net income attributable to non-controlling interest	—	—	2	—
Net income attributable to Leidos common stockholders	\$ 98	\$ 41	\$ 170	\$ 94
Earnings per share:				
Basic	\$ 0.65	\$ 0.56	\$ 1.13	\$ 1.31
Diluted	0.64	0.55	1.11	1.27
Cash dividends declared per share	\$ 0.32	\$ 0.32	\$ 0.64	\$ 0.64

See accompanying notes to condensed consolidated financial statements.

**LEIDOS HOLDINGS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

	Three Months Ended		Six Months Ended	
	June 30, 2017	July 1, 2016	June 30, 2017	July 1, 2016
	(in millions)			
Net income	\$ 98	\$ 41	\$ 172	\$ 94
Other comprehensive income, net of taxes:				
Foreign currency translation adjustments	2	2	13	4
Unrecognized loss on derivative instruments	(2)	—	(1)	—
Total other comprehensive income, net of taxes	—	2	12	4
Comprehensive income	98	43	184	98
Less: comprehensive income attributable to non-controlling interest	—	—	2	—
Comprehensive income attributable to Leidos common stockholders	<u>\$ 98</u>	<u>\$ 43</u>	<u>\$ 182</u>	<u>\$ 98</u>

See accompanying notes to condensed consolidated financial statements.

**LEIDOS HOLDINGS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

	Six Months Ended	
	June 30, 2017	July 1, 2016
	(in millions)	
Cash flows from operations:		
Net income	\$ 172	\$ 94
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	162	17
Stock-based compensation	20	16
Bad debt expense	12	—
Other	15	(3)
Change in assets and liabilities, net of effects of acquisitions and dispositions:		
Receivables	(179)	(76)
Inventory, prepaid expenses and other current assets	35	(7)
Accounts payable and accrued liabilities	(123)	7
Accrued payroll and employee benefits	(7)	2
Deferred income taxes and income taxes receivable/payable	(44)	7
Other long-term assets/liabilities	26	1
Net cash provided by operating activities of continuing operations	89	58
Cash flows from investing activities:		
Payments for property, plant and equipment	(23)	(7)
Collections on promissory note	2	—
Net proceeds from sale of assets	7	3
Proceeds from disposition of business	—	23
Other	—	(1)
Net cash (used in) provided by investing activities of continuing operations	(14)	18
Cash flows from financing activities:		
Payments of long-term debt	(69)	(2)
Proceeds from issuances of stock	7	6
Repurchases of stock and other	(25)	(19)
Dividend payments	(102)	(46)
Net cash used in financing activities of continuing operations	(189)	(61)
Net (decrease) increase in cash and cash equivalents from continuing operations	(114)	15
Cash flows from discontinued operations:		
Net cash used in investing activities of discontinued operations	—	(1)
Net decrease in cash and cash equivalents from discontinued operations	—	(1)
Net (decrease) increase in cash and cash equivalents	(114)	14
Cash and cash equivalents at beginning of period	376	656
Cash and cash equivalents at end of period	\$ 262	\$ 670

See accompanying notes to condensed consolidated financial statements.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 1—Basis of Presentation and Summary of Significant Accounting Policies**

***Nature of Operations and Basis of Presentation***

Leidos Holdings, Inc. ("Leidos") is a holding company whose direct 100%-owned subsidiaries and principal operating companies are Leidos, Inc. and Leidos Innovations Corporation ("Leidos Innovations"). Leidos is a FORTUNE 500<sup>®</sup> science and technology company that provides technology and engineering services and solutions in the defense, intelligence, civil and health markets. Leidos' domestic customers include the U.S. Department of Defense ("DoD"), the U.S. Intelligence Community, the U.S. Department of Homeland Security ("DHS"), the Federal Aviation Administration ("FAA"), the Department of Health and Human Services ("HHS"), U.S. Government civil agencies and state and local government agencies. Leidos' international customers include foreign governments and their agencies, primarily located in the United Kingdom, the Middle East and Australia. Unless indicated otherwise, references to the "Company," "we," "us" and "our" refer collectively to Leidos Holdings, Inc. and its consolidated subsidiaries.

The unaudited condensed consolidated financial statements of Leidos include the balances of its majority-owned and 100%-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

The accompanying unaudited condensed financial information has been prepared in accordance with the rules of the U.S. Securities and Exchange Commission ("SEC") and accounting principles generally accepted in the United States of America ("GAAP"). Certain disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions 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 periods. Management evaluates these estimates and assumptions on an ongoing basis, including those relating to estimated profitability of long-term contracts, indirect billing rates, allowances for doubtful accounts, inventories, fair value and impairment of intangible assets and goodwill, income taxes, stock-based compensation expense and contingencies. These estimates have been prepared by management on the basis of the most current and best available information; however, actual results could differ materially from those estimates.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, which consist of normal recurring adjustments, necessary for a fair presentation thereof. The results reported in these unaudited condensed consolidated financial statements are not necessarily indicative of the results that may be expected for the entire year. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K filed on February 24, 2017.

During the quarter ended March 31, 2017, the Company completed its business reorganization, which resulted in identification of three reportable segments (Defense Solutions, Civil, Health) and corporate expenses. The Company commenced operating and reporting under the new organizational structure effective the beginning of fiscal 2017. As a result of this change, prior year segment results and disclosures have been recast to reflect the new reportable segments (see "Note 14—Business Segments").

Amounts in the prior year condensed consolidated statements of income that have been reclassified to conform to the current year presentation include, "Restructuring expenses," which were previously aggregated within "Selling, general and administrative expenses," and "Interest expense, net" which has been disaggregated into "Interest income" and "Interest expense."

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Changes in Estimates on Contracts**

Changes in estimates related to long-term contracts accounted for using the percentage of completion method of accounting are recognized in the period in which such changes are made for the inception-to-date effect of the changes, with the exception of contracts acquired through the acquisition of the IS&GS Business (see "Note 2--Acquisitions"), where the adjustment is made for the period commencing from the date of acquisition. Changes in these estimates can occur over the contract performance period for a variety of reasons, including changes in contract scope, contract cost estimates and estimated incentive or award fees.

Changes in estimates on contracts for the periods presented were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2017	July 1, 2016	June 30, 2017	July 1, 2016
	(in millions, except per share amounts)			
Net favorable impact to income from continuing operations before taxes	\$ 40	\$ 5	\$ 62	\$ 13
Impact on diluted EPS from continuing operations attributable to Leidos common stockholders	\$ 0.17	\$ 0.04	\$ 0.26	\$ 0.11

**Accounting Standards Updates Adopted**

In March 2016, the FASB issued ASU 2016-09 *Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The ASU requires that an entity, (i) recognize excess tax benefits and deficiencies related to employee share-based payment transactions as an income tax expense or benefit in the income statement rather than in equity; (ii) present the excess tax benefits as an operating activity on the statement of cash flows versus current guidance to present them as financing activities; and, (iii) elect to either recognize stock forfeitures as they occur or estimate them. During the quarter ended July 1, 2016, the Company elected to early adopt the provisions of the ASU prospectively from January 2, 2016, including continuation of estimating forfeitures instead of recording them as they occur. Consequently, the Company recognized a \$3 million and \$7 million discrete tax benefit for the quarter and six months ended July 1, 2016, respectively, and operating cash flows for the six months ended July 1, 2016, increased \$7 million with a corresponding decrease to financing cash flows.

In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. This ASU eliminates Step 2 of the goodwill impairment test and simplifies how the amount of an impairment loss is determined. The update is effective for public companies in the beginning of fiscal year 2020 and shall be applied on a prospective basis. Early adoption is permitted for goodwill impairment tests performed on testing dates after January 1, 2017. The Company adopted the provisions of ASU 2017-04 prospectively in the first quarter of fiscal 2017 and the standard did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In May 2017, the FASB issued ASU 2017-09, *Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting*. This ASU provides clarification on when to apply modification accounting for a stock-based award to reduce diversity in practice. The update is effective for public companies in the beginning of fiscal year 2018 and shall be applied on a prospective basis. Early adoption is permitted for public business entities. The Company adopted the provisions of ASU 2017-09 prospectively in the second quarter of fiscal 2017 and the standard did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Accounting Standards Updates Issued But Not Yet Adopted**

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). This ASU will supersede all revenue recognition requirements in Topic 605, Revenue Recognition, and industry-specific guidance throughout the Industry Topics of the codification. The guidance's core principle is that an entity should recognize revenue to depict the transfer of control for promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the revenue principles, an entity will identify the contract(s) with a customer, identify the performance obligations, determine the transaction price, allocate the transaction price to the performance obligations and recognize revenue when the performance obligation is satisfied (i.e., either over time or point in time). The ASU further states that an entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The Company will adopt the new revenue standard in the beginning of fiscal 2018, under the modified retrospective method, where the cumulative effect is recognized at the date of initial adoption.

Based on the ongoing assessments, the Company believes the timing of and amount of revenue recognition will largely remain consistent between the current revenue standard and the revised revenue standard for the majority of the Company's contracts. Specifically, for time-and-materials, fixed-price-level-of-effort, cost-plus-award-fee, cost-plus-incentive fee and fixed-price-incentive fee contracts, the Company will continue to recognize revenue over time as work progresses because of the continuous transfer of control to the customer, generally using an input measure (e.g., cost incurred) to reflect progress. The Company tentatively expects that differences, if any, in revenue recognition between the current and revised revenue standards will primarily occur within the firm-fixed-price contracts as a result of the identification of new performance obligations. As of the end of the second quarter, the Company is still in the process of reviewing contracts and assessing the financial statement impact of the adoption of the new standard, if any.

**Note 2—Acquisitions**

On August 16, 2016, a wholly-owned subsidiary of Leidos Holdings, Inc. merged with the Information Systems & Global Solutions business (the "IS&GS Business") of Lockheed Martin Corporation in a Reverse Morris Trust transaction (the "Transactions"). The acquired IS&GS Business was renamed Leidos Innovations Corporation.

The preliminary purchase consideration for the acquisition of the IS&GS Business was as follows (in millions):

Value of common stock issued to Lockheed Martin stockholders <sup>(1)</sup>	\$	2,929
Equity consideration for replacement awards <sup>(2)</sup>		9
Preliminary working capital adjustments		55
Preliminary purchase price	\$	<u>2,993</u>

<sup>(1)</sup> Represents approximately 77 million new shares of Leidos common stock issued to those Lockheed Martin stockholders who elected to participate in the exchange offer, based on the Company's August 16, 2016, closing share price of \$51.69, less the Leidos special cash dividend amount of \$13.64, which the Lockheed Martin stockholders were not entitled to receive.

<sup>(2)</sup> The fair value of replacement equity-based awards attributable to pre-Merger service was recorded as part of the consideration transferred in the Merger.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The preliminary fair values of the assets acquired and liabilities assumed at the date of the Transactions were as follows (in millions):

Cash	\$	25
Receivables		954
Inventory, prepaid expenses and other current assets		68
Property, plant and equipment		91
Deferred tax assets		8
Intangible assets		1,202
Other assets		57
Accounts payable and accrued liabilities		(713)
Accrued payroll and employee benefits		(190)
Long-term debt, current portion		(23)
Deferred tax liabilities		(356)
Long-term debt, net of current portion		(1,780)
Other long-term liabilities		(52)
Total identifiable net liabilities assumed		(709)
Non-controlling interest		(13)
Goodwill		3,715
Preliminary purchase price	\$	2,993

Due to the timing and complexity of the Transactions, the Company recorded the assets acquired and liabilities assumed at their preliminary estimated fair values. As of June 30, 2017, the Company had not finalized the determination of fair values allocated to various assets and liabilities, including, but not limited to, receivables; property, plant and equipment; deferred income taxes; intangible assets; accounts payable and accrued liabilities; contractual contingencies; loss contracts; the residual amount allocated to goodwill; and the allocation of goodwill to reporting units. The preliminary purchase price allocation is subject to change as the Company completes its analysis of the provisional fair values of the acquired assets and liabilities assumed at the date of the Transactions.

