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**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, 2022

**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 333-253583

**Leonardo DRS, Inc.**

(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State or Other Jurisdiction  
of Incorporation or Organization)

13-2632319  
(I.R.S. Employer  
Identification Number)

2345 Crystal Drive  
Suite 1000  
Arlington, Virginia 22202  
(703) 416-8000

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Securities registered pursuant to Section 12(b) of the Act: None

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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 every Interactive Data File required to be submitted 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 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 an emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer   
Non-accelerated filer

Accelerated filer   
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 7(a)(2)(B) of the Securities Act.

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

As of August 15, 2022, there were 145 million shares of the registrant's common stock, par value of \$0.01 per share, outstanding.

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### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS AND INFORMATION

This quarterly report on Form 10-Q (the “Quarterly Report”) contains forward-looking statements and cautionary statements within the meaning of the Private Securities Litigation Reform Act of 1995. Some of the forward-looking statements can be identified by the use of forward-looking terms such as “believes,” “expects,” “may,” “will,” “shall,” “should,” “would,” “could,” “seeks,” “aims,” “strives,” “targets,” “projects,” “intends,” “plans,” “estimates,” “anticipates” or other comparable terms. Forward-looking statements include, without limitation, all matters that are not historical facts. They appear in a number of places throughout this Quarterly Report and include, without limitation, statements regarding our intentions, beliefs, assumptions or current expectations concerning, among other things, financial goals, financial position, results of operations, cash flows, prospects, strategies or expectations, and the impact of prevailing economic conditions.

Forward-looking statements are subject to known and unknown risks and uncertainties, many of which may be beyond our control. We caution you that forward-looking statements are not guarantees of future performance or outcomes and that actual performance and outcomes may differ materially from those made in or suggested by the forward-looking statements contained in this Quarterly Report. In addition, even if future performance and outcomes are consistent with the forward-looking statements contained in this

Quarterly Report, those results or developments may not be indicative of results or developments in subsequent periods. New factors emerge from time to time that may cause our business not to develop as we expect, and it is not possible for us to predict all of them. Factors that could cause actual results and outcomes to differ from those reflected in forward-looking statements include, without limitation:

- Disruptions or deteriorations in our relationship with the relevant agencies of the U.S. government, as well as any failure to pass routine audits or otherwise comply with governmental requirements including those related to security clearance or procurement rules, including the False Claims Act;

- Significant delays or reductions in appropriations for our programs and changes in U.S. government priorities and spending levels more broadly;
- Any failure to comply with the proxy agreement with the U.S. Department of Defense (the “DoD”);
- The coronavirus pandemic (“COVID-19”) and related impacts on our business, financial condition and results of operations;
- Our mix of fixed-price, cost-plus and time-and-material type contracts, which could subject us to losses due to cost overruns or a significant increase in or sustained period of increased inflation;
- Our dependence on U.S. government contracts, which often are only partially funded and are subject to immediate termination, and the concentration of our customer base in the U.S. defense industry;
- Our use of estimates in pricing and accounting for many of our programs that are inherently uncertain and which may not prove to be accurate;
- Our ability to realize the full value of our backlog;
- Our ability to predict future capital needs or to obtain additional financing if we need it;
- Our ability to compete efficiently, including due to U.S. government organizational conflict of interest rules which may limit new contract opportunities or require us to wind down existing contracts;
- Our relationships with other industry participants, including any contractual disputes or the inability of our key suppliers to timely deliver our components, parts or services;
- Any failure to meet our contractual obligations including due to potential impacts to our business from supply chain risks, such as longer lead times and shortages of electronics and other components;
- Any security breach, including any cyber attack, cyber intrusion, insider threat, or other significant disruption of our IT networks and related systems as well as any act of terrorism or other threat to our physical security and personnel;
- Our ability to fully exploit or obtain patents or other intellectual property protections necessary to secure our proprietary technology, including our ability to avoid infringing upon the intellectual property of third parties or prevent third parties from infringing upon our own intellectual property;
- The conduct of our employees, agents, affiliates, subcontractors, suppliers, business partners or joint ventures in which we participate which may impact our reputation and ability to do business;
- Our compliance with environmental laws and regulations, and any environmental liabilities that may affect our reputation or financial position;
- The outcome of litigation, arbitration, investigations, claims, disputes, enforcement actions and other legal proceedings in which we are involved;
- Various geopolitical and economic factors, laws and regulations including the Foreign Corrupt Practices Act (“FCPA”), the Export Control Act, the International Traffic in Arms Regulations (“ITAR”), the Export Administration Regulations (“EAR”), and those that we are exposed to as a result of our international business;
- Our ability to obtain export licenses necessary to conduct certain operations abroad, including any attempts by Congress to prevent proposed sales to certain foreign governments;

- Our ability to attract and retain technical and other key personnel;
- The occurrence of prolonged work stoppages;

- The unavailability or inadequacy of our insurance coverage, customer indemnifications or other liability protections to cover all of our significant risks or to pay for material losses we incur;
- Future changes in U.S. tax laws and regulations or interpretations thereof;
- Changes in estimates used in accounting for our pension plans, including in respect of the funding status thereof;
- Changes in future business or other market conditions that could cause business investments and/or recorded goodwill or other long-term assets to become impaired;
- Adverse consequences from any acquisitions such as operating difficulties, dilution and other harmful consequences or any modification, delay or prevention of any future acquisition or investment activity by the Committee on Foreign Investment in the United States (“CFIUS”);
- Natural disasters or other significant disruptions; or
- Any conflict of interest that may arise because Leonardo US Holding, Inc. (“US Holding”), our sole shareholder, or Leonardo S.p.A., our ultimate parent, may have interests that are different from those of our other shareholders, including as a result of any ongoing business relationships Leonardo S.p.A. may have with us, and their significant ownership in us may discourage change of control transactions.

You should read this Quarterly Report completely and with the understanding that actual future results may be materially different from expectations. All forward-looking statements made in this Quarterly Report are qualified by these cautionary statements. These forward-looking statements are made only as of the date of this filing, and we do not undertake any obligation, other than as may be required by law, to update or revise any forward-looking or cautionary statements to reflect changes in assumptions, the occurrence of events, unanticipated or otherwise, and changes in future operating results over time or otherwise.

Other risks, uncertainties and factors, including those discussed under “Risk Factors” in Part II, Item 1A of this Quarterly Report and “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the year end December 31, 2021, filed with the SEC on March 28, 2022 (our “Annual Report”), could cause our actual results to differ materially from those projected in any forward-looking statements we make. Readers should read carefully the discussion of these factors to better understand the risks and uncertainties inherent in our business and underlying any forward-looking statements.

**PART I. FINANCIAL INFORMATION****ITEM 1. UNAUDITED FINANCIAL STATEMENTS****Consolidated Statements of Earnings (Unaudited)**

	<b>Three Months Ended June 30,</b>	
	<b>2022</b>	<b>2021</b>
(Dollars in millions, except per share amounts)		
<b>Revenues:</b>		
Products	\$ 549	\$ 562
Services	78	96
Total revenues	<u>627</u>	<u>658</u>
<b>Cost of revenues:</b>		
Products	(445)	(470)
Services	(55)	(61)
Total cost of revenues	<u>(500)</u>	<u>(531)</u>
<b>Gross profit</b>	<u>127</u>	<u>127</u>
General and administrative expenses	(84)	(73)
Amortization of intangibles	(2)	(2)
Other operating expenses, net	1	(1)
<b>Operating earnings</b>	<u>42</u>	<u>51</u>
Interest expense	(10)	(9)
Other, net	—	1
<b>Earnings before taxes</b>	<u>32</u>	<u>43</u>
Income tax provision	7	11
<b>Net earnings</b>	<u>\$ 25</u>	<u>\$ 32</u>
<b>Net earnings per share from common stock:</b>		
Basic and diluted earnings per share:	0.17	0.22

See accompanying Notes to Consolidated Financial Statements.





**LEONARDO DRS, INC.**  
**Consolidated Statements of Earnings (Unaudited)**

(Dollars in millions, except per share amounts)

**Revenues:**

	Six Months Ended June 30,	
	2022	2021
Products	\$ 1,090	\$ 1,132
Services	149	207
Total revenues	<u>1,239</u>	<u>1,339</u>

**Cost of revenues:**

Products	(867)	(930)
Services	(111)	(146)
Total cost of revenues	<u>(978)</u>	<u>(1,076)</u>

**Gross profit**

General and administrative expenses	(160)	(152)
Amortization of intangibles	(4)	(4)
Other operating expenses, net	1	(5)

**Operating earnings**

Interest expense	(18)	(18)
Other, net	—	—

**Earnings before taxes**

Income tax provision	19	23
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**Net earnings**

	<u>\$ 61</u>	<u>\$ 61</u>
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**Net earnings per share from common stock:**

Basic and diluted earnings per share:	0.42	0.42
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See accompanying Notes to Consolidated Financial Statements.



## LEONARDO DRS, INC.

## Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended June 30,	
	2022	2021
(Dollars in millions)		
<b>Net earnings</b>	\$ 25	\$ 32
<b>Other comprehensive income (loss):</b>		
Foreign currency translation gain (loss), net of income taxes	(1)	3
Gain from pension settlements	—	—
Net unrecognized gain (loss) on postretirement obligations, net of income taxes	(1)	10
<b>Other comprehensive income (loss), net of income tax</b>	(2)	13
<b>Total comprehensive income</b>	\$ 23	\$ 45

See accompanying Notes to Consolidated Financial Statements.

	Six Months Ended June 30,	
	2022	2021
(Dollars in millions)		
<b>Net earnings</b>	\$ 61	\$ 61
<b>Other comprehensive income (loss):</b>		
Foreign currency translation gain (loss), net of income taxes	—	3
Gain from pension settlements	3	—
Net unrecognized gain (loss) on postretirement obligations, net of income taxes	1	9
<b>Other comprehensive income (loss), net of income tax</b>	4	12
<b>Total comprehensive income</b>	\$ 65	\$ 73

See accompanying Notes to Consolidated Financial Statements.

**LEONARDO DRS, INC.**  
**Consolidated Balance Sheets**

	(Unaudited)	
	June 30, 2022	December 31, 2021
(Dollars in millions, except per share amounts)		
<b>ASSETS</b>		
<i>Current assets:</i>		
Cash and cash equivalents	\$ 69	\$ 240
Accounts receivable, net	125	156
Contract assets	874	743
Inventories	249	205
Related party note receivable	—	—
Prepaid expenses	17	23
Other current assets	29	22
Held for sale	174	\$ —
Total current assets	<u>1,537</u>	<u>1,389</u>
<i>Noncurrent assets:</i>		
Property, plant and equipment, net	363	364
Intangible assets, net	47	52
Goodwill	952	1,071
Deferred tax assets, net	46	56
Other noncurrent assets	98	137
Total noncurrent assets	<u>1,506</u>	<u>1,680</u>
<b>Total assets</b>	<u>\$ 3,043</u>	<u>\$ 3,069</u>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
<i>Current liabilities:</i>		
Short-term borrowings and current portion of long-term debt	\$ 140	\$ 41
Accounts payable	291	479
Contract liabilities	156	174
Other current liabilities	279	295
Held for sale	45	—
Total current liabilities	<u>911</u>	<u>989</u>
<i>Noncurrent liabilities:</i>		
Long-term debt	350	352
Pension and other postretirement benefit plan liabilities	54	61

Other noncurrent liabilities	70	74
Total noncurrent liabilities	<u>\$ 474</u>	<u>487</u>
<b>Shareholder's equity:</b>		
Preferred stock, \$0.01 par value: 10,000,000 shares authorized; none issued	\$ —	\$ —
Common stock, \$0.01 par value: 300,000,000 shares authorized; 145,000,000 shares issued and outstanding	1	1
Additional paid-in capital	4,633	4,633
Accumulated deficit	(2,922)	(2,983)
Accumulated other comprehensive loss	(54)	(58)
<b>Total shareholder's equity</b>	<u>1,658</u>	<u>1,593</u>
<b>Total liabilities and shareholder's equity</b>	<u>\$ 3,043</u>	<u>\$ 3,069</u>

See accompanying Notes to Consolidated Financial Statements.

**LEONARDO DRS, INC.**  
**Consolidated Statements of Cash Flows (Unaudited)**

	Six Months Ended June 30,	
	2022	2021
(Dollars in millions)		
<b>Operating activities</b>		
Net earnings	\$ 61	\$ 61
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	31	28
Deferred income taxes	14	23
Other	—	(1)
Changes in assets and liabilities:		
Accounts receivable	24	(3)
Contract assets	(131)	(82)
Inventories	(47)	(10)
Prepaid expenses	(3)	13
Other current assets	(7)	(8)
Other noncurrent assets	22	10
Defined benefit obligations	(3)	(6)
Other current liabilities	(9)	5
Other noncurrent liabilities	(17)	(13)
Accounts payable	(165)	(172)
Contract liabilities	(12)	(30)
Net cash used in operating activities	\$ (242)	\$ (185)
<b>Investing activities</b>		
Capital expenditures	(22)	(29)
Repayments received (net of advances) on related party note receivable	—	115
Investment in unconsolidated affiliate	—	(2)
Net cash provided by investing activities	\$ (22)	\$ 84
<b>Financing activities</b>		
Net decrease in third party borrowings (maturities of 90 days or less)	(17)	(16)
Repayment of related party debt	(335)	(475)
Borrowings from related parties	445	625
Other	—	(2)
Net cash provided by financing activities	\$ 93	\$ 132
Effect of exchange rate changes on cash and cash equivalents	—	(1)
Net change in cash and cash equivalents	\$ (171)	\$ 30
Cash and cash equivalents at beginning of year	240	61
Cash and cash equivalents at end of period	\$ 69	\$ 91



See accompanying Notes to Consolidated Financial Statements.

## LEONARDO DRS, INC.

## Consolidated Statements of Shareholder's Equity (Unaudited)

(Dollars in millions, except per share amounts)

	Common stock	Additional paid- in capital	Accumulated other comprehensive loss	Accumulated deficit	Total
<b>Balance as of December 31, 2020</b>	\$ 1	\$ 4,633	\$ (70)	\$ (3,137)	\$ 1,427
Total comprehensive income	—	—	12	61	73
<b>Balance as of June 30, 2021</b>	\$ 1	\$ 4,633	\$ (58)	\$ (3,076)	\$ 1,500
<b>Balance as of December 31, 2021</b>	\$ 1	\$ 4,633	\$ (58)	\$ (2,983)	\$ 1,593
Total comprehensive income	—	—	4	61	65
<b>Balance as of June 30, 2022</b>	\$ 1	\$ 4,633	\$ (54)	\$ (2,922)	\$ 1,658

See accompanying Notes to Consolidated Financial Statements.

**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****Note 1. Summary of Significant Accounting Policies****A. Organization**

Leonardo DRS, Inc., together with its wholly owned subsidiaries (hereinafter, “DRS,” “the Company,” “us,” “our,” or “we”) is a supplier of defense electronics products, systems and military support services. The Company is controlled by Leonardo S.p.A (hereinafter, “Leonardo S.p.A.” or “the Parent”), an Italian multi-national aerospace, defense and security company headquartered in Rome, Italy, through its direct sole ownership of Leonardo US Holding, Inc. (“US Holding”). US Holding is the direct and sole shareholder of the Company.

DRS is a provider of defense products and technologies that are used across land, air, sea, space and cyber domains. Our diverse array of defense systems and solutions are offered to all branches of the U.S. military, major aerospace and defense prime contractors, government intelligence agencies, international military customers and industrial markets for deployment on a wide range of military platforms. We focus our capabilities in areas of critical importance to the U.S. military, such as sensing, electronic warfare (“EW”), network computing and communications, force protection and electrical power conversion and propulsion.

These capabilities directly align with our two reportable segments: Advanced Sensing and Computing and Integrated Mission Systems. The U.S. Department of Defense (“DoD”) is our largest customer and accounts for approximately 78% and 82% of our total revenues as an end-user for the second quarter and first six months of 2022, respectively, and 85% for the second quarter and first six months of 2021. Specific international commercial market opportunities exist within these segments and make up approximately 22% and 18% of our total revenues for the second quarter and first six months of 2022, respectively, and 15% for the second quarter and first half of 2021. Our two reportable segments reflect the way performance is assessed and resources are allocated by our Chief Executive Officer, who is our chief operating decision maker (“CODM”).

*Advanced Sensing and Computing (“ASC”)*

The ASC segment provides sensing and computing systems and subsystem solutions to the U.S. military and allied nations focused on solving the most complex threat dynamics facing our service men and women today. We provide world class sensing products in all warfighting domains along with the computation systems to provide situational understanding.

