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NORTHROP GRUMMAN CORP  
Form PRE 14A  
March 29, 2001

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

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. )

Filed by the Registrant  [X]

Filed by a Party other than the Registrant  [ ]

Check the appropriate box:

[X] Preliminary Proxy Statement

[ ] CONFIDENTIAL, FOR USE OF THE  
COMMISSION ONLY (AS PERMITTED BY  
RULE 14A-6(E) (2))

[ ] Definitive Proxy Statement

[ ] Definitive Additional Materials

[ ] Soliciting Material Pursuant to (S) 240.14a-11(c) or (S) 240.14a-12

Northrop Grumman Corporation

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

[X] No fee required.

[ ] Fee computed on table below per Exchange Act Rules 14a-6(i) (4) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):  
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(4) Proposed maximum aggregate value of transaction:  
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(5) Total fee paid:  
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Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:  
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(2) Form, Schedule or Registration Statement No.:  
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(3) Filing Party:  
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(4) Date Filed:  
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Notes:

Reg. (S) 240.14a-101.

SEC 1913 (3-99)

[LOGO OF NORTHROP GRUMMAN]

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS  
AND PROXY STATEMENT

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### NOTICE

The Annual Meeting of Stockholders of Northrop Grumman Corporation ("Northrop Grumman") will be held on Wednesday, May 16, 2001 at 10:00 a.m. at the Fairmont Miramar Hotel, 101 Wilshire Boulevard, Santa Monica, California 90401.

Stockholders at the close of business on April 9, 2001 are entitled to vote at the Annual Meeting. The following items are on the agenda:

- (1) Election of three Class I directors, each for a three year term expiring in 2004;
- (2) Proposal to ratify the appointment of Deloitte & Touche LLP as Northrop Grumman's independent auditors for fiscal year ending December 31, 2001;
- (3) Proposal to approve the 2001 Long-Term Incentive Stock Plan;
- (4) Proposal to approve the issuance of shares of Common Stock, par value \$1.00 per share, upon conversion of the Series B Preferred Stock to be issued in the acquisition of Litton Industries, Inc.;
- (5) Proposal to amend Northrop Grumman's Certificate of Incorporation to increase the number of authorized shares of common stock;
- (6) Stockholder proposal regarding offset commitments;
- (7) Stockholder proposal regarding super majority vote;
- (8) Stockholder proposal regarding classified board;
- (9) Stockholder proposal regarding Shareholder Rights Plan;
- (10) Other business as may properly come before the Annual Meeting or any adjournments thereof.

In connection with the acquisition of Litton Industries, Inc. by Northrop Grumman's wholly owned subsidiary, NNG, Inc., Northrop Grumman has agreed to a reorganization in which NNG will change its name to Northrop Grumman Corporation and become the holding company for both Northrop Grumman and Litton. At this time, the timing for completion of the acquisition of a majority of Litton's outstanding stock and the Northrop Grumman reorganization is not known. If the transactions are completed prior to the date of the 2001 Annual Meeting of Stockholders, the Annual Meeting will be the Annual Meeting of Stockholders of the new holding company. Consequently, this notice of Annual Meeting will serve as notice of the Annual Meeting of Stockholders of either Northrop Grumman Corporation, as it exists on the date hereof, or of NNG (as the new holding company), as the case may be.

If the Northrop Grumman reorganization is completed prior to the Annual Meeting, existing Northrop Grumman (as the sole stockholder of NNG on the record date) will vote all of the outstanding shares of NNG "for," "against" or "abstain" with respect to each of the proposals set forth herein in the exact proportions of the votes indicated by stockholders in their proxies/voting instructions with respect to the Annual Meeting, or provided in person at the meeting.

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By order of the Board of Directors,  
/s/ John H. Mullan  
John H. Mullan  
Corporate Vice President and  
Secretary

1840 Century Park East  
Los Angeles, California 90067

April 16, 2001

### IMPORTANT

To assure your representation at the Annual Meeting, please sign, date and return the enclosed proxy card for which a return envelope is provided. No postage is required if mailed in the United States.

You may also vote by telephone or over the Internet. For instructions on electronic voting please see page 2 of this Proxy Statement or the proxy card.

### PROXY STATEMENT

#### GENERAL INFORMATION

This proxy statement is issued in connection with solicitation of the enclosed proxy by the Board of Directors of Northrop Grumman Corporation ("Northrop Grumman") for use at Northrop Grumman's 2001 Annual Meeting of Stockholders (the "Annual Meeting"). Northrop Grumman's principal office is located at 1840 Century Park East, Los Angeles, California, 90067. This proxy material will be sent to stockholders beginning approximately April 16, 2001.

As previously announced, Northrop Grumman has entered into an Amended and Restated Agreement and Plan of Merger dated January 23, 2001, pursuant to which a wholly owned Northrop Grumman subsidiary, NNG, Inc. has offered to acquire all of the outstanding stock of Litton in exchange for cash and stock. Immediately prior to the acquisition of a majority of the outstanding stock of Litton, a wholly-owned subsidiary of NNG will merge with and into Northrop Grumman, in order that Northrop Grumman will become a wholly-owned subsidiary of NNG. That merger is referred to as the "Northrop reorganization." In the Northrop reorganization, all of the outstanding shares of capital stock of Northrop Grumman will become the same number of shares of the same class of capital stock of NNG. Outstanding options to acquire common stock of Northrop Grumman will become options to acquire common stock of NNG. The certificate of incorporation and bylaws of NNG will be identical, in all material respects, to the certificate of incorporation and bylaws of Northrop Grumman, and NNG will adopt a stockholder rights plan which is identical, in all material respects, to the stockholder rights plan of Northrop Grumman. The directors and officers of Northrop Grumman will constitute the board of directors and officers of NNG. Upon completion of the Northrop reorganization, the name of NNG will be changed to "Northrop Grumman Corporation" and the name of the present Northrop Grumman Corporation will be changed to "Northrop Grumman Systems Corporation." The common stock of Northrop Grumman following the Northrop reorganization (i.e., the NNG common stock) will be listed for trading on the NYSE, and certificates representing shares of Northrop Grumman common stock will continue to represent shares of common stock of Northrop Grumman Corporation. No vote of the stockholders of Northrop Grumman is required for the Northrop reorganization.

At this time, the timing for completion of the acquisition of a majority of

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Litton's outstanding stock and the Northrop Grumman reorganization is not known. If the transactions are completed prior to the date of the 2001 Annual Meeting of Stockholders, the Annual Meeting will be the Annual Meeting of Stockholders of the new holding company. Consequently, this proxy statement will serve as the proxy statement of either Northrop Grumman Corporation, as it exists on the date hereof, or of NNG (as the new holding company), as the case may be. If the Northrop Grumman reorganization is completed prior to the Annual Meeting, existing Northrop Grumman (as the sole stockholder of NNG on the record date) will vote all of the outstanding shares of NNG "for," "against" or "abstain" with respect to each of the proposals set forth herein in the exact proportions of the votes indicated by stockholders in their proxies/voting instructions with respect to the Annual Meeting, or provided in person at the meeting.

### OUTSTANDING SECURITIES

On April 9, 2001 there were            shares of Northrop Grumman's common stock, par value \$1.00 per share ("Common Stock"), outstanding. Holders of record of Common Stock at the close of business on April 9, 2001 are entitled to vote at the Annual Meeting. Each share of Common Stock is entitled to one vote on each proposal.

### VOTING AT THE MEETING OR BY PROXY

Shares represented by a properly executed proxy/voting instruction in the accompanying form will be voted at the meeting in accordance with the stockholder's instructions. If no instructions are given, the shares will be voted according to the Board of Directors' recommendations. Therefore, if no instructions are given, the persons named on the card will vote FOR Proposal One to elect the three director nominees listed under "Election of Directors", FOR Proposal Two to ratify the appointment of Deloitte & Touche LLP as auditors of Northrop Grumman for the year

1

ending December 31, 2001, FOR Proposal Three to approve the 2001 Long-Term Incentive Stock Plan, FOR Proposal Four to approve the issuance of shares of Common Stock upon the conversion of the Preferred Stock, FOR Proposal Five to amend Northrop Grumman's Certificate of Incorporation to increase the number of authorized shares of Common Stock, AGAINST Proposal Six, the stockholder proposal regarding offset commitments, AGAINST Proposal Seven, the stockholder proposal regarding super majority vote, AGAINST Proposal Eight, the stockholder proposal regarding classified board and AGAINST Proposal Nine, the stockholder proposal regarding the Shareholder Rights Plan. For those shares held in Northrop Grumman's employee stock ownership plans, if no instructions are provided, the applicable trustee will vote the respective plan shares according to the provisions of the applicable plan documents.

A stockholder who executes a proxy/voting instruction may revoke it at any time before its exercise by delivering a written notice of revocation to the Corporate Secretary or by signing and delivering another proxy that is dated later. A stockholder attending the meeting in person may revoke the proxy/voting instruction by giving notice of revocation to an inspector of election at the meeting or voting at the meeting. If any other matters are properly brought before the meeting, the enclosed proxy/voting instruction card gives discretionary authority to the persons named on the card to vote the shares in their best judgment.

With respect to the election of directors, stockholders may vote in favor of all nominees, or withhold their votes as to all nominees or specific nominees. There is no box to "abstain", but checking the box on the enclosed

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proxy/voting instruction card that withholds authority to vote for a nominee is the equivalent of abstaining. The three nominees receiving the greatest number of votes cast for the election of directors by shares entitled to vote and present in person or by proxy at the Annual Meeting will be elected directors. With respect to any proposal other than the election of directors, stockholders may vote in favor of the proposal, or against the proposal or abstain from voting.

Brokers who hold shares of Common Stock for the accounts of their clients may vote such shares either as directed by their clients or in their own discretion if permitted by the stock exchange or other organization of which they are members. Members of the New York Stock Exchange are permitted to vote their clients' proxies in their own discretion as to the election of directors if the clients have not furnished voting instructions within ten days of the meeting. Certain proposals other than the election of directors are "non-discretionary" and brokers who have received no instructions from their clients do not have discretion to vote on those items. When a broker votes a client's shares on some but not all of the proposals at a meeting, the missing votes are referred to as "broker non-votes".

Broker non-votes will have no effect on the election of directors (Proposal One) or the ratification of the selection of Deloitte & Touche as Northrop Grumman's independent accountants (Proposal Two). Broker non-votes will have no effect on the proposals concerning approval of the 2001 Long-Term Incentive Stock Plan (Proposal Three) and the authorization of issuance of common stock upon conversion of Series B preferred stock (Proposal Four), provided that holders of over 50% of the outstanding shares of common stock cast votes on each of these two proposals. A broker non-vote or an abstention will have the same effect as a vote against the proposed amendment to the Certificate of Incorporation to increase the number of authorized shares of common stock (Proposal Five). Broker non-votes will have no effect on the stockholder proposals (Proposals Six, Seven, Eight and Nine).

The presence in person or by proxy of stockholders entitled to cast at least a majority of the votes that all stockholders are entitled to cast shall constitute a quorum at the annual meeting. Both abstentions and broker non-votes will be counted for purposes of determining the presence of a quorum.