During the quarter ended March 31, 2017, the Company recorded a purchase accounting adjustment to decrease goodwill by \$3 million. During the quarter ended June 30, 2017, the Company recorded a purchase accounting adjustment to increase goodwill by \$303 million related to changes to the preliminary estimated fair values of certain assets acquired and liabilities assumed. Significant changes included program intangibles, receivables, property, plant and equipment, other assets, accounts payable and accrued liabilities and deferred tax liabilities.

During the quarter ended June 30, 2017, the Company recognized a cumulative catch-up adjustment related to the valuation adjustments to intangible assets which resulted in a decrease in amortization expense of \$8 million. This adjustment was offset by a \$7 million increase in amortization expense as a result of the valuation adjustments to equity method investments. The Company recorded the cumulative catch-up adjustments in "Selling, general and administrative expenses" for the intangible assets and "Equity losses of non-consolidated subsidiaries" for the equity method investments in the Company's condensed consolidated statements of income.

During the quarter ended June 30, 2017, the Company recorded a valuation adjustment to fair value the non-controlling interest acquired. The fair value of \$13 million was determined by calculating the present value of future cash flows for the non-controlling interest. Significant assumptions inherent in the valuation of the non-controlling interest include the estimated after-tax cash flows expected to be received and an assessment of the appropriate discount rate.

The goodwill represents intellectual capital and the acquired assembled work force, none of which qualify for recognition as a separate intangible asset. The preliminary value of goodwill has been allocated to the new reporting units on a relative fair value approach (see "Note 6—Goodwill"). Of the total goodwill, \$414 million is tax deductible.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The Company identified \$1.2 billion of intangible assets, representing programs and contract intangibles, backlog and software and technology. The fair value measurements were primarily based on significant inputs that are not observable in the market and represent a Level 3 measurement (see "Note 5—Fair Value Measurements"). The income approach was primarily used to value the intangible assets, consisting primarily of funded backlog and programs acquired. The income approach indicates value for an asset based on the present value of cash flow projected to be generated by the asset. Projected cash flow is discounted at a required rate of return that reflects the relative risk of achieving the cash flow and the time value of money.

The following table summarizes the preliminary fair value of intangible assets acquired at the date of acquisition and the related weighted average amortization period:

	Weighted average amortization period (in years)	Fair value (in millions)
Programs and contract intangibles <sup>(1)</sup>	9.0	\$ 997
Backlog	1.4	178
Software and technology	1.2	27
Total	7.8	\$ 1,202

<sup>(1)</sup> The weighted average amortization period is estimated based on the projected economic benefits associated with these assets. Refer to "Note 7—Intangible Assets" for additional information.

The Company incurred the following expenses related to the acquisition and integration of the IS&GS Business:

	Three Months Ended		Six Months Ended	
	June 30, 2017	July 1, 2016	June 30, 2017	July 1, 2016
	(in millions)			
Acquisition costs	\$ —	\$ 7	\$ 1	\$ 13
Integration costs	16	8	34	11
Total acquisition and integration costs	\$ 16	\$ 15	\$ 35	\$ 24

*Pro Forma Financial Information (unaudited)*

The following pro forma financial information presents condensed consolidated results of operations as if the acquisition had occurred on January 3, 2015. The pro forma financial information was prepared based on historical financial information and has been adjusted to give effect to the events that are directly attributable to the Transactions and factually supportable. The unaudited pro forma results below do not reflect future events that have occurred or may occur after the Transactions, including anticipated synergies or other expected benefits that may be realized from the Transactions. The pro forma financial information is not intended to reflect the actual results of operations that would have occurred if the acquisition had been completed on January 3, 2015, nor is it intended to be an indication of future operating results.

(unaudited)	Three Months Ended	Six Months Ended
	July 1, 2016	July 1, 2016
	(in millions, except per share amounts)	
Revenues	\$ 2,624	\$ 5,261
Income from continuing operations	103	150
Income from continuing operations attributable to Leidos common stockholders	102	147
Earnings per share:		
Basic	\$ 0.68	\$ 0.99
Diluted	0.68	0.97

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The unaudited pro forma financial information above excludes acquisition-related costs of \$7 million and \$13 million for the quarter and six months ended July 1, 2016, respectively, as a nonrecurring significant adjustment. This adjustment was made to account for certain costs incurred as if the Transactions had been completed on January 3, 2015.

**Note 3—Divestitures**

In April 2016, the Company disposed of a business, historically included within the Civil segment, that was primarily focused on providing design, build and heavy construction engineering services. The Company received cash proceeds of \$23 million, resulting in a preliminary pre-tax gain on sale of \$3 million. The major classes of assets and liabilities sold included \$73 million of accounts receivable, net; \$3 million of non-current assets and \$63 million of accounts payable and accrued liabilities. In addition, the Company recorded a \$6 million liability in connection with issuance of a performance guarantee on a contract sold and guarantee of collection of the accounts receivable transferred. The Company paid \$1 million of selling costs related to the transaction. The Company recorded the preliminary pre-tax gain on sale in "Other income (expense), net" in the Company's condensed consolidated statements of income during the quarter ended July 1, 2016.

On July 24, 2015, the Company completed the sale of its equity interests in Plainfield Renewable Energy Holdings LLC ("Plainfield") for an aggregate consideration of \$102 million, subject to certain adjustments and contingent earn-out payments. The consideration received by the Company at closing consisted of a cash payment of \$29 million and a secured promissory note for \$73 million, net of discount (the "Note"). The Note is payable semi-annually with a final lump sum due in July 2018. The Company collected \$6 million of principal and interest during the quarter ended March 31, 2017.

During the quarter ended June 30, 2017, Plainfield exercised the first of three one-year term extension options available under the original credit agreement, thereby extending the maturity date of the Note to July 24, 2018. Concurrent with this extension, the interest rate on the Note increased from 6% to 8%. Also, during the quarter ended June 30, 2017, Leidos and Plainfield entered into an amendment to the Note allowing Plainfield to defer up to \$4 million of the interest and principal payments due in July 2017 and January 2018, until July 2018. In consideration of this deferment, Leidos received certain concessions and releases from obligations under the original transaction documents. As of June 30, 2017, the Company continues to expect the Note to be collectible in full.

**Note 4—Restructuring Expenses**

After the acquisition of the IS&GS Business, the Company began an initiative to align its cost structure, which includes optimization of its real estate portfolio by vacating certain facilities and consolidating others, and by reducing headcount.

The restructuring expenses related to this program were as follows:

	Three Months Ended	Six Months Ended
	June 30, 2017	June 30, 2017
	(in millions)	
Severance costs	\$ 2	\$ 12
Lease termination expenses	4	7
Restructuring expenses related to the IS&GS Business	\$ 6	\$ 19

These restructuring expenses have been recorded within corporate expenses and presented separately on the condensed consolidated statements of income.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The restructuring liability related to this program at June 30, 2017, was:

	Severance costs	Lease termination expenses	Total
	(in millions)		
Balance as of December 30, 2016	\$ 7	\$ 1	\$ 8
Charges	12	7	19
Cash payments	(17)	(6)	(23)
<b>Balance as of June 30, 2017</b>	<b>\$ 2</b>	<b>\$ 2</b>	<b>\$ 4</b>

The Company expects the remainder of the restructuring liability to be substantially settled within one year.

**Note 5—Fair Value Measurements**

The accounting standard for fair value measurements establishes a three-level fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: observable inputs such as quoted prices in active markets (Level 1); inputs other than quoted prices in active markets for identical assets or liabilities that are observable either directly or indirectly or quoted prices that are not active (Level 2); and unobservable inputs in which there is little or no market data (e.g., discounted cash flow and other similar pricing models), which requires the Company to develop its own assumptions (Level 3).

The accounting guidance for fair value measurements requires that the Company maximize the use of observable inputs and minimize the use of unobservable inputs in determining fair value. The accounting guidance provides for the irrevocable option to elect, on a contract-by-contract basis, to measure certain financial assets and liabilities at fair value at inception of the contract and record any subsequent changes in fair value in earnings. We have not made fair value option elections on any of our financial assets and liabilities.

The Company's assets measured on a recurring basis at fair value consisted of the following:

	June 30, 2017		December 30, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(in millions)			
<b>Financial assets</b>				
Derivatives	\$ 30	\$ 30	\$ 29	\$ 29

The Company's derivatives consisted of the fair value interest rate swaps on its \$450 million fixed rate 4.45% senior secured notes maturing in December 2020, and cash flow interest rate swaps on \$1.2 billion of the Company's variable rate senior secured term loans (see "Note 9—Derivative Instruments"). The fair value of the fair value interest rate swaps and cash flow interest rate swaps is determined based on observed values for underlying interest rates on the LIBOR yield curve and the underlying interest rate, respectively (Level 2 inputs).

The carrying amounts of the Company's financial instruments, other than derivatives, which include cash equivalents, accounts receivable, accounts payable and accrued expenses, are reasonable estimates of their related fair values. The carrying value of the Company's notes receivable as of June 30, 2017, of \$91 million approximates fair value as the stated interest rates within the agreements are consistent with the current market rates used in notes with similar terms in the market (Level 2 inputs).

As of June 30, 2017, and December 30, 2016, the fair value of long-term debt was \$3.3 billion for both periods and the carrying amount was \$3.2 billion and \$3.3 billion, respectively (see "Note 10—Debt"). The fair value of long-term debt is determined based on current interest rates available for debt with terms and maturities similar to the Company's existing debt arrangements (Level 2 inputs).

The Company's cash equivalents were primarily comprised of investments in several large institutional money market funds and bank deposits, with original maturity of three months or less.

At June 30, 2017, the Company did not have any assets or liabilities measured at fair value on a non-recurring basis, other than associated with purchase accounting (see "Note 2—Acquisitions").

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 6—Goodwill**

During the quarter ended March 31, 2017, the Company completed its business reorganization, which resulted in identification of three reportable segments (Defense Solutions, Civil, Health) and corporate expenses. The Company commenced operating and reporting under the new organizational structure effective the beginning of fiscal 2017 (see "Note 14—Business Segments").

Goodwill, including the amounts from the acquisition of the IS&GS Business, was allocated to the new reporting units on a relative fair value approach. The amount of goodwill from the acquisition of the IS&GS Business has been valued on a preliminary basis and may change as purchase accounting is finalized (see "Note 2—Acquisitions").

The following table presents changes in the carrying amount of goodwill by reportable segment as of June 30, 2017 and December 30, 2016:

	Defense Solutions	Civil	Health	Total
	(in millions)			
Goodwill at January 1, 2016	\$ 792	\$ 244	\$ 171	\$ 1,207
Acquisition of the IS&GS Business	1,162	1,487	766	3,415
Goodwill at December 30, 2016	1,954	1,731	937	4,622
Adjustment to original purchase price allocation	72	151	77	300
<b>Goodwill at June 30, 2017</b>	<b>\$ 2,026</b>	<b>\$ 1,882</b>	<b>\$ 1,014</b>	<b>\$ 4,922</b>

In conjunction with the change in reportable segments, the Company evaluated goodwill for impairment, both before and after the segment change and determined that goodwill was not impaired.

Goodwill is tested for impairment at the beginning of the fourth quarter and during interim periods whenever events or circumstances indicate that the carrying value may not be recoverable. There were no goodwill impairments during the six months ended June 30, 2017, and July 1, 2016.

**Note 7—Intangible Assets**

Intangible assets, including the preliminary fair values of those acquired through the acquisition of the IS&GS Business, consisted of the following:

	June 30, 2017			December 30, 2016		
	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
	(in millions)					
Finite-lived intangible assets:						
Programs and contract intangibles	\$ 997	\$ (91)	\$ 906	\$ 1,450	\$ (25)	\$ 1,425
Backlog	178	(113)	65	200	(54)	146
Software and technology	89	(59)	30	61	(48)	13
Customer relationships	6	(5)	1	6	(5)	1
Total finite-lived intangible assets	1,270	(268)	1,002	1,717	(132)	1,585
Indefinite-lived intangible assets:						
Trade names	4	—	4	4	—	4
<b>Total intangible assets</b>	<b>\$ 1,274</b>	<b>\$ (268)</b>	<b>\$ 1,006</b>	<b>\$ 1,721</b>	<b>\$ (132)</b>	<b>\$ 1,589</b>

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

Amortization expense related to intangible assets, including those acquired through the Transactions, was \$67 million and \$136 million for the quarter and six months ended June 30, 2017, respectively, and \$2 million and \$3 million for the quarter and six months ended July 1, 2016, respectively. The acquired programs and contract intangible assets are amortized over their respective estimated useful lives in proportion to the pattern of economic benefit based on expected future discounted cash flows. The acquired backlog and software and technology intangible assets, as well as the Company's existing customer relationships and software and technology intangible assets, are amortized on a straight-line basis over their estimated useful lives.

