NORTHROP GRUMMAN CORP /DE/
Form 10-Q
July 29, 2010

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

FORM 10-Q

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

For the quarterly period ended June 30, 2010

or

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

Commission file number 1-16411

NORTHROP GRUMMAN CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**95-4840775**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1840 Century Park East, Los Angeles, California 90067
www.northropgrumman.com
(Address of principal executive offices and internet site)

(310) 553-6262
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

As of July 27, 2010, 294,220,550 shares of common stock were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
$ in millions, except per share amounts	**2010**	2009	**2010**	2009
Sales and Service Revenues				
Product sales	**$ 5,544**	$ 5,420	**$ 11,070**	$ 9,990
Service revenues	**3,282**	3,125	**6,366**	6,490
Total sales and service revenues	**8,826**	8,545	**17,436**	16,480
Cost of Sales and Service Revenues				
Cost of product sales	**4,367**	4,345	**8,663**	7,980
Cost of service revenues	**2,973**	2,845	**5,754**	5,808
General and administrative expenses	**770**	741	**1,538**	1,459
Operating income	**716**	614	**1,481**	1,233
Other (expense) income				
Interest expense	**(68)**	(70)	**(148)**	(143)
Other, net	**(10)**	13	**(3)**	21
Earnings from continuing operations before income taxes	**638**	557	**1,330**	1,111
Federal and foreign income tax (benefit) expense	**(73)**	189	**157**	377
Earnings from continuing operations	**711**	368	**1,173**	734
Earnings from discontinued operations, net of tax		26	**7**	49
Net Earnings	**$ 711**	$ 394	**$ 1,180**	$ 783
Basic Earnings Per Share				
Continuing operations	**$ 2.37**	$ 1.14	**$ 3.90**	$ 2.26
Discontinued operations		0.08	**.02**	.15
Basic earnings per share	**$ 2.37**	$ 1.22	**$ 3.92**	$ 2.41
Weighted-average common shares outstanding, in millions	**299.6**	322.0	**301.1**	324.4
Diluted Earnings Per Share				
Continuing operations	**$ 2.34**	$ 1.13	**$ 3.85**	$ 2.23
Discontinued operations		.08	**.02**	.15

Diluted earnings per share	**$ 2.34**	$ 1.21	**$ 3.87**	$ 2.38
Weighted-average diluted shares outstanding, in millions	**303.8**	325.8	**305.0**	328.9
Net earnings (from above)	**$ 711**	$ 394	**$ 1,180**	$ 783
Other comprehensive income				
Change in cumulative translation adjustment	**(24)**	38	**(52)**	24
Change in unrealized gain on marketable securities and cash flow hedges, net of tax		28		35
Change in unamortized benefit plan costs, net of tax	**39**	53	**79**	106
Other comprehensive income, net of tax	**15**	119	**27**	165
Comprehensive income	**$ 726**	$ 513	**$ 1,207**	$ 948

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

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CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited)

$ in millions	**June 30, 2010**	December 31, 2009
Assets		
Cash and cash equivalents	**$ 2,044**	$ 3,275
Accounts receivable, net of progress payments	**4,160**	3,394
Inventoried costs, net of progress payments	**1,148**	1,170
Deferred tax assets	**648**	524
Prepaid expenses and other current assets	**384**	272
Total current assets	**8,384**	8,635
Property, plant, and equipment, net of accumulated depreciation of $4,465 in 2010 and $4,216 in 2009	**4,763**	4,868
Goodwill	**13,517**	13,517
Other purchased intangibles, net of accumulated amortization of $1,921 in 2010 and $1,871 in 2009	**823**	873
Pension and post-retirement plan assets	**308**	300
Long-term deferred tax assets	**844**	1,010
Miscellaneous other assets	**1,055**	1,049
Total assets	**$ 29,694**	$ 30,252
Liabilities		
Notes payable to banks	**$ 13**	$ 12
Current portion of long-term debt	**760**	91
Trade accounts payable	**1,643**	1,921
Accrued employees compensation	**1,229**	1,281
Advance payments and billings in excess of costs incurred	**1,979**	1,954
Other current liabilities	**2,042**	1,726
Total current liabilities	**7,666**	6,985
Long-term debt, net of current portion	**3,438**	4,191
Pension and post-retirement plan liabilities	**4,487**	4,874
Other long-term liabilities	**1,200**	1,515
Total liabilities	**16,791**	17,565
Commitments and Contingencies (Note 11)		
Shareholders Equity		
Common stock, $1 par value; 800,000,000 shares authorized; issued and outstanding: 2010 294,979,243; 2009 306,865,201	**295**	307
Paid-in capital	**7,949**	8,657
Retained earnings	**7,646**	6,737

Accumulated other comprehensive loss	**(2,987)**	(3,014)
Total shareholders equity	**12,903**	12,687
Total liabilities and shareholders equity	**$ 29,694**	$ 30,252