Our technologies and products are deployed on nearly all military platforms across land, sea, air, cyberspace, and space on individual soldiers, ground vehicles, ships, aircraft, and satellites. We have market leading capabilities in electro-optic and infrared imaging, advanced lasers, electronic warfare and cyber, communications, and computing in these domains.

*Integrated Mission Systems (“IMS”)*

The IMS segment provides critical force protection, platform integration, transportation and logistics and power conversion and propulsion systems to the U.S. military and its allies. Our force protection systems provide much needed protection for our service members and military assets from evolving and proliferating threats and include advanced solutions for counter-unmanned aerial systems, short-range air defense systems and active protection systems on ground vehicles. Additionally, we provide power conversion and propulsion systems for the U.S. Navy’s top priority shipbuilding programs, building on our legacy of providing power components and systems for nearly all naval combat vessels for three decades, positioning us to continue as a leading provider of electrical ship propulsion systems and components for the U.S. Navy and its allies.

*Other*

The Company separately presents the unallocable costs associated with corporate functions and certain non-operating subsidiaries of the Company as Corporate & Eliminations.

**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

See *Note 15: Segment Information* for further information regarding our business segments.

**B. Basis of presentation**

The accompanying unaudited Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and include the accounts of DRS, its wholly owned subsidiaries and its controlling interests. Interests in joint ventures that are controlled by the Company, or for which the Company is otherwise deemed to be the primary beneficiary, are consolidated. For joint ventures in which the Company does not have a controlling interest, but exerts significant influence, the Company applies the equity method of accounting. All intercompany transactions and balances have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to current year presentation.

**Interim Financial Statements.** The unaudited Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). These rules and regulations permit some of the information and footnote disclosures included in financial statements prepared in accordance with U.S. GAAP to be condensed or omitted.

These unaudited Consolidated Financial Statements should be read in conjunction with our audited Consolidated Financial Statements as of and for the year ended December 31, 2021 filed as Exhibit 99.1 to the Current Report on Form 8-K filed on August 2, 2022.

**C. Use of Estimates**

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant of these estimates and assumptions relate to the recognition of contract revenues and estimated costs to complete contracts in process, recoverability of reported amounts of goodwill, long-lived assets and intangible assets, valuation of pensions and other postretirement benefits, the valuation of deferred tax assets and liabilities and the valuation of unrecognized tax benefits. Actual results could differ from these estimates.

**D. Revenue Recognition**

Our revenues consist of sales of products (tangible goods) and sales of services to customers. We recognize the majority of our revenue from contracts with customers using an over time, cost-to-cost method of accounting. On certain other contracts, primarily time and material (“T&M”) and cost-plus contracts, revenue is recognized using the right-to-invoice practical expedient as we are contractually able to bill our customer based on control transferred to the customer. See *Note 2. Revenue from Contracts with Customers* for additional information regarding revenue recognition.

**E. Cost of Revenues**

Cost of revenues includes materials, labor and overhead costs incurred in the manufacturing, design, and provision of products and services sold in the period as well as warranty costs. Material costs include raw materials, purchased components and sub-assemblies, outside processing and inbound freight costs. Labor and overhead costs consist of direct and indirect manufacturing costs, including wages and fringe benefits, operating supplies, depreciation and amortization, occupancy costs, and purchasing, receiving and inspection costs.

**F. Research and Development Expenses**

We conduct research and development (“R&D”) activities using our own funds (referred to as company-funded R&D or independent research and development (“IR&D”)) and under contractual arrangements with our customers (referred to as customer-funded R&D) to enhance existing products and services and to develop future products, solutions, and

technologies. R&D costs include basic research, applied research, concept formulation studies, design, development, and related test activities. IR&D costs are allocated to customer contracts as part of the general

**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

and administrative overhead costs and generally recoverable on our customer contracts with the U.S. Government. Customer-funded R&D costs are charged directly to the related customer contract. Substantially all R&D costs are charged to cost of revenues as incurred.

**G. Foreign Currency**

Significant transactions in foreign currencies are translated into U.S. dollars at the approximate prevailing rate at the time of the transaction. Foreign exchange transaction gains and losses in the second quarter and first six months of 2022 and 2021 were immaterial to the Company's results of operations. The operations of the Company's foreign subsidiaries are translated from the local (functional) currencies into U.S. dollars using weighted average rates of exchange during each monthly period. The rates of exchange at each balance sheet date are used for translating certain balance sheet accounts and gains or losses resulting from these translation adjustments are included in the accompanying Consolidated Balance Sheets as a component of other comprehensive earnings.

**H. Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, deposits with banks or other short-term, highly liquid investments with original maturities of three months or less.

**I. Accounts Receivable**

Accounts receivable consist of amounts billed and currently due from customers. We maintain an allowance recorded in the Allowance for Credit Losses account that is estimated and recorded utilizing relevant information about past events, including historical experience, current conditions and a reasonable and supportable forecast that affects the collectability of the related financial asset. See *Note 3: Accounts Receivable* for additional information regarding accounts receivable.

**J. Inventories**

Inventories are recorded at the lower of cost (determined by either actual, weighted average or first-in, first-out methods) or net realizable value, and include direct production costs as well as indirect costs, such as factory overhead. The net realizable value is calculated as the expected sales price in the course of normal operations net of estimated costs to finish and sell the goods. See *Note 4: Inventories* for additional information regarding inventories.

**K. Property, Plant and Equipment**

Property, plant and equipment is carried at cost less accumulated depreciation. Depreciation is calculated on the straight-line method. The estimated useful lives of plant, machinery and equipment and building and building improvements generally range from 3 to 10 years and 15 to 40 years, respectively. Leasehold improvements are amortized over the shorter of the estimated useful life of the improvements or the remaining life of the lease.

When assets are retired or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the Consolidated Balance Sheets, and the net gain or loss is included in the determination of net earnings. Maintenance and repairs are charged to operations as incurred and renewals and improvements are capitalized. See *Note 5: Property, Plant and Equipment* for additional information regarding property, plant and equipment.

**L. Goodwill**

Goodwill is assigned to reporting units and is reviewed for impairment at the reporting unit level on an annual basis, or whenever changes in circumstances indicate that the carrying amount may not be recoverable. A reporting unit is an operating segment, or one level below that operating segment (the component level) if discrete financial information is prepared and regularly reviewed by the segment manager. Two or more components of an operating segment may be aggregated and deemed a single reporting unit if the components

have similar economic characteristics. Based upon the aggregation criteria the Company concluded it had seven reporting units at both June 30, 2022 and December 31, 2021. The annual impairment test is conducted as of December 31. The Company



**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

did not identify any triggering events during the six months ended June 30, 2022 or June 30, 2021. See *Note 7: Goodwill* for additional information regarding goodwill.

**M. Long-Lived Assets and Acquired Identifiable Intangible Assets**

Identifiable intangible assets represent assets acquired as part of the Company's business acquisitions and include customer and program/contract-related assets. The values assigned to acquired identifiable intangible assets are determined as of the date of acquisition based on estimates and judgments regarding expectations for the estimated future after-tax cash flows from those assets over their lives, including the probability of expected future contract renewals and revenues, all of which are discounted to present value.

The Company assesses the recoverability of the carrying value of its long-lived assets and intangible assets with finite useful lives whenever events or changes in circumstances indicate that the carrying amount of the assets or asset group may not be recoverable. If there are any indicators of impairment present, the Company then evaluates the recoverability of the potentially impaired long-lived assets and acquired identifiable intangible assets based upon expectations of undiscounted net cash flows from such assets. If the sum of the expected future undiscounted net cash flows is less than the carrying amount of the asset or asset group, a loss is recognized for the difference between the estimated fair value and the carrying amount of the assets. Assets to be disposed of, including those of discontinued operations, are reported at the lower of the carrying amount or fair value, less the costs to sell. See *Note 5: Property, Plant and Equipment* and *Note 8: Intangible Assets* for additional information regarding long-lived assets and intangible assets.

**N. Derivative Financial Instruments**

The Company does not use derivative financial instruments for trading purposes. All derivative instruments are carried on the Consolidated Balance Sheets as either assets or liabilities at fair value. The classification of gains and losses resulting from changes in the fair values of derivatives depends on the intended use of the derivative and its resultant designation. The Company had no significant derivative or hedging instruments for the periods presented.

**O. Pension and Other Postretirement Benefits**

The obligations for the Company's pension plans and postretirement benefit plans and the related annual costs of employee benefits are calculated based on several long-term assumptions, including discount rates for participant benefit liabilities, rates of return on plan assets, expected annual rates of salary increases for employee participants in the case of pension plans and expected annual increases in the costs of medical and other health care benefits in the case of postretirement benefit plans. These long-term assumptions are subject to revision based on changes in interest rates, financial market conditions, expected versus actual returns on plan assets, participant mortality rates and other actuarial assumptions, including future rates of salary increases, benefit formulas and levels, and rates of increase in the costs of benefits. Changes in these assumptions, if significant, can materially affect the amount of annual net periodic benefit costs recognized in the Company's results of operations from one year to the next, the liabilities for the pension plans and postretirement benefit plans and the Company's annual cash requirements to fund these plans. See *Note 11: Pension and Other Postretirement Benefits* for further information regarding our pension and postretirement plans.

**P. Income Taxes**

We and US Holding have entered into a Tax Allocation Agreement ("Tax Allocation Agreement"), dated as of November 16, 2020, with members of an affiliated group, as defined in Section 1504(a) of the U.S. Internal Revenue Code of 1986, as amended (the "Tax Code"), members of one or more consolidated, combined, unitary or similar state tax groups and additional parties who are part of an "expanded affiliated group" for certain tax purposes. The agreement provides for the method of computing and allocating the consolidated U.S. federal tax liability of the affiliated group among its members and of allocating any state group tax liabilities among the state members for the taxable year ending December 31, 2020 and each subsequent year in which the parties are members of a group (whether federal or state). The agreement also provides for reimbursement of US Holding and/or DRS for payment of such tax liabilities, for compensation of any member for use of its "net operating loss" or "tax credits" in arriving at such tax liabilities and the allocation and payment of any refund arising from a carryback of net operating losses



**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

or tax credits from subsequent taxable years. Under the agreement, the parties have agreed to calculate and allocate their respective tax liabilities and other tax attributes for taxable years beginning with the first consolidated taxable year that included DRS (i.e., the taxable year ended December 31, 2008) as if the agreement was then in effect.

We calculate the provision for incomes taxes during interim periods by applying an estimate of our annual effective tax rate for the full year to “ordinary” income or loss (pretax income or loss excluding unusual or infrequently occurring discrete items).

The provision for income taxes is determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. Income taxes as presented attribute deferred income taxes of US Holding to DRS in a manner that is systematic, rational and consistent with the asset and liability method and the governing Tax Allocation Agreement which allocates the tax liability amongst the entities, including DRS.

The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax basis of DRS’ assets and liabilities and are adjusted for changes in tax rates and tax laws when such changes are enacted.

In general, the taxable income of DRS is included in the consolidated U.S. federal and state tax returns of US Holding. Where applicable, US Holding’s current portion of U.S. federal income taxes payable were offset against DRS’ net operating loss carryforwards in the period the related tax expense was recorded. Consequently, our net operating loss carryforwards are deemed to have been settled with US Holding in each year in an amount commensurate with the carrying value of the tax effected net operating loss utilized.

If management determines that some portion or all of a deferred tax asset is not “more likely than not” to be realized, a valuation allowance is recorded as a component of the income tax provision to reduce the deferred tax asset to the amounts expected to be realized. In determining whether the Company’s deferred tax assets are realizable, management considers all evidence, both positive and negative, including the history of financial reporting earnings, existing taxable temporary differences and their projected reversals, as well as projected future income and tax planning strategies. We believe it is more likely than not that we will generate sufficient taxable income in future periods to realize our deferred tax assets, subject to the valuation allowances recognized.

The Company assesses its tax positions for all periods open to examination by tax authorities based on the latest available information. Those positions are evaluated to determine whether they will more likely than not be sustained upon examination by the relevant taxing authorities. Liabilities for unrecognized tax benefits are measured based on the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. These unrecognized tax benefits are recorded as a component of income tax expense. Interest and penalties related to unrecognized tax benefits are not material.

See *Note 9: Income Taxes* for additional information regarding income taxes.

**Q. Earnings Per Share**

Basic earnings per share (“EPS”) is computed by dividing net earnings by the weighted average number of shares of common stock outstanding during each period. The computation of diluted EPS includes the dilutive effect of outstanding stock-based compensation awards, only in periods in which such effect would have been dilutive for the period. In February 2021, the Company completed a forward stock split of 1,450,000 - for- 1 share of common stock. The consolidated financial statements have been adjusted to reflect the forward stock split for all periods presented. There were 100 shares and 145 million basic and diluted common shares outstanding before and after the forward stock split, respectively, for all periods presented.

**R. Fair Value Measurements**

Fair value is the price the Company would receive to sell an asset or pay to transfer a liability in an orderly transaction with a market participant on the measurement date. We are required to maximize the use of observable inputs and minimize the use of unobservable inputs in measuring fair value, and to utilize a three-level fair value



**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

hierarchy that prioritizes the inputs used to measure fair value. The three hierarchical levels used to measure fair value are as follows:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and inputs other than quoted prices that are directly or indirectly observable.

Level 3 — Significant inputs to the valuation model are unobservable.

In certain instances, fair value is determined through information obtained from third parties using the latest available market data. In obtaining such data from third parties, we have evaluated the methodologies used to develop the estimate of fair value in order to assess whether such valuations are representative of fair value. The Company categorizes plan assets for disclosure purposes in accordance with this fair value hierarchy. Certain plan investments are measured at fair value using the net asset value (“NAV”) per share (or its equivalent) practical expedient and are therefore not categorized as Level 1, 2, or 3. NAV is defined as the total value of the fund divided by the number of the fund’s shares outstanding. See *Note 12: Pension and Other Postretirement Benefits* for further information regarding our pension and postretirement plans.

**S. Financial Instruments**

Our financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses and other current liabilities. Financial instruments are reported in the Consolidated Balance Sheets at carrying value, which other than the 7.5% Term loan due November 30, 2023, approximate fair value. See *Note 11: Debt* for further information regarding our debt.

**T. Acquisitions, Investments and Variable Interest Entities***Acquisitions*

Our consolidated financial statements include the operations of acquired businesses from the date of acquisition. We account for acquired businesses using the acquisition method of accounting, which requires that any assets acquired and liabilities assumed be measured at their respective fair values on the acquisition date. The accounting for business combinations requires the Company to make significant judgments and estimates. Any excess of the fair value of consideration transferred over the assigned values of the net assets acquired is recognized as goodwill.

As previously announced, on June 21, 2022, we entered into the Agreement and Plan of Merger, dated as of June 21, 2022 (the “merger agreement”), by and among the Company, RADA Electronic Industries Ltd (“RADA”) and Blackstart Ltd, a company organized under the laws of the State of Israel and a wholly owned subsidiary of DRS (“Merger Sub”). Upon the terms and subject to the conditions of the merger agreement, and in accordance with the Companies Law, 5759-1999, of the State of Israel, at the effective time of the merger contemplated by the merger agreement (the “merger”), Merger Sub will be merged with and into RADA, with RADA as the surviving company of the merger and thereby becoming a wholly owned subsidiary of DRS. At the effective time of the merger (the “effective time”), each ordinary share of RADA, par value New Israeli Shekel 0.03 per share (“RADA shares”), issued and outstanding immediately prior to the effective time will be converted into and become exchangeable for one share of common stock of DRS, par value \$0.01 per share (“DRS common stock”). Immediately prior to the effective time, the shares of DRS common stock held by US Holding, the current sole stockholder of DRS, will be split (rounded up to the nearest whole share), as necessary, such that, immediately following the effective time and the issuance of the shares of DRS common stock to holders of RADA shares and the treatment of options to purchase RADA shares: (A) US Holding will hold 80.5% of the issued and outstanding shares of DRS common stock on a fully diluted basis (with US Holding’s ownership percentage including 50% of any awards or other equity interests that DRS may issue pursuant to entitlements under any grants of certain one-time special awards of restricted stock units (the “One-Time Awards”) and the foregoing percentage calculation excluding any awards or other equity interests that DRS may issue pursuant to entitlements under the DRS’s long term incentive plan and 50% of any awards or other equity interests that DRS may issue pursuant to entitlements in



**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

connection with any grants of One-Time Awards, and such foregoing percentage will assume a reference price for RADA options equal to the volume-weighted average price of the RADA shares on the NASDAQ for the ten trading days immediately prior to the closing date); and (B) the holders of RADA shares, RADA vested options and RADA unvested options (or DRS options issued pursuant to the provisions of the merger agreement) will hold or have entitlements to 19.5% of the issued and outstanding shares of DRS common stock on a fully diluted basis (the foregoing percentage calculation excluding any awards or other equity interests that DRS may issue pursuant to entitlements under the DRS long-term incentive plan or the issuance of any One-Time Awards).