The estimated annual amortization expense as of June 30, 2017, was as follows:

Fiscal Year Ending	(in millions)
2017 (remainder of year)	\$ 149
2018	206
2019	180
2020	132
2021	111
2022 and thereafter	224
	<u>\$ 1,002</u>

The acquired asset balances related to the Transactions may change upon final valuation (see "Note 2—Acquisitions").

**Note 8—Property, Plant and Equipment**

Property, plant and equipment, net, including preliminary fair value of those acquired through the acquisition of the IS&GS Business, consisted of the following:

	June 30, 2017	December 30, 2016
	(in millions)	
Computers and other equipment	\$ 191	\$ 172
Leasehold improvements	167	161
Buildings and improvements	54	104
Office furniture and fixtures	35	35
Land	49	57
Construction in progress	8	12
	<u>504</u>	<u>541</u>
Less: accumulated depreciation and amortization	<u>(289)</u>	<u>(282)</u>
	<u>\$ 215</u>	<u>\$ 259</u>

Depreciation expense was \$13 million and \$26 million for the quarter and six months ended June 30, 2017, respectively, and \$7 million and \$14 million for the quarter and six months ended July 1, 2016, respectively. The acquired asset balances related to the Transactions may change upon final valuation (see "Note 2—Acquisitions").

**Note 9—Derivative Instruments**

The Company manages its risk to changes in interest rates through the use of derivative instruments. The Company does not hold derivative instruments for trading or speculative purposes. For fixed rate borrowings, the Company uses variable interest rate swaps, effectively converting fixed rate borrowings to variable rate borrowings. These swaps are designated as fair value hedges. For variable rate borrowings, the Company uses fixed interest rate swaps, effectively converting a portion of the variable rate borrowings to fixed rate borrowings. These swaps are designated as cash flow hedges.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

*Fair Value Hedges*

The Company has interest rate swap agreements to hedge the fair value of the \$450 million fixed rate 4.45% senior secured notes maturing in December 2020 (the "Notes"). The objective of these instruments is to hedge the Notes against changes in fair value due to the variability in the six-month LIBOR rate (the benchmark interest rate). Under the terms of the interest rate swap agreements, the Company will receive semi-annual interest payments at the coupon rate of 4.45% and will pay variable interest based on the six-month LIBOR rate.

The interest rate swaps were accounted for as a fair value hedge of the Notes and qualified for the shortcut method of hedge accounting, which allows for the assumption of no ineffectiveness reported in earnings. The resulting changes in the fair value of the interest rate swaps are fully offset by the changes in the fair value of the underlying debt (the hedged item).

The fair value of the Notes is stated at an amount that reflects changes in the benchmark interest rate, the six-month LIBOR rate, subsequent to the inception of the interest rate swaps through the reporting date.

*Cash Flow Hedges*

In August 2016, the Company entered into interest rate swap agreements to hedge the cash flows with respect to \$1.2 billion of the Company's variable rate senior secured term loans (the "Variable Rate Loans"). The objective of these instruments is to reduce variability in the forecasted interest payments of the Company's Variable Rate Loans, which is based on the LIBOR rate. Under the terms of the interest rate swap agreements, which mature in December 2021, the Company will receive monthly variable interest payments based on the one-month LIBOR rate and will pay interest at a fixed rate of 1.08%. The counterparties to these agreements are financial institutions.

The interest rate swaps were accounted for as a cash flow hedge of the Variable Rate Loans and qualified for hedge accounting treatment through the application of the long-haul method, which involves the comparison of cumulative changes in the fair value of the swap to the cumulative change in fair value of scheduled interest payments on the notional value (the perfectly effective hypothetical or "PEH"). The effective portion of the gain/loss on the swap is reported as a component of other comprehensive income/loss and will be reclassified into earnings on the dates the interest payments impact earnings. The amount of ineffectiveness recorded in the earnings is equal to the excess of the cumulative change in fair value of the swap over the cumulative change in the fair value of the PEH.

The fair value of the interest rate swaps was as follows:

	Balance sheet line item	June 30, 2017	December 30, 2016
		(in millions)	
Fair value interest rate swaps	Other assets	\$ 5	\$ 3
Cash flow interest rate swaps	Other assets	25	26

The effect of the Company's cash flow hedge on other comprehensive income and earnings for the periods presented was as follows:

	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017
	(in millions)	
Effective portion recognized in other comprehensive income	\$ (4)	\$ (3)
Effective portion reclassified from accumulated other comprehensive income (loss) to earnings	—	1
Ineffective portion recognized in earnings	1	1

The Company expects to reclassify gains of \$3 million from accumulated other comprehensive income (loss) into earnings during the next 12 months.

The cash flows associated with both interest rate swaps are classified as operating activities in the condensed consolidated statements of cash flows.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 10—Debt**

The Company's long-term debt consisted of the following:

	Stated interest rate	Effective interest rate	June 30, 2017 <sup>(1)</sup>	December 30, 2016 <sup>(1)</sup>
(in millions)				
<b>Senior secured notes:</b>				
\$450 million notes, due December 2020	4.45%	4.53%	\$ 453	\$ 451
\$300 million notes, due December 2040	5.95%	6.03%	216	216
<b>Senior secured term loans:</b>				
\$400 million Term Loan A, due August 2019	3.06%	4.04%	89	123
\$690 million Term Loan A, due August 2021	3.06%	3.63%	661	676
\$310 million Term Loan A, due August 2021	3.06%	3.60%	297	304
\$1,131 million Term Loan B, due August 2023	3.31%	3.67%	1,105	1,110
<b>Senior unsecured notes:</b>				
\$250 million notes, due July 2032	7.13%	7.43%	246	246
\$300 million notes, due July 2033	5.50%	5.88%	158	158
Capital leases due on various dates through fiscal 2020	0%-5.94%	Various	6	3
<b>Total long-term debt</b>			<b>3,231</b>	<b>3,287</b>
<b>Less: current portion</b>			<b>84</b>	<b>62</b>
<b>Total long-term debt, net of current portion</b>			<b>\$ 3,147</b>	<b>\$ 3,225</b>

<sup>(1)</sup> The carrying amounts of the senior secured term loans and notes and unsecured notes as of June 30, 2017, and December 30, 2016, include the remaining principal outstanding of \$3,270 million and \$3,336 million, respectively, plus \$5 million and \$3 million, respectively, related to the fair value of the interest rate swaps (see "Note 9—Derivative Instruments"), less unamortized debt discounts of \$41 million and \$46 million, respectively, less deferred debt issuance costs of \$9 million for both periods.

The interest rate on the Company's senior secured term loans is determined based on the LIBOR rate plus a margin. The margin for the Term Loan A loans ranges from 1.75% to 2.25%, depending on the Company's senior secured leverage ratio, and is computed on a quarterly basis. At June 30, 2017, the current margin on Term Loan A was 2.00%.

In February 2017, Leidos repriced the Company's senior secured \$1.1 billion Term Loan B, due August 2023. As a result, the margin on Term Loan B was reduced by 50 basis points to 2.25% and the six month call provision was extended an additional six months. The repricing of the term loan became effective on February 16, 2017.

In addition to the required quarterly payments on the Company's term loans, the Company prepaid \$25 million of its senior secured \$400 million Term Loan A, due August 2019, on June 30, 2017.

Principal of the Company's variable rate senior secured term loans is payable on a quarterly basis, with the majority of the principal due at maturity. Interest on the variable rate senior secured term loans is payable on a periodic basis, which must be at least quarterly. Interest on the senior fixed rate secured notes and unsecured notes is payable on a semi-annual basis with principal payments due at maturity.

Amortization for the senior secured term loans and notes and unsecured notes was \$3 million and \$7 million for the quarter and six months ended June 30, 2017, respectively. Amortization for the senior secured notes and unsecured notes was immaterial for the quarter and six months ended July 1, 2016.

The Company has a revolving credit facility providing up to \$750 million in secured borrowing capacity at interest rates determined based upon the LIBOR rate plus a margin that is subject to step-down provisions based on the Company's senior secured leverage ratio. The maturity date of this credit facility is August 2021. As of June 30, 2017 and December 30, 2016, there were no borrowings outstanding under the credit facility.

The senior secured term loans and notes, unsecured notes and revolving credit facility are fully and unconditionally guaranteed and contain certain customary restrictive covenants, including among other things, restrictions on the Company's ability to create liens and enter into sale and leaseback transactions under certain circumstances. The Company was in compliance with all covenants as of June 30, 2017.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 11—Accumulated Other Comprehensive Income (Loss)**

The components of accumulated other comprehensive income (loss) were as follows:

	Foreign currency translation adjustments	Unrecognized (loss) gain on derivative instruments	Pension liability adjustments	Total accumulated other comprehensive income (loss)
(in millions)				
Balance at January 1, 2016	\$ —	\$ (4)	\$ (4)	\$ (8)
Other comprehensive (loss) income	(8)	26	1	19
Taxes	1	(10)	2	(7)
Reclassification from accumulated other comprehensive income (loss)	—	(2)	(6)	(8)
Balance at December 30, 2016	(7)	10	(7)	(4)
Other comprehensive income (loss)	15	(1)	—	14
Taxes	(2)	1	—	(1)
Reclassification from accumulated other comprehensive income (loss)	—	(1)	—	(1)
<b>Balance at June 30, 2017</b>	<b>\$ 6</b>	<b>\$ 9</b>	<b>\$ (7)</b>	<b>\$ 8</b>

Reclassifications for unrecognized (loss) gain on derivative instruments associated with outstanding debt are recorded in "Interest expense" in the Company's condensed consolidated statements of income.

Reclassifications for pension liability adjustments are recorded in "Selling, general and administrative expenses" in the Company's condensed consolidated statements of income.

**Note 12—Earnings Per Share ("EPS")**

The following table provides a reconciliation of the weighted average number of shares outstanding used to compute basic and diluted EPS for the periods presented:

	Three Months Ended		Six Months Ended	
	June 30, 2017	July 1, 2016	June 30, 2017	July 1, 2016
(in millions)				
Basic weighted average number of shares outstanding	151	73	151	72
Dilutive common share equivalents—stock options and other stock awards	2	1	2	2
Diluted weighted average number of shares outstanding	153	74	153	74

Anti-dilutive stock-based awards are excluded from the weighted average number of shares outstanding used to compute diluted EPS. For the quarter and six months ended June 30, 2017 and July 1, 2016, there were a total of 1 million of outstanding stock options and vesting stock awards that were antidilutive.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 13—Supplementary Cash Flow Information**

Supplementary cash flow information, including non-cash activities, for the periods presented was as follows:

	Six Months Ended	
	June 30, 2017	July 1, 2016
	(in millions)	
Supplementary cash flow information:		
Cash paid for interest	\$ 59	\$ 43
Cash paid for income taxes, net of refunds	107	38
Non-cash financing activity:		
Capital lease obligation	6	—

**Note 14—Business Segments**

During the quarter ended March 31, 2017, the Company completed its business reorganization, which resulted in identification of three reportable segments and corporate expenses. The Company's operations and the new reportable segments are aligned around the the nature of work and customers it serves. The Company commenced operating and reporting under the new organizational structure effective the beginning of fiscal 2017.