### VOTING BY TELEPHONE OR THE INTERNET

Registered stockholders and participants in Northrop Grumman's employee stock ownership plans may vote their shares over the telephone or on the Internet. The law of Delaware, under which Northrop Grumman is incorporated, specifically permits electronically transmitted proxies, provided that each such proxy contains or is submitted with information from which the inspectors of election can determine that such proxy was authorized by the shareholder. The voting procedures available to registered shareholders for the Annual Meeting are

2

designed to authenticate each shareholder by use of a Control Number, to allow shareholders to vote their shares, and to confirm that their instructions have been properly recorded.

Registered shareholders and plan participants may go to <http://www.eproxyvote.com/noc> to vote on the Internet. They will be required to provide the Control Numbers contained on their proxy cards. After providing the correct Control Number, the voter will be asked to complete an electronic proxy card. The votes will be generated on the computer screen and the voter will be prompted to submit or revise them as desired. Any registered

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shareholder or plan participant using a touch-tone telephone may also vote by calling 1-877-779-8683 (toll-free) and following the recorded instructions.

Most beneficial owners whose stock is held in street name receive voting instruction forms from their banks, brokers or other agents, rather than Northrop Grumman's proxy/voting instruction card. Beneficial owners may also be able to vote by telephone or the Internet. They should follow the instructions on the form they receive from their bank, broker, or other agent.

The method of voting used will not limit a stockholder's right to attend the Annual Meeting.

VOTING SECURITIES

On December 31, 2000, there were 72,058,736 shares of Northrop Grumman's Common Stock outstanding. The following entities beneficially owned, to Northrop Grumman's knowledge, more than five percent of the outstanding Common Stock:

Name and Address of Beneficial Owner -----	Amount and Nature of Beneficial Ownership	Percent of Class -----
State Street Bank and Trust Company(a)..... 225 Franklin St., Boston, MA 02110	5,541,069 shares	7.69%
Wellington Management Company, LLP(b)..... 75 State Street, Boston, MA 02109	9,015,500 shares	12.51%
U.S. Trust Company, N.A.(c)(d)..... 555 So. Flower St., Los Angeles, CA 90071-2429	9,633,326 shares	13.37%

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- (a) This information was provided by State Street Bank and Trust Company ("State Street") in a Schedule 13G filed with the SEC on February 12, 2001. According to State Street, as of December 31, 2000, State Street had sole voting power over 1,263,552 shares, shared voting power over 4,238,561 shares, sole dispositive power over 5,538,758 and shared dispositive power over 2,311 shares. This total includes 4,078,898 shares held for the account of employee participants in the Employee Stock Ownership Plan portion of the Northrop Grumman Savings and Investment Plan for which State Street acts as a trustee.
  - (b) This information was provided by Wellington Management Company, LLP ("Wellington") in a Schedule G filed with the SEC on February 14, 2001. According to Wellington, as of December 31, 2000, Wellington had shared voting power over 5,838,900 and shared dispositive power over 8,991,500.
  - (c) This information was provided by U.S. Trust Company, N.A. ("U.S. Trust Company") in a Schedule 13G filed with the SEC on January 18, 2001. U.S. Trust Company is an Investment Manager (the "Investment Manager") for the Northrop Grumman Pension Plan and the pension plans for certain divisions of Northrop Grumman (the "Pension Plans"); Northrop Grumman has established a Master Trust with State Street Bank and Trust Company as Trustee ("Trustee"). Under the Master Trust, the Investment Manager has responsibility for the management and control of the Northrop Grumman shares held in the Master Trust as assets of the Pension Plans. The Investment Manager has sole dispositive and voting power over 9,633,326 shares held in the Master Trust between Northrop Grumman Corporation and the Trustee.

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- (d) These shares are held for the account of (but not beneficially owned by) the Trustee. The Investment Manager has voting power over these shares, except in the event of a contested election of directors or in connection with a tender offer. In such cases, the shares are voted in accordance with instructions received from eligible participants in the Pension Plans and undirected shares are voted in the same proportion as shares for which instructions are received.

3

### Stock Ownership of Officers and Directors

The following table shows beneficial ownership (as defined by applicable rules for proxy statement reporting purposes) of the Common Stock as of April 9, 2001 (the Annual Meeting record date) by each director and nominee, by the Chief Executive Officer and the other four most highly compensated executive officers (collectively, the "Named Executive Officers") and all directors and executive officers as a group. Each individual owned less than 1% of the outstanding Common Stock. Unless otherwise indicated, each individual has sole investment power and sole voting power with respect to the shares owned by such person. No family relationship exists between any of the directors or executive officers of Northrop Grumman.

	Number of Shares Beneficially Owned	Percentage of Outstanding Shares (6) Beneficially Owned
<b>Directors</b>		
Jack R. Borsting.....	8,892 (1)	*
John T. Chain, Jr.....	8,974	*
Lewis W. Coleman.....	0	*
Vic Fazio.....	1,593	*
Phillip Frost.....	18,664	*
Charles R. Larson.....	59	*
Robert A. Lutz.....	8,034	*
Aulana L. Peters.....	13,349	*
John E. Robson.....	14,304	*
Richard M. Rosenberg.....	11,047	*
John Brooks Slaughter.....	7,974	*
Richard J. Stegemeier.....	10,353 (2)	*
<b>Named Executive Officers</b>		
Kent Kresa (3).....	651,334 (4)	*
Richard B. Waugh, Jr.....	68,544 (5)	*
Herbert W. Anderson.....	29,672	*
James G. Roche.....	61,149	*
Ralph D. Crosby, Jr. ....	56,802	*
<b>Directors and Executive Officers as a Group (23 persons).....</b>	<b>1,101,866</b>	<b>[ ]</b>

\* The percentage of shares of Common Stock beneficially owned does not exceed one percent of the outstanding shares of Common Stock.

- (1) Includes 1,200 shares held in the Borsting Family Trust of which Dr. Borsting is trustee.
- (2) Includes 1,000 shares held in the Richard J. Stegemeier Family Trust of which Mr. Stegemeier and his wife are trustees.
- (3) Mr. Kresa also serves as Chairman of the Board.
- (4) Includes 461,925 shares held by the Kresa Family Trust of which Mr. Kresa



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is trustee.

- (5) Includes 46,392 shares held by the Waugh Family Trust of which Mr. Waugh and his wife are trustees.
- (6) Includes options exercisable within 60 days and shares or share equivalents beneficially owned under one or more of Northrop Grumman's compensation or benefit plans, respectively, as follows: J.R. Borsting 6,500 and 0 shares; J.T. Chain 7,000 and 0 shares; L.W. Coleman 0 and 0 shares; V. Fazio 1,500 and 0 shares; P. Frost 6,500 and 1,203 shares; C.R. Larson 0 and 0 shares; R.A. Lutz 6,000 and 564 shares; A.L. Peters 7,000 and 2,777 shares; J.E. Robson 7,000 and 2,577 shares; R.M. Rosenberg 7,000 and 0 shares; J.B. Slaughter 7,000 and 0 shares; R.J. Stegemeier 7,000 and 0 shares; K. Kresa 184,123 and 5,286 shares; R.B. Waugh 18,750 and 3,402 shares; H.W. Anderson 27,000 and 1,474 shares; J.G. Roche 41,250 and 606 shares; and R.D. Crosby 31,250 and 2,885 shares.

4

### PROPOSAL ONE: ELECTION OF DIRECTORS

Northrop Grumman's Certificate of Incorporation provides for a classified Board of Directors. Three directors in Class I will be elected at the 2001 Annual Meeting to hold office for three years until the 2004 Annual Meeting of Stockholders or until their successors have been elected and qualified. Unless instructed otherwise, the persons named in the accompanying proxy will vote the shares represented by such proxy for the election of the three Class I Director Nominees listed in the table below. Each of the three Class I Director Nominees has consented to serve, and the Board does not know of any reason why any of them would be unable to serve. If a nominee becomes unavailable or unable to serve before the Annual Meeting (for example, due to serious illness), the Board can either reduce its size or designate a substitute nominee. If any nominee becomes unavailable for election to the Board of Directors, an event that is not anticipated, the persons named as proxies have full discretion and authority to vote or refrain from voting for any other nominee in accordance with their judgment.

The following information, furnished with respect to each of the three nominees for election as a Class I director, and each of the four Class II and three Class III directors whose terms continue after the Annual Meeting, is obtained from Northrop Grumman's records or from information furnished directly by the individual to Northrop Grumman. All the nominees are presently serving on the Board of Directors. Members of the Board of Directors are generally ineligible to stand for election if they will have attained age 70 by the date of Northrop Grumman's Annual Meeting of Stockholders at which such election is held. Jack R. Borsting, Richard M. Rosenberg and Richard J. Stegemeier, all Class I directors, are ineligible to stand for election by reason of this policy.

All of the following directors first became directors of NNG, Inc. in 2001.

#### NOMINEES DIRECTOR -- CLASS I

LEWIS W. COLEMAN, 59. President, Gordon and Betty Moore Foundation.

Director since 2001

Lewis W. Coleman became President of the Gordon and Betty Moore Foundation in January 2001. In December 2000, he resigned as Chairman of Banc of America Securities, LLC, a subsidiary of Bank of America Corporation after having served in that position since joining Banc of America Securities, LLC in December 1995. Prior to that, he spent ten years at BankAmerica Corporation

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where he held various positions including Chief Financial Officer, head of World Banking Group and head of Capital Markets. Previous to that he spent thirteen years with Wells Fargo & Co. in a variety of wholesale and retail banking positions. He is also on the Board of Directors of Chiron Corporation.

KENT KRESA\*, 63. Chairman, President and Chief Executive Officer.

Director since 1987

Before joining Northrop Grumman, Kent Kresa was associated with the Lincoln Laboratory of M.I.T. and the Defense Advanced Research Projects Agency of the Department of Defense. In 1975, he joined Northrop Grumman as Vice President and Manager of Northrop Grumman's Research and Technology Center. He became General Manager of the Ventura Division in 1976, Group Vice President of the Aircraft Group in 1982 and Senior Vice President for Technology and Development in 1986. Mr. Kresa was elected President and Chief Operating Officer of Northrop Grumman in 1987. He was named Chief Executive Officer in 1989 and Chairman of the Board in 1990. Mr. Kresa is a member of the National Academy of Engineering and is past Chairman of

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\* Mr. Kresa serves on the Board of Directors as part of the class of directors with terms expiring in 2003. In order to apportion the directors among the three classes as evenly as possible, Mr. Kresa has been nominated for election this year and upon his election, will resign from the class of 2003, which will then be reduced to three members.

5

the Board of Governors of the Aerospace Industries Association and Chairman of the Defense Policy Advisory Committee on Trade. He is also an Honorary Fellow of the American Institute of Aeronautics and Astronautics and a member of the M.I.T. Lincoln Library Advisory Board. He serves on the Board of Directors of the W.M. Keck Foundation and on the Board of Trustees of the California Institute of Technology, and serves as a director of Avery Dennison Corporation, the Los Angeles World Affairs Council, the John Tracy Clinic and Eclipse Aviation Corporation. He is also a Member of the Corporation, Draper Laboratories, Inc. and serves on the Board of Governors of the Performing Arts Center of Los Angeles.