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30	
$ in millions	**2010**	2009
Operating Activities		
Sources of Cash Continuing Operations		
Cash received from customers		
Progress payments	**$ 2,746**	$ 3,560
Collections on billings	**14,002**	12,499
Other cash receipts	**3**	20
Total sources of cash continuing operations	**16,751**	16,079
Uses of Cash Continuing Operations		
Cash paid to suppliers and employees	**(15,499)**	(14,616)
Pension contributions	**(364)**	(236)
Interest paid, net of interest received	**(144)**	(141)
Income taxes paid, net of refunds received	**(632)**	(467)
Excess tax benefits from stock-based compensation	**(10)**	
Other cash payments	**(14)**	(58)
Total uses of cash continuing operations	**(16,663)**	(15,518)
Cash provided by continuing operations	**88**	561
Cash provided by discontinued operations		97
Net cash provided by operating activities	**88**	658
Investing Activities		
Payments for businesses purchased		(33)
Additions to property, plant, and equipment	**(238)**	(297)
Payments for outsourcing contract costs and related software costs	**(4)**	(37)
Other investing activities, net	**24**	5
Net cash used in investing activities	**(218)**	(362)
Financing Activities		
Net borrowings under lines of credit	**1**	3
Principal payments of long-term debt	**(90)**	(72)
Proceeds from exercises of stock options and issuances of common stock	**103**	17
Dividends paid	**(270)**	(269)

Excess tax benefits from stock-based compensation	**10**	
Common stock repurchases	**(855)**	(423)
Net cash used in financing activities	**(1,101)**	(744)
Decrease in cash and cash equivalents	**(1,231)**	(448)
Cash and cash equivalents, beginning of period	**3,275**	1,504
Cash and cash equivalents, end of period	**$ 2,044**	$ 1,056

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

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$ in millions	Six Months Ended June 30 **2010**	2009
Reconciliation of Net Earnings to Net Cash Provided by Operating Activities		
Net earnings	**$ 1,180**	$ 783
Adjustments to reconcile to net cash provided by operating activities		
Depreciation	**284**	278
Amortization of assets	**70**	75
Stock-based compensation	**69**	55
Excess tax benefits from stock-based compensation	**(10)**	
Pre-tax gain on sale of business	**(10)**	
(Increase) decrease in		
Accounts receivable, net	**(766)**	(347)
Inventoried costs, net	**(14)**	(96)
Prepaid expenses and other current assets	**(19)**	(74)
Increase (decrease) in		
Accounts payable and accruals	**(549)**	(287)
Deferred income taxes	**(8)**	63
Income taxes payable	**(71)**	(48)
Retiree benefits	**(69)**	171
Other non-cash transactions, net	**1**	(12)
Cash provided by continuing operations	**88**	561
Cash provided by discontinued operations		97
Net cash provided by operating activities	**$ 88**	$ 658
Non-Cash Investing and Financing Activities		
Capital expenditures accrued in accounts payable	**$ 47**	$ 34

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

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CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
(Unaudited)

	Six Months Ended June 30	
$ in millions, except per share	**2010**	2009
Common Stock		
At beginning of period	**$ 307**	$ 327
Common stock repurchased	**(15)**	(10)
Employee stock awards and options	**3**	2
At end of period	**295**	319
Paid-in Capital		
At beginning of period	**8,657**	9,645
Common stock repurchased	**(861)**	(427)
Employee stock awards and options	**153**	25
At end of period	**7,949**	9,243
Retained Earnings		
At beginning of period	**6,737**	5,590
Net earnings	**1,180**	783
Dividends declared	**(271)**	(269)
At end of period	**7,646**	6,104
Accumulated Other Comprehensive Loss		
At beginning of period	**(3,014)**	(3,642)
Other comprehensive income, net of tax	**27**	165
At end of period	**(2,987)**	(3,477)
Total shareholders equity	**$ 12,903**	$ 12,189
Cash dividends declared per share	**$ .90**	$ .83

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. BASIS OF PRESENTATION

Principles of Consolidation The unaudited condensed consolidated financial statements include the accounts of Northrop Grumman Corporation and its subsidiaries. All material intercompany accounts, transactions, and profits are eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements of the company have been prepared by management in accordance with the instructions to Form 10-Q of the Securities and Exchange Commission (SEC). These statements include all adjustments of normal recurring nature considered necessary by management for a fair presentation of the condensed consolidated financial position, results of operations, and cash flows. The results reported in these financial statements are not necessarily indicative of results that may be expected for the entire year. These financial statements should be read in conjunction with the audited consolidated financial statements, including the notes thereto contained in the company s 2009 Annual Report on Form 10-K.

The quarterly information is labeled using a calendar convention; that is, first quarter is consistently labeled as ending on March 31, second quarter as ending on June 30, and third quarter as ending on September 30. It is management s long-standing practice to establish actual interim closing dates using a fiscal calendar, which requires the businesses to close their books on a Friday near these quarter-end dates in order to normalize the potentially disruptive effects of quarterly closings on business processes. The effects of this practice only exist within a reporting year.

Accounting Estimates The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The preparation thereof requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Estimates have been prepared on the basis of the most current and best available information and actual results could differ materially from those estimates.

Accumulated Other Comprehensive Loss The components of accumulated other comprehensive loss are as follows:

$ in millions	**June 30, 2010**	December 31, 2009
Cumulative translation adjustment	**$ (11)**	$ 41
Net unrealized gain on marketable securities and cash flow hedges, net of tax expense of $2 as of June 30, 2010, and $3 as of December 31, 2009	**4**	4
Unamortized benefit plan costs, net of tax benefit of $1,934 as of June 30, 2010, and $1,984 as of December 31, 2009	**(2,980)**	(3,059)
Total accumulated other comprehensive loss	**$ (2,987)**	$ (3,014)

The changes in the unamortized benefit plan costs, net of tax, were $79 million and $106 million, respectively for the six months ended June 30, 2010, and 2009 and are included in other comprehensive income in the condensed consolidated statements of operations. Unamortized benefit plan costs consist primarily of net after-tax actuarial loss amounts totaling $3,001 million and $3,082 million as of June 30, 2010, and December 31, 2009, respectively. Net actuarial gains or losses principally arise from gains or losses on plan assets due to variations in the fair market value of the underlying assets and changes in the benefit obligation due to changes in actuarial assumptions. Net actuarial gains or losses are amortized to expense when they exceed ten percent of the greater of the plan assets or projected benefit obligations by benefit plan. The excess of gains or losses over the ten percent threshold are subject to amortization over the average future service period of employees of approximately ten years.