At June 30, 2017, the Company's reportable segments and corporate expenses were:

- Defense Solutions – delivers cutting edge technology and services to the DoD, military services, the U.S. Intelligence Community, DHS, agencies of U.S. allies abroad and other federal and civilian customers. The Company's Defense Solutions business is focused on cybersecurity, data analytics, IT modernization and software development, as well as technology to support intelligence, surveillance and reconnaissance services.
- Civil – provides services and solutions to civil agencies of the U.S. Government and commercial customers. The Company's Civil business is focused on software development, operations and sustainment, enterprise IT modernization, systems engineering and cyber services.
- Health – provides services and solutions to the Defense Health Agency, Veterans Administration, HHS, other civil health agencies of the U.S. Government and commercial healthcare providers. The Company's Health business is focused on enterprise IT modernization, software development, data analytics, electronic health record implementation, mission critical operations and sustainment, life sciences and public health.
- Corporate expenses – includes the operations of various corporate activities and certain expense items that are not reimbursed by the Company's U.S. Government customers.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The segment information for the periods presented, of which the prior period has been recast to reflect the Company's current reportable segment structure, was as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2017	July 1, 2016	June 30, 2017	July 1, 2016
	(in millions)			
<b>Revenues:</b>				
Defense Solutions	\$ 1,243	\$ 785	\$ 2,537	\$ 1,565
Civil	875	300	1,717	661
Health	454	203	897	374
Corporate expenses	(1)	—	—	—
<b>Total revenues</b>	<b>\$ 2,571</b>	<b>\$ 1,288</b>	<b>\$ 5,151</b>	<b>\$ 2,600</b>
<b>Operating income (loss):</b>				
Defense Solutions	\$ 63	\$ 60	\$ 142	\$ 131
Civil	66	20	120	42
Health	74	18	121	34
Corporate expenses	(37)	(23)	(76)	(43)
<b>Total operating income</b>	<b>\$ 166</b>	<b>\$ 75</b>	<b>\$ 307</b>	<b>\$ 164</b>

The financial performance measures used to evaluate segment performance are revenues and operating income. As a result, "Other income (expense), net," "Interest income," "Interest expense" and "Income tax expense," as reported in the condensed consolidated financial statements are not allocated to the Company's segments. Under U.S. Government Cost Accounting Standards, indirect costs including depreciation expense are collected in numerous indirect cost pools, which are then collectively allocated out to the Company's reportable segments based on a representative causal or beneficial relationship of the costs in the pool to the costs in the base.

Asset information by segment is not a key measure of performance used by the Company's chief operating decision maker, currently the Chairman and Chief Executive Officer.

**Note 15—Contingencies**

**Legal Proceedings**

*MSA Venture*

On November 10, 2015, Mission Support Alliance, LLC ("MSA"), a joint venture with Jacobs Engineering Group, Inc. and Centerra Group, LLC, received a final decision of the Department of Energy ("DoE") contracting officer for the Mission Support Contract concluding that certain payments to MSA by DoE for the performance of IT services by Lockheed Martin Services, Inc. ("LMSI") under a subcontract to MSA constituted alleged affiliate fees in violation of the Federal Acquisition Regulation (the "FAR"). Lockheed Martin Integrated Technology LLC (now known as Leidos Integrated Technology LLC) is a member entity of MSA. At the same time, the contracting officer advised MSA that he would not approve certain provisional fee payments to MSA pending resolution of the matters set forth in his decision. Subsequent to the contracting officer's final decision, MSA, LMSI, and Lockheed Martin Corporation received notice from the U.S. Attorney's Office for the Eastern District of Washington that the U.S. Government had initiated a False Claims Act investigation into the facts surrounding this dispute, and each of MSA, LMSI and Lockheed Martin Corporation have produced information in response to Civil Investigative Demands from the U.S. Attorney's Office. In addition, the U.S. Attorney's office has advised that a parallel criminal investigation is open, although no subjects or targets of the investigation have been identified.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

Since this issue first was raised by the DoE, MSA has asserted that the IT services performed by LMSI under a fixed price/fixed unit rate subcontract approved by the DoE meet the definition of a "commercial item" under the FAR and any profits earned on that subcontract are permissible. MSA filed an appeal of the contracting officer's decision with the Civilian Board of Contract Appeals and that appeal is pending, but has been stayed pending resolution of the False Claims Act investigation. Subsequent to the filing of MSA's appeal, the contracting officer demanded that MSA reimburse the DoE in the amount of \$64 million, which was his estimate of the profits earned during the period from 2010 to 2014 by LMSI. The DoE has deferred that demand, pending resolution of the appeal, but to date the demand has not been rescinded. MSA and the other members of MSA have indicated they believe if MSA incurs a liability in this matter, then Leidos Integrated Technology, LLC is responsible to MSA for the loss. Under the terms of the Separation Agreement, Lockheed Martin has agreed to indemnify the Company for 100% of any damages in excess of \$38 million up to \$64 million, and 50% of any damages in excess of \$64 million, with respect to claims asserted against MSA related to this matter. At June 30, 2017, the Company has a liability of \$39 million and an indemnification asset of \$1 million recorded in the condensed consolidated balance sheets.

*Securities Litigation*

Between February and April 2012, alleged stockholders filed three putative securities class actions. One case was withdrawn and two cases were consolidated in the U.S. District Court for the Southern District of New York in *In Re: SAIC, Inc. Securities Litigation*. The consolidated securities complaint named as defendants the Company, a former chief financial officer, two former chief executive officers, a former group president and the former program manager on the Company's contract to develop and implement an automated time and attendance and workforce management system for certain agencies of the City of New York ("CityTime") and was filed purportedly on behalf of all purchasers of the Company's common stock from April 11, 2007, through September 1, 2011. The consolidated securities complaint asserted claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 based on allegations that the Company and individual defendants made misleading statements or omissions about the Company's revenues, operating income and internal controls in connection with disclosures relating to the CityTime project. The plaintiffs sought to recover from the Company and the individual defendants an unspecified amount of damages class members allegedly incurred by buying Leidos' stock at an inflated price. On October 1, 2013, the District Court dismissed many claims in the complaint with prejudice and on January 30, 2014, the District Court entered an order dismissing all remaining claims with prejudice and without leave to replead. The plaintiffs then appealed to the United States Court of Appeals for the Second Circuit. On March 29, 2016, the Second Circuit issued an opinion affirming in part, and vacating in part, the District Court's ruling. In particular, the Second Circuit held that the plaintiffs should be permitted to pursue omissions claims against the Company with respect to the annual report the Company filed on Form 10-K on March 25, 2011; the Second Circuit affirmed dismissal of all other claims, including all the claims against the individual defendants, and the case was remanded to the District Court. On September 23, 2016, the District Court issued an order clarifying that the applicable class period relating to the March 2011 Form 10-K ends on June 2, 2011, not September 1, 2011, as plaintiffs argued. The Company filed a petition for a writ of certiorari in the U.S. Supreme Court, which was granted on March 27, 2017. A decision is expected by June 2018. The District Court granted the Company's request to stay all proceedings, including discovery, pending the outcome at the Supreme Court.

Any potential loss relating to this matter is not reasonably estimable due to unresolved questions of fact and law. However, the Company does not expect any ultimate liability to have a material effect on the Company's financial position, liquidity or capital resources.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

*Greek Government Contract*

In 2003, the Company entered into a firm-fixed-price contract with the Hellenic Republic of Greece to provide a Command, Control, Communications, Coordination and Integration System. The Greek government disputed the contract balance owed to the Company and has not paid the Company's final invoice. In 2013, the Company received an arbitral award by the International Chamber of Commerce for \$45 million, which has not been satisfied. In January 2017, the U.S. District Court granted an order to enforce the arbitration award and entered judgment in the Company's favor, for which the award was subsequently increased to \$63 million. The Greek government sought to annul the award through separate litigation in the Greek courts, however, on July 27, 2017, the Athens Court of Appeals issued a final decision rejecting the government's position. Based on the complex nature of this contractual situation and the difficulties encountered to date, significant uncertainties exist and the Company is unable to reliably estimate the ultimate outcome.

*Other*

The Company is also involved in various claims and lawsuits arising in the normal conduct of its business, none of which, in the opinion of the Company's management, based upon current information, will likely have a material adverse effect on the Company's condensed consolidated financial position, results of operations, or cash flows.

**Other Contingencies**

*VirnetX, Inc.*

In fiscal 2007, the Company transferred several patents to VirnetX Inc., a subsidiary of VirnetX Holding Corp. In consideration of this transfer, the Company received certain license rights and the right to receive a percentage of the consideration received in patent infringement or enforcement claims against third parties. In November 2012, a jury found that Apple Corporation infringed two of the patents that the Company previously transferred to VirnetX and awarded \$368 million to VirnetX, but the United States Court of Appeals for the Federal Circuit vacated this award. Although VirnetX petitioned the appeals court for an en banc review, this request was denied and the case was remanded to the Federal District Court for further proceedings, including a new jury trial which began on January 25, 2016.

On February 3, 2016, the jury in the United States Court for the Eastern District of Texas, Tyler Division, awarded VirnetX \$626 million in a verdict against Apple for willful infringement of four VirnetX patents. However, on July 29, 2016, the court issued a new order in the pending litigation against Apple, Case No. 6:10-cv-417 ("Apple I") and Case No. 6:12-cv-855 ("Apple II"), vacating its previous order consolidating the two cases and ordering the parties to retry them as separate cases. On September 30, 2016, a jury in the United States Court for the Eastern District of Texas, Tyler Division, in the Apple I case, awarded VirnetX \$302 million in a verdict against Apple for infringing four VirnetX patents. A jury trial in the Apple II case is expected to be scheduled by the court shortly after the conclusion of the Apple I case. Under its agreements with VirnetX, Leidos would receive 25% of the proceeds obtained by VirnetX after reduction for attorneys' fees and costs. However, it is expected that Apple will appeal the verdict and no assurances can be given when or if the Company will receive any proceeds in connection with this jury award. In addition, if the Company receives any proceeds, the Company is required to pay a royalty to the customer who paid for the development of the technology.

The Company does not have any assets or liabilities recorded in connection with this matter as of June 30, 2017.

*Government Investigations and Reviews*

The Company is routinely subject to investigations and reviews relating to compliance with various laws and regulations with respect to its role as a contractor to federal, state and local government customers and in connection with performing services in countries outside of the United States. Adverse findings could have a material adverse effect on the Company's business, financial position, results of operations and cash flows due to its reliance on government contracts.

Indirect cost audits by the Defense Contract Audit Agency remain open for fiscal 2012 and subsequent years for Leidos, Inc., and fiscal 2010 and subsequent years for Leidos Innovations. Although the Company has recorded contract revenues upon an estimate of costs that the Company believes will be approved upon final audit or review, the Company cannot predict the outcome of any ongoing or future audits or reviews and adjustments, and if future adjustments exceed the Company's estimates, its profitability would be adversely affected.

**LEIDOS HOLDINGS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

As of June 30, 2017, the Company believes it has adequately reserved for potential adjustments from audits or reviews of contract costs.

**Note 16—Commitments**

The Company has outstanding letters of credit of \$82 million as of June 30, 2017, principally related to guarantees on contracts. The Company also has outstanding surety bonds in the amount of \$157 million, principally related to performance and subcontractor payment bonds on the Company's contracts. The outstanding letters of credit and surety bonds have various terms with the majority of the letters of credit and bonds expiring over the next four fiscal years.

Additionally, the Company has outstanding performance guarantees and cross-indemnity agreements in connection with certain aspects of its business. As of June 30, 2017, the Company is not aware of any existing event of default that would require it to satisfy any of these guarantees.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following discussion and analysis of Leidos Holdings, Inc.'s ("Leidos") financial condition, results of operations and quantitative and qualitative disclosures about market risk should be read in conjunction with Leidos' condensed consolidated financial statements and related notes.*

*The following discussion contains forward-looking statements, including statements regarding our intent, belief, or current expectations with respect to, among other things, trends affecting our financial condition or results of operations, backlog, our industry, government budgets and spending, the impact of competition and the performance and carrying value of our assets. Such statements are not guarantees of future performance and involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statements as a result of various factors. Some of these factors include, but are not limited to, the risk factors set forth in our Annual Report on Form 10-K, as updated periodically through our subsequent quarterly reports on Form 10-Q. Due to such uncertainties and risks, you are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to update these factors or to publicly announce the results of any changes to our forward-looking statements due to future events or developments.*

*Unless indicated otherwise, references in this report to the "Company," "we," "us" and "our" refer collectively to Leidos and its consolidated subsidiaries.*

**Overview**

We are a FORTUNE 500® science and technology company that provides technology and engineering services and solutions in the defense, intelligence, civil and health markets. We bring domain-specific capability and cross-market innovations to customers in each of these markets by leveraging seven core capabilities: command, control, computing, communications and intelligence surveillance and reconnaissance ("C4ISR"); cybersecurity; systems engineering; large-scale agile software development; data analytics; enterprise IT modernization; and operations and sustainment. Our domestic customers include the U.S. Department of Defense ("DoD"), the U.S. Intelligence Community, the U.S. Department of Homeland Security ("DHS"), the Federal Aviation Administration ("FAA"), the Department of Health and Human Services ("HHS"), U.S. Government civil agencies and state and local government agencies. Our international customers include foreign governments and their agencies, primarily located in the United Kingdom, the Middle East and Australia.