Each of DRS's and RADA's obligation to consummate the merger is subject to the satisfaction or waiver of a number of conditions specified in the merger agreement.

The merger is expected to close in the fourth quarter of 2022. On August 3, 2022, we filed a registration statement on Form S-4 with the SEC for the shares of DRS common stock to be issued in the merger, which has not yet been declared effective by the SEC.

*Investments*

Investments where we have the ability to exercise significant influence, but do not control, are accounted for under the equity method of accounting and are included in other noncurrent assets on our Consolidated Balance Sheets. Significant influence typically exists if we have a 20% to 50% ownership interest in the investee. Under this method of accounting, our share of the net earnings or losses of the investee is included in operating profit in other income, net on our Consolidated Statements of Earnings since the activities of the investee are closely aligned with the operations of the business segment holding the investment. We evaluate our equity method investments for impairment whenever events or changes in circumstances indicate that the carrying amounts of such investments may be impaired. If a decline in the value of an equity method investment is determined to be other than temporary, a loss is therefore recorded during the current period.

The Company's cost method investment consists of an investment in a private company in which we do not have the ability to exercise significant influence over its operating and financial activities. Management evaluates this investment for possible impairment quarterly.

*Variable Interest Entities*

The Company occasionally forms joint ventures and/or enters into arrangements with special purpose limited liability companies for the purpose of bidding and executing on specific projects. The Company analyzes each such arrangement to determine whether it represents a variable interest entity ("VIE"). If the arrangement is determined to be a VIE, the Company assesses whether it is the primary beneficiary of the VIE and if it is, consequently required to consolidate the VIE. The Company did not have any investment in VIEs for the periods presented.

*Divestitures / Held for Sale*

On March 21, 2022, the Company entered into a definitive agreement to sell its Global Enterprise Solutions ("GES") business to SES Government Solutions, Inc., a wholly-owned subsidiary of SES S.A., for \$450 million in cash. The transaction was completed on August 1, 2022 and resulted in proceeds of \$427 million. We are in the process of finalizing the accounting for the transaction and will report the gain on the transaction in the third quarter. GES, which was part of the ASC segment, provides commercial satellite communications to the U.S. Government and delivers satellite communications and security solutions to customers worldwide. SES S.A. has guaranteed the payment of the purchase price and performance of all other obligations of SES Government Solutions, Inc. under the agreement. As of June 30, 2022, the assets and liabilities related to GES were reported on the Consolidated Balance Sheets as Held for Sale.

In February 2022, the Company's Board of Directors approved the strategic initiative to divest of the Company's interest in Advanced Acoustic Concepts ("AAC"). On April 19, 2022, we entered into a definitive sales agreement to divest our share of our equity investment in AAC for \$56 million to Thales Defense & Security, Inc., the minority partner in the joint venture. The transaction was completed on July 8, 2022 and resulted in proceeds of





**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

\$56 million. We are in the process of finalizing the accounting for the transaction and will report the gain on the transaction in the third quarter. As of June 30, 2022, the Investment was reported as Held for Sale.

The proceeds generated from the GES and AAC divestitures resulted in a \$396 million dividend to Leonardo US Holdings, our sole shareholder. The \$396 million represents the proceeds generated net of our costs to sell and estimated tax obligations. The dividend was issued on August 5, 2022

**Note 2. Revenue from Contracts with Customers**

The Company recognizes revenue for each separately identifiable performance obligation in a contract representing an obligation to transfer a distinct good or service to a customer. In most cases, goods and services provided under the Company's contracts are accounted for as single performance obligations due to the complex and integrated nature of our products and services. These contracts generally require significant integration of a group of goods and/or services to deliver a combined output. In some contracts, the Company provides multiple distinct goods or services to a customer. In those cases, the Company accounts for the distinct contract deliverables as separate performance obligations and allocates the transaction price to each performance obligation based on its relative standalone selling price, which is generally estimated using cost plus a reasonable margin. We classify revenues as products or services on our Consolidated Statements of Earnings based on the predominant attributes of the performance obligations. While the Company provides warranties on certain contracts, we typically do not provide for services beyond standard assurances and therefore do not consider warranties to be separate performance obligations. Typically we enter into three types of contracts: fixed-price contracts, cost-plus contracts and T&M contracts (cost-plus contracts and T&M contracts are aggregated below as flexibly priced contracts). The majority of our total revenues are derived from fixed-price contracts; refer to the revenue disaggregation disclosures that follow.

For fixed-price contracts, customers agree to pay a fixed amount, negotiated in advanced for a specified scope of work.

For cost-plus contracts typically we are reimbursed for allowable or otherwise defined total costs (defined as cost of revenues plus allowable general and administrative expenses) incurred, plus a fee. The contracts may also include incentives for various performance criteria, including quality, timeliness and cost-effectiveness. In addition, costs are generally subject to review by clients and regulatory audit agencies, and such reviews could result in costs being disputed as non-reimbursable under the terms of the contract.

T&M contracts provide for reimbursement of labor hours expended at a contractual fixed labor rate per hour, plus the actual costs of material and other direct non-labor costs. The fixed labor rates on T&M contracts include amounts for the cost of direct labor, indirect contract costs and profit.

Estimating the transaction price for an arrangement requires judgment and is based on expected results which are determined using the Company's historical data. We estimate that the revenue that we expect to be entitled to receive from a customer to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur.

Revenue from contracts with customers is recognized when the performance obligations are satisfied through the transfer of control over the good or service to the customer, which may occur either over time or at a point in time.

Revenues for the majority of our contracts are measured as determined by the ratio of cumulative costs incurred to date to estimated total contract costs at completion (the "cost-to-cost method"). We believe this is an appropriate measure of progress toward satisfaction of performance obligations as this measure most accurately depicts the progress of our work and transfer of control to our customers. Due to the long-term nature of many of our contracts, developing the estimated total cost at completion and total transaction price often requires judgment. Factors that must be considered in estimating the cost of the work to be completed include the nature and complexity of the work to be performed, subcontractor performance and the risk and impact of delayed performance.



## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

After establishing the estimated total cost at completion, we follow a standard Estimate at Completion (“EAC”) process in which we review the progress and performance on our ongoing contracts at least quarterly. Adjustments to original estimates for a contract's revenue, estimated costs at completion and estimated profit or loss often are required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change and are also required if contract modifications occur. When adjustments in estimated total costs at completion or in estimated total transaction price are determined, the related impact on revenue and operating income are recognized using the cumulative catch-up method, which recognizes in the current period the cumulative effect of such adjustments for all prior periods. Any anticipated losses on these contracts are fully recognized in the period in which the losses become evident.

EAC adjustments had the following impacts to revenue for the periods presented:

<i>(Dollars in millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Revenue	\$ (10)	\$ (8)	\$ (11)	\$ (9)
Total % of Revenue	1.6 %	1.3 %	0.9 %	0.7 %

The impacts noted above are attributed primarily to changes in our firm-fixed-price type programs. They consist of changes in the designs required to achieve contractual specifications for fixed priced development programs and inflationary impacts on certain naval production programs that resulted in a change in the programs' estimate and related profitability. The reduction to revenue for the three- and six-month periods ended June 30, 2022 and June 30, 2021 was attributed primarily to certain cost impacts on surface ship programs within our IMS segment and inflationary pressures on naval programs within our ASC segment.

Conversely, if the requirements for the recognition of contracts over time are not met, revenue is recognized at a point in time when control transfers to the customer, which is generally upon transfer of title. In such cases, the production that is in progress and costs that will be recognized at a future point in time are reported within "inventories".

Costs to obtain a contract are incremental direct costs incurred to obtain a contract with a customer, including sales commissions and dealer fees, and are capitalized if material. Costs to fulfill a contract include costs directly related to a contract or specific anticipated contract (e.g., certain design costs) that generate or enhance our ability to satisfy our performance obligations under these contracts. These costs are capitalized to the extent they are expected to be recovered from the associated contract.

*Contract Assets and Liabilities*

The timing of revenue recognition, billings and cash collections results in billed accounts receivable, unbilled receivables (contract assets), and customer advances and deposits (contract liabilities) on the Consolidated Balance Sheets. Amounts are billed as work progresses in accordance with agreed-upon contractual terms, either at periodic intervals (e.g., biweekly or monthly) or upon achievement of contractual milestones. Generally, billing occurs subsequent to revenue recognition, resulting in contract assets. However, we sometimes receive advances or deposits from our customers before revenue is recognized, resulting in contract liabilities.

<i>(Dollars in millions)</i>	June 30, 2022	December 31, 2021
Contract assets	\$ 874	\$ 743
Contract liabilities	156	174
<b>Net contract assets</b>	<b>\$ 718</b>	<b>\$ 569</b>

Revenue recognized in the three-and six-month periods ended June 30, 2022 that was included in the contract liability balance at the beginning of each period was \$33 million and \$107 million, respectively. Revenue recognized in the three- and six-month periods ended June 30, 2021 that was included in the contract liability balance at the beginning of each period was \$20 million and \$89 million, respectively.

## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The change in the balances of the Company's contract assets and liabilities primarily results from timing differences between revenue recognition and customer billings and/or payments.

Contract assets related to amounts withheld by customers until contract completion are not considered a significant financing component of our contracts because the intent is to protect the customers from our failure to satisfactorily complete our performance obligations. Payments received from customers in advance of revenue recognition (contract liabilities) are not considered a significant financing component of our contracts because they are utilized to pay for contract costs within a one-year period or are requested by us to ensure the customers meet their payment obligations.

*Value of Remaining Performance Obligations*

The value of remaining performance obligations, which we also refer to as total backlog, includes the following components:

- **Funded** - Funded backlog represents the revenue value of orders for services under existing contracts for which funding is appropriated or otherwise authorized less revenue previously recognized on these contracts.
- **Unfunded** - Unfunded backlog represents the revenue value of firm orders for products and services under existing contracts for which funding has not yet been appropriated less funding previously recognized on these contracts.

The following table summarizes the value of our total backlog as of June 30, 2022, incorporating both funded and unfunded components:

<b>Backlog:</b>	<u>June 30, 2022</u>
<i>(Dollars in millions)</i>	
<b>Total Backlog</b>	<u>\$ 3,051</u>

We expect to recognize approximately 39% of our June 30, 2022 backlog as revenue over the next six months, with the remainder to be recognized thereafter.

*Disaggregation of Revenue*

*ASC:* ASC revenue is primarily derived from U.S. government development and production contracts and is generally recognized over time using the cost-to-cost method. We disaggregate ASC revenue by geographical

## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

region, customer relationship and contract type. We believe these categories best depict how the nature, amount, timing and uncertainty of ASC revenue and cash flows are affected by economic factors:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
<i>(Dollars in millions)</i>				
<b>Revenue by Geographical Region</b>				
United States	\$ 367	\$ 457	\$ 739	\$ 901
International	74	28	96	63
Intersegment Sales	3	4	5	7
<b>Total</b>	<b>\$ 444</b>	<b>\$ 489</b>	<b>\$ 840</b>	<b>\$ 971</b>
<b>Revenue by Customer Relationship</b>				
Prime contractor	\$ 216	\$ 279	\$ 448	\$ 555
Subcontractor	225	206	387	409
Intersegment Sales	3	4	5	7
<b>Total</b>	<b>\$ 444</b>	<b>\$ 489</b>	<b>\$ 840</b>	<b>\$ 971</b>
<b>Revenue by Contract Type</b>				
Firm Fixed Price	\$ 394	\$ 419	\$ 736	\$ 845
Flexibly Priced <sup>(1)</sup>	47	66	99	119
Intersegment Sales	3	4	5	7
<b>Total</b>	<b>\$ 444</b>	<b>\$ 489</b>	<b>\$ 840</b>	<b>\$ 971</b>

(1) Includes revenue derived from time-and-materials contracts.

## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

IMS: IMS revenue is primarily derived from U.S. government development and production contracts and is generally recognized over time using the cost-to-cost method. We disaggregate IMS revenue by geographical region, customer relationship and contract type

We believe these categories best depict how the nature, amount, timing and uncertainty of IMS revenue and cash flows are affected by economic factors:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
<i>(Dollars in millions)</i>				
<b>Revenue by Geographical Region</b>				
United States	\$ 178	\$ 160	\$ 390	\$ 349
International	8	14	14	26
Intersegment Sales	1	—	1	—
<b>Total</b>	<b>\$ 187</b>	<b>\$ 174</b>	<b>\$ 405</b>	<b>\$ 375</b>
<b>Revenue by Customer Relationship</b>				
Prime contractor	\$ 36	\$ 42	\$ 69	\$ 86
Subcontractor	150	132	335	289
Intersegment Sales	1	—	1	—
<b>Total</b>	<b>\$ 187</b>	<b>\$ 174</b>	<b>\$ 405</b>	<b>\$ 375</b>
<b>Revenue by Contract Type</b>				
Firm Fixed Price	\$ 154	\$ 146	\$ 347	\$ 316
Flexibly Priced <sup>(1)</sup>	32	28	57	59
Intersegment Sales	1	—	1	—
<b>Total</b>	<b>\$ 187</b>	<b>\$ 174</b>	<b>\$ 405</b>	<b>\$ 375</b>

(1) Includes revenue derived from time-and-materials contracts.

**Note 3. Accounts Receivable**

Accounts receivable represent amounts billed and currently due from customers. Payment is typically received from our customers either at periodic intervals (e.g., biweekly, or monthly) or upon achievement of contractual milestones.

Accounts receivable consist of the following:

*(Dollars in millions)*

Accounts receivable

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
	\$ 126	\$ 157
Less allowance for credit losses	<u>(1)</u>	<u>(1)</u>
<b>Accounts receivable, net</b>	<u>\$ 125</u>	<u>\$ 156</u>

The Company maintains certain agreements with financial institutions to sell certain trade receivables. Receivables are derecognized in their entirety when sold, and the Company's continuing involvement in the sold receivables is limited to their servicing, for which the Company receives a fee commensurate with the service provided. Pursuant to the servicing agreements, the Company collected approximately \$1 million and \$15 million at June 30, 2022 and December 31, 2021, respectively, of these sold receivables that had not yet been remitted to the financial institutions. These unremitted amounts collected on behalf of the financial institutions are included within short-term borrowings and current portion of long-term debt in the Consolidated Balance Sheets.



## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

**Note 4. Inventories**

Inventories consists of the following:

*(Dollars in millions)*

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Raw materials	\$ 49	\$ 43
Work in progress	198	161
Finished goods	2	1
<b>Total</b>	<u>\$ 249</u>	<u>\$ 205</u>

**Note 5. Property, Plant and Equipment**

Property, plant and equipment by major asset class consists of the following:

*(Dollars in millions)*

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Land, buildings and improvements	\$ 321	\$ 312
Plant and machinery	194	191
Equipment and other	303	298
Total property, plant and equipment, at cost	818	801
Less accumulated depreciation	(455)	(437)
<b>Total property, plant and equipment, net</b>	<u>\$ 363</u>	<u>\$ 364</u>

Depreciation expense related to property, plant and equipment was \$14 million and \$27 million for the three- and six-month periods ended June 30, 2022, and \$12 million and \$24 million for the three- and six-month periods ended June 30, 2021, respectively.

**Note 6. Other Liabilities**

A summary of significant other liabilities by balance sheet caption follows:

*(Dollars in millions)*

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
Salaries, wages and accrued bonuses	\$ 46	\$ 70
Fringe benefits	75	74
Litigation	10	10
Restructuring costs	1	4
Provision for contract losses	57	48
Operating lease liabilities	22	24
Other <sup>(1)</sup>	68	65
<b>Total other current liabilities</b>	<b>\$ 279</b>	<b>\$ 295</b>
Operating lease liabilities	\$ 68	\$ 73
Other	2	1
<b>Total other noncurrent liabilities</b>	<b>\$ 70</b>	<b>\$ 74</b>

(1) Consists primarily of taxes payable, environmental remediation reserves and warranty reserves. *See Note 15: Commitments and Contingencies for more information regarding the warranty provision.*

## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

**Note 7. Goodwill**

Changes in the carrying amount of goodwill by reportable segment are as follows:

*(Dollars in millions)*

	ASC	IMS	Total
<b>Balance as of December 31, 2021</b>	\$ 652	\$ 419	\$ 1,071
Reclassification to assets held for sale	(117)	—	(117)
Acquisition adjustment	(2)		(2)
<b>Balance as of June 30, 2022</b>	<u>533</u>	<u>419</u>	<u>952</u>

**Note 8. Intangible Assets**

Other intangible assets mainly refer to the fair value of existing customer contractual relationships attributable to the acquired business and patents which are being amortized over their respective lives. The fair value of intangible assets typically is determined, as of the date of acquisition, based on estimates and judgments regarding expectations for the estimated future after-tax earnings and cash flows (including cash flows for working capital) arising from backlog and follow-on sales to the customer over their estimated lives, including the probability of expected future contract renewals and sales, less a contributory assets charge, all of which is discounted to present value.