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Financial Statement Reclassifications Certain amounts in the prior period financial statements and related notes have been reclassified to conform to the 2010 presentation and the realignment of business operations in 2010 (see Note 7).

2. ACCOUNTING STANDARDS UPDATES

Accounting Standards Updates Not Yet Effective
Accounting Standards Updates not effective until after June 30, 2010, are not expected to have a significant effect on the company s consolidated financial position or results of operations.

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

Investments in Marketable Securities The company holds a portfolio of marketable securities, primarily consisting of equity securities that are classified as either trading or available-for-sale and can be liquidated without restriction. These assets are recorded at fair value, substantially all of which are based upon quoted market prices for identical instruments in active markets (Level 1 inputs). As of June 30, 2010, and December 31, 2009, respectively, there were marketable equity securities of $54 million and $58 million included in prepaid expenses and other current assets and $228 million and $233 million of marketable equity securities included in miscellaneous other assets.

Derivative Financial Instruments and Hedging Activities The company utilizes derivative financial instruments in order to manage exposure to interest rate risk and foreign currency exchange rate risk. The company does not use derivative financial instruments for trading or speculative purposes, nor does it use leveraged financial instruments. Interest rate swap agreements utilize floating interest rates as an offset to the fixed-rate characteristics of certain long-term debt instruments. Foreign currency forward contracts are used to manage foreign currency exchange rate risk related to receipts from customers and payments to suppliers denominated in foreign currencies.

Derivative financial instruments are recognized as assets or liabilities in the financial statements and are measured at fair value, substantially all of which are based on active or inactive markets for identical or similar instruments or model-derived valuations whose inputs are observable (Level 2 inputs). Changes in the fair value of derivative financial instruments that qualify and are designated as fair value hedges are recorded in earnings from continuing operations, while the effective portion of the changes in the fair value of derivative financial instruments that qualify and are designated as cash flow hedges are recorded in other comprehensive income. The income approach was used to determine fair value using inputs including, but not limited to, the London Interbank Offered Rate (LIBOR) swap rates. Credit risk related to derivative financial instruments is considered minimal and is managed by requiring high credit standards for counterparties and periodic settlements of the underlying transactions.

For derivative financial instruments not designated as hedging instruments as well as the ineffective portion of cash flow hedges, gains or losses resulting from changes in the fair value are reported in Other, net in the condensed consolidated statements of operations. Unrealized gains or losses on cash flow hedges are reclassified from other comprehensive income to earnings from continuing operations upon the recognition of the underlying transactions.

As of June 30, 2010, an interest rate swap with a notional value of $200 million and foreign currency purchase and sale forward contract agreements with notional values of $73 million and $116 million, respectively, were designated for hedge accounting. The remaining notional values outstanding at June 30, 2010, under foreign currency purchase and sale forward contracts of $13 million and $92 million, respectively, were not designated for hedge accounting.

As of December 31, 2009, an interest rate swap with a notional value of $200 million and foreign currency purchase and sale forward contract agreements with notional values of $77 million and $151 million, respectively, were designated for hedge accounting. The remaining notional values outstanding at December 31, 2009, under

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foreign currency purchase and sale forward contracts of $19 million and $74 million, respectively, were not designated for hedge accounting.

The derivative fair values and related unrealized gains and losses at June 30, 2010, and December 31, 2009, were not material.

There were no material transfers of financial instruments between the three levels of fair value hierarchy during the six months ended June 30, 2010.

Cash Surrender Value of Life Insurance Policies The company maintains whole life insurance policies on a group of executives which are recorded at their cash surrender value as determined by the insurance carrier. Additionally, the company has split-dollar life insurance policies on former officers and executives from acquired businesses which are recorded at the lesser of their cash surrender value or premiums paid. The policies are utilized as a partial funding source for deferred compensation and other non-qualified employee retirement plans. As of June 30, 2010, and December 31, 2009, respectively, the carrying values associated with these policies of $238 million and $242 million were recorded in miscellaneous other assets.

Long-Term Debt As of June 30, 2010, and December 31, 2009, respectively, the carrying values of the long-term debt were $4.2 billion and $4.3 billion and the related estimated fair values were $5.0 billion and $4.8 billion. The fair value of the long-term debt was calculated based on interest rates available for debt with terms and maturities similar to the company s existing debt arrangements.

The carrying amounts of all other financial instruments not discussed above approximate fair value due to the short-term nature of these items.

4. DIVIDENDS ON COMMON STOCK

Dividends on Common Stock In May 2010, the company s board of directors approved an increase to the quarterly common stock dividend, from $0.43 per share to $0.47 per share, for shareholders of record as of June 1, 2010.

In May 2009, the company s board of directors approved an increase to the quarterly common stock dividend, from $0.40 per share to $0.43 per share, for shareholders of record as of June 1, 2009.

5. BUSINESS ACQUISITIONS AND DISPOSITIONS

Acquisitions
In April 2009, the company acquired Sonoma Photonics, Inc., as well as assets from Swift Engineering s Killer Bee Unmanned Air Systems product line for an aggregate amount of approximately $33 million in cash. The operating results of these businesses are reported in the Aerospace Systems segment from the date of acquisition. The assets, liabilities, and results of operations of these businesses were not material to the company s consolidated financial position or results of operations, and thus pro-forma financial information is not presented.