During the quarter ended March 31, 2017, we completed our business reorganization, which resulted in identification of three reportable segments (Defense Solutions, Civil, Health) and corporate expenses. We commenced operating and reporting under the new organizational structure effective the beginning of fiscal 2017. As a result of this change, prior year segment results and disclosures have been recast to reflect the new reportable segments (see "Note 14—Business Segments").

**Business Environment and Trends**

*U.S. Government Markets*

For fiscal 2016, we generated approximately 81% of our total revenues from contracts with the U.S. Government. Accordingly, our business performance is affected by the overall level of U.S. Government spending, especially on national security, homeland security and intelligence, and the alignment of our service and product offerings and capabilities with current and future budget priorities of the U.S. Government.

The following are updates based on events that have occurred in the political and economic environment since the filing of our Annual Report on Form 10-K.

As Congress had enacted only one of its 12 appropriations bills for the current government fiscal year ("GFY 2017"), a continuing resolution ("CR") was enacted allowing the government to operate under the previous year's spending levels, with some exceptions, until April 28, 2017. Prior to the expiration of the April 28, 2017 CR, Congress passed another short term CR with an expiration date of May 5, 2017. The second short-term CR was necessary to allow Congress the time to complete action on a GFY 2017 Omnibus Appropriation bill to fund the entire government through the last day of September 2017. Prior to expiration of the second short-term CR, Congress approved the GFY 2017 Omnibus Appropriation bill, providing discretionary funding for the federal government for the current fiscal year. The administration has submitted its budget request for GFY 2018 and Congress is currently in the process of considering a budget resolution. Congress is also moving forward on all 12 appropriations bills for the fiscal year beginning in October 2017. This process is expected to continue through the summer and into the fall.

*International Markets*

Sales to customers in international markets represented 9% of total revenues for fiscal 2016. Our acquisition of the IS&GS Business has increased the relative contribution from international business, particularly in the United Kingdom ("U.K.") and Australia, and has therefore increased our exposure to international markets and the associated international regulatory and geopolitical risks.

**Lockheed Martin Transaction**

On August 16, 2016, a wholly-owned subsidiary of Leidos Holdings, Inc. merged with the Information Systems & Global Solutions business (the "IS&GS Business") of Lockheed Martin Corporation in a Reverse Morris Trust transaction (the "Transactions"). The acquired IS&GS Business was renamed Leidos Innovations Corporation.

We incurred acquisition and integration costs of \$16 million and \$35 million during the three and six months ended June 30, 2017, respectively, and \$15 million and \$24 million during the three and six months ended July 1, 2016, respectively, and expect to incur additional integration costs in connection with the Transactions through fiscal 2019.

**Key Performance Measures**

The primary financial performance measures we use to manage our business and monitor results of operations are revenue, operating income, cash flows from operations and diluted EPS. We also believe that bookings and backlog are useful measures for management and investors to evaluate our performance and potential future revenues.

**Results of Operations**

The following table summarizes our condensed consolidated results of operations for the periods presented:

	Three Months Ended				Six Months Ended			
	June 30, 2017	July 1, 2016	Dollar change	Percent change	June 30, 2017	July 1, 2016	Dollar change	Percent change
	(dollars in millions)							
Revenues	\$ 2,571	\$ 1,288	\$ 1,283	99.6%	\$ 5,151	\$ 2,600	\$ 2,551	98.1%
Operating income	166	75	91	121.3%	307	164	143	87.2%
Non-operating expense, net	(31)	(15)	(16)	106.7%	(64)	(26)	(38)	146.2%
Income from continuing operations before income taxes	135	60	75	125.0%	243	138	105	76.1%
Income tax expense	(37)	(19)	(18)	94.7%	(71)	(44)	(27)	61.4%
Net income	98	41	57	139.0%	172	94	78	83.0%
Less: net income attributable to non-controlling interest	—	—	—	NM	2	—	2	NM
Net income attributable to Leidos common stockholders	\$ 98	\$ 41	\$ 57	139.0%	\$ 170	\$ 94	\$ 76	80.9%
Operating margin	6.5%	5.8%			6.0%	6.3%		

NM - Not meaningful

The results of operations include revenues of \$1,371 million and \$2,735 million and operating income of \$95 million and \$169 million for the three and six months ended June 30, 2017, respectively, attributable to the acquired IS&GS Business.

The revenue increases in constant currency<sup>(1)</sup> for the three and six months ended June 30, 2017, were 100.2% and 98.8%, respectively, as compared to an overall increase of 99.6% and 98.1% for the three and six months ended July 1, 2016, respectively. The adverse foreign currency impact was attributable to our U.K. business in the Civil segment.

<sup>(1)</sup> The non-GAAP measure of constant currency revenues is used to assess the performance of revenue activity without the effect of foreign currency exchange rate fluctuations. We calculate revenues on a constant currency basis by translating current period revenue using the comparable period's foreign currency exchange rates. This calculation is performed for all subsidiaries where the functional currency is not the U.S. dollar.

LEIDOS HOLDINGS, INC.

Segment results and corporate expenses

Defense Solutions	Three Months Ended				Six Months Ended			
	June 30, 2017	July 1, 2016	Dollar change	Percent change	June 30, 2017	July 1, 2016	Dollar change	Percent change
(dollars in millions)								
Revenues	\$ 1,243	\$ 785	\$ 458	58.3%	\$ 2,537	\$ 1,565	\$ 972	62.1%
Operating income	63	60	3	5.0%	142	131	11	8.4%
Operating income margin	5.1%	7.6%			5.6%	8.4%		

The revenue increases for the three and six months ended June 30, 2017 as compared to the three and six months ended July 1, 2016, were primarily attributable to the acquired IS&GS Business of \$468 million and \$993 million, respectively, and growth in airborne programs. The increase was partially offset by reduced scope and completion of certain contracts.

The increase in operating income for the three months ended June 30, 2017 as compared to the three months ended July 1, 2016, was primarily due to strong performance on certain contracts.

The increase in operating income for the six months ended June 30, 2017 as compared to the six months ended July 1, 2016, was primarily due to net operating income from the acquired IS&GS Business of \$16 million and strong performance on certain contracts, partially offset by reduced scope and completion of certain contracts.

Civil	Three Months Ended				Six Months Ended			
	June 30, 2017	July 1, 2016	Dollar change	Percent change	June 30, 2017	July 1, 2016	Dollar change	Percent change
(dollars in millions)								
Revenues	\$ 875	\$ 300	\$ 575	191.7%	\$ 1,717	\$ 661	\$ 1,056	159.8%
Operating income	66	20	46	NM	120	42	78	185.7%
Operating income margin	7.5%	6.7%			7.0%	6.4%		

NM - Not meaningful

The revenue increases for the three and six months ended June 30, 2017 as compared to the three and six months ended July 1, 2016, were primarily attributable to the acquired IS&GS Business of \$632 million and \$1,218 million, respectively, partially offset by the divestiture of the heavy construction business in fiscal 2016 of \$17 million and \$103 million, respectively, reduced scope and completion of certain contracts, and the adverse impact of foreign currency of \$7 million and \$17 million, respectively.

The adverse impact of foreign currency was primarily due to the movement of the exchange rate between the U.S. dollar and the British pound.

The increase in operating income for the three and six months ended June 30, 2017 as compared to the three and six months ended July 1, 2016, were primarily due to net operating income from the acquired IS&GS Business of \$41 million and \$72 million, respectively.

Health	Three Months Ended				Six Months Ended			
	June 30, 2017	July 1, 2016	Dollar change	Percent change	June 30, 2017	July 1, 2016	Dollar change	Percent change
(dollars in millions)								
Revenues	\$ 454	\$ 203	\$ 251	123.6%	\$ 897	\$ 374	\$ 523	139.8%
Operating income	74	18	56	NM	121	34	87	NM
Operating income margin	16.3%	8.9%			13.5%	9.1%		

NM - Not meaningful

The revenue increase for the three months ended June 30, 2017 as compared to the three months ended July 1, 2016, was primarily attributable to the acquired IS&GS Business of \$271 million, partially offset by lower revenues from our commercial health business due to timing.

LEIDOS HOLDINGS, INC.

The revenue increase for the six months ended June 30, 2017 as compared to the six months ended July 1, 2016, was primarily attributable to the acquired IS&GS Business of \$524 million and growth in our federal health business, partially offset by lower revenues from our commercial health business due to timing.

The increases in operating income for the three and six months ended June 30, 2017 as compared to the three and six months ended July 1, 2016, were primarily due to net operating income from the acquired IS&GS Business of \$58 million and \$90 million, respectively.

Corporate expenses	Three Months Ended				Six Months Ended			
	June 30, 2017	July 1, 2016	Dollar change	Percent change	June 30, 2017	July 1, 2016	Dollar change	Percent change
	(dollars in millions)							
Revenues	\$ (1)	\$ —	\$ (1)	NM	\$ —	\$ —	\$ —	NM
Operating loss	(37)	(23)	(14)	60.9%	(76)	(43)	(33)	76.7%

NM - Not meaningful

The increases in operating loss for the three and six months ended June 30, 2017 as compared to the three and six months ended July 1, 2016, were primarily driven by increases of \$5 million and \$18 million, respectively, of restructuring expenses due to severance costs and lease termination expenses and increases of \$1 million and \$11 million, respectively, of acquisition and integration costs related to the acquired IS&GS Business.

Restructuring expenses include costs associated with optimization of our real estate portfolio and severance costs associated with reducing headcount. We anticipate this restructuring program to last through fiscal 2020, and expect to incur a total of approximately \$112 million in connection with these restructuring activities.

*Non-Operating Expense, net*

Non-operating expense, net for the three and six months ended June 30, 2017, increased \$16 million and \$38 million, respectively, as compared to the three and six months ended July 1, 2016, primarily due to interest expense associated with our term loans secured in connection with the Transactions. The increase in expense was partially offset by an increase in foreign currency exchange gains, mostly due to the movement of the exchange rate between the U.S. dollar and the British pound.

*Provision for Income Taxes*

For the three months ended June 30, 2017, our effective tax rate was 27.4% compared to 31.7% for the three months ended July 1, 2016. The decrease was primarily related to the settlement of share based awards in accordance with ASU 2016-09 and the impact of foreign and state related items.

For the six months ended June 30, 2017, our effective tax rate was 29.2% compared to 31.9% for the six months ended July 1, 2016. The decrease was primarily due to the settlement of share based awards in accordance with ASU 2016-09 and the impact of foreign related items, partially offset by state related items.

*Non-controlling Interest*

Net income attributable to non-controlling interest of \$2 million for the six months ended June 30, 2017, relates to our interest in Mission Support Alliance, LLC, a joint venture with Jacobs Engineering Group, Inc. and Centerra Group, LLC, acquired as part of the Transactions.

**Bookings and Backlog**

We received net bookings worth an estimated \$2.7 billion and \$4.4 billion during the three and six months ended June 30, 2017, respectively, compared to \$1.0 billion and \$2.2 billion for the three and six months ended July 1, 2016, respectively.

## LEIDOS HOLDINGS, INC.

Backlog estimates are subject to change and may be affected by factors including modifications of contracts and foreign currency movements. The estimated value of our total backlog was as follows:

	June 30, 2017	December 30, 2016
(in millions)		
<b>Defense Solutions:</b>		
Funded backlog	\$ 2,326	\$ 3,171
Negotiated unfunded backlog	5,064	4,936
Total Defense Solutions backlog	<u>\$ 7,390</u>	<u>\$ 8,107</u>
<b>Civil:</b>		
Funded backlog	\$ 2,007	\$ 1,950
Negotiated unfunded backlog	4,883	5,250
Total Civil backlog	<u>\$ 6,890</u>	<u>\$ 7,200</u>
<b>Health:</b>		
Funded backlog	\$ 660	\$ 854
Negotiated unfunded backlog	2,151	1,575
Total Health backlog	<u>\$ 2,811</u>	<u>\$ 2,429</u>
<b>Total:</b>		
Funded backlog	\$ 4,993	\$ 5,975
Negotiated unfunded backlog	12,098	11,761
Total backlog	<u>\$ 17,091</u>	<u>\$ 17,736</u>

Total backlog at June 30, 2017 included \$120 million of benefit due to the impact of foreign currency movement between the U.S. dollar and the British pound.