AULANA L. PETERS, 59. Retired Partner, Gibson, Dunn & Crutcher.

Director since 1992

Aulana L. Peters is a retired partner of the law firm of Gibson, Dunn & Crutcher where she was a partner from 1988 to December 2000. Effective January 1, 2001 she was elected to the Public Oversight Board of the AICPA. From 1984 to 1988 she served as Commissioner of the Securities and Exchange Commission. Ms. Peters is a director of Callaway Golf Company, Minnesota Mining and Manufacturing Company, and Merrill Lynch & Co., Inc. She is also a member of the Board of Directors of Community Television for Southern California (KCET). Ms. Peters served as a member of the Financial Accounting Standards Board Steering Committee for its Financial Reporting Project and as a member of the Public Oversight Board's Panel on Audit Effectiveness.

Vote Required

The vote of a plurality of the shares of Common Stock voting at the Annual Meeting is required for the election of directors.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" THE THREE NOMINEES FOR DIRECTOR LISTED ABOVE.

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### CONTINUING DIRECTORS -- CLASS II

PHILLIP FROST, 64. Chairman of the Board and Chief Executive Officer, IVAX Corporation, a pharmaceutical company.

Director since 1996

Dr. Phillip Frost has served as Chairman of the Board of Directors and Chief Executive Officer of IVAX Corporation since 1987 and served as President from 1991 to 1995. Dr. Frost was Chairman of the Department of Dermatology at Mt. Sinai Medical Center of Greater Miami, Miami Beach, Florida from 1972 to 1990 and was Chairman of the Board of Directors of Key Pharmaceuticals, Inc. from 1972 to 1986. He is Chairman of Whitman Education Group and Vice Chairman of Continucare Corporation. He is also Vice Chairman of the Board of Trustees of the University of Miami and is a member of the Board of Governors of the American Stock Exchange.

ROBERT A. LUTZ, 69. Chairman of the Board and Chief Executive Officer, Exide Corporation, a battery manufacturing company.

Director since 1997

Robert A. Lutz has served as Chairman and Chief Executive Officer of Exide Corporation since December 1998. He also served as President of Exide Corporation from December 1998 through May 2000. Previously he had joined Chrysler Corporation in 1986 as Executive Vice President of Chrysler Motors Corporation and was elected a director of Chrysler Corporation that same year. He was elected President in 1991 and Vice Chairman in 1996. He retired from Chrysler Corporation in July 1998. Prior to joining Chrysler Corporation, Mr. Lutz held senior positions with Ford Motor Company, General Motors Corporation Europe and Bavarian Motor Werke. He is an executive director of the National Association of Manufacturers and a member of the National Advisory Council of the University of Michigan School of Engineering, the Board of Trustees of the U.S. Marine Corps University Foundation and the Advisory Board of the University of California-Berkeley, Haas School of Business. Mr. Lutz is also a director of ASCOM Holdings, A.G. and Silicon Graphics, Inc.

6

JOHN E. ROBSON, 70. Senior Advisor, Robertson Stephens, a FleetBoston Financial Company, investment bankers.

Director since 1993

Since 1993 John E. Robson has been a Senior Advisor at Robertson Stephens. From 1989 to 1993 he served as Deputy Secretary of the United States Treasury. He was Dean and Professor of Management at the Emory University School of Business Administration from 1986 to 1989 and President and Chief Executive Officer and Executive Vice President and Chief Operating Officer of G.D. Searle & Co., a pharmaceutical company, from 1977 to 1986. Previously, he held government posts as Chairman of the U.S. Civil Aeronautics Board, regulator of the airline industry and Under Secretary of the U.S. Department of Transportation, and engaged in the private practice of law as a partner of Sidley and Austin. Mr. Robson is a director of Pharmacia Corporation and ProLogis Trust. He is also a Distinguished Visiting Fellow of the Hoover Institution at Stanford University, a Visiting Fellow at the Heritage Foundation and a director of the University of California San Francisco Foundation.

JOHN BROOKS SLAUGHTER, 67. President and Chief Executive Officer, The National

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Action Council for Minorities in Engineering, Inc.

Director since 1993

Dr. John Brooks Slaughter held electronics engineering positions with General Dynamics Convair and the U.S. Navy Electronics Laboratory. In 1975, he became Director of the Applied Physics Laboratory of the University of Washington. In 1977, he was appointed Assistant Director for Astronomics, Atmospheric, Earth and Ocean Sciences at the National Science Foundation. From 1979 to 1980, he served as Academic Vice President and Provost of Washington State University. In 1980, he returned to the National Science Foundation as Director and served in that capacity until 1982 when he became Chancellor of the University of Maryland, College Park. From 1988 to July 1999, Dr. Slaughter was President of Occidental College in Los Angeles and in August 1999, he assumed the position of Melbo Professor of Leadership in Education at the University of Southern California. In June 2000, Dr. Slaughter was named President and Chief Executive Officer of The National Action Council for Minorities in Engineering, Inc. He is a member of the National Academy of Engineering, a fellow of the American Academy of Arts and Sciences and serves as a director of Solutia, Inc. and International Business Machines Corporation.

### CONTINUING DIRECTORS -- CLASS III

JOHN T. CHAIN, JR., 66. General, United States Air Force (Ret.) and Chairman of the Board, Thomas Group, Inc. a management consulting company.

Director since 1991

General John T. Chain has been Chairman of Thomas Group, Inc. since May 1998 and has been a member of the Board of Directors of Thomas Group since May 1995. He has also served as the President of Quarterdeck Equity Partners, Inc. since December 1996. He served as Special Assistant to the Chairman of Burlington Northern Santa Fe Corporation from November 1995 to March 1996, and as an Executive Vice President of Burlington Northern from 1991 to November 1995. During his military career, General Chain's commands included military assistant to the Secretary of the Air Force, Director of Politico-Military Affairs, Department of State and Chief of Staff of Supreme Headquarters Allied Powers Europe. After serving as Commander in Chief, Strategic Air Command, he retired from the Air Force in February 1991. General Chain serves as a director of R.J. Reynolds, Inc. and Kemper Insurance Company.

VIC FAZIO, 58. Senior Partner, Clark & Weinstock, a consulting firm.

Director since 2000

Vic Fazio served as a Member of Congress for 20 years representing California's third congressional district. During that time he served as a member of the Armed Services, Budget and Ethics Committees and was a member of the House Appropriations Committee where he served as Subcommittee Chair or ranking member for 18 years. Mr. Fazio was a member of the elected Democratic Leadership in the House from 1991-1998 including four years as Chair of the Democratic Caucus, the third ranking position in the party. From 1975 to 1978 Mr. Fazio served in

the California Assembly and was a member of the staff of the California Assembly Speaker from 1971 to 1975. Upon leaving Congress in early 1999, he became a Senior Partner at Clark & Weinstock, a strategic communications

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consulting firm. He is a member of numerous boards including The California Institute, Coro National Board of Governors, which he chairs, the U.S. Capitol Historical Society, the Board of the U.S. Capitol Visitors Center and the Board of Visitors, The University of California at Davis Medical School.

CHARLES R. LARSON, 64. Admiral, United States Navy (Ret.)

Director since 2000

Admiral Charles R. Larson is recognized as the first Naval officer to be selected as a White House Fellow. He also served as Naval aide to the President. He served as superintendent of the U.S. Naval Academy from 1983 to 1986 and in 1991 he became senior military commander in the Pacific. He returned to U.S. Naval Academy in 1994, where he served as superintendent until 1998. Currently, Admiral Larson is Chairman of the Board of the U.S. Naval Academy Foundation, Vice Chairman of the Board of Regents of the University System of Maryland and serves on the board of directors of such organizations as Constellation Energy Group, Inc., Edge Technologies, Inc., Fluor Global Services, the Atlantic Council, Military.com and the National Academy of Sciences' Committee on International Security and Arms Control. In addition, he is a member of the Council on Foreign Relations and is a senior fellow of The CNA Corporation.

### Committees of the Board of Directors

The Board of Directors has Audit, Compensation and Management Development, Nominating and Corporate Governance, Finance and Public Issues and Policy Committees. The membership of these committees is usually determined at the organizational meeting of the Board held in conjunction with the Annual Meeting. The membership of each committee is as follows, with the chairman listed first:

Audit	Compensation and Management Development	Nominating and Corporate Governance	Finance	Public and
John Brooks Slaughter	John T. Chain, Jr.	Jack R. Borsting	Richard M. Rosenberg	Aulana L.
Jack R. Borsting	Jack R. Borsting	John T. Chain, Jr.	John T. Chain, Jr.	Vic Fazio
Lewis W. Coleman	Lewis W. Coleman	Vic Fazio	Lewis W. Coleman	Phillip F
Vic Fazio	Robert A. Lutz	Phillip Frost	Phillip Frost	Charles R
Charles R. Larson	John E. Robson	Richard M. Rosenberg	Robert A. Lutz	John Broo
Aulana L. Peters	Richard J. Stegemeier		John E. Robson	
Richard J. Stegemeier				

### Audit Committee

The Audit Committee meets periodically with management and with both Northrop Grumman's independent auditors and Northrop Grumman's chief internal auditor to review audit results and the adequacy of Northrop Grumman's system of internal controls. In addition, the Audit Committee recommends to the Board of Directors the appointment or discharge of Northrop Grumman's independent auditors, and reviews professional services of a non-audit nature to be provided by the independent auditors to evaluate the impact of undertaking such added services on the independence of the auditors. The Audit Committee held seven meetings in 2000.

### Compensation and Management Development Committee

The Compensation and Management Development Committee (the "Compensation

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Committee") recommends to the Board of Directors the base salary and incentive compensation of all executive officers and takes final action with respect to base salary and incentive compensation for certain other officers and key employees. It reviews Northrop Grumman's compensation policies and management actions with respect to succession of qualified officers. The Compensation Committee also establishes Northrop Grumman's annual performance objectives under the incentive compensation plans and recommends to the Board of Directors the amounts to be appropriated for awards under such plans and under Northrop Grumman's 1973 Incentive Compensation Plan (the "1973 Incentive Plan"). The Compensation Committee grants awards under and

8

administers Northrop Grumman's Stock Plans (as defined below) and recommends to the Board of Directors all compensation plans in which Northrop Grumman officers are eligible to participate. The Compensation Committee held seven meetings in 2000.

### Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee reviews candidates to serve as directors and recommends to the Board of Directors nominees for election. The activities and associations of each candidate are examined to ensure that there is no legal impediment, conflict of interest or other consideration that might prevent service on the Board of Directors. In making its selection, the Board of Directors bears in mind that the foremost responsibility of a Northrop Grumman director is to represent the interests of the stockholders as a whole. The Nominating and Corporate Governance Committee will consider nominees recommended by stockholders if such nominations have been submitted in writing, accompanied both by a description of the proposed nominee's qualifications and an indication of the consent of the proposed nominee and relevant biographical information. The recommendation should be addressed to the Nominating and Corporate Governance Committee in care of the Secretary of Northrop Grumman. In addition, the Nominating and Corporate Governance Committee makes recommendations to the Board of Directors concerning the composition and size of the Board of Directors, candidates to fill vacancies, the remuneration of non-employee directors, and matters of corporate governance as appropriate. The Nominating and Corporate Governance Committee held six meetings in 2000.