The following disclosure presents certain information regarding the Company's intangible assets as of June 30, 2022 and December 31, 2021. All intangible assets are being amortized over their estimated useful lives, as indicated below, with no estimated residual values.

	June 30, 2022			December 31, 2021		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
<i>(Dollars in millions)</i>						
Customer relationships	\$ 957	\$ (913)	\$ 44	\$ 957	\$ (908)	\$ 49
Patents and licenses	9	(6)	3	9	(6)	3
<b>Total intangible assets</b>	<u>\$ 966</u>	<u>\$ (919)</u>	<u>\$ 47</u>	<u>\$ 966</u>	<u>\$ (914)</u>	<u>\$ 52</u>

Amortization expense related to intangible assets was \$2 million and \$4 million for the three- and six-month periods ended June 30, 2022 and was \$2 million and \$4 million for the three- and six-month periods ended June 30, 2021.

Customer relationships are amortized on a straight-line basis over their estimated useful lives of 10 to 15 years. Patents and licenses are amortized on a straight-line basis over their estimated useful lives of 5 to 10 years.



## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

**Note 9. Income Taxes**

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of June 30, 2022 and December 31, 2021 are as follows:

(Dollars in millions)

	June 30, 2022	December 31, 2021
Deferred tax assets	\$ 107	\$ 120
Valuation allowance	10	10
Deferred tax assets	97	110
Deferred tax liabilities	51	54
<b>Deferred tax assets, net</b>	<b>\$ 46</b>	<b>\$ 56</b>

Our deferred tax balance associated with our retirement benefit plans includes a deferred tax asset of \$10 million and \$11 million as of June 30, 2022 and December 31, 2021, respectively, that are recorded in accumulated other comprehensive earnings to recognize the funded status of our retirement plans. See *Note 11: Pension and Other Postretirement Benefits* for additional details.

**Note 10. Debt**

The Company's debt consists of the following:

(Dollars in millions)

	June 30, 2022	December 31, 2021
7.5% Term loan due November 30, 2023 <sup>(1)</sup>	\$ 139	\$ 139
5.0% Daylight term loan due October 15, 2024 <sup>(1)</sup>	78	78
Borrowings under revolving credit facility <sup>(1)</sup>	110	—
Finance lease and other	162	161
Short-term borrowings	1	15
<b>Total debt principal</b>	<b>490</b>	<b>393</b>
Less unamortized debt issuance costs and discounts	—	—
<b>Total debt, net</b>	<b>490</b>	<b>393</b>
Less short-term borrowings and current portion of long-term debt	(140)	(41)
<b>Total long-term debt</b>	<b>\$ 350</b>	<b>\$ 352</b>

(1) The Company's debt with related parties consists of two term loans and a working capital credit facility with US Holding, as described below.

***Term Loans***

In January 2009, the Company entered into a credit agreement with its ultimate parent company, Finmeccanica S.p.A. (presently Leonardo S.p.A.) in the amount of \$2 billion (the “2009 Credit Agreement”). The 2009 Credit Agreement was subsequently assigned to US Holding and has a maturity of November 30, 2023. The 2009 Credit Agreement provides for a term loan bearing interest at a rate of 7.5%, with interest payments due semi-annually on June 20 and December 20 in each year (the “7.5% Term loan”). The outstanding balance of the 7.5% Term loan at June 30, 2022 and December 31, 2021 was \$139 million. The fair value of this term loan at June 30, 2022 and December 31, 2021 was \$142 million and \$182 million, respectively; however, the Company has the ability to prepay the outstanding principal balance at the carrying amount without penalty.

In June 2017, the Company entered into an unsecured term loan with US Holding in the principal amount of \$137.5 million, the proceeds of which were used to finance the acquisition of Daylight Solutions, Inc. (the “Daylight

**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

Term Loan”). The Daylight Term Loan had an outstanding balance of \$78 million at June 30, 2022 and December 31, 2021. The fair value of the Daylight Term Loan as of June 30, 2020 and December 31, 2021 was approximately \$81 million and \$84 million, respectively. The Daylight Term Loan matures on October 15, 2024. The Daylight Term Loan has an interest rate of 5.0%, with interest payments due semi-annually on April 15 and October 15.

***Credit Facilities***

The 2009 Credit Agreement provides for a revolving credit facility available for working capital needs of the Company (the “Revolving Credit Facility”). As of June 30, 2022 and December 31, 2021, the Revolving Credit Facility had a credit limit of \$450 million and an interest rate of LIBOR plus 3.5%. There is a commitment fee of 0.25% applied to the unused balance of the Revolving Credit Facility and there are no compensating balance requirements. The outstanding balance as of June 30, 2022 was \$110 million and there was no balance on the Revolving Credit Facility as of December 31, 2021.

The Company also maintains uncommitted working capital credit facilities with certain financial institutions in the aggregate of \$65 million at June 30, 2022 and December 31, 2021, respectively (the “Financial Institution Credit Facilities”). The Financial Institution Credit Facilities are guaranteed by Leonardo S.p.A. The primary purpose of the Financial Institution Credit Facilities is to support standby letter of credit issuances on contracts with customers and also includes a revolving facility with a maximum borrowing limit of \$15 million, which bears interest at LIBOR plus 0.5%. At June 30, 2022 and December 31, 2021, there was no balance outstanding on the revolving facility. The Company had letters of credit outstanding of approximately \$31 million and \$35 million as of June 30, 2022, and December 31, 2021, respectively, which reduces the available capacity of the Financial Institution Credit Facilities by an equal amount.

***Short-term Borrowings***

As of June 30, 2022 and December 31, 2021, the Company recognized \$1 million and \$15 million, respectively, collected on behalf of the buyers of our trade receivables pursuant to our factoring arrangements as short-term borrowings and current portion of long-term debt in the Consolidated Balance Sheets, which approximates its fair value. Refer to *Note 3: Accounts Receivable* for more information.

**Note 11. Pension and Other Postretirement Benefits*****Retirement Plan Summary Information***

The Company maintains multiple pension plans, both contributory and non-contributory, covering employees at certain locations. Eligibility requirements for participation in the plans vary, and benefits generally are based on the participant's compensation and years of service, as defined in the respective plan. The Company's funding policy generally is to contribute in accordance with cost accounting standards that affect government contractors, subject to the Tax Code and regulations thereunder. Plan assets are invested primarily in equities, bonds (both corporate and U.S. government), U.S. government-sponsored entity instruments, cash and cash equivalents and real estate.

The Company also provides postretirement medical benefits for certain retired employees and dependents at certain locations. Participants are eligible for these benefits when they retire from active service and meet the eligibility requirements for the Company's postretirement benefit plans. The Company's contractual arrangements with the U.S. government provide for the recovery of contributions to a Voluntary Employees' Beneficiary Association (“VEBA”) trust and, for non-funded plans, recovery of claims on a pay-as-you-go basis, subject to the Tax Code and regulations thereunder, with the retiree generally paying a portion of the costs through contributions, deductibles and coinsurance provisions.

The Company also maintains certain non-contributory and unfunded supplemental retirement plans. Eligibility for participation in the supplemental retirement plans is limited, and benefits generally are based on the participant's compensation and/or years of service.





## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table summarizes the components of net periodic benefit cost for the Company's pension, postretirement and supplemental retirement plans for the three months ended June 30:

	Defined Benefit Pension Plans		Postretirement Benefit Plan		Supplemental Retirement Plans	
	Three Months Ended June 30, 2022	Three Months Ended June 30, 2021	Three Months Ended June 30, 2022	Three Months Ended June 30, 2021	Three Months Ended June 30, 2022	Three Months Ended June 30, 2021
<i>(Dollars in millions)</i>						
Service cost	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Interest cost	1	2	—	—	—	—
Less Expected return on plan assets	(2)	(2)	—	—	—	—
Amortization of net actuarial loss (gain)	1	—	—	—	—	—
Amortization of prior service cost	—	—	—	—	—	—
Settlement expense (income)	—	—	—	—	—	—
<b>Net periodic benefit cost</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>

The following table summarizes the components of net periodic benefit cost for the Company's pension, postretirement and supplemental retirement plans for the six months ended June 30:

	Defined Benefit Pension Plans		Postretirement Benefit Plan		Supplemental Retirement Plans	
	Six Months Ended June 30, 2022	Six Months Ended June 30, 2021	Six Months Ended June 30, 2022	Six Months Ended June 30, 2021	Six Months Ended June 30, 2022	Six Months Ended June 30, 2021
<i>(Dollars in millions)</i>						
Service cost	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Interest cost	\$ 3	\$ 3	—	—	—	—
Less Expected return on plan assets	\$ (4)	\$ (4)	—	—	—	—
Amortization of net actuarial loss (gain)	\$ 1	\$ 1	—	—	—	—
Amortization of prior service cost	\$ —	\$ —	—	—	—	—
Settlement expense (income)	\$ 1	\$ —	—	—	—	—
<b>Net periodic benefit cost</b>	<b>\$ 1</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>

The expected long-term return on plan assets assumption represents the average rate that the Company expects to earn over the long-term on the assets of the Company's benefit plans, including those from dividends, interest income and capital appreciation. The assumption has been determined based on expectations regarding future rates of return for the plans' investment portfolio, with consideration given to the allocation of investments by asset class and historical rates of return for each individual asset class.

Pension related expenses are reflected in the Total costs of revenues and General and administrative expenses on the Consolidated Statement of Earnings (unaudited).



**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

A one percentage increase or decrease in healthcare trend rates in the table above would have an insignificant impact to our service and interest cost and the postretirement medical obligations.

**Note 12. Share-based compensation plans**

The Company does not have any share-based compensation plans. See *Note 6: Other Liabilities*, for information regarding cash compensation.

**Note 13. Commitments and Contingencies*****Commitments***

The Company's commitments are primarily related to our lease and credit agreements.

***Contingencies***

From time to time we are subject to certain legal proceedings and claims in the ordinary course of business. These matters are subject to many uncertainties and it is possible that some of these matters ultimately could be decided, resolved or settled in a manner adverse to us. Although the precise amount of liability that may result from these matters is not ascertainable, the Company believes that any amounts exceeding the Company's recorded accruals should not materially adversely affect the Company's financial condition or liquidity. It is possible, however, that the ultimate resolution of those matters could result in a material adverse effect on the Company's results of operations and/or cash flows from operating activities for a particular reporting period. We establish reserves for specific legal matters when we determine that the likelihood of an unfavorable outcome is probable and the loss is reasonably estimable.

Some environmental laws, such as the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (also known as "CERCLA" or the "Superfund law") and similar state statutes, can impose liability upon former owners or operators for the entire cost of investigating and remediating contaminated sites regardless of the lawfulness of the original activities that led to the contamination. In July 2000, an entity which later became a subsidiary of the Company received a Section 104(e) Request for Information ("RFI") from the National Park Service ("NPS"), pursuant to CERCLA, regarding the presence of radioactive material at a site within a national park, which site was operated by an alleged predecessor to our subsidiary over 50 years ago. Following the subsidiary's response to the RFI, the NPS directed it and another alleged former operator to perform an Engineering Evaluation and Cost Analysis ("EE/CA") of a portion of the site. The Company's subsidiary made a good faith offer to conduct an alternative EE/CA work plan, but the NPS rejected this offer and opted to perform the EE/CA itself. The NPS previously posted its intention to open a formal public comment period regarding the EE/CA at the end of 2019. To the Company's knowledge, the EE/CA has not been released and a public comment period has yet to be opened.

Following completion of the EE/CA, the NPS may seek reimbursement for its investigative and remedial efforts to date, or direct one or more of the potentially responsible parties to perform any remediation that may be required by CERCLA or may enter an alternative dispute resolution proceeding to attempt to resolve each party's share. In addition, the NPS may seek to recover damages for loss of use of certain natural resources. The Company believes that it has legitimate defenses to its subsidiary's potential liability and that there are other potentially responsible parties for the environmental conditions at the site, including the U.S. government as owner, operator and arranger at the site. The potential liability associated with this matter could change substantially due to such factors as additional information on the nature or extent of contamination, methods of remediation that might be recommended or required, changes in the apportionment of costs among the responsible parties, whether the NPS seeks to recover additional damages, whether the NPS's plans to investigate additional areas to identify a need for further remedial action for which the Company may be identified as a potentially responsible party and other actions by governmental agencies or private parties.

The Company has recorded its best estimate of damages and its share of remediation costs related to the site to reflect what we and our advisors reasonably believe we would be liable for based on the current information and circumstances of the claim, exclusive of other potential liabilities that may be asserted in the future.



## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

In the performance of our contracts we routinely request contract modifications that require additional funding from the customer. Most often, these requests are due to customer-directed changes in the scope of work. While we are entitled to recovery of these costs under our contracts, the administrative process with our customer may be protracted. Based on the circumstances, we periodically file requests for equitable adjustment (“REAs”) that are sometimes converted into claims. In some cases, these requests are disputed by our customer. We believe our outstanding modifications, REAs and other claims will be resolved without material impact to our results of operations, financial condition or cash flows.

As a government contractor, with customers including the U.S. government as well as various state and local government entities, the Company may be subject to audits, investigations and claims with respect to its contract performance, pricing, costs, cost allocations and procurement practices. Additionally, amounts billed under such contracts, including direct and indirect costs, are subject to potential adjustments before final settlement.

Management believes that adequate provisions for such potential audits, investigations, claims and contract adjustments, if any, have been made in the financial statements.

***Product Warranties***

Product warranty costs generally are accrued in proportion to product revenue realized in conjunction with our over-time revenue recognition policy. Product warranty expense is recognized based on the term of the product warranty, generally one year to three years, and the related estimated costs, considering historical claims expense. Accrued warranty costs are reduced as these costs are incurred and as the warranty period expires, and otherwise may be modified as specific product performance issues are identified and resolved. The following is a summary of changes in the product warranty balances during the period ended June 30, 2022:

*(Dollars in millions)*

<b>Balance as of December 31, 2021</b>	\$	19
Additional provision		6
Reversal and utilization		(6)
<b>Balance as of June 30, 2022</b>		<u>19</u>

**Note 14. Related Party Transactions**

The Company provides services related to the US interface for the Parent and its other affiliates. These services include financial, tax, trade compliance, marketing and communications and legal.

The Company also has related-party sales with the Parent and its other affiliates that occur in the regular course of business.

Related-party sales for these transactions are included in revenues and were \$54 million and \$4 million or the six-month periods ended June 30, 2022 and June 30, 2021, respectively and \$51 million and \$2 million for the three-month periods ended June 30, 2022 and June 30, 2021 respectively.

The Company has related-party purchases with the Parent and its other affiliates that occur in the regular course of business. Related-party purchases for these transactions are included in cost of revenues and were \$18 million and \$6 million for the six-month periods ended June 30, 2022 and June 30, 2021, respectively and related-party purchases for these transactions are included in cost of revenues for the three-month periods ended June 30, 2022 and June 30, 2021 were \$7 million and \$5 million, respectively.

The receivables related to these transactions with the Parent and its other affiliates of \$17 million and \$2 million as of June 30, 2022 and December 31, 2021, respectively, and payables of \$9 million and \$1 million respectively, are recorded in our Consolidated Balance Sheets. An unbilled receivable with the Parent and its other affiliates of \$36 million is included in contract assets in our Consolidated Balance Sheets as of June 30, 2022.



## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company entered into a Surplus Treasury Agreement with US Holding (the “Surplus Agreement”) in December 2019. The Surplus Agreement allows the Company to advance excess funds to US Holding when funds are available. The advances bear interest at LIBOR plus between 5 and 20 basis points depending on the tenor of the advance. As of June 30, 2022 and December 31, 2021 the Company did not advance any amount to US Holding.

The Company entered into Tax Allocation Agreement with US Holding, dated as of November 16, 2020. Refer to *Note 1: Summary of Significant Accounting Policies* for more information.