**Liquidity and Capital Resources***Overview*

As of June 30, 2017, we had \$262 million in cash and cash equivalents. In addition, we have a secured revolving credit facility which can provide up to \$750 million in secured borrowing capacity, if required. During the six months ended June 30, 2017, there were no borrowings outstanding under the credit facility and we were in compliance with related financial covenants.

At June 30, 2017, and December 30, 2016, we had outstanding debt of \$3.2 billion and \$3.3 billion, respectively. In addition to the required quarterly payments on our term loans, we repaid \$25 million of our senior secured \$400 million Term Loan A, due August 2019, on June 30, 2017. The notes outstanding as of June 30, 2017, contain financial covenants and customary restrictive covenants. We were in compliance with all covenants as of June 30, 2017.

We paid dividends of \$52 million and \$102 million during the three and six months ended June 30, 2017, respectively, and \$23 million and \$46 million during the three and six months ended July 1, 2016, respectively.

For the next 12 months, we anticipate that we will be able to meet our liquidity needs, including servicing our debt, through cash generated from operations, available cash balances and, if needed, borrowings from our revolving credit facility.

*Summary of Cash Flows*

The following table summarizes cash flow information for the periods presented:

	Six Months Ended	
	June 30, 2017	July 1, 2016
	(in millions)	
Net cash provided by operating activities of continuing operations	\$ 89	\$ 58
Net cash (used in) provided by investing activities of continuing operations	(14)	18
Net cash used in financing activities of continuing operations	(189)	(61)
Net (decrease) increase in cash and cash equivalents from continuing operations	(114)	15
Net decrease in cash and cash equivalents from discontinued operations	—	(1)
Net (decrease) increase in cash and cash equivalents	\$ (114)	\$ 14

Net cash provided by operating activities of continuing operations increased \$31 million for the six months ended June 30, 2017, when compared to the prior year, primarily due to the favorable timing of working capital changes, partially offset by higher payments for taxes and interest, restructuring and integration expenses.

Net cash (used in) provided by investing activities of continuing operations increased \$32 million for the six months ended June 30, 2017, when compared to the prior year, primarily due to higher purchases of property, plant and equipment and proceeds received from the divestiture of the heavy construction business in fiscal 2016.

Net cash used in financing activities of continuing operations increased \$128 million for the six months ended June 30, 2017, when compared to the prior year, primarily due to higher dividend payments of \$56 million and increased payments of long-term debt of \$67 million.

**Off-Balance Sheet Arrangements**

We have outstanding performance guarantees and cross-indemnity agreements in connection with certain aspects of our business. We also have letters of credit outstanding principally related to guarantees on contracts and surety bonds outstanding principally related to performance and payment bonds as described in "Note 16—Commitments" of the notes to the condensed consolidated financial statements contained within this Quarterly Report on Form 10-Q. These arrangements have not had, and management does not believe it is likely that they will in the future have, a material effect on our liquidity, capital resources, operations or financial condition.

**Commitments and Contingencies**

We are subject to a number of reviews, investigations, claims, lawsuits, other uncertainties and future obligations related to our business. For a discussion of these items, see "Note 15—Contingencies" and "Note 16—Commitments" of the notes to the condensed consolidated financial statements contained within this Quarterly Report on Form 10-Q.

**Critical Accounting Policies**

There were no material changes to our critical accounting policies, estimates or judgments that occurred in the quarterly period covered by this report from those discussed in our Annual Report on Form 10-K for the year ended December 30, 2016.

**Recently Adopted and Issued Accounting Pronouncements**

For a discussion of these items, see "Note 1—Basis of Presentation and Summary of Significant Accounting Policies" of the notes to the condensed consolidated financial statements contained within this Quarterly Report on Form 10-Q.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

During the six months ended June 30, 2017, there were no material changes in our market risk exposure. For a discussion of our market risk associated with interest rate risk and foreign currency risk as of December 30, 2016, see "Quantitative and Qualitative Disclosures about Market Risk" in Part II of our Annual Report on Form 10-K for the year ended December 30, 2016.

**Item 4. Controls and Procedures.**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our principal executive officer (our Chairman and Chief Executive Officer) and principal financial officer (our Executive Vice President and Chief Financial Officer), has evaluated the effectiveness of Leidos' disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) as of June 30, 2017. Based upon that evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the U.S. Securities and Exchange Commission. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control Over Financial Reporting**

As part of our integration of the IS&GS Business, we continue to integrate controls and related procedures with respect to the acquired operations. Other than incorporating the IS&GS Business controls, there have been no other changes in Leidos' internal control over financial reporting that occurred in the quarterly period covered by this report that materially affected, or are reasonably likely to materially affect, Leidos' internal control over financial reporting.

## LEIDOS HOLDINGS, INC.

## PART II—OTHER INFORMATION

**Item 1. Legal Proceedings.**

We have furnished information relating to legal proceedings, and any investigations and reviews that we are involved with in "Note 15—Contingencies" of the notes to the condensed consolidated financial statements contained within this Quarterly Report on Form 10-Q.

**Item 1A. Risk Factors.**

There were no material changes from the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 30, 2016.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

(a) None

(b) None

(c) Purchases of Equity Securities by the Company

In December 2013, our Board of Directors authorized us to establish a stock repurchase program under which we may repurchase up to 20 million shares of Leidos common stock. Stock repurchases may be made on the open market or in privately negotiated transactions with third parties including through accelerated share repurchase agreements. The timing and number of share repurchases depends on a variety of factors including price, corporate capital requirements, other market conditions and regulatory requirements. The repurchase authorization may be accelerated, suspended, delayed or discontinued at any time. Pursuant to the Tax Matters Agreement entered into in connection with the Transactions, we are generally restricted from repurchasing our stock for a two-year period following the closing date of the Transactions.

The following table presents repurchases of Leidos common stock during the quarter ended June 30, 2017:

Period	Total Number of Shares (or Units) Purchased <sup>(1)</sup>	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Repurchase Plans or Programs	Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
April 1, 2017 - April 30, 2017	15,139	\$ 50.65	—	5,718,172
May 1, 2017 - May 31, 2017	24,447	52.87	—	5,718,172
June 1, 2017 - June 30, 2017	21,845	55.32	—	5,718,172
Total	61,431	53.20	—	

<sup>(1)</sup> The total number of shares purchased includes: (i) shares surrendered to satisfy statutory tax withholdings obligations related to vesting of restricted stock units; and (ii) shares purchased upon surrender by stockholders of previously owned shares in payment of the exercise price of non-qualified stock options and/or to satisfy statutory tax withholdings obligations.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

None.

## LEIDOS HOLDINGS, INC.

**Item 6. Exhibits.**

Exhibit Number	Description of Exhibit
10.1	Amended and Restated Leidos Holdings, Inc.'s 2006 Employee Stock Purchase Plan.
10.2	Leidos Holdings, Inc.'s 2017 Omnibus Incentive Plan. Incorporated by reference to Exhibit 4.3 to our Registration Statement on Form S-3 filed with the SEC on June 1, 2017.
10.3	Retirement Agreement dated June 5, 2017, between Leidos Holdings, Inc. and Vincent A. Maffeo. Incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the SEC on June 9, 2017.
31.1	Certification of Chairman and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Executive Vice President and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chairman and 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	Certification of Executive Vice President and 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	Interactive Data File.

**LEIDOS HOLDINGS, INC.**

**SIGNATURES**

Pursuant to the requirements 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.

Date: August 4, 2017

Leidos Holdings, Inc.

/s/ James C. Reagan

---

**James C. Reagan**  
**Executive Vice President and Chief Financial Officer and**  
**as a duly authorized officer**



**2006 EMPLOYEE STOCK PURCHASE PLAN  
(Amended and Restated Effective September 8, 2016)**

**1. Establishment of Plan.**

Leidos Holdings, Inc. (the “*Company*”) proposes to grant options for purchase of the Company’s Common Stock as determined by the Committee to eligible Employees of the Company and its Participating Subsidiaries pursuant to this 2006 Employee Stock Purchase Plan (this “*Plan*”). This Plan is an omnibus document which includes a Section 423 Plan Component designed to qualify as an “employee stock purchase plan” under Section 423 of the Code, although the Company makes no undertaking or representation to maintain such qualification. In addition, the Plan authorizes the grant of options under a Non-423 Plan Component pursuant to rules, procedures or sub-plans adopted by the Board (or its designate). To the extent that the Company grants options to Employees of its Affiliates under this Plan, such grants shall be made only under the Non-423 Plan Component.

The Section 423 Plan Component shall be a separate and independent plan from the Non-423 Plan Component, provided, however, that the total number of Shares authorized to be issued under the Plan applies in the aggregate to both the Section 423 Plan Component and the Non-423 Plan Component. Offerings under the Non-423 Plan Component may be made to achieve desired tax or other objectives in particular locations outside the United States of America or to comply with local laws applicable to offerings in such foreign jurisdictions. In the event of a conflict between the terms of the Non-423 Plan Component and the terms of this Plan, then with the exception of Sections 3, 11(c), 15 and 25 with respect to the total number of Shares available to be offered under the Plan for all sub-plans, the terms of the Non-423 Plan Component will control. Except to the extent expressly set forth herein or where the context suggests otherwise, any reference herein to “Plan” shall be construed to include a reference to both the Section 423 Plan Component and the Non-423 Plan Component.

All eligible Employees shall have equal rights and privileges with respect to this Plan so that the Section 423 Plan Component qualifies as an “employee stock purchase plan” within the meaning of Section 423 of the Code, except for differences that may be mandated by local law and that are consistent with Code Section 423(b)(5). Participants participating in the Non-423 Plan Component by means of rules, procedures or sub-plans adopted pursuant to Section 20 need not have the same rights and privileges as participants participating in the Section 423 Plan Component.

The purpose of this Plan is to provide eligible Employees of the Company and Participating Subsidiaries with a convenient means of acquiring an equity interest in the Company through payroll deductions, to align the interests of such Employees with those of the Company’s stockholders, and to provide an incentive for continued employment.

**2. Definitions.**

Any term not expressly defined in this Plan but defined for purposes of Section 423 of the Code shall have the same definition herein. In addition, this Plan uses the following defined terms:

“*Affiliate*” means any entity other than a Subsidiary in which the Company has a controlling interest and which is not a “subsidiary corporation” as defined in Section 424(f) of the Code.

“*Board*” means the Board of Directors of the Company.

“*Code*” means the Internal Revenue Code of 1986, as amended.

“*Committee*” means a management, administrative or other committee of the Company as established by the Board or committee of the Board.

“*Common Stock*” means the common stock of the Company, par value \$0.0001 per share.

“*Company*” means Leidos Holdings, Inc., a Delaware corporation.

“*Compensation*” means the definition of Compensation established by the Committee, which definition shall comply with Treasury Regulation Section 1.423-2(f).

**“Employee”** means any individual who is an employee of the Company or a Participating Subsidiary. Whether an individual qualifies as an Employee shall be determined by the Committee, in its sole discretion. The Committee shall be guided by the provisions of Treasury Regulation Section 1.423-2(e) and Section 3401(c) of the Code and the Treasury Regulations thereunder as to Employees in the United States, with the intent that the Plan cover all “employees” within the meaning of those provisions other than those who are not eligible to participate in the Plan, provided, however, that any determinations regarding whether an individual is an “Employee” shall be prospective only, unless otherwise determined by the Committee. Unless the Committee makes a contrary determination, the Employees of the Company shall, for all purposes of this Plan, be those individuals who are employees of the Company or a Participating Subsidiary for regular payroll purposes or are on a leave of absence for not more than 90 days. Any inquiries regarding eligibility to participate in the Plan shall be directed to the Committee, whose decision shall be final.