### Finance Committee

The Finance Committee reviews and makes recommendations concerning proposed dividend actions and issuance or repurchase of debt or equity securities. The Finance Committee considers and makes recommendations for final action by the Board on material acquisitions, mergers or divestments. The Finance Committee also reviews the investment performance of the employee benefit plans, capital asset requirements and short-term investment policy when appropriate. The Finance Committee held seven meetings in 2000.

### Public Issues and Policy Committee

On March 15, 2000 the Board of Directors approved a change in name of the Executive and Public Policy Committee to the Public Issues and Policy Committee. This Committee reviews and monitors the Northrop Grumman Employees Political Action Committee and makes policy and budget recommendations to the Board on proposed charitable contributions and aid to higher education. The Public Issues and Policy Committee reviews and approves Northrop Grumman's policy for engaging the services of consultants and commission agents. The Public Issues and Policy Committee held two meetings in 2000.

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### BOARD AND COMMITTEE MEETINGS

During 2000, the Board held 10 meetings and the committees described above held 29 meetings. Average attendance at all such meetings was 94%. Each incumbent director attended at least 75% of the total number of board and committee meetings he or she was eligible to attend, with the exception of Phillip Frost who attended 64%.

### COMPENSATION OF DIRECTORS

Northrop Grumman paid each director an annual retainer of \$32,000 and an additional \$1,000 for each Board and committee meeting attended during 2000. Committee chairpersons are paid an annual retainer of \$3,000. Any director who performs extraordinary services for the Board at the request of the Chairman of the Board or the chairman of a committee is paid \$1,000 per day. Directors are reimbursed for all reasonable expenses in attending these meetings and in performing extraordinary services. Directors who are employees of Northrop Grumman do not receive any compensation for their service as directors.

9

The 1993 Stock Plan For Non-Employee Directors provides that 30% of the retainer earned by each director is paid in shares of Common Stock, issued following the close of the fiscal year. In addition, directors may defer payment of all or a portion of their remaining retainer fees, Committee chairperson retainer fees and/or Board and committee meeting fees. Deferred compensation may either be distributed in shares of Common Stock, issued after the close of the fiscal year, or placed in a stock unit account until the conclusion of a director-specified deferral period, generally for a minimum of two years from the time the compensation is earned. All deferral elections must be made prior to the beginning of the year for which the retainer and fees will be paid. Directors are credited with dividend equivalents in connection with the shares of Common Stock, which are distributed early in the year following the year earned or deferred into the stock unit account. The Board has adopted a Northrop Grumman stock ownership guideline for outside directors which encourages directors to hold shares of Common Stock equal in market value to three times the annual retainer, to be achieved within five years of joining the Board.

The 1995 Stock Option Plan for Non-Employee Directors, as amended, provides for the annual grant of options to each non-employee director to purchase 1,500 shares of Common Stock with an exercise price equal to the fair market value of the Common Stock on the grant date. The options have a term of ten years. If the individual ceases to serve as a director, the options continue to be exercisable for the lesser of five years or the expiration of the original term of the options. If termination is for cause, the options terminate when the director ceases to serve.

On March 19, 1997, the Board of Directors adopted the Northrop Grumman Non-Employee Directors Equity Participation Plan (the "Equity Plan" and, together with the Retirement Plan, collectively, the "Directors Plans"). The Equity Plan is applicable to outside directors who become such after March 1, 1997 and directors serving prior to that date who elected to participate in the Equity Plan. Directors who elected to participate in the Equity Plan terminated their participation in the Retirement Plan. Under the Equity Plan, outside directors shall have an amount equal to 50% of their annual retainer credited to an equity participation account and converted into stock units based on the then fair market value of the Common Stock. Beginning in 2001 Northrop Grumman will also credit an amount equal to 5% of their annual retainer to the equity participation account unless: (1) no amount was appropriated for payment of awards with respect to the preceding calendar year

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pursuant to Northrop Grumman's Incentive Compensation Plan or (2) Northrop Grumman did not attain the pre-established financial and non-financial measures set by the Compensation and Management Development Committee for payment of awards pursuant to such Incentive Compensation Plan with respect to that preceding year. Each stock unit will be credited with dividend equivalents, which will be deemed reinvested in additional stock units. Each outside director who terminates service after three or more years of service shall be entitled to receive cash payments from the equity participation account in a number of annual installments equal to the number of years for which benefits have been accrued (not to exceed ten), each installment to be in an amount equal to the dollar value of the equity participation account based on Common Stock value as of the date of determination of the installment payment, divided by the number of installments then remaining to be paid. Upon a change in control (as defined in the Equity Plan) benefits under the Equity Plan immediately vest. The Board of Directors believes that the Equity Plan will further align the interests of the directors with the interests of the stockholders by making this part of the directors' benefits dependent upon the value of the Common Stock.

### REPORT OF THE COMPENSATION AND MANAGEMENT DEVELOPMENT COMMITTEE

The Compensation Committee of the Board of Directors has furnished the following report on executive compensation applicable to employees elected as executive officers of Northrop Grumman. The Compensation Committee is comprised exclusively of outside directors.

#### Compensation Philosophy

Northrop Grumman's executive compensation program is designed to promote recruitment and retention of key employees of exceptional ability and to motivate superior performance. It is comprised of linked plans that encourage and reward participants for achieving outstanding performance, financial results exceeding specific thresholds, and long-term prosperous growth.

10

Major components of executive compensation are at risk and vary directly in their amount with each executive's impact on desired business results. Successful accomplishment of business goals in both annual operating performance and resulting stockholder value can produce significant individual rewards. Failure to attain business goals will have a negative effect on rewards.

In addition to variations attributable to individual performance against business goals and Northrop Grumman performance, executive total compensation is influenced directly by competitive considerations. Base salaries of executives are targeted at a competitive market median on a job-by-job basis with individual variations explained by differences in experience, skills and sustained performance. Annual incentive compensation and long-term incentive stock compensation vary with individual job level, scope and overall influence on Northrop Grumman's business results and individual, business element and Northrop Grumman performance.

Normalized for these individual variations, annual total cash compensation--the sum of base salary and annual incentive compensation--will be lower than competitive market median in years of below target performance and above competitive market median in years performance exceeds target.

#### Deductibility of Compensation

Section 162(m) of the Internal Revenue Code generally limits the tax



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deduction to \$1 million for compensation paid to the corporation's chief executive officer and the four other most highly compensated executive officers. Qualifying performance-based compensation is not subject to the deduction limit.

In December 1998, the Compensation Committee approved amendments to the Incentive Compensation Plan to comply with the performance based criteria of Section 162(m) and, in May 1999, stockholders adopted the amended and restated Incentive Compensation Plan. As a result, compensation paid under the Incentive Compensation Plan for 1999 and thereafter should be deductible.

### Measuring Northrop Grumman Performance

Consistent with Northrop Grumman's business plan, management in each organizational element prepares and submits for assessment an Annual Operating Plan containing Financial and Supplemental Goals together with defined performance measures and numerical weights.

- . Financial Goals focus on operating earnings, cash flow and stockholder value metrics.
- . Supplemental Goals focus on such factors as customer satisfaction, new product development, new business initiatives, productivity, quality improvement, workplace diversity, management development, and environmental management.

Annually, the Compensation Committee reviews, approves or--at its discretion--modifies the CEO's written proposal of goals and numerical values for Performance Measurement Factors. Performance highlights against 2000 goals can be found below in Chief Executive Officer 2000 Compensation.

For Performance Year 2000 the Compensation Committee established Performance Measurement Factors addressing Stockholder Value Creation, Pre-tax Return on 3-Year Average Stockholder Equity, Cash Flow and Supplemental Goals in order to judge Northrop Grumman's performance and that of executive officers.

### Determining Competitive Compensation

In determining base salaries and incentive compensation for the Named Executive Officers, sources of competitive compensation information are independent surveys of industry peer companies. Peer companies include:

- . Companies comprising the aerospace and defense group depicted in the performance graph in the Shareowner Return Performance Presentation following this Report and other companies designated by the Compensation Committee.

11

Northrop Grumman uses executive surveys provided by Hewitt Associates, Towers Perrin and Frederic W. Cook, Inc., as well as periodic custom surveys of companies selected by the Compensation Committee to assess competitiveness of executive compensation.

### Establishing Executive Compensation

Northrop Grumman's executive compensation program includes the following linked elements:

- . Base Salary

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- . Annual Incentive Compensation
- . Long-Term Incentive Compensation.

### Base Salary

Annually, the Compensation Committee reviews, and accepts or modifies as it deems appropriate, base salary recommendations submitted by the CEO for executive officers (other than the CEO). Separately, the Compensation Committee reviews the CEO's base salary, giving consideration to competitive compensation data, its assessment of past performance and its expectation of future contributions. The Board then approves or modifies the Compensation Committee's recommendations for executive officers and the CEO.

### Annual Incentive Compensation

Executive officers are eligible for incentive compensation annually under Northrop Grumman's stockholder-approved 1973 Incentive Compensation Plan as amended. Performance criteria, as approved by shareholders, include objective tests of financial performance. The Committee appropriates an amount (Tentative Appropriated Incentive Compensation) to the Plan equal to 3% of Northrop Grumman's income before income taxes. However, no appropriation shall be made with respect to any Performance Year that would reduce the pre-tax return on stockholder equity below 10%, or in which no dividend is declared on common stock.

As stipulated by the Plan, the maximum potential individual incentive compensation award for a Performance Year for an executive officer shall be the lesser of \$3,000,000 or the respective percentage of Tentative Appropriated Incentive Compensation, as follows:

Chief Executive Officer:	30.0%
Each Other Section 162(m) Officer:	17.5%

Accompanying his annual performance report, the CEO submits recommendations to the Compensation Committee for individual incentive awards for the executive officers, except the CEO, which reflect judgments as to contributions to the accomplishment of annual goals and Northrop Grumman's long-term business plan. Separately, the Compensation Committee considers an incentive compensation award for the CEO based on its assessment of performance.

As part of this process, the Compensation Committee reviews the amount of the total Tentative Appropriated Incentive Compensation for that Performance Year and in its sole discretion may reduce (but not increase) that amount after taking into account the overall performance of Northrop Grumman in the attainment of predetermined financial and non-financial objectives selected by the Compensation Committee. Each executive officer's Incentive Compensation award is based upon the foregoing and the Compensation Committee's assessment of the individual's performance. The incentive compensation awards for the executive officers and the CEO must be ratified by the Board.

### Long-Term Incentive Compensation

The 1993 Long Term Incentive Stock Plan and the proposed 2001 Long Term Incentive Stock Plan provide flexibility to grant awards in a variety of forms including stock options, restricted stock rights (RSRs) and

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restricted performance stock rights (RPSRs). The purpose of this form of compensation is to establish long-term performance horizons for participants. By promoting ownership of Northrop Grumman's common stock, the Stock Plans create stockholder-managers interested in the sustained growth and prosperity of Northrop Grumman.