**Note 15. Segment Information**

Operating segments represent components of an enterprise for which separate financial information is available that is regularly reviewed by the CODM in determining how to allocate resources and assess performance. Our Chief Executive Officer is our CODM and he uses a variety of measures to assess the performance of the Company as a whole, depending on the nature of the activity. Beginning in the first quarter of 2022, the Company’s operating and reportable segments were revised into two reportable segments, ASC and IMS, to align our market strategy and capital allocation decision making with our operating structure. Prior year information was revised to reflect the new segment structure. All other operations, which consists primarily of DRS Corporate Headquarters and certain non-operating subsidiaries of the Company, are grouped in Corporate & Eliminations.

We primarily use Adjusted EBITDA to manage the Company and allocate resources. Adjusted EBITDA of our business segments includes our net earnings before income taxes, amortization of acquired intangible assets, depreciation, restructuring costs, interest, transaction costs related to an anticipated offering of securities, acquisition and divestiture related expenses, foreign exchange, COVID-19 response costs, non-service pension expenditures and other one-time non-operational events. Adjusted EBITDA is used to facilitate a comparison of the ordinary, ongoing and customary course of our operations on a consistent basis from period to period and provide an additional understanding of factors and trends affecting our business segments. This measure assists the CODM in assessing segment operating performance consistently over time without the impact of our capital structure, asset base and items outside the control of the management team and expenses that do not relate to our core operations.

Certain information related to our segments for the three- and six-month periods ended June 30, 2022 and June 30, 2021 is presented in the following tables. Consistent accounting policies have been applied by all segments within the Company, within all reporting periods. A description of our reportable segments as of June 30, 2022 and June 30, 2021 has been included in *Note 1: Summary of Significant Accounting Policies*. Transactions between segments generally are negotiated and accounted for under terms and conditions that are similar to other government and commercial contracts; however, these intercompany transactions are eliminated in consolidation.

Total revenues and intersegment revenues by segment for the three- and six-month periods ended June 30, 2022 and, June 30, 2021 consists of the following:

<i>(Dollars in millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
ASC	\$ 444	\$ 489	\$ 840	\$ 97
IMS	187	174	405	37
Corporate & Eliminations	(4)	(4)	(6)	(
<b>Total revenue</b>	<b>\$ 627</b>	<b>\$ 658</b>	<b>\$ 1,239</b>	<b>\$ 1,33</b>

*(Dollars in millions)*

	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
ASC	\$ 3	\$ 4	\$ 5	\$
IMS	1	—	1	-
<b>Total intersegment revenue</b>	<u>\$ 4</u>	<u>\$ 4</u>	<u>\$ 6</u>	<u>\$</u>



## LEONARDO DRS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Depreciation by segment for the three- and six-month periods ended June 30, 2022 and June 30, 2021 consists of the following:

<i>(Dollars in millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
ASC	\$ 9	\$ 8	\$ 18	\$ 1
IMS	5	4	9	
<b>Total depreciation</b>	<b>\$ 14</b>	<b>\$ 12</b>	<b>\$ 27</b>	<b>\$ 2</b>

Total assets by segment as of June 30, 2022 and December 31, 2021 consist of the following:

<i>(Dollars in millions)</i>	June 30, 2022	December 31, 2021
ASC	\$ 1,619	\$ 1,54
IMS	1,124	1,14
Corporate & Eliminations	126	37
Held for Sale	174	-
<b>Total assets</b>	<b>\$ 3,043</b>	<b>\$ 3,06</b>

Reconciliation of reportable segment Adjusted EBITDA to Net Earnings (loss) consists of the following:

(Dollars in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
<b>Adjusted EBITDA</b>				
ASC	\$ 57	\$ 61	\$ 89	\$ 11
IMS	10	7	51	2
Corporate & Eliminations	—	1	—	-
<b>Total Adjusted EBITDA</b>	<u>67</u>	<u>69</u>	<u>140</u>	<u>14</u>
Amortization of intangibles	(2)	(2)	(4)	(
Depreciation	(14)	(12)	(27)	(2
Restructuring costs	—	—	—	-
Interest expense	(10)	(9)	(18)	(1
Deal related transaction costs	(8)	—	(10)	(
Acquisition and divestiture related expenses	—	—	—	-
Foreign exchange	—	(1)	—	(
COVID-19 response costs	—	(2)	—	(
Non-service pension expense	(1)	—	(1)	-
Other one-time non-operational events	—	—	—	-
Income tax (provision) benefit	(7)	(11)	(19)	(2
<b>Net earnings</b>	<u>\$ 25</u>	<u>\$ 32</u>	<u>\$ 61</u>	<u>\$ (</u>

**LEONARDO DRS, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****Note 16. Subsequent Events**

The Company has evaluated subsequent events through August 15, 2022, which represents the date on which the Consolidated Financial Statements were issued.

On August 4, 2022, the Board of Directors approved a \$396 million dividend to US Holding which was paid on August 5, 2022. The dividend was paid from proceeds received from the completion of the sale of GES on August 1, 2022, and the sale of ACC on July 8, 2022.



## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*You should read this discussion together with our consolidated financial statements and related notes thereto included elsewhere in this Quarterly Report.*

*This discussion and other parts of this Quarterly Report include forward-looking statements such as those relating to our plans, objectives, expectations and beliefs, which involve risks, uncertainties and assumptions. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties discussed under "Special Note Regarding Forward-Looking Statements and Information" and Part II, Item 1A. "Risk Factors" in this Quarterly Report, and under "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year end December 31, 2021, filed with the SEC on March 28, 2022. Actual results may differ materially from those contained in any forward-looking statements.*

### Business Overview and Considerations

#### *General*

DRS is a leading provider of defense products and technologies that provide battlefield superiority today while shaping the battlefield of tomorrow for the U.S. military and our allies abroad. We offer a broad portfolio of products and services in our core technologies including advanced sensing, network computing, force protection, and electric power conversion and propulsion. Our leadership positions in these markets have created a foundational base of programs within the DoD that has yielded five straight years of organic revenue growth. We believe these technologies will not only support our Armed Services in today's mission but will also underpin the DoD's strategy to migrate towards more autonomous, dynamic, interconnected, and multi-domain capabilities needed to win in tomorrow's battlefield. We expect that the DoD's focus on effectively countering growing peer threats from China and Russia while simultaneously pursuing a counter-terrorism strategy against asymmetrical organizations and actors will increase its reliance on the core technologies that DRS provides, reinforcing our position in our high growth markets.

Our overall strategy is to be a balanced and diversified company, less vulnerable to any one budgetary platform or service decision with a specific focus on establishing strong technical and market positions in areas of priority for the U.S. Department of Defense ("DoD"). The DoD is our largest customer. For the second quarter and first six months of 2022, the DoD accounted for approximately 78% and 82%, respectively, of our business as an end-user. The revenues for the three- and six-month periods ended June 30, 2022 are principally derived directly or indirectly from contracts with the U.S. Army, which represented 33% and 33%, respectively, and the U.S. Navy, which represented 29% and 32%, respectively, of our consolidated revenue, in each case consistent with historic trends.

Our operations and reporting are structured into the following two technology driven segments based on the capabilities and solutions offered to our customers:

*Advanced Sensing and Computing ("ASC"):* Our Advanced Sensing and Computing segment is organized to provide equipment that enables the capture and communication of value battlefield information necessary to ensure our armed forces are equipped with real-time intelligence required to deliver enhanced decision making and execution in theater. From leading long-range sensing capabilities, expanding our reach, to rugged, trusted, and cyber resilient computing, our ASC products provide our customers with the ability to be successful in their mission.

Our ASC segment provides ground vehicle systems including third generation infrared, long-range threat detection, situational awareness, targeting and vehicle protection. Additionally, we offer a full complement of soldier systems, including next generation sensors, targeting systems and optics to improve infantry combat effectiveness. Our sensing technologies also support aircraft survivability through advanced two-color infrared sensors and our quantum cascade lasers which detect and protect aircraft from missile attacks.

In addition to our optical sensing systems, we utilize state of the art technology in EW and cyber systems to provide our customers integrated capabilities for multi-domain operations to supplement kinetic warfare. Our



mounted and dismounted EW systems and intelligence solutions across a broad range of platforms bring world-class capability to our customers.

Our sensing capabilities are complemented by our network computing and communications products. We are the leading global supplier of battle management systems and mounted computing hardware for ground forces worldwide. For the U.S. and allied naval customers, we provide naval computing systems and networks, shipboard communications, radar, surface ship and submarine combat and command and control systems.

*Integrated Mission Systems (“IMS”)*: Our Integrated Mission Systems segment consists of both land and naval system integration capabilities. The IMS segment provides critical force protection, vehicle integration, transportation and logistics and electrical control, distribution and conversion, and ship propulsion systems to the U.S. military and allied forces.

Our force protection systems provide protection for our service members and military assets from evolving threats and include advanced solutions for counter-unmanned aerial systems, short-range air defense systems and active protection systems on ground vehicles. We have military transportation and logistics offerings and ground vehicle integration capabilities to support U.S. forces in a wide range of operational environments.

Additionally, we provide power conversion and propulsion systems for the U.S. Navy’s top priority shipbuilding programs, building on our legacy of providing power components and systems for nearly all naval combat vessels for three decades, positioning us to continue as a leading provider of electrical ship propulsion systems and components for the U.S. Navy.

### ***Focus on Customer and Execution***

DRS and its employees focus on our end-customers – the men and women of the armed forces in the U.S. and its allies. We seek to provide high-quality equipment and services to support their mission success. We strive for excellence in everything we do, in every job in our Company, in order to satisfy our customers’ needs embedded in our contractual commitments. We seek to ensure that we learn from every lesson experienced in our Company and insist that these lessons affect all elements of our businesses. This approach permeates through the Company with a focus on continuous improvement at every level.

Part of this learning has resulted in institutionalizing our continuous improvement process through our Operational Excellence initiative called “Always Performing For Excellence,” or “APEX,” program. The APEX program’s goal is to strive for continuous improvement through unification of our business practices, tools and metrics, ongoing employee training and innovation. We believe that excellence is not a destination, but by constantly challenging ourselves to be better, we will improve, and ultimately approach excellence. We challenge ourselves to exceed our customers’ expectations and we partner with them to work to ensure that our execution meets their needs.

Continuous improvement, through the APEX program also allows us to improve our efficiency, which contributes to increased margins, helps us to remain competitive and allows us to make strategic investments, all while maintaining our focus on customer satisfaction. In these elements, our goals are aligned with those of our customers. We are humbled by the dedication and sacrifice that our ultimate customers have made to serve and we work to perform for them with excellence in everything we do.

### ***Impacts of COVID-19 On Our Business***

The coronavirus (“COVID-19”) pandemic has caused significant disruptions to national and global economies and government activities since March 2020. We continue to closely monitor COVID-related impacts on all aspects of our business and geographies, including on our workforce, supply chain and customers.

The United States has taken several steps to respond to the pandemic. On September 9, 2021, President Biden announced a COVID-19 action plan, including an executive order, the Safer Workforce Task Force guidance issued on September 24, 2021 and the DoD’s Force Health Protection guidance. This executive order and guidance (as amended) contained a clause that required covered federal contractors and subcontractors to implement federally required vaccine mandates. This clause was implemented into several of our applicable federal contracts. In light of





certain of certain court orders, however, the Office of Management and Budget has stated that the U.S. Government will not take action to enforce this clause until further notice. If ultimately upheld, this federal contract requirement may impact several of our contracts. We are continuing to evaluate these evolving requirements, especially as our customers determine when and how to implement the potential contractual requirements. We cannot at this stage predict the various impacts they may have on our workforce, our suppliers, or our company. These evolving government requirements, along with broader impacts of the continuing pandemic, could impact our workforce and performance, as well as those of our suppliers.

We continue to follow the practice started in the first quarter of 2022 that any remaining additional costs to operate our business in response to the COVID-19 environment should be reported as part of our normal business operations and not separately identified as an adjustment to EBITDA. In addition to the challenges that COVID-19 is presenting to the industry and our Company, significant adverse supply chain disruptions continue throughout the industry and for the Company, including delays in the receipt and delivery of materials,

### ***Business Environment***

Revenues derived directly, as a prime contractor, or indirectly, as a subcontractor, from contracts with the U.S. government represented 78% and 82% of our consolidated revenue for the second quarter and first six months of 2022, respectively, and 85% and 86% of our consolidated revenue for the second quarter and first six months of 2021. Of these sales directly to the U.S. government, the Army and Navy are our largest customers. For the three- and six-month periods ended June 30, 2022, U.S. government sales with the U.S. Army represented 33% and 33% and U.S. government sales with the U.S. Navy represented 29% and 32%, respectively, of our consolidated revenue. For the three- and six-month periods ended June 30, 2021, U.S. government sales with the U.S. Army represented 31% and 38% and U.S. government sales with the U.S. Navy represented 32% and 31%, respectively, of our consolidated revenue.

The Second Quarter was highlighted by congressional defense committee work on Fiscal Year 2023 (“FY 23”) authorization and appropriations legislation following the President’s FY23 budget release in the first quarter of the calendar year. The first committee to act was the Senate Armed Services Committee making up their version in closed session of the FY23 National Defense Authorization Act. Next, the House Defense Appropriations Committee completed work on their version of FY23 appropriations legislation. Finally, the House Armed Services Committee considered their authorization legislation passing it in full committee. This bill likely be brought to the full House in the third quarter.

In February 2022, Russian forces invaded Ukraine. In response, the United States and several other countries imposed economic and trade sanctions, export controls and other restrictions targeting Russia and Belarus. The conflict and these sanctions have caused disruptions to global economies and some global businesses, including heightened cybersecurity risks, supply chain challenges, increased energy costs, foreign currency exchange rate fluctuations, as well as an exacerbation of existing inflationary pressures. In addition, the Russia-Ukraine conflict has created some potential supply chain challenges for our Company and our suppliers, which we will continue to monitor and manage.

The Russia-Ukraine conflict may also impact the FY23 U.S. government defense budget due to the heightened national security threat. Internationally, many countries in the region have expressed a renewed commitment to defense-related spending. As a result, we may see additional demand for our products and services.

## **Key Financial and Operating Measures**

### ***Overview***

We measure our business using both key financial and operating data including key performance indicators (“KPIs”) and non-GAAP financial measures and use the following metrics to manage our business, monitor results of operations and ensure proper allocation of capital: (i) Revenue, (ii) Bookings, (iii) Backlog, (iv) Adjusted EBITDA, (v) Adjusted EBITDA Margin, (vi) Adjusted Earnings Per Share (“EPS”) and (vii) Free Cash Flow. We



believe that these financial performance metrics represent the primary drivers of value enhancement, balancing both short and long-term indicators of increased shareholder value. These are the metrics we use to measure our results and evaluate our business and related contract performance. See “—Results from Operations” for further detail.

### ***Financial and Operating Data***

<i>(Dollars in millions, except per share amounts)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Total revenues	\$ 627	\$ 658	\$ 1,239	\$ 1,339
Bookings	683	720	1,430	1,435
Backlog	3,051	3,387	3,051	3,387
Adjusted EBITDA <sup>(1)</sup>	67	69	140	140
Adjusted EBITDA Margin <sup>(1)</sup>	10.8%	10.5%	11.3%	10.4%
Adjusted EPS <sup>(1)(2)</sup>	\$ 0.23	\$ 0.23	\$ 0.49	\$ 0.48
Free Cash Flow <sup>(1)</sup>	\$ 4	\$ 48	\$ (264)	\$ (214)

(1) Note on non-GAAP financial measures: Throughout the discussion of our results of operations we use non-GAAP financial measures including Adjusted EBITDA, Adjusted EBITDA Margin, Adjusted EPS and Free Cash Flow, as measures of our overall performance. Definitions and reconciliations of these measures to the most directly comparable financial measure calculated and presented in accordance with U.S. GAAP are included below.

(2) Gives effect to a 1,450,000-for-1 forward stock split on our common stock effected on February 25, 2021.

*Bookings* - We define bookings as the total value of contract awards received from the U.S. government for which it has appropriated funds and legally obligated such funds to the Company through a contract or purchase order, plus the value of contract awards and orders received from customers other than the U.S. government.

*Backlog* - We define Backlog to include the following components:

- (1) **Funded** - Funded backlog represents the revenue value of orders for services under existing contracts for which funding is appropriated or otherwise authorized less revenue previously recognized on these contracts.
- (2) **Unfunded** - Unfunded backlog represents the revenue value of firm orders for products and services under existing contracts for which funding has not yet been appropriated less funding previously recognized on these contracts.