**“Fair Market Value”** means the value of a Share as determined as follows. If the Shares are listed on any established stock exchange or quoted on a national market system, including, without limitation, the New York Stock Exchange or the NASDAQ Stock Market, the Fair Market Value shall be the closing price of a Share as quoted on such exchange or system on the day before the date for which the value is being determined (or if no sales were reported, the closing price on the trading date immediately preceding such date), as reported by The Wall Street Journal. In the absence of an established market for the Shares, the Fair Market Value shall be determined in good faith by the Committee and such determination shall be conclusive and binding on all persons.

**“Maximum Share Amount”** means a maximum number of Shares which may be purchased by any Employee at any single Purchase Date. Prior to the commencement of any Offering Period or prior to such time period as specified by the Committee, the Committee may, in its sole discretion, set a Maximum Share Amount. If the Committee does not set a Maximum Share Amount, the Maximum Share Amount shall be 1,000 Shares. If a new Maximum Share Amount is set, then all participants must be notified of such Maximum Share Amount prior to the commencement of the next Offering Period. The Maximum Share Amount shall continue to apply with respect to all succeeding Purchase Dates and Offering Periods unless revised by the Committee as set forth above.

**“Non-423 Plan Component”** means a component of this Plan which does not qualify under Section 423 of the Code.

**“Notice Period”** means the period within two (2) years from the Offering Date relating to the applicable Shares or one (1) year from the Purchase Date on which the applicable Shares were purchased.

**“Offering Date”** means the first business day of each Offering Period.

**“Offering Period”** means a period commencing and ending on those dates determined by the Committee. The Offering Periods of this Plan may be up to twenty-four (24) months in duration and may consist of up to eight (8) Purchase Periods during which payroll deductions of the participants are accumulated under this Plan. However, unless and until determined otherwise by the Committee, each Offering Period shall have a duration of three months and shall commence on April 1, July 1, October 1 or January 1 and each Offering Period shall have only one Purchase Period which shall run simultaneously with the Offering Period.

The duration and timing of Offering Periods may be changed pursuant to Section 6, Section 15 and Section 25 of this Plan, provided that no Offering Period shall exceed a period of twenty-four (24) months.

**“Parent Corporation”** shall have the same meaning as “parent corporation” in Section 424(e) of the Code.

**“Participating Subsidiaries”** means Leidos, Inc. and such Parent Corporations, Subsidiaries or Affiliates that the Board designates from time to time as corporations that shall participate in this Plan.

**“Plan”** means this 2006 Employee Stock Purchase Plan of the Company.

**“Purchase Date”** means the last business day of each Purchase Period.

**“Purchase Period”** means a period commencing and ending on those dates determined by the Committee. However, unless and until determined otherwise by the Committee, each Purchase Period shall have a duration of three (3) months and shall be coincident with an Offering Period. The duration and timing of Purchase Periods may be changed pursuant to Section 6, Section 15 and Section 25 of this Plan, provided that no Purchase Period shall exceed a period of six (6) months, other than the first purchase period commencing after adoption of this restatement.

**“Reserves”** means the number of Shares covered by each option under this Plan which has not yet been exercised and the number of Shares which have been authorized for issuance under this Plan, but have not yet been placed under option.

**“Section 423 Plan Component”** means the component of the Plan designed to qualify as an “employee stock purchase plan” under Section 423 of the Code.

**“Share”** means a share of Common Stock.

“*Subsidiary*” shall have the same meaning as “subsidiary corporation” in Section 424(f) of the Code.

### **3. Number of Shares.**

The maximum number of Shares that will be offered under the Plan after September 8, 2016 through the remaining term of this Plan is 5,000,000 Shares, subject to adjustment as permitted under Section 15.

### **4. Administration.**

This Plan shall be administered by the Committee, including (a) prescribing, amending and rescinding rules and regulations relating to the Plan; (b) prescribing forms for carrying out the provisions and purposes of the Plan; (c) interpreting the Plan; and (d) making all other determinations deemed necessary or advisable for the administration of the Plan, including factual determinations. Subject to the provisions of this Plan, the Committee shall have all authority to (i) determine and change the percentage discount pursuant to Section 9, (ii) determine and change the Offering Periods and Offering Dates pursuant to Section 6, (iii) determine and change the purchase price for Shares pursuant to Section 9, (iv) prescribe minimum holding periods for the Shares issued under this Plan, and (v) prescribe, amend and rescind rules and regulations relating to this Plan. All decisions of the Committee shall be final and binding upon all participants. Members of the Committee shall receive no compensation for their services in connection with the administration of this Plan, other than standard fees as established from time to time by the Board for services rendered by Board members serving on Board committees. All expenses incurred in connection with the administration of this Plan shall be paid by the Company.

In its rules and procedures for the administration of the Plan (including, without limitation, procedures covering any directions, elections, or other actions by Employees, and the delivery of statements and other disclosure materials to such individuals), the Committee may provide for the use of electronic communications and other media in a manner consistent with any applicable laws.

### **5. Eligibility.**

Any Employee of the Company or the Participating Subsidiaries is eligible to participate in an Offering Period under this Plan except the following:

- (a) Employees who are not employed by the Company or a Participating Subsidiary prior to the beginning of such Offering Period or prior to such other time period as specified by the Committee;
- (b) Employees who, as a result of being granted an option under this Plan with respect to such Offering Period, would, together with any other person whose stock would be attributed to such Employee pursuant to Section 424(d) of the Code, own stock or hold options to purchase stock possessing five percent (5%) or more of the total combined voting power or value of all classes of stock of the Company or any of its Subsidiaries or any Parent Corporation;
- (c) individuals who provide services to the Company or any of its Participating Subsidiaries as independent contractors who are reclassified as common law employees for any reason, provided that this exclusion will not apply if such individuals are considered employees for purposes of Section 423 of the Code; and
- (d) Employees who reside in countries for whom such Employees’ participation in the Plan would result in a violation under any corporate or securities laws of such country of residence.

Individuals who are not Employees of the Company or a Participating Subsidiary shall not be eligible to participate in an Offering Period.

### **6. Offering Dates.**

The Committee shall have the power to change the Offering Dates, the Purchase Dates and the duration of Offering Periods or Purchase Periods without stockholder approval if such change is announced prior to the relevant Offering Period or prior to such other time period as specified by the Committee.

### **7. Participation in this Plan.**

Eligible Employees may become participants in an Offering Period under this Plan on the Offering Date, after satisfying the eligibility requirements, by delivering a subscription agreement to the Company prior to such Offering Date, or such other time period as specified by the Committee. An eligible Employee who does not deliver a subscription agreement to the Company after becoming eligible to participate in an Offering Period shall not participate in that Offering Period or any subsequent Offering Period unless such Employee enrolls in this Plan by delivering a subscription agreement to the Company prior to such Offering Period, or such other time

period as specified by the Committee. Once an Employee becomes a participant in an Offering Period by filing a subscription agreement, such Employee shall automatically participate in the Offering Period commencing immediately following the last day of the prior Offering Period unless the Employee withdraws or is deemed to withdraw from this Plan or terminates further participation in the Offering Period as set forth in Section 12 below. Such participant is not required to file any additional subscription agreement in order to continue participation in this Plan.

#### **8. Grant of Option on Enrollment.**

Enrollment by an eligible Employee in this Plan with respect to an Offering Period shall constitute the grant (as of the Offering Date) by the Company to such Employee of an option to purchase on the Purchase Date up to that number of Shares determined by a fraction, the numerator of which is the amount accumulated in such Employee's payroll deduction account during such Purchase Period and the denominator of which is the purchase price per Share determined under Section 9, provided, however, that the number of Shares subject to any option granted pursuant to this Plan shall not exceed the lesser of (x) the maximum number of Shares set by the Committee pursuant to Section 11(c) below with respect to the applicable Purchase Date, or (y) the maximum number of Shares which may be purchased pursuant to Section 11(b) below with respect to the applicable Purchase Date. Notwithstanding the foregoing, in the event of a change in generally accepted accounting principles which would adversely affect the accounting treatment applicable to any current Offering Period, the Committee may make such changes to the number of Shares purchased at the end of the Purchase Period or the purchase price paid as are allowable under generally accepted accounting principles and as it deems necessary in the sole discretion of the Committee to avoid or minimize adverse accounting consequences.

#### **9. Purchase Price.**

The purchase price per Share at which a Share shall be sold in any Offering Period shall be as determined by the Committee but no less than eighty-five percent (85%) of the lesser of the Fair Market Value of the Shares on the Offering Date or the Fair Market Value of the Shares on the Purchase Date.

#### **10. Payment of Purchase Price; Changes in Payroll Deductions; Issuance of Shares.**

(a) The purchase price of the Shares is accumulated by regular payroll deductions made during each Offering Period. The deductions are made as a percentage of the participant's Compensation in one percent (1%) increments, not less than one percent (1%), nor greater than ten percent (10%), or such lower limit set by the Committee. Payroll deductions shall commence on the first payday of the Offering Period and shall continue to the end of the Offering Period unless sooner altered or terminated as provided in this Plan. If payroll deductions are not permitted in a jurisdiction, participants in that jurisdiction may contribute via check or pursuant to another method approved by the Committee.

(b) A participant may increase or decrease the rate of payroll deductions during an Offering Period by filing with the Company a new authorization for payroll deductions, in which case the new rate shall become effective for the next payroll period commencing after the Company's receipt and processing of the authorization and shall continue for the remainder of the Offering Period unless changed as described below. Such change in the rate of payroll deductions may be made at any time during an Offering Period. The Committee shall have the authority to impose restrictions on the number of increases or decreases a participant may make within an Offering Period as set forth in this Subsection (b).

(c) All payroll deductions made for a participant are credited to his or her account under this Plan and are deposited with the general funds of the Company. No interest accrues on the payroll deductions, unless required by local law. All payroll deductions received or held by the Company may be used by the Company for any corporate purpose, and the Company shall not be obligated to segregate such payroll deductions, unless required by local law.

(d) On each Purchase Date, for so long as this Plan remains in effect, and provided that the participant has not submitted a signed and completed withdrawal form before that date, which notifies the Company that the participant wishes to withdraw from that Offering Period under this Plan and have all payroll deductions accumulated in the account maintained on behalf of the participant, as of that date returned to the participant, the Company shall apply the funds then in the participant's account to the purchase of whole and fractional Shares reserved under the option granted to such participant with respect to the Offering Period to the extent that such option is exercisable on the Purchase Date. The purchase price per Share shall be as specified in Section 9 of this Plan. In the event that this Plan has been oversubscribed, all funds not used to purchase Shares on the Purchase Date shall be returned to the participant, without interest. No Share shall be purchased on a Purchase Date on behalf of any Employee whose participation in this Plan has terminated prior to such Purchase Date.

(e) As soon as practicable after the Purchase Date, the Company shall issue Shares for the participant's benefit representing the Shares purchased upon exercise of his or her option.

(f) During a participant's lifetime, his or her option to purchase Shares hereunder is exercisable only by him or her. The

participant shall have no interest or voting rights in Shares covered by his or her option until such option has been exercised and Shares have been issued to the participant.

(g) Payroll deductions shall be suspended for any participant as required under the Code and the terms of any Code section 401(k) plan upon a participant's receipt of a hardship withdrawal under such a plan.

#### **11. Limitations on Shares to be Purchased.**

(a) No participant shall be entitled to purchase stock under this Plan at a rate which, when aggregated with his or her rights to purchase stock under all other employee stock purchase plans of the Company or any Subsidiary, exceeds \$25,000 in Fair Market Value, determined as of the Offering Date (or such other limit as may be imposed by the Code) for each calendar year in which the Employee participates in this Plan. The Company shall have the authority to take all necessary action, including but not limited to, suspending the payroll deductions of any participant, in order to ensure compliance with this Section.

(b) No participant shall be entitled to purchase more than the Maximum Share Amount on any single Purchase Date.

(c) If the number of Shares to be purchased on a Purchase Date by all Employees participating in this Plan exceeds the number of Shares then available for issuance under this Plan, then the Company shall make a pro rata allocation of the remaining Shares in as uniform a manner as shall be reasonably practicable and as the Committee shall determine to be equitable. In such event, the Company shall give written notice of such reduction of the number of Shares to be purchased under a participant's option to each participant affected.