Dispositions
In December 2009, the company sold its Advisory Services Division (ASD) for $1.65 billion in cash to an investor group led by General Atlantic, LLC, and affiliates of Kohlberg Kravis Roberts & Co. L.P., and recognized a gain of $15 million, net of taxes. During the six months ended June 30, 2010, an additional $7 million gain, net of taxes, was

recorded to reflect the purchase price adjustment called for under the sale agreement. ASD was a business unit comprised of the assets and liabilities of TASC, Inc., its wholly-owned subsidiary TASC Services Corporation, and certain contracts carved out from other Northrop Grumman businesses also in the Information Systems segment that provide systems engineering technical assistance (SETA) and other analysis and advisory services. Sales and operating income for this business for the three months ended June 30, 2009, were approximately $412 million and $39 million, respectively. Sales and operating income for this business for the six months ended June 30, 2009, were approximately $797 million and $75 million,

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respectively. The operating results of this business unit are reported as discontinued operations in the condensed consolidated financial statements for all periods presented.

6. SHIPBUILDING STRATEGIC ACTIONS

In July 2010, the company announced plans to consolidate its Gulf Coast shipbuilding operations by winding down the shipbuilding work at the Avondale, Louisiana facility in 2013 after completing the LPD-class ships currently under construction. Future LPD-class ships will be built in a single production line at the company s Pascagoula, Mississippi facility. The consolidation is intended to reduce costs, increase efficiency, and address shipbuilding overcapacity. Due to the consolidation, the company expects higher costs to complete ships currently under construction in Avondale due to anticipated reductions in productivity and has increased the estimates to complete for LPDs 23 and 25 by approximately $210 million. The company recognized a $113 million pre-tax charge to Shipbuilding s second quarter 2010 operating income for these contracts, which are both now in a forward loss position.

In addition, the company anticipates that it will incur substantial restructuring and facilities shutdown-related costs, including, but not limited to, severance, relocation expense, and asset write-downs related to the Avondale facility decision. These costs are expected to be allowable expenses under government accounting standards and thus will be recoverable in future years overhead costs.

The company also announced in July 2010 that it will evaluate whether a separation of the Shipbuilding segment would be in the best interests of shareholders, customers, and employees by allowing both the company and the Shipbuilding segment to more effectively pursue their respective opportunities to maximize long-term value. Strategic alternatives for the Shipbuilding segment include, but are not limited to, a spin-off to the company s shareholders. While the company continues its evaluation of strategic alternatives for the Shipbuilding segment it will continue to be reported in continuing operations.

7. SEGMENT INFORMATION

The company is aligned into five reportable segments: Aerospace Systems, Electronic Systems, Information Systems, Shipbuilding, and Technical Services.

In January 2010, the company transferred its internal information technology services unit from the Information Systems segment to the company s shared services group. The intersegment sales and operating income for this business that were previously recognized in the Information Systems segment are immaterial and have been eliminated for all periods presented.

The following table presents segment sales and service revenues for the three and six months ended June 30, 2010, and 2009:

	Three Months Ended June 30		Six Months Ended June 30	
$ in millions	**2010**	2009	**2010**	2009
Sales and service revenues				
Aerospace Systems	**$ 2,842**	$ 2,673	**$ 5,538**	$ 5,129

Electronic Systems	**1,984**	1,967	**3,866**	3,755
Information Systems	**2,123**	2,151	**4,187**	4,244
Shipbuilding	**1,598**	1,524	**3,319**	2,899
Technical Services	**801**	702	**1,564**	1,334
Intersegment eliminations	**(522)**	(472)	**(1,038)**	(881)
Total sales and service revenues	**$ 8,826**	$ 8,545	**$ 17,436**	$ 16,480

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The following table presents segment operating income (loss) reconciled to total operating income for the three and six months ended June 30, 2010, and 2009:

	Three Months Ended June 30		Six Months Ended June 30	
$ in millions	**2010**	2009	**2010**	2009
Operating income (loss)				
Aerospace Systems	**$ 335**	$ 257	**$ 631**	$ 515
Electronic Systems	**264**	251	**490**	480
Information Systems	**205**	163	**388**	349
Shipbuilding	**(16)**	14	**90**	98
Technical Services	**52**	43	**101**	80
Intersegment eliminations	**(68)**	(48)	**(118)**	(87)
Total segment operating income	**772**	680	**1,582**	1,435
Non-segment factors affecting operating income				
Unallocated corporate (expenses) income	**(46)**	21	**(79)**	(32)
Net pension adjustment	**(8)**	(76)	**(16)**	(152)
Royalty income adjustment	**(2)**	(11)	**(6)**	(18)
Total operating income	**$ 716**	$ 614	**$ 1,481**	$ 1,233

Unallocated Corporate (Expenses) Income Unallocated corporate expenses generally include the portion of corporate expenses not considered allowable or allocable under applicable U.S. Government Cost Accounting Standards (CAS) regulations and the Federal Acquisition Regulation, and therefore not allocated to the segments, for costs related to management and administration, legal, environmental, certain compensation costs and retiree benefits, and other expenses.

Net Pension Adjustment The net pension adjustment reflects the difference between pension expense determined in accordance with GAAP and pension expense allocated to the operating segments determined in accordance with CAS.

Royalty Income Adjustment Royalty income is included in segment operating income and reclassified to other income for financial reporting purposes.