The unfunded and funded backlog combine to equal the total backlog as depicted in the table below at the respective date presented:

<b>Backlog:</b>	<b>June 30, 2022</b>
<i>(Dollars in millions)</i>	
<b>Total Backlog</b>	<b>\$ 3,051</b>

***Non-GAAP Financial Measures***

We believe the non-GAAP financial measures presented in this Quarterly Report will help investors understand our financial condition and operating results and assess our future prospects. We believe these non-GAAP financial measures, each of which is discussed in greater detail below, are important supplemental measures because they exclude unusual or non-recurring items as well as non-cash items that are unrelated to or may not be indicative of our ongoing operating results. Further, when read in conjunction with our U.S. GAAP results, these non-GAAP financial measures provide a baseline for analyzing trends in our underlying businesses and can be used by management as a tool to help make financial, operational and planning decisions. Finally, these measures are often

used by analysts and other interested parties to evaluate companies in our industry by providing more comparable measures that are less affected by factors such as capital structure.

We recognize that these non-GAAP financial measures have limitations, including that they may be calculated differently by other companies or may be used under different circumstances or for different purposes, thereby affecting their comparability from company to company. In order to compensate for these and the other limitations discussed below, management does not consider these measures in isolation from or as alternatives to the comparable financial measures determined in accordance with U.S. GAAP. Readers should review the reconciliations below and should not rely on any single financial measure to evaluate our business.

We define these non-GAAP financial measures as:

*Adjusted EBITDA and Adjusted EBITDA Margin* - We define Adjusted EBITDA as our net earnings before income taxes, amortization of acquired intangible assets, depreciation, restructuring costs, interest, transaction costs related to an anticipated offering of securities, acquisition and divestiture related expenses, foreign exchange, COVID-19 response costs, non-service pension expenditures and other one-time non-operational events. Adjusted EBITDA Margin is calculated by dividing Adjusted EBITDA by revenue. Adjusted EBITDA and Adjusted EBITDA Margin are not measures calculated in accordance with U.S. GAAP, and they should not be considered an alternative to any financial measures that were calculated under U.S. GAAP. Adjusted EBITDA and Adjusted EBITDA Margin are used to facilitate a comparison of the ordinary, ongoing and customary course of our operations on a consistent basis from period to period and provide an additional understanding of factors and trends affecting our business. Adjusted EBITDA and Adjusted EBITDA Margin are driven by changes in volume, performance, contract mix and general and administrative expenses and investment levels. Performance, as used in this definition, refers to changes in profitability and is primarily based on adjustments to estimates at completion on individual contracts. These adjustments result from increases or decreases to the estimated value of the contract, the estimated costs to complete the contract, or both. These measures therefore assist management and our board and may be useful to investors in comparing our operating performance consistently over time as they remove the impact of our capital structure, asset base and items outside the control of the management team and expenses that do not relate to our core operations. Adjusted EBITDA and Adjusted EBITDA Margin may not be comparable to similarly titled non-GAAP measures used by other companies as other companies may have calculated the measures differently. The reconciliation of Adjusted EBITDA to net earnings (loss) is provided below:

*Consolidated Entity Adjusted EBITDA Reconciliation:*

<i>(Dollars in millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Net earnings (loss)	\$ 25	\$ 32	\$ 61	\$ 61
Income tax provision (benefit)	\$ 7	\$ 11	\$ 19	\$ 23
Amortization of intangibles	\$ 2	\$ 2	\$ 4	\$ 4
Depreciation	14	12	27	24
Restructuring costs	—	—	—	—
Interest expense	10	9	18	18
Deal related transaction costs	8	—	10	4
Foreign exchange	—	1	—	1
COVID-19 response costs	—	2	—	5
Non-service pension expense	1	—	1	—
Other one-time non-operational events	—	—	—	—
Adjusted EBITDA	<u>\$ 67</u>	<u>\$ 69</u>	<u>\$ 140</u>	<u>\$ 140</u>

*Adjusted EPS* – We calculate Adjusted EPS by excluding transaction costs related to an anticipated offering of securities, acquisition and divestiture related expenses and COVID-19 response costs from our net earnings (loss) to arrive at Adjusted EPS. We believe that Adjusted EPS allows investors to effectively compare our core performance from period to period by excluding items that are not indicative of, or are unrelated to, results from our ongoing business operations such as our capital structure, significant non-cash expenses, the impacts of financing decisions on earnings, and items incurred outside the ordinary, ongoing and customary course of our business. Adjusted EPS has limitations as an analytical tool and does not represent, and should not be considered an alternative to basic or diluted EPS as determined in accordance with U.S. GAAP. The reconciliation of Adjusted EPS to U.S. GAAP EPS is shown below:

*Consolidated Entity Reconciliation of Adjusted EPS:*

<i>(Dollars in millions, except per share amounts)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Net earnings (loss)	\$ 25	\$ 32	\$ 61	\$ 61
Deal related transaction costs	\$ 8	\$ —	\$ 10	\$ 4
COVID-19 response costs	\$ —	\$ 2	\$ —	\$ 5
Adjusted net earnings (loss)	<u>\$ 33</u>	<u>\$ 34</u>	<u>\$ 71</u>	<u>\$ 70</u>
Adjusted EPS <sup>(1)</sup>	\$0.23	\$0.23	\$0.49	\$0.48

(1) Gives effect to a 1,450,000-for-1 forward stock split on our common stock effected on February 25, 2021.



*Free Cash Flow* – We define free cash flow as the sum of the cash flows provided by operating activities and the cash flows provided by (used in) investment activities pertaining to capital expenditures and proceeds generated from the sale of capital assets.

We believe that free cash flow provides management and investors with an important measure of our ability to generate cash on a normalized basis. Free cash flow also provides insight into our flexibility to allocate capital and pursue opportunities that may enhance shareholder value. We believe that while expenditures and dispositions of property, plant and equipment will fluctuate period to period, we seek to ensure that we have adequate capital on hand to maintain ongoing operations and enable growth of the business. Additionally, free cash flow is of limited usefulness, in that it does not represent residual cash flows available for discretionary expenditures, due to the fact the measures do not deduct the payments required for debt service and other contractual obligations or payments. The reconciliation between free cash flow and net cash provided by operating activities (the most comparable U.S. GAAP measure) is shown below:

*Consolidated Entity Reconciliation of Free Cash Flow:*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
<i>(Dollars in millions)</i>				
Net Cash provided by (used in)	\$ 13	\$ 64	\$ (242)	\$ (185)
Capital expenditures	(9)	(16)	(22)	(29)
Proceeds from sales of assets	—	—	—	—
Free cash flow	\$ 4	\$ 48	\$ (264)	\$ (214)

## Factors Impacting Our Performance

### *U.S. Government Spending and Federal Budget Uncertainty*

Changes in the volume and relative mix of U.S. government spending as well as areas of spending growth could impact our business and results of operations. In particular, our results can be affected by shifts in strategies and priorities on homeland security, intelligence, defense-related programs, infrastructure and urbanization and continued increased spending on technology and innovation, including cybersecurity, artificial intelligence, connected communities and physical infrastructure. Cost-cutting and efficiency initiatives, current and future budget restrictions, spending cuts and other efforts to reduce government spending and shifts in overall priorities (for example, in response to the COVID-19 pandemic) could cause our government customers to reduce or delay funding or invest appropriated funds on a less consistent basis or not at all, and demand for our solutions or services could diminish. Furthermore, any disruption in the functioning of government agencies, including as a result of government closures and shutdowns, could have a negative impact on our operations and cause us to lose revenue or incur additional costs due to, among other things, our inability to maintain access and schedules for government testing or deploy our staff to customer locations or facilities as a result of such disruptions.

There is also uncertainty around the timing, extent, nature and effect of Congressional and other U.S. government actions to address budgetary constraints, caps on the discretionary budget for defense and non-defense departments and agencies, and the ability of Congress to determine how to allocate the available budget authority and pass appropriations bills to fund both U.S. government departments and agencies that are, and those that are not, subject to the caps. Additionally, budget deficits and the growing U.S. national debt, including as a result of legislative actions in response to the COVID-19 pandemic, may increase pressure on the U.S. government to reduce federal spending across all federal agencies, with uncertainty about the size and timing of those reductions. Furthermore, delays in the completion of future U.S. government budgets could in the future delay



procurement of the federal government services we provide. A reduction in the amount of, or reductions, delays, or cancellations of funding for, services that we are contracted to provide to the U.S. government as a result of any of these impacts or

related initiatives, legislation or otherwise could have a material adverse effect on our business and results of operations.

### ***Operational Performance on Contracts***

Revenue, earnings (margin) and the timing of our cash flows depend on our ability to perform on our contracts. When agreeing to contractual terms, our management team makes assumptions and projections about future conditions and events. The accounting for our contracts and programs requires assumptions and estimates about these conditions and events. These projections and estimates assess:

- the productivity and availability of labor;
- the allocation of indirect costs to labor and material costs incurred;
- the complexity of the work to be performed;
- the cost and availability of materials and components; and
- schedule requirements.

If there is a significant change in one or more of these circumstances, estimates or assumptions, or if the risks under our contracts are not managed adequately, the profitability of contracts could be adversely affected. This could affect earnings and margin materially.

In particular, profitability can fluctuate predicated on the type of contract awarded. Typically fixed-price development programs on complex systems represent a higher risk profile to complete on-budget. To the extent our fixed-price development efforts create a larger portion of our revenue output, this may result in reduced operating margins given the higher risk profile. The following represents the impact that changing certain of our estimates, which are primarily attributed to changes in our firm-fixed-price type programs. They consist of changes in the designs required to achieve contractual specifications for fixed priced development programs and inflationary impacts on certain naval production programs that resulted in a change in the programs' estimate and related profitability. The reduction to revenue for the three- and six-month periods ended June 30, 2022 and June 30, 2021 was attributed primarily to certain cost impacts on surface ship programs within our IMS segment and inflationary pressures on naval programs within our ASC segment.

### ***Impact of Change in Estimates on our Revenue Results***

<i>(Dollars in millions)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2022</b>	<b>2021</b>	<b>2022</b>	<b>2021</b>
Revenue	\$ (10)	\$ (8)	\$ (11)	\$ (9)
Total % of Revenue	1.6 %	1.3 %	0.9 %	0.7 %

Additionally, the timing of our cash flows is impacted by the timing of achievement of billable milestones on contracts. Historically, this has resulted and could continue to result in fluctuations in working capital levels and quarterly free cash flow results. As a result of such quarterly fluctuations in free cash flow results, we believe that quarter-to-quarter comparisons of our results of operations may not necessarily be meaningful and should not be relied upon as indicators of future performance.

### ***Regulations***

Increased audit, review, investigation and general scrutiny by U.S. government agencies of performance under government contracts and compliance with the terms of those contracts and applicable laws could affect our operating results. Negative publicity and increased scrutiny of government contractors in general, including us, relating to government

expenditures for contractor services and incidents involving the mishandling of sensitive or classified information as well as the increasingly complex requirements of the DoD and the United States

intelligence community, including those related to cybersecurity, could impact our ability to perform in the markets we serve.

### ***International & Commercial Sales***

International revenue, including foreign military sales, foreign military financing, and direct commercial sales, accounted for approximately 22% and 18% of our revenue for the three- and six-months ended June 30, 2022, respectively, and 15% and 14% of our revenue for the three- and six-months ended June 30, 2021. The increase is due in part to increased purchases resulting from new and expanded military aid programs in support of Ukraine in its conflict with Russia. Since our focus is primarily with the DoD and our investments are focused as such, we anticipate that international sales will continue to account for a similar percentage of revenue in the future. We remain subject to the spending levels, pace and priorities of the U.S. government as well as international governments and commercial customers, and to general economic conditions that could adversely affect us, our customers and our suppliers.

Additionally, some international sales may expose us to foreign exchange fluctuations and changing dynamics of foreign competitiveness based on variations in the value of the U.S. dollar relative to other currencies. The impact of those fluctuations is reflected throughout our Consolidated Financial Statements, but in the aggregate, did not have a material impact on our results of operations for three- and six-month periods ended June 30, 2022.

### ***Acquisitions, Divestitures and Held for Sale***

We consider the acquisition of businesses and investments that we believe will expand or complement our current portfolio and allow access to new customers or technologies. We also may explore the divestiture of businesses that no longer meet our needs or strategy or that could perform better outside of our organization. On March 22, 2022 we announced the signing of a definitive sale agreement for 100% of the stock of our Global Enterprise Solutions (“GES”) operating unit, which was completed on August 1, 2022 and on April 19, 2022 we signed a definitive sale agreement for our 51% ownership stake in our Advanced Acoustics Concepts Joint Venture with Thales (“AAC”), which was completed on July 8, 2022. The assets and liabilities of GES and our investment in AAC were both been classified as held for sale on the Consolidated Balance Sheets as of June 30, 2022.

## **Components of Operations**

### ***Revenue***

Revenue consists primarily of product related revenue, generating 88% of our total revenues for the second quarter and first six months of 2022. Our remaining revenue is generated from service related contracts. Additionally, 87% of our revenue is derived from firm-fixed priced contracts for three- and six-month periods ended June 30, 2022. This is consistent for both contract types when compared to product sales and firm-fixed priced sales of 86% and 87%, respectively, for the three- and six- month periods ended June 30, 2021.

Under flexibly priced contracts, we are reimbursed for allowable or otherwise defined total costs (defined as cost of revenues plus allowable general and administrative expenses) incurred, plus a fee. The contracts may also include incentives for various performance criteria, including quality, timeliness, cost-effectiveness or other factors. For the second quarter and first six months of 2022 flexible priced contracts represented 13% respectively, of our total revenues. This is consistent for flexible priced contracts sales of 14% and 13%, respectively, for the three- and six- month periods ended June 30, 2021.

Please refer to *Note 1. Summary of Significant Accounting Policies* and *Note 2. Revenue from Contracts with Customers* in the Notes to our Consolidated Financial Statements.

### ***Cost of Revenues***

Cost of revenues includes materials, labor and overhead costs incurred in the manufacturing, design, and provision of products and services sold in the period as well as warranty costs. Material costs include raw materials,



purchased components and sub-assemblies and outside processing and inbound freight. Labor and overhead costs consist of direct and indirect manufacturing costs, including wages and fringe benefits, operating supplies, depreciation and amortization, occupancy costs, and purchasing, receiving, inspection costs and inbound freight costs.

### ***General and Administrative Expenses***

General and administrative expenses include general and administrative expenses not included within cost of revenues such as salaries, wages and fringe benefits, facility costs and other costs related to these indirect functions. Additionally, general and administrative expenses include internal research and development costs as well as expenditures related to bid and proposal efforts. We expect general and administrative expenses will be impacted by the costs associated with being a publicly-traded company.

### **Results from Operations**

The following discussion of operating results is intended to help the reader understand the results of operations and financial condition of the Company, as well as individual segments, for the second quarter and first six months of 2022, as compared to the second quarter and first six months of 2021. Given the nature of our business, we believe revenue and earnings from operations are most relevant to an understanding of our performance at a business and segment level. Our operating cycle is lengthy and involves various types of production contracts and varying delivery schedules. Accordingly, operating results in a particular year may not be indicative of future operating results.

			June 30, 2022 vs. June 30, 2021 Variance	
	Three Months Ended June 30, 2022	Three Months Ended June 30, 2021		
<i>(Dollars in millions, except per share amounts)</i>				
Total revenues	\$ 627	\$ 658	\$ (31)	(4.7)%
Total cost of revenues	(500)	(531)	\$ 31	(5.8)%
Gross profit	\$ 127	\$ 127	\$ —	— %
Gross margin	20.3 %	19.3 %	1.0 %	4.9 %
General and administrative expenses	(84)	(73)	\$ (11)	15.1 %
Amortization of intangibles	(2)	(2)	\$ —	— %
Other operating expenses, net	1	(1)	\$ 2	(200.0)%
Operating earnings	\$ 42	\$ 51	\$ (9)	(17.6)%
Interest expense	\$ (10)	\$ (9)	\$ (1)	9.3 %
Other, net	\$ —	\$ 1	\$ (1)	(100.0)%
Earnings before taxes	\$ 32	\$ 43	\$ (11)	(25.2)%
Income tax provision	\$ 7	\$ 11	\$ (4)	(36.4)%
Net earnings	\$ 25	\$ 32	\$ (7)	(21.4)%
Shares outstanding <sup>(1)</sup>	145	145	\$ —	— %
Basic EPS <sup>(1)</sup>	\$ 0.17	\$ 0.22	\$ (0.05)	21.4 %
Diluted EPS <sup>(1)</sup>	\$ 0.17	\$ 0.22	\$ (0.05)	21.4 %
Adjusted EPS <sup>(1,2)</sup>	\$ 0.23	\$ 0.23	\$ (0.01)	3.4 %
Adjusted EBITDA <sup>(2)</sup>	\$ 67	\$ 69	\$ (2)	(2.0)%
Adjusted EBITDA Margin <sup>(2)</sup>	10.8 %	10.5 %	0.3 %	2.9 %
Backlog <sup>(2)</sup>	\$ 3,051	\$ 3,387	\$ (336)	(9.9)%
Bookings <sup>(2)</sup>	\$ 683	\$ 720	\$ (37)	(5.1)%
Free cash flow <sup>(2)</sup>	\$ 4	\$ 48	\$ (44)	(91.3)%

NM- percentage change not meaningful

(1) Gives effect to a 1,450,000-for-1 forward stock split on our common stock effected on February 25, 2021.