In 1998, to further promote alignment of management and stockholder interests, the Board adopted Stock Ownership Guidelines for the CEO and other officers of Northrop Grumman. These guidelines contemplate that officers own Northrop Grumman stock denominated as a percentage of their annual salaries, accumulated over a 3-year period: seven times annual salary for the CEO; three times annual salary for other elected officers; one and one-half times annual salary for appointed officers.

No regular awards of Options or Restricted Stock were granted to executive officers or the CEO during 2000. The last regular awards were granted in 1999 to the CEO and Named Executive Officers. The next grant of stock options is scheduled to occur in June 2001. If approved by shareholders, the proposed 2001 Long Term Incentive Stock Plan will govern awards issued in June.

### 2000 Chief Executive Officer Compensation

After considering executive compensation survey data from nationally recognized survey sources, the Committee recommended and the Board approved a salary increase for Mr. Kresa consistent with its pay philosophy.

In considering the performance of Mr. Kresa and establishing his annual incentive compensation, the Committee reviewed the overall performance of Northrop Grumman against the 2000 financial and supplemental goals and Mr. Kresa's contributions during the year. The Committee noted that Northrop Grumman exceeded all of the Performance Measurement Criteria set forth at the beginning of the period. Additionally, the Committee recognized that under Mr. Kresa's leadership:

- . The year was highlighted by operational excellence and successful execution of Northrop Grumman's strategic plan to position itself as a premier provider of systems to meet customers needs for defense electronics, systems integration, information systems, precision strike, reconnaissance/intelligence and unmanned vehicles.
- . Solid growth occurred with strong performance in all major programs. Overall, contract acquisitions increased by 20% to \$9.2 billion. Backlog increased to \$10.1 billion.
- . Presence in the international market was strengthened by virtue of major contract awards, new international teaming arrangements and joint ventures. Electronic Sensors and Systems Sector was responsible for the UAE F-16 radar system and partnering with Boeing for the Australian Wedgetail. The strategic relationship between the Integrated Systems Sector and EADS expands international market access based on sharing technologies and capabilities.
- . Domestic military wins included the F/A-18 MYP program, Vertical Takeoff Unmanned Air Vehicle (VTUAV), Airborne Laser Mine Detection System (ALMDS)--a potential new product line, JOINT Stars Total Systems Support, and several important development contracts built on Northrop Grumman's leadership position in unmanned systems.
- . Logicon won a record level of new contracts worth over \$2 billion during the year from a wide spectrum of customers.

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- . Cash Management was outstanding with approximately \$975 million generated and net debt reduced by \$750 million providing the financial strength to pursue strategic mergers and acquisitions to enhance Northrop Grumman's three growth engines--systems integration, defense electronics and information technology. Northrop Grumman exceeded its targeted performance goal for improvement in Warranted Equity Value.

13

- . The successful acquisition and integration of Comptek Research Inc., Federal Data Corporation and Sterling Software's Federal Systems Group served to augment Northrop Grumman's core business strengths.
- . The sale of the aerostructures business provided extra financial flexibility to pursue additional strategic opportunities that was culminated by successful negotiations leading to the agreement to acquire Litton Industries.

Based on its assessment, the Compensation Committee determined and the Board ratified an incentive compensation award for Mr. Kresa for 2000 as depicted in the Summary Compensation Table.

### THE COMPENSATION AND MANAGEMENT DEVELOPMENT COMMITTEE

JOHN T. CHAIN, JR., CHAIRMAN  
JACK R. BORSTING  
ROBERT A. LUTZ  
JOHN E. ROBSON  
RICHARD J. STEGEMEIER

14

### AUDIT COMMITTEE REPORT

In accordance with its written charter adopted by the Board of Directors, the Audit Committee of the Board assists the Board in fulfilling its oversight responsibilities by reviewing financial reports and other financial information provided by Northrop Grumman to the shareholders and the Securities and Exchange Commission; Northrop Grumman's internal control structure; Northrop Grumman's internal and external audit process; and any other matters relating to Northrop Grumman's accounting and financial reporting process.

During the year, the Audit Committee met seven times. In addition, the Committee Chair, as the representative of the Audit Committee, discussed with Northrop Grumman's Chief Financial Officer and Deloitte & Touche, Northrop Grumman's independent auditors, the interim financial information contained in each quarterly earnings announcement prior to its release.

In discharging its oversight responsibility for the audit process, the Audit Committee received a letter from Deloitte & Touche regarding the firm's independence as required under Independence Standards Board Standard No. 1, "Independence Discussions with Audit Committees," as amended by the Independence Standards Board. The Audit Committee discussed with management, the internal auditors and Deloitte & Touche the quality of Northrop Grumman's internal controls. The Audit Committee reviewed the internal audit function's organization, responsibilities, budget and staffing. The Audit Committee also reviewed with both the internal auditor and Deloitte & Touche their respective

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audit plans, audit scope and identification of audit risks.

The Audit Committee discussed and reviewed with Deloitte & Touche all communications required by generally accepted auditing standards, including those described in Statement on Auditing Standards No. 61, as amended, "Communications with Audit Committees" and, with and without management present, discussed and reviewed the results of Deloitte & Touche's examination of the financial statements, along with the results of internal audit's examinations.

The Audit Committee reviewed its charter and, after appropriate review and discussion, reaffirmed the Audit Committee Charter without amendments. A copy of the Audit Committee Charter is attached to this proxy as Exhibit A.

The Audit Committee reviewed the audited financial statements of Northrop Grumman as of and for the year ended December 31, 2000, with management and Deloitte & Touche.

Management has primary responsibility for Northrop Grumman's financial statements and the overall reporting process, including Northrop Grumman's system of internal controls.

The independent auditors audit the annual financial statements prepared by management, express an opinion as to whether these financial statements fairly present the financial position, results of operations and cash flows of Northrop Grumman in conformity with generally accepted accounting principles, and discuss with the Audit Committee any issues they believe should be raised.

Based upon the Audit Committee's review and discussions with management and Deloitte & Touche relative to Northrop Grumman's audited consolidated statements of financial position as of December 31, 2000 and 1999 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2000, the Audit Committee recommended to the Board of Directors that Northrop Grumman's Annual Report on Form 10-K include these financial statements. The Audit Committee also recommended the reappointment, subject to shareholder ratification, of Deloitte & Touche and the Board of Directors concurred on such recommendation.

Each of the members of the Audit Committee is independent as defined under the listing standards of the New York Stock Exchange.

### Audit Committee

Dr. John Brooks Slaughter, Chair  
Jack R. Borsting  
Vic Fazio

Charles R. Larson  
Aulana L. Peters  
Richard J. Stegemeier

### Stockholder Return Performance Presentation

The line graph below compares the relative change for the five year period ended December 31, 2000 in the cumulative total stockholder return on Northrop Grumman's Common Stock against the cumulative total return of the S&P Composite-500 Stock Index, and the S&P Aerospace/Defense Index comprised of The Boeing Company, General Dynamics Corporation, B.F. Goodrich, Lockheed Martin Corporation, Northrop Grumman Corporation, Raytheon Company (B), Rockwell International Corporation and United Technologies Corporation.

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COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN  
 AMONG NORTHROP GRUMMAN CORPORATION,  
 S&P 500 INDEX S&P AEROSPACE/DEFENSE INDEX  
 [GRAPH OF NORTHROP GRUMMAN]

Measurement Period (Fiscal Year Covered)	NORTHROP GRUMMAN	S&P 500 INDEX	S&P AEROSPACE/DEFENSE
Measurement Pt-1995	\$100	\$100	\$100
FYE 1996	\$132	\$123	\$129
FYE 1997	\$186	\$163	\$134
FYE 1998	\$121	\$210	\$123
FYE 1999	\$ 92	\$253	\$120
FYE 2000	\$144	\$230	\$169

16

EXECUTIVE COMPENSATION

The table below shows the annual and long-term compensation for services in all capacities to Northrop Grumman for the years ended December 31, 1998, 1999 and 2000 of the Named Executive Officers at December 31, 2000:

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation		
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)	Restricted Stock Award(s) (\$)	Securities Underlying Options/ SARs (#)	P
1) KENT KRESA..... Chairman of the Board, President and Chief Executive Officer	2000	1,009,615	2,800,000	61,545 (4)		89,125 (5)	
	1999	936,346	1,400,000	296,420 (6)	1,384,250		
	1998	900,000	0	50,068 (7)		200,000	
2) RICHARD B. WAUGH, JR..... Corporate Vice President and Chief Financial Officer	2000	460,192	800,000			25,602 (5)	
	1999	436,154	400,000		565,000		
	1998	390,885	92,000	56,217 (8)	329,062	75,000	
3) JAMES G. ROCHE..... Corporate Vice President and President Electronic Sensors and Systems Sector	2000	474,231	825,000	60,667 (9)			
	1999	444,231	425,000	65,299 (10)	565,000		
	1998	385,731	111,000	63,527 (11)	329,062	75,000	

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4) HERBERT W. ANDERSON.....	2000	403,269	700,000			
Corporate Vice	1999	369,231	575,000 (12)		508,500	7,500
President, President and Chief Executive Officer, Logicon, Inc.	1998	306,827	182,000 (12)		263,250	60,000
5) RALPH D. CROSBY, JR.....	2000	464,231	925,000 (13)	90,873 (14)		
Corporate Vice	1999	436,154	400,000	59,814 (15)	565,000	
President and President, Integrated Systems Sector	1998	357,693	50,000		329,062	75,000

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- (1) The amounts listed in this column do not include amounts paid for vacation hours accrued but not used for the following individuals in the following years: Mr. Kresa: \$15,966 in 2000; Mr. Waugh: \$29,927 in 2000, \$12,100 in 1999, \$9,109 in 1998; Dr. Roche: \$26,318 in 2000, \$23,468 in 1999, \$16,053 in 1998; Mr. Anderson: \$7,786 in 2000, \$1,062 in 1999, \$1,292 in 1998; and Mr. Crosby: \$4,185 in 1998.
- (2) At December 31, 2000, (i) Mr. Kresa owned 19,600 RSRs with a value of \$1,626,800; (ii) Mr. Waugh owned 8,000 RSRs with a value of \$664,000 and 4,500 time-vested RPSRs with a value of \$373,500; (iii) Dr. Roche owned 8,000 RSRs with a value of \$664,000 and 4,500 time-vested RPSRs with a value of \$373,500; (iv) Mr. Anderson owned 7,200 RSRs with a value of \$597,600 and 4,050 time-vested RPSRs with a value of \$336,150; and (v) Mr. Crosby owned 8,000 RSRs with a value of \$664,000 and 4,500 time-vested RPSRs with a value of \$373,500. The RSRs vest over a five-year period with 20% of the total grant vesting one year after the date of grant and 20% vesting annually thereafter. There are no dividends paid on RSRs. Time-vested RPSRs vest one-third three years prior to the end of the payment period and one-third annually thereafter. Dividends are paid on RPSRs in the form of additional shares of stock. The time-vested RPSRs reflected in this column were previously disclosed in respect of the year of grant in the proxy statements for years 1999 or 2000.
- (3) "All Other Compensation" consists of Northrop Grumman contributions to the Northrop Grumman Savings and Investment Plan for the Named Executive Officers.
- (4) Amount includes \$21,015 for car allowance and \$16,750 for tax preparation services.
- (5) All option grants in 2000 to Messrs. Kresa and Waugh were "re-load" grants as more fully described on page 19 under the heading "Option Grants in Last Fiscal Year."