8. EARNINGS PER SHARE

Basic Earnings Per Share Basic earnings per share from continuing operations are calculated by dividing earnings from continuing operations available to common shareholders by the weighted-average number of shares of common stock outstanding during each period.

Diluted Earnings Per Share Diluted earnings per share include the dilutive effect of stock options and other stock awards granted to employees under stock-based compensation plans. The dilutive effect of these securities totaled 4.2 million shares and 3.9 million shares for the three and six months ended June 30, 2010, respectively. The dilutive effect of these securities totaled 3.8 million shares and 4.5 million shares for the three and six months ended June 30, 2009, respectively. The weighted-average diluted shares outstanding for the three and six months ended June 30, 2010, exclude the anti-dilutive effects of stock options to purchase approximately 2.6 million shares, because such options have exercise prices in excess of the average market price of the company s common stock during the period. The weighted-average diluted shares outstanding for the three and six months ended June 30, 2009, exclude the anti-dilutive effects of stock options to purchase approximately 8.4 million and 10.6 million shares, respectively.

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Share Repurchases The table below summarizes the company s share repurchases beginning January 1, 2009:

Repurchase Program Authorization Date	Amount Authorized (in millions)	Average Price Per Share[2]	Total Shares Retired (in millions)	Shares Repurchased (in millions) Six Months Ended June 30	
				2010	2009
December 19, 2007[1]	$ 3,600	$ 59.88	59.3	**14.8**	10.0

(1) On December 19, 2007, the company s board of directors authorized a share repurchase program of up to $2.5 billion of the company s common stock. On November 5, 2009, the board of directors authorized an additional $1.1 billion to the December 19, 2007 authorization. As of the end of the second quarter 2010, the company had $48 million remaining under this authorization for share repurchases.

(2) Includes commissions paid and calculated as the average price per share since the repurchase program authorization date.

On June 16, 2010, the company s board of directors authorized a share repurchase program of up to $2 billion of the company s common stock. No repurchases took place under this authorization during the period.

Share repurchases take place at management s discretion or under pre-established non-discretionary programs from time to time, depending on market conditions, in the open market, and in privately negotiated transactions. The company retires its common stock upon repurchase and has not made any purchases of common stock other than in connection with these publicly announced repurchase programs.

9. GOODWILL AND OTHER PURCHASED INTANGIBLE ASSETS

Goodwill

The carrying amounts of goodwill at June 30, 2010, and December 31, 2009, were as follows:

$ in millions	Aerospace Systems	Electronic Systems	Information Systems	Shipbuilding	Technical Services	**Total**
Goodwill	$ 3,801	$ 2,402	$ 5,248	$ 1,141	$ 925	**$ 13,517**

Accumulated goodwill impairment losses at June 30, 2010, and December 31, 2009, totaled $3.1 billion of which $570 million and $2,490 million were at the Aerospace Systems and Shipbuilding segments, respectively.

Purchased Intangible Assets

The table below summarizes the company s aggregate purchased intangible assets:

	June 30, 2010			December 31, 2009		
$ in millions	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Contract and program intangibles	**$ 2,644**	**$ (1,841)**	**$ 803**	$ 2,644	$ (1,793)	$ 851
Other purchased intangibles	**100**	**(80)**	**20**	100	(78)	22
Total	**$ 2,744**	**$ (1,921)**	**$ 823**	$ 2,744	$ (1,871)	$ 873

The company s purchased intangible assets are subject to amortization and are being amortized on a straight-line basis over an aggregate weighted-average period of 30 years. Aggregate amortization expense for the three and six months ended June 30, 2010, was $23 million and $50 million, respectively. Aggregate amortization expense for the three and six months ended June 30, 2009, was $26 million and $52 million, respectively.

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The table below shows expected amortization for purchased intangibles for the remainder of 2010 and for the next five years:

$ in millions	
Year ending December 31	
2010 (July 1 December 31)	$ 42
2011	57
2012	56
2013	48
2014	36
2015	34

10. INVESTIGATIONS, CLAIMS AND LITIGATION

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

In the second quarter of 2007, the U.S. Coast Guard issued a revocation of acceptance under the Deepwater Program for eight converted 123-foot patrol boats (the vessels) based on alleged hull buckling and shaft alignment problems and alleged nonconforming topside equipment on the vessels. The company submitted a written response that argued that the revocation of acceptance was improper. The Coast Guard advised Integrated Coast Guard Systems, LLC (ICGS), which was formed by the contractors to perform the Deepwater Program, that it was seeking $96.1 million from ICGS as a result of the revocation of acceptance. The majority of the costs associated with the 123-foot conversion effort are associated with the alleged structural deficiencies of the vessels, which were converted under contracts with the company and a subcontractor to the company. In 2008, the Coast Guard advised ICGS that the Coast Guard would support an investigation by the U.S. Department of Justice of ICGS and its subcontractors instead of pursuing its $96.1 million claim independently. The Department of Justice conducted an investigation of ICGS under a sealed False Claims Act complaint filed in the U.S. District Court for the Northern District of Texas and decided in early 2009 not to intervene at that time. On February 12, 2009, the District Court unsealed the complaint filed by Michael J. DeKort, a former Lockheed Martin employee, against ICGS, Lockheed Martin Corporation and the company relating to the 123-foot conversion effort. On October 15, 2009, the three defendants moved to dismiss the Fifth Amended complaint. On April 5, 2010, the District Court ruled on the defendants motions to dismiss, granting them in part and denying them in part. As to the company, the District Court dismissed conspiracy claims and those pertaining to the C4ISR systems. The District Court denied the motion with respect to those claims relating to hull, mechanical and engineering work. The matter is set for trial on November 1, 2010.