(2) See “—Non-GAAP Financial Measures” above for definitions of these measures. Adjusted EPS, Adjusted EBITDA, Adjusted EBITDA Margin and free cash flow are non-GAAP measures. See “—Key Financial and Operating Measures—Non-GAAP Financial Measures” above for reconciliations of these measures to the most directly comparable financial measure calculated and presented in accordance with U.S. GAAP.





			<b>June 30, 2022 vs. June 30, 2021 Variance</b>	
	<b>Six Months Ended June 30, 2022</b>	<b>Six Months Ended June 30, 2021</b>		
<i>(Dollars in millions, except per share amounts)</i>				
Total revenues	\$ 1,239	\$ 1,339	\$ (100)	(7.5)%
Total cost of revenues	(978)	(1,076)	\$ 98	(9.1)%
Gross profit	\$ 261	\$ 263	\$ (2)	(0.8)%
Gross margin	21.1 %	19.6 %	1.4 %	7.2 %
General and administrative expenses	(160)	(152)	\$ (8)	5.3 %
Amortization of intangibles	(4)	(4)	\$ —	— %
Other operating expenses, net	1	(5)	\$ 6	(120.0)%
Operating earnings	\$ 98	\$ 102	\$ (4)	(3.9)%
Interest expense	\$ (18)	\$ (18)	\$ —	(0.9)%
Other, net	\$ —	\$ —	\$ —	— %
Earnings before taxes	\$ 80	\$ 84	\$ (4)	(4.6)%
Income tax provision	\$ 19	\$ 23	\$ (4)	(17.4)%
Net earnings	\$ 61	\$ 61	\$ —	0.3 %
Shares outstanding <sup>(1)</sup>	145	145	\$ —	— %
Basic EPS <sup>(1)</sup>	\$ 0.42	\$ 0.42	\$ —	0.3 %
Diluted EPS <sup>(1)</sup>	\$ 0.42	\$ 0.42	\$ —	0.3 %
Adjusted EPS <sup>(1,2)</sup>	\$ 0.49	\$ 0.48	\$ 0.01	1.2 %
Adjusted EBITDA <sup>(2)</sup>	\$ 140	\$ 140	\$ —	0.4 %
Adjusted EBITDA Margin <sup>(2)</sup>	11.3 %	10.4 %	0.9 %	8.6 %
Backlog <sup>(2)</sup>	\$ 3,051	\$ 3,387	\$ (336)	(9.9)%
Bookings <sup>(2)</sup>	\$ 1,430	\$ 1,435	\$ (5)	(0.3)%
Free cash flow <sup>(2)</sup>	\$ (264)	\$ (214)	\$ (50)	(23.3)%

NM- percentage change not meaningful

(1) Gives effect to a 1,450,000-for-1 forward stock split on our common stock effected on February 25, 2021.

(2) See “—Non-GAAP Financial Measures” above for definitions of these measures. Adjusted EPS, Adjusted EBITDA, Adjusted EBITDA Margin and free cash flow are non-GAAP measures. See “—Key Financial and Operating Measures—Non-GAAP Financial Measures” above for reconciliations of these measures to the most directly comparable financial measure calculated and presented in accordance with U.S. GAAP.

Our operating results for the six months ended June 30, 2022 showed mixed results when compared to the six months ended June 30, 2021. Despite a revenue decrease, we reported net earnings and Adjusted EBITDA consistent to the prior year, driving continued margin expansion offsetting inflationary impacts to our profitability. Our cash usage increased for the six months ended June 30, 2022 when compared to the six months ended June 30, 2021 across both of our operating segments as we continue to procure materials in advance of need to reduce the effect of extending lead times. We reported bookings in line with the prior year and achieved a number of important program wins and performance milestones.

Revenue of \$1,239 million represented a decrease of \$100 million or 7.5% while operating earnings decreased \$4 million or 4% and net earnings remaining unchanged at \$61 million for the six months ended June 30, 2022 when compared to the six months ended June 30, 2021. Adjusted EBITDA remained consistent with the prior year, increasing slightly to \$140.4 million an increase of 0.4% while Adjusted EBITDA margins also increased by 89 bps to 11.3% for the six months ended June 30, 2022 when compared to the six months ended June 30, 2021.

***Revenue***

Our revenue of \$1,239 million decreased \$31 million or 4.7% from the three months ended June 30, 2021 and \$100 million or 7% over six months ended June 30, 2021. The revenue decrease for the six months ended June 30, 2022 is attributed to a decline in our ASC segment, partially offset by an increase in our IMS segment. Our ASC segment decreased revenues by \$131 million or 13% driven by availability of electronic components and customer installation staffing levels impacting certain order quantities on our computing programs. Our IMS segment revenues increased by \$30 million or 8% as compared to the prior year period primarily due to the increased deliveries in the Force Protection market, highlighted by our counter unmanned aerial threat production program with the US Army.

***Cost of Revenues***

Cost of revenue for the three months ended June 30, 2022 decreased \$31 million or 6% from \$531 million to \$500 million when compared to the three months ended June 30, 2021. Cost of revenue for the six months ended June 30, 2022 decreased by \$98 million or 9% from 1,076 million to 978 million primarily due to decreased revenue as described above. Additionally, the cost of revenue improvement was also impacted by improved contract performance, decreasing the cost of revenues as a percentage of revenue highlighted by continued cost savings generated from our operational excellence program, APEX, and the continued transition of development programs into production. The program transition and improved profitability is highlighted by our submarine electric propulsion programs within our IMS sector.

***Gross Profit***

Gross profit held at \$127 million for the second quarter and was down \$2 million, or 1% to \$261 million for the six months ended June 30, 2022 as compared to \$127 million and \$263 million for the three- and six- month periods ended June 30, 2021 respectively. This was primarily due to decreased revenue, largely offset by the improved program performance as noted above.

***General and Administrative Expenses***

General and administrative expenses for the three months ended June 30, 2022 increased by \$11 million or 13% from the three months ended June 30, 2021 and increased by \$8 million or 5% for the six-months ended June 30, 2022 as compared to the six-months ended June 30, 2021. As a percentage of revenue, general and administrative expenses increased to 13% for the six months ended June 30, 2022 from 11% for the six months ended June 30, 2021. The primary driver for the increase in general and administrative expenses is deal related transaction costs which increased \$8 million and \$6 million when compared to the three months and six months ended June 30, 2021, respectively.

***Other Operating Expenses, Net***

Other operating expenses increased by \$2 million to \$1 million in the three months ended June 30, 2022 when compared to \$(1) million for the three months ended June 30, 2021. For the six months ended June 30, 2022 other operating expenses increased by \$6 million from \$(5) million for six months ended June 30, 2021 to \$1 million for six months ended June 30, 2022. The increase for both the quarter and six months is primarily due to employee safety costs related to COVID-19 investments \$2 million and \$5 million, respectively, incurred in the prior year. In the current year, we no longer classify COVID-19 expenditures separately and expenses incurred are reflected in Cost of Revenues or General and Administrative Expenses.

***Amortization of Intangibles***

Amortization of intangibles of \$2 million and \$4 million for three and six months ended June 30, 2022 were consistent with three and six months ended June 30, 2021.



***Operating Earnings***

Operating earnings decreased by \$9 million and \$4 million to \$42 million and \$98 million for three- and six- month periods ended June 30, 2022 from \$51 and \$102 million for the three- and six- month periods ended June 30, 2021. The decrease was driven by increased general and administrative expenditures resulting from transaction related expenditures, as previously mentioned above.

***Interest Expense***

Interest expense increased in the three months ended June 30, 2022 by \$1 million or 9% when compared to the three months ended June 30, 2021, There was no change in interest expense for the six months ended June 30, 2022 from the prior year of \$18 million of interest expenditures realized for the six months ended June 30, 2021.

***Other, Net***

Other, net decreased for the three months ended June 30, 2022 to \$0 million from \$1 million for the three months ended June 30, 2021, with \$0 for the six months ended June 30, 2022 and June 30, 2021. This was primarily due a reduction in foreign exchange related charges realized during the period.

***Earnings Before Taxes***

Earnings before taxes decreased by \$11 million and \$4 million to \$32 million and \$80 million for the three- and six- month periods ended June 30, 2022, respectively, from \$43 million and \$84 million for the three- and six- month periods ended June 30, 2021. The reduced profitability resulted in a 5% decrease in earnings before taxes for the six months ended June 30, 2021 as compared to the prior year period. The decrease was primarily due to an increase in general and administrative expenses as discussed above.

***Income Tax Provision***

Income tax provision decreased by \$4 million and \$4 million to \$7 million and \$19 million for the three- and six- month periods ended June 30, 2022, respectively, from \$11 million and \$23 million for the three- and six- month periods ended June 30, 2021. This was primarily attributable to a decrease in earnings before taxes of \$11 million and \$4 million for the second quarter and six months ended June 30, 2022, respectively, and unfavorable discrete tax expense recorded during the six months ended March 31, 2021. The discrete items were due to certain state law tax changes and an increase in estimated nondeductible expenses.

***Net Earnings***

Net earnings decreased by \$7 million to \$25 million for the three months ended June 30, 2022 and stayed constant at \$61 million for the six months ended June 30, 2022, respectively, when compared to the three- and six- months ended June 30, 2021. The decrease for the three months ended June 30, 2022 was driven by decreased earnings before taxes of \$4 million offset by decreased income tax provision of \$4 million, as described above.

***Adjusted EBITDA***

Adjusted EBITDA decreased by \$2 million or 2% to \$67 million for the three months ended June 30, 2022 and stayed constant at \$140 million for the six months ended June 30, 2022 when compared to \$69 million and \$140 million for the three- and six- month periods ended June 30, 2021, respectively. The slight decrease is driven by lower gross profit as noted above driven by lower revenue volumes, offset by improved profitability.

***Adjusted EBITDA Margin***

Adjusted EBITDA Margin increased from 10.5% for the three months ended June 30, 2021 to 10.8% for the three months ended June 30, 2022 and from 10.4% for the six months ended June 30, 2021 to 11.3% for the six months ended June 30, 2022. This was primarily due to improved program performance driven by the transition of certain development programs into production driving margin expansion most notably on our submarine electric propulsion programs within our IMS sector.

### ***Adjusted EPS***

For the three- and six- month periods ended June 30, 2022 there were no changes in the number of basic and diluted shares. No equity awards were issued during the period. As of June 30, 2022 there were 145,000,000 shares of common stock outstanding resulting in Adjusted EPS of \$0.49, relatively consistent with the \$0.48 realized for the six months ended June 30, 2021. The consistent Adjusted EPS is driven by consistent net income generated during the respective periods when adjusted for COVID costs and deal related expenditures realized during the respective periods.

### ***Backlog***

Backlog decreased by \$336 million to \$3,051 million for the six months ended June 30, 2022 from \$3,387 million for the six months ended June 30, 2021, despite bookings exceeding our revenue totals by 15% during the period. This is attributed to a strong revenue contribution realized in the second half of 2021 while bookings were negatively impacted by delayed awards and a reduction in new starts stemming from the continuing resolution, driving 2nd half revenues in 2021 that were 25% in excess of our bookings total for the same period. Despite the decline from prior period ended June 30, 2021, our backlog has increased 7% since December 31, 2021 driven by our strong book to bill ratio noted above.

### ***Bookings***

Bookings for the six months ended June 30, 2022 decreased by 1% or \$5 million to \$1,430 million as compared to \$1,435 million for the six months ended June 30, 2021. The decrease is primarily attributed to performance within our ASC segment due to a reduction of ground vehicle awards received on our ruggedized computing programs with the U.S. Army offset by increases in our IMS segment driven by the definitization of certain Counter UAS and Short Range Air Defense programs with the U.S. Army, additional funding received on our Next Generation Ballistic Submarine program with the U.S. Navy and the receipt of additional international orders under new and expanded military aid programs in support of Ukraine and other Eastern European countries. Despite the reduction in year over year bookings through June, we anticipate full year new awards to exceed the prior year results.

### ***Free cash flow***

Free cash flow usage increased by \$50 million to \$264 million for the six months ended June 30, 2022 from \$214 million for the six months ended June 30, 2021. This was primarily due to cash used to fund working capital for the three- and six- month periods ended June 30, 2022 when compared to the six months ended June 30, 2021.

## **Review of Operating Segments**

The following is a discussion of operating results for each of our operating segments. We have elected to use Revenue, Adjusted EBITDA, Adjusted EBITDA Margin, and Bookings to provide detailed information on our

segment performance. Additional information regarding our segments can be found in *Note 15: Segment information* within the unaudited Consolidated Financial Statements.

<i>(Dollars in millions)</i>	Three Months Ended June 30,		Three Months Ended June 30, 2022 vs. June 30, 2021		Variance
	2022	2021			
<b>Revenue:</b>					
ASC	\$ 444	\$ 489	\$ (45)		(9.1 %)
IMS	\$ 187	\$ 174	\$ 13		7.4 %
Corporate & Eliminations	\$ (4)	\$ (4)	\$ —		(4.8 %)
Total revenue	\$ 627	\$ 658	\$ (31)		(4.8 %)
<b>Adjusted EBITDA:</b>					
ASC	\$ 57	\$ 61	\$ (4)		(6.6 %)
IMS	\$ 10	\$ 7	\$ 3		38.6 %
Corporate & Eliminations	\$ —	\$ 1	\$ (1)		(91.0 %)
Total Adjusted EBITDA	\$ 67	\$ 69	\$ (2)		(3.2 %)
<b>Adjusted EBITDA Margin:</b>					
ASC	12.8 %	12.5 %	0.3 %		2.8 %
IMS	5.2 %	4.0 %	1.2 %		29.0 %
<b>Bookings:</b>					
ASC	\$ 485	\$ 481	\$ 4		0.9 %
IMS	\$ 197	\$ 240	\$ (42)		(17.6 %)
Total bookings	\$ 682	\$ 720	\$ (38)		(5.3 %)



<i>(Dollars in millions)</i>	Six Months Ended June 30,		Six Months Ended June 30, 2022 vs. June 30,, 2021		
	2022	2021	Variance		
<b>Revenue:</b>					
ASC	\$ 840	\$ 971	\$ (131)	(13.5 %)	
IMS	\$ 405	\$ 375	\$ 30	8.0 %	
Corporate & Eliminations	\$ (6)	\$ (7)	\$ 1	(14.3 %)	
Total revenue	\$ 1,239	\$ 1,339	\$ (100)	(7.5 %)	
<b>Adjusted EBITDA:</b>					
ASC	\$ 89	\$ 115	\$ (26)	(22.6 %)	
IMS	\$ 51	\$ 25	\$ 26	102.8 %	
Corporate & Eliminations	\$ —	\$ —	\$ —	— %	
Total Adjusted EBITDA	\$ 140	\$ 140	\$ —	(0.2 %)	
<b>Adjusted EBITDA Margin:</b>					
ASC	10.6 %	11.8 %	(1.2 %)	(10.5 %)	
IMS	12.5 %	6.7 %	5.9 %	87.8 %	
<b>Bookings:</b>					
ASC	\$ 873	\$ 974	\$ (100)	(10.3 %)	
IMS	\$ 556	\$ 461	\$ 95	20.6 %	
Total bookings	\$ 1,430	\$ 1,435	\$ (5)	(0.4 %)	

## ***ASC***

### *Revenue:*

The ASC segment reported revenue decreases in the three months ended June 30, 2022 decreasing by 9.1% or \$45 million to \$444 million from \$489 million for three months ended June 30, 2021. The ASC contribution to revenue for the six months ended June 30, 2022 decreased by 13.5% or \$131 million to \$840 million from \$971 million for the six months ended June 30, 2021. This decrease is primarily attributed to supply chain delays impacting revenue generation on various programs within the U.S. Army. Additionally on our ruggedized computing programs we realized a reduction of awards driven by lower than anticipated customer installation rates. Additionally, the ASC segment realized delays in the receipt of awards on certain components to support computing hardware for naval systems.

### *Adjusted EBITDA and Adjusted EBITDA Margin:*

ASC's Adjusted EBITDA decreased by \$4 million or 7%, from \$61 million for three months ended June 30, 2021 to \$57 million for three months ended June 30, 2022. Despite the reduction in Adjusted EBITDA realized during the three months ended June 30, 2022, our Adjusted EBITDA Margin increased 30bps to 12.8% from 12.5% realized during the three months ended June 30, 2021.