17

- (6) As a result of Northrop Grumman's decision in 1997 to relocate its corporate offices to Northern Virginia and the subsequent abandonment of that decision following the termination of the proposed merger with Lockheed Martin Corporation, Northrop Grumman in 1999 paid \$211,200 to a third party relocation company in connection with the relocation company's purchase (at appraised value) of the Alexandria, Virginia house that Mr. Kresa had purchased in connection with the planned Corporate office move. It also paid \$31,229 to transport Mr. Kresa's

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household goods to California under its applicable policies.

- (7) Amount includes \$20,464 for car allowance and \$17,526 for premium amounts paid on behalf of Mr. Kresa for life, accidental death and dismemberment, medical, dental and long-term disability insurance.
- (8) Amount includes \$17,295 for car allowance, \$15,000 for income tax preparation services and \$18,838 for premium amounts paid on behalf of Mr. Waugh for life, accidental death and dismemberment, medical, dental and long-term disability insurance.
- (9) Amount includes, among other items, \$16,423 for car allowance.
- (10) Amount includes, among other items, \$16,571 for spouse travel.
- (11) Amount includes, among other items, \$15,934 for car allowance.
- (12) In connection with the merger with Logicon, Inc. and Northrop Grumman's desire to retain certain key employees, Northrop Grumman paid Mr. Anderson bonus compensation equal to 33 1/3% of his pre-merger base salary one year following the merger and 66 2/3% of pre-merger base salary two years following the merger. Under this arrangement, Mr. Anderson received \$90,000 in 1998 and \$180,000 in 1999.
- (13) Includes \$100,000 special award to Mr. Crosby as a key participant in Northrop Grumman's acquisition and divestiture activities and associated transition efforts.
- (14) Amount includes, among other items, \$35,597 for spouse travel and \$26,032 for gross-up.
- (15) Amount includes \$17,940 for car allowance and \$18,947 for spouse travel.

\* Upon the February 26, 1998 shareholder vote in favor of the proposed merger of Northrop Grumman with Lockheed Martin Corporation (the "Merger Vote"), the unvested RPSRs under the 1993 Stock Plan vested and became distributable. In response to these accelerations, the Compensation Committee and the Board of Directors adopted a program ("Program") to preserve the incentive and employee-retention benefits of such amounts. The Program involved placing in escrow the net shares of Northrop Grumman stock issued to the executive officers after the acceleration. Fifty percent of the number of RPSRs that vested upon the shareholder vote were issued, and the remaining fifty percent was deemed tax owed with respect to the vested RPSRs. Of the fifty percent deemed tax owed, any amount in excess of the amount each executive officer previously instructed Northrop Grumman to withhold for taxes was paid to the executive officer in cash. The shares issued were placed in escrow pursuant to the terms of the Program as described on Page 23, and remained subject to the risks of forfeiture, company performance and overall market conditions until the expiration of the escrow period and the release of those shares on March 1, 2000.

The 1993 Stock Plan provides for release of RPSRs in annual interim installments in the third and fourth years, with final reconciliation in the fifth year in the event payments are then due to the executive. For the Named Executive Officers, the numbers of shares placed in escrow and the aggregate dollar value of RPSR shares which vested under the 1993 Stock Plan are as follows:

Mr. Kresa, 43,926 shares, \$12,145,539; Mr. Waugh, 13,276 shares, \$3,670,952; Dr. Roche, 12,328 shares, \$3,408,554; Mr. Anderson, 11,899 shares, \$3,290,074; and Mr. Crosby, 12,365 shares, \$3,418,923. The dollar



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amounts of the RPSR shares that accelerated were calculated using the vesting date price per share of \$138.25. On March 1, 2000, the date the escrow period expired, the price of a share of Northrop Grumman stock was \$43.8125.

18

OPTION GRANTS IN LAST FISCAL YEAR

There were no stand-alone grants of stock options in 2000 and the table below shows individual "re-load" grants of stock options made in 2000 to Named Executive Officers.

Option Grants in Last Fiscal Year

	Individual Grants				Potent
	Number of Securities Underlying Options Granted (#) (1)	% of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Sh)	Expiration Date	At A of Sto fo 5%
Kent Kresa.....	23,059	3.45	73.0625	11/18/03	2
	29,375	4.39	73.0625	12/21/04	4
	36,691	5.48	70.875	11/16/05	7
Richard B. Waugh, Jr. ..	3,327	0.50	45.9375	7/19/00	
	4,349	0.65	45.9375	11/18/03	
	5,772	0.86	45.9375	11/18/02	
	5,251	0.78	57.125	11/18/03	
	6,903	1.03	57.125	12/21/04	

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- (1) All option grants in 2000 to Named Executive Officers were made pursuant to a provision in the 1993 Plan that provides for the award of a new option when the exercise price of an existing option has been paid by tendering shares of Common Stock to Northrop Grumman. These new option grants are limited to the number of shares tendered at the exercise and the shares withheld for taxes, with the "re-load" option purchase price set at the then fair market value and never extend beyond the remaining term of the option exercised.
  - (2) The potential realizable value of each grant of options assuming that the market price of Northrop Grumman's Common Stock from the date of grant to the end of the option term (between one and five years, as applicable) appreciates in value at an annualized rate of 5% and 10%.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FY-END OPTION VALUES

Name	Shares Acquired on Exercise (#)	Value Realized (\$)	Number of Securities Underlying Unexercised Options at FY-End(#)	Val
			Exercisable/Unexercisable	In-th Opti FY-E Exerc
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Kent Kresa.....	116,400	3,068,800	184,123/150,002	1,078
Richard B. Waugh, Jr. ..	36,942	714,061	67,810/56,250	1,133
James G. Roche.....	0	0	41,250/56,250	291
Herbert W. Anderson.....	1,720	104,598	53,900/52,500	1,090
Ralph D. Crosby, Jr. ...	0	0	58,650/56,250	1,079

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(1) Based on the market value at December 31, 2000 of \$83.

19

Pension Plans

For purposes of illustration, the following table shows the amount of annual retirement benefits that would be accrued at age 65 under the Northrop Grumman Pension Plan (the "Pension Plan"), as supplemented by the Northrop Corporation ERISA Supplemental Plan 1 ("ERISA 1") and the ERISA Supplemental Program 2 ("ERISA 2") (collectively, the "Supplemental Retirement Plans").

Annual Average Compensation (highest 3 years out of last 10)	Years of Benefit Service						
	5	10	15	20	25	30	35
\$ 100,000	\$ 8,300	\$ 16,700	\$ 25,000	\$ 33,300	\$ 41,700	\$ 50,000	\$ 50,000
150,000	12,500	25,000	37,500	50,000	62,500	75,000	75,000
200,000	16,700	33,300	50,000	66,700	83,300	100,000	100,000
250,000	20,800	41,700	62,500	83,300	104,200	125,000	125,000
300,000	25,000	50,000	75,000	100,000	125,000	150,000	150,000
400,000	33,300	66,700	100,000	133,300	166,700	200,000	200,000
500,000	41,700	83,300	125,000	166,700	208,300	250,000	250,000
600,000	50,000	100,000	150,000	200,000	250,000	300,000	300,000
1,000,000	83,300	166,700	250,000	333,300	416,700	500,000	500,000
1,400,000	116,700	233,300	350,000	466,700	583,300	700,000	700,000
1,800,000	150,000	300,000	450,000	600,000	750,000	900,000	900,000
2,200,000	183,300	366,700	550,000	733,300	916,700	1,100,000	1,100,000
2,600,000	216,700	433,300	650,000	866,700	1,083,300	1,300,000	1,300,000
3,000,000	250,000	500,000	750,000	1,000,000	1,250,000	1,500,000	1,500,000

Compensation covered by the plans for executive officers is substantially equivalent to salary and bonuses as reflected in the Summary Compensation Table. Benefit Service earned after January 1, 1995 in excess of 30 years will not be taken into account for accrual of retirement benefits. Benefits payable under the Supplemental Retirement Plans have been secured through the establishment of two grantor trusts. The credited years of service under the Pension Plan and Supplemental Retirement Plans of the five individuals named in the Summary Compensation Table are as follows: Mr. Kresa, 26 years; Mr. Waugh, 22 years; Dr. Roche, 17 years; Mr. Anderson, 16 years; and Mr. Crosby, 20 years. Benefits are calculated on a straight life annuity basis at selected compensation levels and years of service reflected in the table above. The listed benefit amounts are not subject to any reduction for Social Security benefits or other offset amounts.

Northrop Grumman maintains a Supplemental Retirement Income Program for

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Senior Executives ("SRI"), under which certain employees are designated by the Board of Directors to receive benefits in lieu of benefits otherwise payable under the Pension Plan and the Supplemental Retirement Plans. The amount of the supplemental benefit under the SRI is equal to the greater of (1) the participant's benefit under the Pension Plan calculated without regard to the limits imposed under Sections 415 and 401(a)(17) of the Code, or (2) a fixed percentage of the participant's final average salary (which term includes bonus and is based on the highest 3 years out of the last 5) equal to 30% at age 55, increasing 4% for each year up to and including age 60, and increasing 2% for each year beyond age 60 to 65, in each case offset by the benefit allowable under the Pension Plan. Mr. Kresa, who is eligible to receive an annual benefit (estimated to be \$1,566,675 payable at age 65, assuming continued employment and based upon estimated levels of final average salary) under SRI, is the only Named Executive Officer currently participating in the SRI. SRI eligibility, in addition to designation by the Board of Directors requires the attainment of age 55 and 10 years of vesting service. The vesting service requirement may be waived by the CEO.

On February 25, 1998, the Northrop Grumman Board adopted the CPC Supplemental Executive Retirement Program (the "CPC SERP"). The CPC SERP is applicable to elected officers who report directly to the CEO (which group currently consists of eight elected executive officers of Northrop Grumman as of January 1, 2000). The CPC SERP provides to each participant a pension accrual of 1.667% of final average pay for each year or

20

portion thereof that the participant has served as an elected officer reporting to the CEO. The total accrual percentage under the CPC SERP cannot exceed the greater of 1) 10% or 2) the percentage necessary for the participant to receive an annuity of 50% of final average salary when all pension benefits are taken in total. This provides a pension accrual to the elected officer for the period that he has served as such, in addition to regular pension benefits payable from Northrop Grumman's tax qualified and supplemental retirement plans on the basis of all creditable years of service. The benefits paid from this plan are paid in a lump sum or in installments upon termination of employment. The amount is the actuarial equivalent of the straight life benefit beginning on the retirement date. The compensation used in the calculation of benefit is the same as for the qualified plan. The pension table is applicable if benefit years of service is considered only for CPC Service. The CPC service years for the four Named Executive Officers who report directly to the CEO are as follows: Mr. Waugh 8.08, Dr. Roche, 8.58, Mr. Anderson 6.00, and Mr. Crosby, 6.58.

### Change in Control Arrangements

March 2000 Special Agreements. Effective March 1, 2000, Northrop Grumman entered into special severance agreements (the "March 2000 Special Agreements") with its executive officers, including Messrs. Kresa, Waugh, Roche, Anderson and Crosby. The purpose of the March 2000 Special Agreements is to encourage these key executives to continue to carry out their duties in the event of the possibility of a change in control of Northrop Grumman.