In August 2008, the company disclosed to the Antitrust Division of the Department of Justice possible violations of federal antitrust laws in connection with the bidding process for certain maintenance contracts at a military installation in California. In February 2009, the company and the Department of Justice signed an agreement admitting the company into the Corporate Leniency Program. As a result of the company s acceptance into the Program, the company will be exempt from federal criminal prosecution and criminal fines relating to the matters the company reported to the Department of Justice if the company complies with certain conditions, including its continued cooperation with the government s investigation and its agreement to make restitution if the government was harmed by the violations.

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Based upon the available information regarding matters that are subject to U.S. Government investigations, the company believes that the outcome of any such matters would not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Litigation Various claims and legal proceedings arise in the ordinary course of business and are pending against the company and its properties.

The company is one of several defendants in litigation brought by the Orange County Water District in Orange County Superior Court in California on December 17, 2004, for alleged contribution to volatile organic chemical contamination of the County s shallow groundwater. The lawsuit includes counts against the defendants for violation of the Orange County Water District Act, the California Super Fund Act, negligence, nuisance, trespass and declaratory relief. Among other things, the lawsuit seeks unspecified damages for the cost of remediation, payment of attorney fees and costs, and punitive damages. The June 2009 trial date was vacated. The litigation has been stayed until the next scheduled status conference, which has been set for August 26, 2010.

On March 27, 2007, the U.S. District Court for the Central District of California consolidated two Employee Retirement Income Security Act (ERISA) lawsuits that had been separately filed on September 28, 2006, and January 3, 2007, into In Re Northrop Grumman Corporation ERISA Litigation. The plaintiffs seek to have the lawsuits certified as class actions. On August 6, 2007, the District Court denied plaintiffs motion for class certification, and the plaintiffs appealed the District Court s decision on class certification to the U.S. Court of Appeals for the Ninth Circuit. On September 8, 2009, the Ninth Circuit vacated the Order denying class certification and remanded the issue to the District Court for further consideration. As required by the Ninth Circuit s Order, the case was also reassigned to a different judge. The plaintiffs renewed motion for class certification was rejected on a procedural technicality, but they are expected to re-file. The trial is scheduled for January 11, 2011.

On June 22, 2007, a putative class action was filed against the Northrop Grumman Pension Plan and the Northrop Grumman Retirement Plan B and their corresponding administrative committees, styled as *Skinner et al. v. Northrop Grumman Pension Plan, etc., et al.,* in the U.S. District Court for the Central District of California. The putative class representatives alleged violations of ERISA and breaches of fiduciary duty concerning a 2003 modification to the Northrop Grumman Retirement Plan B. The modification relates to the employer funded portion of the pension benefit available during a five-year transition period that ended on June 30, 2008. The plaintiffs dismissed the Northrop Grumman Pension Plan, and in 2008 the District Court granted summary judgment in favor of all remaining defendants on all claims. The plaintiffs appealed, and in May 2009, the U.S. Court of Appeals for the Ninth Circuit reversed the decision of the District Court and remanded the matter back to the District Court for further proceedings, finding that there was ambiguity in a 1998 summary plan description related to the employer-funded component of the pension benefit. The plaintiffs filed a motion to certify a class. The parties also filed cross-motions for summary judgment. On January 26, 2010, the District Court granted summary judgment in favor of the Plan and denied plaintiffs motion for summary judgment. The District Court also denied plaintiffs motion for class certification and struck the trial date of March 23, 2010 as unnecessary given the District Court s grant of summary judgment for the Plan. Plaintiffs appealed the District Court s order to the Ninth Circuit.

Based upon the information available, the company believes that the resolution of any of these various claims and legal proceedings would not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Other Matters The company is pursuing legal action against an insurance provider arising out of a disagreement concerning the coverage of certain losses related to Hurricane Katrina (see Note 11). The company commenced the action against Factory Mutual Insurance Company (FM Global) on November 4, 2005, which is now pending in the U.S. District Court for the Central District of California, Western Division. In August 2007, the District Court issued an order finding that the excess insurance policy provided coverage for the company s Katrina-related loss. FM Global appealed the District Court s order, and on August 14, 2008, the U.S. Court of Appeals for the Ninth Circuit reversed the earlier summary judgment order in favor of the company, holding

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that the FM Global excess policy unambiguously excludes damage from the storm surge caused by Hurricane Katrina under its Flood exclusion. The Ninth Circuit remanded the case to the District Court to determine whether the California efficient proximate cause doctrine affords the company coverage under the policy even if the Flood exclusion of the policy is unambiguous. On April 2, 2009, the Ninth Circuit denied the company s Petition for Rehearing and remanded the case to the District Court. On June 10, 2009, the company filed a motion seeking leave of court to file a complaint adding AON Risk Services, Inc. of Southern California as a defendant. On July 1, 2009, FM Global filed a motion for partial summary judgment seeking a determination that the California efficient proximate cause doctrine is not applicable or that it affords no coverage under the policy. Both motions have been fully briefed and argued. The ultimate resolution of this matter is not expected to have a negative effect on the company s consolidated financial position or results of operations.