(d) Any payroll deductions accumulated in a participant's account which are not used to purchase stock due to the limitations in this Section 11 shall be returned to the participant as soon as practicable after the end of the applicable Purchase Period, without interest unless required by local law.

#### **12. Withdrawal.**

(a) Each participant may withdraw from an Offering Period under this Plan by signing and delivering to the Company a written notice to that effect on a form provided for such purpose. Such withdrawal may be elected at any time prior to the end of an Offering Period, or such other time period as specified by the Committee.

(b) Upon withdrawal from this Plan prior to the deadline established by the Committee, the accumulated payroll deductions shall be returned to the withdrawn participant, without interest, and his or her interest in this Plan shall terminate. In the event a participant voluntarily elects to withdraw from this Plan, he or she may not resume his or her participation in this Plan during the same Offering Period, but he or she may participate in any Offering Period under this Plan which commences on a date subsequent to such withdrawal by filing a new authorization for payroll deductions in the same manner as set forth in Section 7 above for initial participation in this Plan.

#### **13. Termination of Employment.**

Termination of a participant's employment for any reason, including retirement, death or the failure of a participant to remain an eligible Employee of the Company or of a Participating Subsidiary, shall immediately terminate his or her participation in this Plan. In such event, the payroll deductions credited to the participant's account shall be returned to him or her or, in the case of his or her death, to his or her legal representative, without interest. For purposes of this Section 13, an Employee shall not be deemed to have terminated employment or failed to remain in the continuous employ of the Company or of a Participating Subsidiary in the case of sick leave, military leave, or any other leave of absence approved by the Board or Committee, provided, however that such leave is for a period of not more than ninety (90) days or reemployment upon the expiration of such leave is guaranteed by contract or statute. Whether and when employment is deemed terminated for purposes of this Plan shall be determined by the Committee in its sole discretion and may be determined without regard to statutory notice periods or other periods following termination of active employment.

#### **14. Return of Payroll Deductions.**

In the event a participant's interest in this Plan is terminated by withdrawal, termination of employment or otherwise prior to the withdrawal deadline established by the Committee, or in the event this Plan is terminated by the Board, the Company shall deliver to the participant all payroll deductions credited to such participant's account. No interest shall accrue on the payroll deductions of a participant in this Plan, unless required by local law. In the event a participant dies with payroll deductions having been accumulated to purchase Shares at the next Purchase Date, and the Committee receives notice of such death prior to the withdrawal deadline established by the Committee, the Company shall deliver to the estate of the participant all payroll deductions credited to such participant's account.

## **15. Capital Changes.**

Subject to any required action by the stockholders of the Company, the Reserves, as well as the price per Share covered by each option under this Plan which has not yet been exercised, and limits on the number of Shares that may be purchased by an Employee, shall be proportionately adjusted for any increase or decrease in the number of issued and outstanding Shares resulting from a stock split or the payment of a stock dividend (but only on the Shares), any other increase or decrease in the number of issued and outstanding Shares effected without receipt of any consideration by the Company or other change in the corporate structure or capitalization affecting the Company's present Shares, provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Committee, whose determination shall be final, binding and conclusive. Except as expressly provided herein, no issue by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Shares subject to an option.

In the event of the proposed dissolution or liquidation of the Company, the Offering Period shall terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Committee. The Committee may, in the exercise of its sole discretion in such instances, declare that this Plan shall terminate as of a date fixed by the Committee and give each participant the right to purchase Shares under this Plan prior to such termination. In the event of (i) a merger or consolidation in which the Company is not the surviving corporation (other than a merger or consolidation with a wholly-owned subsidiary, a reincorporation of the Company in a different jurisdiction, or other transaction in which there is no substantial change in the stockholders of the Company or their relative stock holdings and the options under this Plan are assumed, converted or replaced by the successor corporation, which assumption shall be binding on all participants), (ii) a merger in which the Company is the surviving corporation but after which the stockholders of the Company immediately prior to such merger (other than any stockholder that merges, or which owns or controls another corporation that merges, with the Company in such merger) cease to own their shares or other equity interest in the Company, (iii) the sale of all or substantially all of the assets of the Company, or (iv) the acquisition, sale, or transfer of more than fifty percent (50%) of the outstanding shares of the Company by tender offer or similar transaction, the Plan shall continue with regard to Offering Periods that commenced prior to the closing of the proposed transaction and Shares shall be purchased based on the Fair Market Value of the surviving corporation's stock on each Purchase Date, unless otherwise provided by the Committee.

The Committee may, if it so determines in the exercise of its sole discretion, also make provision for adjusting the Reserves, as well as the price per Share covered by each outstanding option, and limits on the number of Shares that may be purchased by an Employee, in the event that the Company effects one or more reorganizations, recapitalizations, rights offerings or other increases or reductions of its outstanding Shares, or in the event of the Company being consolidated with or merged into any other corporation.

## **16. Nonassignability.**

Neither payroll deductions credited to a participant's account nor any rights with regard to the exercise of an option or to receive Shares under this Plan may be assigned, transferred, pledged or otherwise disposed of in any way (other than by will, the laws of descent and distribution) by the participant. Any such attempt at assignment, transfer, pledge or other disposition shall be void and without effect.

## **17. Reports.**

Individual accounts shall be maintained for each participant in this Plan. Each participant shall receive, as soon as practicable after the end of each Purchase Period, a report in written or electronic form of his or her account setting forth the total payroll deductions accumulated, the number of Shares purchased, and the per Share price thereof.

## **18. Notice of Disposition.**

Each participant shall notify the Company in writing if the participant disposes of any of the Shares purchased in any Offering Period pursuant to this Plan if such disposition occurs within the Notice Period. The Company may, at any time during the Notice Period, place a legend or legends on any certificate representing Shares acquired pursuant to this Plan requesting the Company's transfer agent to notify the Company of any transfer of the Shares. The obligation of the participant to provide such notice shall continue notwithstanding the placement of any such legend on the certificates.

## **19. No Rights to Continued Employment.**

(a) An Employee's employment with the Company or a Subsidiary is not for any specified term and may be terminated by such Employee or by the Company or a Subsidiary at any time, for any reason, with or without cause and with or without notice. Nothing in this Plan or any covenant of good faith and fair dealing that may be found implicit in this Plan shall (i) confer upon any Employee any right to continue in the employ of, or affiliation with, the Company or a Subsidiary; (ii) constitute any promise or commitment by the Company or a Subsidiary regarding the fact or nature of future positions, future work assignments, future

compensation or any other term or condition of employment or affiliation; (iii) confer any right or benefit under this Plan unless such right or benefit has specifically accrued under the terms of this Plan; or (iv) deprive the Company of the right to terminate the Employee at will.

(b) The right to continue participation in this Plan is conditioned on a participant's continuing as an Employee at the will of the Company or a Subsidiary and the Company has the right to reorganize, sell, spin-out or otherwise restructure one or more of its businesses at any time or from time to time, as it deems appropriate (a "reorganization"). Such a reorganization could result in the termination of a participant's relationship as an Employee or the termination of the participant's employer's status as a Participating Subsidiary and the loss of benefits available to the participant under this Plan.

## **20. Additional Provisions to Comply with Local Law.**

The Committee may from time to time establish one or more sub-plans under the Plan for purposes of satisfying applicable laws of state and local domestic United States and non-United States jurisdictions. The Committee shall establish such sub-plans by adopting supplements to this Plan containing such additional terms and conditions not otherwise inconsistent with the Plan as the Committee shall deem necessary or desirable. To the extent inconsistent with the requirements of Code Section 423, such sub-plans and/or supplements shall be considered part of the Non-423 Plan Component, and the options granted thereunder shall not be considered to comply with Code Section 423. All supplements adopted by the Committee shall be deemed to be part of the Plan and the Company shall not be required to provide copies of any supplement to participants in any jurisdiction that is not the subject of such supplement.

## **21. Notices.**

All notices or other communications by a participant to the Company under or in connection with this Plan shall be deemed to have been duly given when received in the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof.

## **22. Term; Stockholder Approval.**

The restatement of this Plan shall be approved by the stockholders of the Company, in any manner permitted by applicable corporate law, within twelve (12) months before or after the date the restatement of this Plan is adopted by the Board. No purchase of Shares pursuant to this Plan shall occur prior to such stockholder approval. This Plan shall continue until the earlier to occur of (a) termination of this Plan by the Board (which termination may be effected by the Board at any time), (b) issuance of all of the Shares available for issuance under this Plan, or (c) ten (10) years from the approval of the restatement of this Plan by the stockholders.

## **23. Conditions Upon Issuance of Shares; Limitation on Sale of Shares.**

Shares shall not be issued with respect to an option unless the exercise of such option and the issuance and delivery of such Shares pursuant thereto shall comply with all applicable provisions of law, domestic or foreign, including, without limitation, the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the rules and regulations promulgated thereunder, and the requirements of any stock exchange or automated quotation system upon which the Shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

## **24. Applicable Law.**

The Plan shall be governed by the substantive laws (excluding the conflict of laws rules) of the State of Delaware.

## **25. Amendment or Termination.**

The Board may at any time amend or terminate this Plan, except that any such termination cannot affect options previously granted under this Plan, nor may any amendment make any change in an option previously granted which would adversely affect the right of any participant, nor may any amendment be made without approval of the stockholders of the Company obtained in accordance with Section 22 above within twelve (12) months of the adoption of such amendment (or earlier if required by Section 22) if such amendment would:

- (a) increase the number of Shares that may be issued under this Plan; or
- (b) change the designation of the employees (or class of employees) eligible for participation in this Plan.

Notwithstanding the foregoing, the Board may make such amendments to the Plan as the Board determines to be advisable, including changes with respect to current Offering Periods or Purchase Periods, if the continuation of the Plan or any Offering Period

would result in financial accounting treatment for the Plan that is different from the financial accounting treatment in effect on the date this Plan is adopted by the Board.

**26. Tax Obligations.**

To the extent any (i) grant of an option to purchase Shares, (ii) purchase of Shares, or (iii) disposition of Shares purchased under the Plan gives rise to any tax withholding obligation (including, without limitation, income and payroll withholding taxes imposed by any jurisdiction) the Committee may implement appropriate procedures to ensure that such tax withholding obligations are met. Those procedures may include, without limitation, increased withholding from an Employee's current compensation, cash payments to the Company or another Participating Subsidiary by an Employee, or a sale of a portion of the stock purchased under the Plan, which sale may be required and initiated by the Company.

**LEIDOS HOLDINGS, INC.**  
**CERTIFICATION OF CHAIRMAN AND CHIEF EXECUTIVE OFFICER PURSUANT TO**  
**SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Roger A. Krone, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2017, of Leidos Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including the registrant's consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2017

/s/ Roger A. Krone

---

**Roger A. Krone**  
**Chairman and Chief Executive Officer**

## LEIDOS HOLDINGS, INC.

CERTIFICATION OF EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James C. Reagan, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2017, of Leidos Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including the registrant's consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2017

/s/ James C. Reagan

---

James C. Reagan  
Executive Vice President and Chief Financial Officer

**LEIDOS HOLDINGS, INC.**  
**CERTIFICATION OF CHAIRMAN AND CHIEF EXECUTIVE OFFICER PURSUANT TO**  
**18 U.S.C SECTION 1350,**  
**AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Leidos Holdings, Inc. ("Leidos") on Form 10-Q for the period ended June 30, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Roger A. Krone, Chairman and Chief Executive Officer of Leidos Holdings, Inc., certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 4, 2017

/s/ Roger A. Krone

---

**Roger A. Krone**  
**Chairman and Chief Executive Officer**

**LEIDOS HOLDINGS, INC.**  
**CERTIFICATION OF EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER PURSUANT TO**  
**18 U.S.C SECTION 1350,**  
**AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Leidos Holdings, Inc. ("Leidos") on Form 10-Q for the period ended June 30, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James C. Reagan, Executive Vice President and Chief Financial Officer of Leidos Holdings, Inc., certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 4, 2017

/s/ James C. Reagan

---

**James C. Reagan**  
**Executive Vice President and Chief Financial Officer**