The March 2000 Special Agreements are generally effective until February 28, 2003. The term of the March 2000 Special Agreements will be extended for additional one-year periods until notice is given by Northrop Grumman that the agreements will terminate. If a Change in Control (as defined below) occurs during the term of the agreements, the term of the agreements will not end earlier than two years following the Change in Control. The March 2000 Special Agreements replace Northrop Grumman's "Special Agreements" that generally were entered into in August 1996 and terminated in February 2000.

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Under the March 2000 Special Agreements, a "Change in Control," is generally deemed to occur when (1) certain persons acquire more than 33 1/3% of Northrop Grumman's voting securities; (2) certain majority changes in Northrop Grumman's Board of Directors occur during a 24-month period; (3) Northrop Grumman is liquidated or all or substantially all of Northrop Grumman's assets are sold in one or a series of related transactions; or (4) Northrop Grumman is merged, consolidated, or reorganized and Northrop Grumman's stockholders before the event do not own more than 50% of the voting stock of the resulting or surviving entity.

Executives are entitled to severance benefits under the March 2000 Special Agreements only (1) upon a termination of the executive's employment that constitutes a Qualifying Termination (as defined below), and (2) only if the termination occurs during a Protected Period (as defined below) prior to a Change in Control or in the 24-month period following a Change in Control. A "Qualifying Termination" generally means that the executive's employment by Northrop Grumman is terminated for any reason other than Cause (as defined below) or by the executive for Good Reason (as defined below), that Northrop Grumman breaches the agreement, or that a successor breaches or fails to assume the agreement.

The "Protected Period" is the period of time that the executive is entitled to severance protections under the March 2000 Special Agreement prior to a Change in Control. Depending on the nature of the Change in Control, the Protected Period may commence as early as six months prior to a Change in Control event.

The March 2000 Special Agreements define "Cause" as: (1) the executive's conviction for committing an act of fraud, embezzlement, theft, or other act constituting a felony; or (2) the willful engaging by the executive in misconduct which would have resulted in the executive's termination by Northrop Grumman under its policies and practices applicable to the executive on September 1, 1999. However, no act or failure to act, on an executive's part, will be considered "willful" for this purpose unless done, or omitted to be done, by the executive not in good faith and without reasonable belief that the act or omission was in the best interest of Northrop Grumman.

21

"Good Reason" is defined in the March 2000 Special Agreements to include: (1) certain material reductions in the nature or status of the executive's authorities, duties and/or responsibilities (when such authorities, duties, and/or responsibilities are viewed in the aggregate); (2) a reduction of the executive's base salary as in effect on the date of the agreement or as increased thereafter; (3) a significant reduction of the executive's aggregate incentive opportunities under the Northrop Grumman short and/or long term incentive programs as such opportunities exist on the date of the agreement or as increased thereafter; (4) Northrop Grumman's failure to maintain the executive's relative level of coverage and accruals under Northrop Grumman's employee benefit and/or retirement plans, policies, practices or arrangements in which the executive participates as of the date of the agreement; (5) the failure of Northrop Grumman to obtain a satisfactory agreement from any successor to assume and agree to perform Northrop Grumman's obligations under the agreement; and (6) any purported termination of the executive's employment with Northrop Grumman that is not effected pursuant to the procedures set forth in the agreement. If an executive is a vice president, the executive's loss of vice president status (other than a promotion to a higher level office) will constitute Good Reason. In addition, if an executive reports directly to the Northrop Grumman Chief Executive Officer immediately prior to the start of the Protected Period, Good Reason will be deemed to exist if the

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executive's reporting relationship is changed such that the executive does not report to one of the following: the Chairman of the Northrop Grumman Board of Directors, or the Northrop Grumman Chief Executive Officer, President, or Chief Operating Officer.

Severance benefits generally consist of: (1) an amount equal to three times the executive's highest annualized base salary earned with respect to the three full fiscal years prior to the date of the termination of the executive's employment; (2) an amount equal to three times the greater of (a) the average of the executive's bonus earned with respect to the three full fiscal years prior to the date of the termination of the executive's employment or (b) the executive's target annual bonus established for the bonus plan year during which the executive's termination occurs; (3) an amount equal to the executive's unpaid base salary and accrued vacation pay through the effective date of termination, together with a pro rata portion of the executive's target bonus for the bonus plan year during which termination occurs; (4) continuation for 36 months following the effective date of termination of all benefits pursuant to all welfare benefit plans under which the executive or his family is eligible to receive benefits as of the effective date of the Change in Control, and further continuation of medical benefits for the lives of the executive and his spouse; (5) a lump sum cash payment representing the present value of the executive's benefits accrued under Northrop Grumman's qualified defined benefit pension plan and supplemental retirement plans (calculated as though the executive's employment had continued for three years) offset by the actuarial present value equivalent of the benefits payable to the executive from Northrop Grumman's qualified defined benefit pension plan accrued through the effective date of termination; and (6) a lump sum cash payment equal to the entire balance of the executive's deferred compensation, if any, together with any interest thereon. Executives had the ability to elect, on or before March 1, 2000, an override of the benefit described in clause (5). If an executive elected an override, his or her supplemental retirement plan benefits will be paid in accordance with the provisions of those plans rather than an automatic lump sum payment.

The March 2000 Special Agreements also provide that if, following a Change in Control, excise taxes under Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") apply to payments made under the March 2000 Special Agreements or other plans or agreements, the executive will be entitled to receive an additional payment (net of income, Medicare and excise taxes) to compensate the executive for any excise tax imposed.

Long-Term Incentive Stock Plans. The 1993 Stock Plan and the 1987 Stock Plan (collectively, the "Stock Plans"), permit grants to selected employees of Northrop Grumman consisting of stock options ("Stock Options"), RPSRs, RSRs and RASs. A Stock Option granted under the Stock Plans is a right to purchase a number of shares of Common Stock for a specified period of time at a price per share not less than the fair market value on the date of grant. An RPSR is a right to receive a number of shares of Common Stock on a specified future date conditioned upon continued employment and Northrop Grumman's achievement of specified performance in relation to a list of peer companies. RSRs are the right to receive a specified number of shares of Common Stock contingent upon continued employment with Northrop Grumman and other terms set forth in the Stock Plans. RASs are restricted shares of Common Stock granted under the 1987 Stock Plan.

Prior to amendment of the 1993 Stock Plan on November 18, 1998, under the Stock Plans, a "Change in Control" had the same definition as used in the Special Agreements. Consequently, the Merger Vote constituted a "Change in

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Control" for purposes of the Stock Plans, and, upon the Merger Vote, (a) all Stock Options under the Stock Plans outstanding as of February 26, 1998 vested and became fully exercisable; (b) the RPSRs under the Stock Plans outstanding as of February 26, 1998 vested and became payable in shares of Northrop Grumman Common Stock, which payment is calculated based upon attainment of certain stock price performance targets; and (c) the RSRs and RASs under the Stock Plans outstanding as of February 26, 1998 vested and became distributable.

On November 18, 1998, the Board amended the 1993 Stock Plan to provide that the vesting of stock options would not accelerate upon a vote of the Stockholders approving a change in control of Northrop Grumman. Rather, options would accelerate: (i) if a successor company failed to continue those options; or (ii) if continued only following both an actual close of a change in control transaction and either termination of an option holder not for Cause or termination by an option holder for Good Reason. Following a change in control, RPSRs would accelerate only prorated on time lapsed from the start of the performance period for which they were granted.

1998 Restricted Stock Rights Plan. In response to the acceleration of RPSR, RSR and RAS stock awards under the Stock Plans caused by the Merger Vote, the uncertainty created by the Government's decision to challenge the Merger on antitrust grounds and Northrop Grumman's agreement to defer the closing of the Merger pending resolution of the Government's antitrust challenge, the Compensation Committee and the Board of Directors of Northrop Grumman concluded that it was appropriate to adopt a program that would undertake to ensure that receipt by Northrop Grumman's executive officers and key employees of shares ("Shares") of Common Stock issuable pursuant to the RPSR, RSR and RAS stock awards would not adversely affect their incentive to serve Northrop Grumman's and the stockholders' best interests. The Compensation Committee and the Board of Directors also concluded that a program pursuant to which the Shares were placed into escrow for a period of time would have the effect of creating an incentive for such persons to remain with Northrop Grumman and to create additional value in Northrop Grumman in other ways in the event that the Merger was not consummated. Accordingly, on March 24, 1998, the Board of Directors adopted the 1998 Restricted Stock Rights Plan and related Ownership Retention Agreements (the "1998 Plan"). All executive officers of Northrop Grumman (including the Named Executive Officers) voluntarily agreed to participate in the 1998 Plan and placed their Shares (net of tax withholding as described below) into escrow until the earlier of (i) March 1, 2000, (ii) a "Change in Control" (which includes consummation of the Merger) or (iii) the executive officer's death, qualifying Retirement (as defined therein) subsequent to March 1, 1999, disability or termination by Northrop Grumman other than for Cause. They also agreed to forfeit their Shares if they voluntarily left Northrop Grumman other than for Good Reason (which has the same definition as in the Special Agreements) or if they were terminated for Cause. Pursuant to the 1998 Plan, applicable tax owed with respect to receipt of the Shares was deemed to equal the value of the remaining fifty percent of vested Shares as of the vesting date (February 26, 1998), with any amount in excess of the amount the executive officers previously instructed Northrop Grumman to withhold for taxes paid to the executive officer in cash.

The 1998 Plan also applied to the vested Shares received by Northrop Grumman key employees other than executive officers, with the addition that, any key employee who voluntarily placed his or her Shares into escrow, also received an award of additional shares ("Additional Shares") of Common Stock when the Merger had not been consummated on or prior to July 1, 1998. The awards made to key employees consisted of a restricted stock right (the "Right") to receive subject to the terms and conditions of the 1998 Plan, a number of Additional Shares equal to 14.5% of the total number of his or her Shares (29% of the shares placed in escrow). As stated on page 18, the escrow period ended and the shares were released on March 1, 2000. The 1998 Plan terminated on

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March 24, 2000.

23

Northrop Grumman Estate Enhancement Program (the "Estate Program")

The Estate Program at present provides Mr. Kresa with the ability to elect, as an investment alternative under the Northrop Grumman Executive Deferred Compensation Plan (the "Executive Deferred Compensation Plan") to have all or a portion of his deferral account balance converted to the Estate Program.

The amount and type of coverage under the life insurance policy is specified in an individual agreement with Mr. Kresa. Northrop Grumman retains a collateral assignment of the cash value of the policy. Upon the death of Mr. Kresa and his wife, Northrop Grumman will receive the greater of the cash accumulation value of the policy or the premiums paid for the policy, and Mr. and Mrs. Kresa's beneficiaries will receive the remaining amount. Alternatively, certain persons designated by Mr. Kresa may elect to transfer ownership of the policy to Northrop Grumman, in which case death benefits to the beneficiaries will be paid out of the corporation's general funds.