During 2008, the company received notification from Munich-American Risk Partners (Munich Re), the only remaining insurer within the primary layer of insurance coverage with which a resolution has not been reached, that it will pursue arbitration proceedings against the company related to approximately $19 million owed by Munich Re to Northrop Grumman Risk Management Inc. (NGRMI), a wholly-owned subsidiary of the company, for certain losses related to Hurricane Katrina. An arbitration was later invoked by Munich Re in the United Kingdom under the reinsurance contract. The company was also notified that Munich Re will seek reimbursement of approximately $44 million of funds previously advanced to NGRMI for payment of claim losses of which Munich Re provided reinsurance protection to NGRMI pursuant to an executed reinsurance contract, and $6 million of adjustment expenses. The company believes that NGRMI is entitled to full reimbursement of its covered losses under the reinsurance contract and has substantive defenses to the claim of Munich Re for return of the funds paid to date.

11. COMMITMENTS AND CONTINGENCIES

Contract Performance Contingencies Contract profit margins may include estimates of revenues not contractually agreed to between the customer and the company for matters such as settlements in the process of negotiation, contract changes, claims and requests for equitable adjustment for previously unanticipated contract costs. These estimates are based upon management s best assessment of the underlying causal events and circumstances, and are included in determining contract profit margins to the extent of expected recovery based on contractual entitlements and the probability of successful negotiation with the customer. As of June 30, 2010, the recognized amounts related to claims and requests for equitable adjustment are not material individually or in the aggregate.

Guarantees of Subsidiary Performance Obligations From time to time in the ordinary course of business, the company guarantees performance obligations of its subsidiaries under certain contracts. In addition, the company s subsidiaries may enter into joint ventures, teaming and other business arrangements (collectively, Business Arrangements) to support the company s products and services in domestic and international markets. The company generally strives to limit its exposure under these arrangements to its subsidiary s investment in the Business Arrangements, or to the extent of such subsidiary s obligations under the applicable contract. In some cases, however, the company may be required to guarantee performance by the Business Arrangements and, in such cases, the company generally obtains cross-indemnification from the other members of the Business Arrangements. At June 30, 2010, the company is not aware of any existing event of default that would require it to satisfy any of these guarantees.

Environmental Matters The estimated cost to complete remediation has been accrued where it is probable that the company will incur such costs in the future to address environmental impacts at currently or formerly owned or leased operating facilities, or at sites where it has been named a Potentially Responsible Party (PRP) by the Environmental

Protection Agency, or similarly designated by other environmental agencies. These accruals do not include any litigation costs related to environmental matters, nor do they include amounts recorded as asset retirement obligations. To assess the potential impact on the company s consolidated financial statements, management estimates the range of reasonably possible remediation costs that could be incurred by the company, taking into account currently available facts on each site as well as the current state of technology and prior

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experience in remediating contaminated sites. These estimates are reviewed periodically and adjusted to reflect changes in facts and technical and legal circumstances. Management estimates that as of June 30, 2010, the range of reasonably possible future costs for environmental remediation sites is $265 million to $625 million, of which $126 million is accrued in other current liabilities and $187 million is accrued in other long-term liabilities. A portion of the environmental remediation costs is expected to be recoverable through overhead charges on government contracts and, accordingly, such amounts are deferred in inventoried costs (current portion) and miscellaneous other assets (non-current portion). Factors that could result in changes to the company s estimates include: modification of planned remedial actions, increases or decreases in the estimated time required to remediate, changes to the determination of legally responsible parties, discovery of more extensive contamination than anticipated, changes in laws and regulations affecting remediation requirements, and improvements in remediation technology. Should other PRPs not pay their allocable share of remediation costs, the company may have to incur costs in addition to those already estimated and accrued. In addition, there are some potential remediation sites where the costs of remediation cannot be reasonably estimated. Although management cannot predict whether new information gained as projects progress will materially affect the estimated liability accrued, management does not anticipate that future remediation expenditures will have a material adverse effect on the company s consolidated financial position, results of operations or cash flows.

Hurricane Impacts In 2008, a subcontractor s operations in Texas were severely impacted by Hurricane Ike. The subcontractor produces compartments for two of the LPD amphibious transport dock ships under construction at the Gulf Coast shipyards. In 2009, the company received $25 million of insurance proceeds representing interim payments on the Hurricane Ike insurance claim. In the first quarter of 2010, the company received $17 million in final settlement of its claim. The insurance proceeds were recorded as operating income at the Shipbuilding segment.

In August 2005, the company s Gulf Coast operations were significantly impacted by Hurricane Katrina and the company s shipyards in Louisiana and Mississippi sustained significant windstorm damage from the hurricane. As a result of the storm, the company incurred costs to replace or repair destroyed or damaged assets, suffered losses under its contracts, and incurred substantial costs to clean up and recover its operations. As of the date of the storm, the company had a comprehensive insurance program that provided coverage for, among other things, property damage, business interruption impact on net profitability, and costs associated with clean-up and recovery. The company has recovered a portion of its Hurricane Katrina claim and expects that its remaining claim will be resolved separately with the two remaining insurers, FM Global and Munich Re.

The company has full entitlement to any insurance recoveries related to business interruption impacts on net profitability resulting from these hurricanes. However, because of uncertainties concerning the ultimate determination of recoveries related to business interruption claims, in accordance with company policy no such amounts are recognized until they are resolved with the insurers. Furthermore, due to the uncertainties with respect to the company s disagreement with FM Global in relation to the Hurricane Katrina claim, no receivables have been recognized by the company in the accompanying condensed consolidated financial statements for insurance recoveries from FM Global.

In accordance with U.S. Government cost accounting regulations affecting the majority of the company s contracts, the cost of insurance premiums for property damage and business interruption coverage, other than coverage of profit, is an allowable expense that may be charged to contracts. Because a substantial portion of long-term contracts at the shipyards are flexibly-priced, the government customer would benefit from a portion of insurance recoveries in excess of the net book value of damaged assets and clean-up and restoration costs paid by the company. When such insurance recoveries occur, the company is obligated to return a portion of these amounts to the government.