ASC's Adjusted EBITDA decrease can also be seen in the six months ended June 30, 2022 with Adjusted EBITDA decreasing by \$26 million or 23% from \$115 million for the six months ended June 30, 2021 to \$89 million for the six months ended June 30, 2022. The Adjusted EBITDA reduction is attributed to the decreased revenue output as noted above. Similarly, the lower revenue volume allowed for less absorption of general and administrative and other fixed costs reducing our Adjusted EBITDA Margins 120 bps from 11.8% to 10.6% for the six months end June 30, 2021 as compared to the six months ended June 30, 2022.

### *Bookings:*

The ASC segment contributed \$485 million and \$873 million in new bookings for three- and six - month periods ended June 30, 2022, respectively. Bookings were down for both the three- and six- month periods ended June 30, 2022, by 1% or \$4 million and 10% or \$100 million as compared to the three- and six- month periods ended June 30, 2021. The reduction is primarily due to reduced order quantities on our ruggedized computing programs due to a delay in installation capabilities attributed to COVID-19 employment disruption within the U.S. Army, reduction in satellite bandwidth contract awards in our held for sale GES business, as well as significant 'lump' awards received during the six months ended June 30, 2021, including pilot training systems awarded for the JSF lot 15. These reductions were partially offset by additional international orders under new and expanded military aid programs in support of Ukraine and other Eastern European countries, including awards for thermal weapon sights and ground vehicle sensing for the Poland M1 Abrams tank award. Despite the reduction in year over year bookings through June, we anticipate full year new awards for the ASC segment to exceed the prior year results.

## ***IMS***

### *Revenue:*

IMS segment revenue increased by \$13 million or 7% to \$187 million for the three months ended June 30, 2022 from \$174 million for the three months ended June 30, 2021. For the six months ended June 30, 2022 IMS revenue increased by \$30 million or 8% to \$405 million from \$375 million for the six months ended June 30, 2021. This increase was primarily attributed to improved progress on our submarine programs as well as sustaining full rate production on our surface ship power system production programs.

### *Adjusted EBITDA and Adjusted EBITDA Margin:*

IMS's Adjusted EBITDA increased by \$3 million or 39% to \$10 million for three months ended June 30, 2022 from \$7 million for the three months ended June 30, 2021 with the trend continuing for the six months ended

June 30, 2022. Adjusted EBITDA increased by \$26 million or 103% from \$25 million for the six month ended June 30, 2021 to \$51 million for the six months ended June 30, 2022. Adjusted EBITDA Margin increased from 4% for the three months ended June 30, 2021 to 5% for three months ended June 30, 2022. Adjusted EBITDA continued to drive increases in Adjusted EBITDA Margins from 7% to 13% for the six months ended June 30, 2021 to the six months ended June 30, 2022 respectively. This was primarily due to improved performance on our Next Generation Ballistic Submarine program and increased revenue contribution and related operational leverage generated as noted above.

#### *Bookings:*

The IMS segment contributed \$197 million and \$556 million in new bookings for the three- and six- month periods ended June 30, 2022, respectively. Bookings decreased for both the three months ended June 30, 2022 by (18%) or \$(42) million but reported an increase of 21% or \$95 million for the six months ended June 30, 2022 as compared to the three- and six- month periods ended June 30, 2021. This was primarily due to increased bookings for our force protection products including the definitization of 124 mission equipment package (MEP) contract to provide short range air defense for the U.S. Army. In addition to providing short range air defense solutions, our IMS segment also received new awards to support ballistic missile defense on the Patriot missile defense system, further driving the increase in bookings as compared to the prior year. Additionally, IMS continues to realize increased funding on the Next Generation Ballistic Submarine program as we transition from development into production.

#### **Liquidity and Capital Resources**

We endeavor to ensure the most efficient conversion of operating income into cash for deployment in our business and to maximize shareholder value through cash deployment activities. In addition to our cash position, we use various financial measures to assist in capital deployment decision-making, including cash provided by operating activities and free cash flow, a non-GAAP measure described in more detail below. We believe that the combination of our existing cash, access to credit facilities as described in *Note 10: Debt* and future cash that we expect to generate from our operations will be sufficient to meet our short and long-term liquidity needs. There can be no assurance, however, that our business will continue to generate cash flow at current levels or that anticipated operational improvements will be achieved. We may also pursue acquisitions or other strategic priorities that will require additional liquidity beyond the liquidity we generate through our operations. Our cash balance as of June 30, 2022, was \$69 million compared to \$240 million as of December 31, 2021.

The following table summarizes our cash flows for the periods presented:

	Six Months Ended June 30,	
	2022	2021
(Dollars in millions)		
Net cash used in operating activities	\$ (242)	\$ (185)
Net cash provided by investing activities	(22)	84
Net cash provided by financing activities	93	132
Effect of exchange rate changes on cash and cash equivalents	—	(1)
Net increase in cash and cash equivalents	\$ (171)	\$ 30
Free cash flow <sup>(1)</sup>	\$ (264)	\$ (214)

(1) Free cash flow is a Non-GAAP measure. The reasons we use this Non-GAAP financial measure and its reconciliation to the most directly comparable U.S. GAAP financial measure is provided above under “—Key Financial and Operating Measures—Non-GAAP Financial Measures.”

#### ***Operating Activities***

Cash flows related to the operating activities decreased by \$57 million, increasing cash usage from \$185 million for the six months ended June 30, 2021 to \$242 million for the six months ended June 30, 2022. This was primarily due to cash used to fund working capital for the six months ended June 30, 2022 when compared to six month ended

June 30, 2021 driven by a reduction in accounts payable and an increase in contract assets and inventory during the period. The increase in contract assets and inventory are attributable to advanced procurements to combat the extending lead times impacting supply chain.

#### ***Investing Activities***

Net cash provided by investing activities decreased by \$106 million for the six months ended June 30, 2022 as compared to the six months ended June 30, 2021. The reduced cash generation was attributed the pay-back of the Surplus Treasury Agreement with US Holding. For the year ended December 31, 2020 we advanced US Holding \$115 million which was subsequently repaid in the three months ended March 31, 2021 driving the decrease in investing cash generation as compared to the six months June 30, 2021.

#### ***Financing Activities***

Net cash provided by financing activities decreased by \$39 million for the six months ended June 30, 2022 versus June 30, 2021. The decrease was primarily related to a decrease in the net borrowings under our revolving credit facility due to working capital management as compared to the six months ended June 30, 2021.

#### ***Free Cash Flow***

Free cash flow decreased by \$50 million to \$(264) million for six months ended June 30, 2022 from \$(214) million for the six months ended June 30, 2021. This was primarily due to the decrease in cash used to fund working capital for the six months ended June 30, 2022 when compared to three months ended June 30, 2021.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK**

#### ***Equity Risk***

We currently have limited risk related to fluctuations in marketable securities. Outside of pension assets which are disclosed in *Note 11: Pension and Other Postretirement Benefits* to the Consolidated Financial Statements, the only investments the Company holds are overnight money market accounts. Fluctuations are unlikely and would have limited impact on the financial statements of the Company.

#### ***Interest Rate Risk***

We are exposed to interest rate risk on variable-rate borrowings under our revolving credit facilities, which had an outstanding balance of \$110 million as of June 30, 2022. Our remaining debt facilities are fixed rate obligations and not subject to fluctuations in interest rates. For additional information please refer to *Note 10. Debt*.

#### ***Foreign Currency Risk***

In certain circumstances, we may be exposed to foreign currency risk. However, as the overwhelming majority of our revenue is derived from U.S. sources directly as a prime contractor or indirectly as a subcontractor for the U.S. government as end-customer, we have limited foreign currency exposure. Currently our exposure is primarily with the Canadian dollar and limited to receivables owed of \$55 million as of June 30, 2022. A 10% fluctuation in exchange rates would not have a material impact on our financial statements. We do not enter into or issue derivative instruments for trading purposes.

#### ***Inflation Risk***

Given the broader inflation in the economy, we are monitoring the risk inflation presents to active and future contracts. To the extent feasible, we have consistently followed the practice of adjusting our estimated cost at completion to reflect the impact of inflation on salaries and fringe benefits for employees and the cost of purchased materials and services. These adjustments are reflected in our June financial results and we have not seen broad based increases in costs from inflation that are material to the business as a whole; however, if

we begin to experience greater than expected supply chain and labor inflation, our profits and margins under our contracts, in particular fixed price contracts, could be adversely affected. Bids for longer-term firm fixed-price contracts

typically include assumptions for labor and other cost escalations in amounts that historically have been sufficient to cover cost increases over the period of performance.



**Item 4. Controls and Procedures*****Evaluation of Disclosure Controls and Procedures***

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the six-month period ended June 30, 2022, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based on this evaluation, our principal executive officer and principal financial officer has concluded that during the period covered by this report, our disclosure controls and procedures were effective.

Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

***Changes in Internal Control over Financial Reporting***

There was no change in our internal control over financial reporting that occurred during the three-month period ended June 30, 2022 covered by this Quarterly Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

For information relating to legal proceedings, see Note 13 to the unaudited Consolidated Financial Statements in Part I, Item 1.

**ITEM 1A. Risk Factors**

You should carefully review and consider the information regarding certain factors that could materially affect our business, results of operations, and financial condition as set forth under “Risk Factors” in Part I, Item 1A of our Annual Report. Except as set forth in this Item 1A. “Risk Factors,” we do not believe that there have been any material changes to the risk factors previously disclosed in our Annual Report. We may disclose changes to such risk factors or disclose additional risk factors from time to time in our future filings with the SEC. Additional risks and uncertainties not presently known to us or that we currently believe not to be material also may adversely impact our business, financial condition and results of operations.

In addition to the risk factors previously disclosed in our Annual Report, the following are risks related to our pending merger with RADA, as described further in *Note 1: Summary of Significant Accounting Policies—T. Acquisitions, Investments and Variable Interest Entities* within the unaudited Consolidated Financial Statements:

- Because the exchange ratio is fixed and will not be adjusted in the event of any change in RADA’s share price, the value of the shares of DRS immediately following completion of the merger (the “combined company”) and the other transactions contemplated by the merger agreement is uncertain.
- The market price for shares of common stock of the combined company following the completion of the merger may be affected by factors different from, or in addition to, those that historically have affected or currently affect the market prices of RADA shares.
- The lack of a public market for DRS common stock makes it more difficult to evaluate the fairness of the merger.
- The shares of DRS common stock to be received by RADA shareholders as a result of the merger will have rights different from the RADA shares.
- RADA shareholders will each have reduced ownership and voting interest in and will exercise less influence over management of DRS.
- Until the completion of the merger or the termination of the merger agreement in accordance with its terms, DRS and RADA are each prohibited from entering into certain transactions and taking certain actions that might otherwise be beneficial to DRS or RADA and their respective stockholders and shareholders.
- Difficulties in obtaining required approvals and satisfying closing conditions may prevent or delay completion of the merger.
- DRS and RADA must obtain certain regulatory approvals and clearances to consummate the merger, which, if delayed, not granted or granted with conditions not presently anticipated, could prevent, substantially delay or impair consummation of the merger, result in additional expenditures of money and resources or reduce the anticipated benefits of the merger.
- Failure to attract, motivate and retain executives and other key employees could diminish the anticipated benefits of the merger.
- The merger, including uncertainty regarding the merger, may cause customers, suppliers or strategic partners to delay or defer decisions concerning DRS and RADA or seek to change or cancel existing business relationships
- Whether or not the merger is completed, the announcement and pendency of the merger could cause disruptions in the businesses of DRS and RADA, which could have an adverse effect on their respective businesses and financial results.
- The merger may not be completed on the terms or timeline currently contemplated, or at all, and the failure to complete the merger could adversely impact the market price of RADA shares, as well as its business and operating results.



- The merger agreement may be terminated in accordance with its terms and the merger may not be consummated.
- Any termination of the merger agreement could negatively impact DRS and RADA.
- The directors and executive officers of DRS and RADA have interests that may be different from, or in addition to, those of DRS stockholders and RADA shareholders generally.
- DRS or RADA may waive one or more of the closing conditions without re-soliciting shareholder approval or amending this proxy statement/prospectus.
- The merger agreement contains provisions that could discourage a potential competing acquirer that might be willing to provide additional value to acquire or merge with either DRS or RADA.
- Each of DRS and RADA will incur significant transaction, merger-related and restructuring costs in connection with the merger.
- RADA shareholders will not be entitled to dissenters', appraisal, cash exit or similar rights in the merger.
- If it is determined the merger does not qualify as a tax-free "reorganization" for U.S. federal income tax purposes, U.S. holders of RADA shares will generally recognize capital gain or loss as a result of the merger.
- Even if the merger qualifies as a "reorganization" under Section 368(a) of the Tax Code, a U.S. holder may still recognize gain as a result of the merger if RADA is or was classified as a "passive foreign investment company" for any taxable year during which a U.S. holder held RADA shares.
- DRS could be liable for certain tax liabilities, including tax liabilities of US Holding and its subsidiaries, under tax law and the tax allocation agreement.
- Lawsuits filed against DRS or RADA, or against DRS or RADA directors, challenging the merger, and an adverse ruling in any such lawsuit may prevent the merger from becoming effective or becoming effective within the expected time frame.
- The effects of the COVID-19 pandemic could adversely affect the business, results of operations and financial condition of DRS, RADA and the combined company following the completion of the merger.
- Climate change, or legal, regulatory or market measures to address climate change, may materially adversely affect the combined company's financial condition and business operations.
- The failure to successfully combine the businesses of DRS and RADA may adversely affect the combined company's future results.
- The combined company may not be able to retain customers or suppliers or customers or suppliers may seek to modify contractual obligations with the combined company, which could have an adverse effect on the combined company's business and operations.
- The combined company may be exposed to increased litigation, which could have an adverse effect on the combined company's business and operations.
- Combining the businesses of DRS and RADA may be more difficult, costly or time-consuming than expected and the combined company may fail to realize the anticipated benefits of the merger, which may adversely affect the combined company's business results and negatively affect the value of the common stock of the combined company following the merger.

- The failure to integrate successfully the businesses and operations of DRS and RADA in the expected time frame may adversely affect the combined company's future results.

- The combined company's industry is highly competitive, which may impact its results of operations.
- The combined company will operate in a global, competitive environment which gives rise to operating and market risk exposure.
- The DRS and RADA unaudited prospective financial information is inherently subject to uncertainties, the unaudited pro forma financial data included in this document is preliminary and the combined company's actual financial position and results of operations after the merger may differ materially from these estimates and the unaudited pro forma financial data included in this proxy statement/prospectus.
- DRS and RADA will incur significant transaction and merger-related costs in connection with the merger.
- The revenue of the combined company will depend on DRS's and RADA's ability to maintain certain levels of government business. The loss of contracts with U.S. and non-U.S. government agencies could adversely affect the combined company's revenue.
- Third parties may terminate or alter existing contracts or relationships with DRS or RADA.
- The combined company may be unable to retain DRS and RADA personnel successfully after the merger is completed.
- The combined company's debt may adversely affect its financial condition, limit its financial flexibility, or decrease its business flexibility.
- Declaration, payment and amounts of dividends, if any, distributed to stockholders of the combined company will be uncertain.

These risks are discussed more fully in the registration statement on Form S-4 we filed with the SEC on August 3, 2022. Although the registration statement has not yet been declared effective, we urge you to read it and any amendments and supplements thereto, because they contain important information about the merger, including relevant risk factors.

## **ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

## **ITEM 3. Defaults Upon Senior Securities**

None.

## **ITEM 4. Mine Safety Disclosures**

Not Applicable

## **ITEM 5. Other Information**

None.





**ITEM 6. Exhibits**

Exhibit Number	Exhibit Description
2.1*	Agreement and Plan of Merger, dated as of June 21, 2022, by and among Leonardo DRS, Inc., Blackstart Ltd and RADA Electronic Industries Ltd. (incorporated by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K, filed on June 21, 2022)
31.1	<a href="#">Certification by principal executive officer</a> pursuant to Rule 13A-14(a) or 15D-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	<a href="#">Certification by principal financial officer</a> pursuant to Rule 13A-14(a) or 15D-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	<a href="#">Certification by principal executive officer</a> pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	<a href="#">Certification by principal financial officer</a> pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document – the instance document does not appear on the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

\*Certain Schedules and exhibits have been omitted pursuant to Item 601(a)(5) of Regulation S-K.

**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 15, 2022

**LEONARDO DRS, INC.**

By: /s/ William J. Lynn III  
Name: William J. Lynn III  
Title: Chief Executive Officer