Shipbuilding Quality Issues In conjunction with a second quarter 2009 review of design, engineering and production processes at Shipbuilding undertaken as a result of leaks discovered in the USS San Antonio s (LPD 17) lube oil system, the company became aware of quality issues relating to certain pipe welds on ships under production in the Gulf Coast as well as those that had previously been delivered. Since that discovery, the

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company has been working with its customer to determine the nature and extent of the pipe weld issue and its possible impact on related shipboard systems. This effort has resulted in the preparation of a technical analysis of the problem, additional inspections on the ships, a rework plan for ships previously delivered and in various stages of production, and modifications to the work plans for ships being placed into production, all of which has been done with the knowledge and support of the U.S. Navy. Shipbuilding responsible incremental costs associated with the anticipated resolution of these matters have been reflected in the financial performance analysis and contract booking rates beginning with the second quarter of 2009.

In the fourth quarter of 2009, certain bearing wear and debris were found in the lubrication system of the main propulsion diesel engines (MPDE) installed on LPD 21. Shipbuilding is participating with the Navy and other industry participants involved with the MPDEs in a review panel established by the Navy to examine the MPDE lubrication system s design, construction, operation and maintenance for the LPD 17 class of ships. The team is focusing on identification and understanding of the root causes of the MPDE diesel bearing wear and debris in the lubrication system and potential future impacts on maintenance costs. To date the review has identified several potential system improvements for increasing the system reliability. Certain changes are being implemented on ships under construction at this time and the Navy is implementing some changes on in-service ships in the class at the earliest opportunity.

In July 2010, the Navy released its report documenting the results of a Judge Advocate General s manual (JAGMAN) investigation of the failure of MPDE bearings on LPD 17 subsequent to the Navy s Planned Maintenance Availability (PMA) which was completed in October 2009. During sea trials following the completion of the Navy conducted PMA, one of the ship s MPDEs suffered a casualty as the result of a bearing failure. The JAGMAN investigation determined that the bearing failure could be attributed to a number of possible factors, including deficiencies in the acquisition process, maintenance, training, and execution of shipboard programs, as well as debris from the construction process. Shipbuilding s technical personnel reviewed the JAGMAN report and provided feedback to the Navy on the report, recommending that the company and the Navy perform a comprehensive review of the LPD 17 Class propulsion system design and its associated operation and maintenance procedure in order to enhance reliability. Discussions between the company and the Navy on this recommendation are ongoing.

The company and the Navy continue to work in partnership to investigate and identify any additional corrective actions to address quality issues associated with ships manufactured in the company s Gulf Coast shipyards and the company will implement appropriate corrective actions. The company does not believe that the ultimate resolution of the matters described above will have a material adverse effect upon its consolidated financial position, results of operations or cash flows.

Financial Arrangements In the ordinary course of business, the company uses standby letters of credit and guarantees issued by commercial banks and surety bonds issued principally by insurance companies to guarantee the performance on certain contracts and to support the company s self-insured workers compensation plans. At June 30, 2010, there were $424 million of stand-by letters of credit, $126 million of bank guarantees, and $452 million of surety bonds outstanding.

The company has also guaranteed a $200 million loan made to Shipbuilding in connection with the Gulf Opportunity Zone Industrial Revenue Development Bonds issued by the Mississippi Business Finance Corporation in December 2006. Under the guaranty, the company guaranteed to the Bond Trustee the repayment of all payments due under the trust indenture and loan agreement. In addition a subsidiary of the company has guaranteed Shipbuilding s outstanding $84 million Economic Development Revenue Bonds (Ingalls Shipbuilding, Inc. Project), Taxable Series 199A.

Indemnifications The company has retained certain warranty, environmental, income tax, and other potential liabilities in connection with certain of its divestitures. The settlement of these liabilities is not expected to have a material adverse effect on the company s consolidated financial position, results of operations or cash flows.

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U.S. Government Claims From time to time, the U.S. Government advises the company of claims and penalties concerning certain potential disallowed costs. When such findings are presented, the company and the U.S. Government representatives engage in discussions to enable the company to evaluate the merits of these claims as well as to assess the amounts being claimed. The company believes, but can give no assurance, that the outcome of any such matters would not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Operating Leases Rental expense for operating leases (net of immaterial amounts of sublease rental income), for the three and six months ended June 30, 2010, was $129 million and $257 million, respectively, and $143 million and $283 million, respectively, for the three and six months ended June 30, 2009.

Related Party Transactions For all periods presented, the company had no material related party transactions.

12. RETIREMENT BENEFITS

The cost of the company s pension plans and medical and life benefits plans is shown in the following table:

	Three Months Ended June 30				Six Months Ended June 30			
	Pension Benefits		Medical and Life Benefits		Pension Benefits		Medical and Life Benefits	
$ in millions	**2010**	2009	**2010**	2009	**2010**	2009	**2010**	2009
Components of Net Periodic Benefit Cost								
Service cost	**$ 164**	$ 164	**$ 13**	$ 12	**$ 329**	$ 329	**$ 25**	$ 24
Interest cost	**349**	337	**38**	41	**698**	674	**77**	82
Expected return on plan assets	**(437)**	(389)	**(14)**	(12)	**(875)**	(778)	**(28)**	(24)
Amortization of:								
Prior service cost (credit)	**12**	12	**(15)**	(15)	**24**	24	**(30)**	(30)
Net loss from previous years	**61**	85	**6**	7	**122**	170	**13**	14

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