In the event of a Change in Control (as defined in the Estate Program), the Estate Program becomes irrevocable, and the Company must transfer the ownership of Mr. Kresa's policy to an irrevocable trust. Northrop Grumman or its successor will continue to be responsible for any obligations under the Estate Program not paid by the trust or for obligations that the trust's assets are insufficient to cover.

As of January 1, 2001, Mr. Kresa was the only participant in the Estate Program. Under Mr. Kresa's agreement, a \$10 million policy issued by the Travelers Life and Annuity Company covers Mr. Kresa and his wife, Joyce A. Kresa. Northrop Grumman paid \$2.175 million in premiums attributable to the investment of Mr. Kresa's deferral amounts under the Executive Deferred Compensation Plan. Upon the death of the last surviving of Mr. and Mrs. Kresa, any amounts received by Northrop Grumman under the policy that are in excess of 200% of the premiums paid by Northrop Grumman will be remitted to Mr. and Mrs. Kresa's beneficiaries, together with the balance of Mr. Kresa's deferred compensation plan.

### Certain Transactions

Ms. Peters retired as a partner of the law firm of Gibson, Dunn & Crutcher on December 31, 2000. A partner and a senior advisor of Gibson, Dunn & Crutcher are consultants for Northrop Grumman, providing analysis and advice with respect to pending and proposed legislation. The firm also provided legal counsel during 2000 in connection with various corporate matters.

### Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires Northrop Grumman's officers and directors, and persons who own more than ten percent of a registered class of Northrop Grumman's equity securities, to file reports of ownership and changes in ownership on Forms 3, 4 and 5 with the SEC and the New York Stock Exchange. The SEC requires officers, directors and greater than ten percent beneficial owners to furnish Northrop Grumman with copies of all Forms 3, 4 and 5 they file.

Northrop Grumman believes that all its officers, directors and greater than ten percent beneficial owners complied with all their applicable filing requirements for 2000 transactions. This is based on Northrop Grumman's review of copies of Forms 3, 4 and 5 it has received and of written representations

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from certain reporting persons that they were not required to file a Form 5.

PROPOSAL TWO: APPOINTMENT OF INDEPENDENT AUDITORS

During the year ending on December 31, 2000, Northrop Grumman paid Deloitte & Touche, its independent auditors, the following fees:

Audit Fees.....	\$3,690,000
Financial Information Systems Design and Implementation Fees.....	\$ 0
All Other Fees.....	\$4,606,000

The Board of Directors recommends that the stockholders ratify the Board's appointment of Deloitte & Touche LLP as Northrop Grumman's independent auditors for 2001. Deloitte & Touche LLP served Northrop Grumman as its independent auditors for 2000. Should the stockholders fail to ratify the appointment of Deloitte & Touche LLP, the Board of Directors will consider this an indication to select other auditors for the following year.

A representative of Deloitte & Touche LLP will be present at the Annual Meeting of Stockholders and will have the opportunity to make a statement if such representative desires to do so and also will be available to answer appropriate questions from stockholders.

Vote Required

The affirmative vote of a majority of the shares of Common Stock voting at the annual meeting is required for approval of this proposal.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" THE ABOVE PROPOSAL.

PROPOSAL THREE: APPROVAL OF THE NORTHROP GRUMMAN 2001 LONG-TERM INCENTIVE STOCK PLAN

Stockholders are being asked to approve the Northrop Grumman 2001 Long-Term Incentive Stock Plan (the "Plan" or the "2001 Plan"). The Board of Directors adopted the Plan, subject to stockholder approval, on February 21, 2001.

Northrop Grumman believes that incentives and stock-based awards focus employees on the objective of creating stockholder value and promoting the success of Northrop Grumman, and that incentive compensation plans like the 2001 Plan are an important attraction, retention and motivation tool for participants in the Plan. The Board of Directors believes that the 2001 Plan will promote the interests of Northrop Grumman and its stockholders and that it will give Northrop Grumman flexibility to continue to provide incentives that are based on the attainment of corporate objectives and increases in stockholder value.

Northrop Grumman currently maintains the Northrop Grumman 1993 Long-Term Incentive Stock Plan (the "1993 Plan"). As of January 31, 2001, 5,790,969 shares of Common Stock were subject to awards outstanding under the 1993 Plan and an additional 330,775 shares remained available for grant purposes under the 1993 Plan. An additional 1,080,881 shares (the 2001 evergreen installment) became available for grant purposes under the 1993 Plan on December 31, 2000.



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The Board of Directors approved the 2001 Plan based, in part, on a belief that the aggregate number of shares available under the 1993 Plan is insufficient to adequately provide for future incentives. Northrop Grumman's ability to grant additional awards under the 1993 Plan will terminate if stockholders approve the 2001 Plan. Awards then outstanding under the 1993 Plan will continue in accordance with their terms.

### Summary Description of the 2001 Plan

The following summary of the principal terms of the 2001 Plan is qualified in its entirety by the full text of the Plan, which is Exhibit B to this Proxy Statement.

**Purpose.** The purpose of the 2001 Plan is to promote the long-term success of Northrop Grumman and to increase stockholder value by providing officers and selected employees with incentives to create excellent performance and to continue service with Northrop Grumman, its subsidiaries and affiliates. Both by encouraging officers and employees to become owners of Common Stock and by providing actual ownership through Plan awards, it is intended that Plan participants will view Northrop Grumman from an ownership perspective.

**Administration.** The Compensation Committee of the Board will administer the Plan. The Compensation Committee may delegate its authority to make grants under the Plan to one or more committees of directors. (The appropriate acting body, be it the Compensation Committee or another authorized committee of directors, is referred to in this Proposal as the "Committee"). The Committee determines the number of shares that are to be subject to awards and the terms and conditions of awards, including the price (if any) to be paid for the shares or the award. Subject to the other provisions of the Plan, the Committee has the authority to make certain adjustments to an outstanding award and to authorize the conversion, succession or substitution of an award pursuant to Section 6 of the Plan.

The Committee may allow the purchase price of an award or shares of Common Stock under the Plan to be paid in the form of cash, by the delivery of already-owned shares of Common Stock, by the surrender of an award of equivalent value, through a third-party purchase where the third party agrees to sell a number of shares on behalf of a participant and the participant assigns the right to receive the proceeds from such sale to Northrop Grumman in payment of the purchase price, or any other form permitted by law.

**No Repricing.** The Committee may not cancel an outstanding option for the purpose of replacing or re-granting the option with an exercise price that is less than the exercise price of the original option. The

26

Committee may not amend an outstanding option for the purpose of reducing the exercise price of the option. (Adjustments to reflect stock splits and similar events will not be considered amendments for this purpose.)

**Eligibility.** Persons eligible to receive awards under the Plan include key employees of Northrop Grumman and key employees of any other entity that is directly or indirectly controlled by Northrop Grumman or in which Northrop Grumman has a significant equity interest. All officers and employees of Northrop Grumman and its subsidiaries (including all of Northrop Grumman's named executive officers) are considered eligible under the 2001 Plan at the present time. The Committee determines from time to time the participants to whom awards will be granted.

**Authorized Shares; Limits on Awards.** The maximum number of shares of Common

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Stock that may be issued or transferred pursuant to awards under the 2001 Plan equals the sum of:

- . 8,000,000 shares; plus
- . any shares of Common Stock available but not issued under the 1993 Plan (the approximate number of shares that are currently available or expected to become available under the 1993 Plan is set forth above); plus
- . any shares of Common Stock that Northrop Grumman repurchases with proceeds received from option exercises.

In addition, any shares that are forfeited back to Northrop Grumman under the 2001 Plan or the 1993 Plan, and any shares that have been exchanged by a participant as full or partial payment to Northrop Grumman in connection with any award under the 2001 Plan or the 1993 Plan, as well as any shares exchanged by a participant or withheld by Northrop Grumman to satisfy the tax withholding obligations related to an award under the 2001 Plan or the 1993 Plan, will be available for issuance under the Plan.

In instances where a stock appreciation right ("SAR") or other award granted under the Plan or the 1993 Plan is settled in cash or a form other than shares, the shares that would have been issued had there been no cash or other settlement will not be counted against the share limits of that plan for purposes of determining the number of shares that remain available for issuance under the Plan. The payment of cash dividends and dividend equivalents in conjunction with outstanding awards will not be counted against the shares available for issuance under the Plan. In addition, the Plan generally provides that shares issued in connection with awards that are granted by or become obligations of Northrop Grumman through the assumption of awards (or in substitution for awards) in connection with an acquisition of another company will not count against the shares available for issuance under the Plan.

The following other limits are also contained in the 2001 Plan:

- . No more than 3,000,000 of the shares available for issuance under the Plan may be issued pursuant to stock awards granted under Section 8(c) of the Plan (generally, Section 8(c) contemplates awards other than stock options and stock appreciation rights ("SARs") -such other types of awards could include stock bonuses, restricted stock performance shares and other types of awards).
- . No more than 4,000,000 shares may be delivered under the Plan pursuant to stock options qualified as incentive stock options ("ISOs") under Section 422 of the Internal Revenue Code.
- . No more than 900,000 shares may be awarded to any participant during any three-year period pursuant to stock option grants and SAR grants under the Plan.
- . "Performance-Based Awards" under Section 8(c)(ii) of the Plan (other than stock options or SARs, and without giving effect to any related dividend equivalents) that are granted to any participant during any three consecutive years may not relate to or provide for payment of more than 300,000 shares.
- . Performance-Based Awards payable only in cash, not related to shares, and granted to any participant in any calendar year may not provide for payment of more than \$3,000,000.

The foregoing share limits apply with respect to all 2001 Plan awards regardless of whether the underlying shares are attributable to the fixed 8,000,000 shares to be made available for Plan award purposes or shares available but not issued under the 1993 Plan.

As is customary in incentive plans of this nature, the number and kind of shares available under the Plan and the then outstanding awards, as well as exercise and purchase prices, performance targets under certain performance-based awards, and share limits, are subject to adjustment in the event of certain stock dividends, stock splits, combinations or exchanges of shares, mergers, consolidations, spin-offs, recapitalizations and similar events.

The Plan will not limit the authority of the Board of Directors or the Committee to grant awards or authorize any other compensation, with or without reference to the Common Stock, under any other plan or authority, except, as noted above, Northrop Grumman's ability to grant additional awards under the 1993 Plan will terminate if stockholders approve the 2001 Plan.

**Types of Awards.** The Plan authorizes stock options, SARs, and other forms of awards granted or denominated in Common Stock or units of Common Stock. The Plan retains flexibility to offer competitive incentives and to tailor benefits to specific needs and circumstances. Any award may be paid or settled in cash.

A stock option is the right to purchase shares of Common Stock at a future date at a specified price per share (the "exercise price"). The per share exercise price of an option may not be less than the fair market value of a share of Common Stock on the date of grant. The maximum term of an option is ten years from the date of grant. An option may either be an ISO or a nonqualified stock option. ISO benefits are taxed differently from nonqualified stock options, as described under "Federal Income Tax Treatment of Awards under the 2001 Plan" below. ISOs are also subject to more restrictive terms and are limited in amount by the Code and the Plan. ISOs may only be granted to key employees of Northrop Grumman or a subsidiary. The Committee may grant stock options that provide for the award of a new option when the exercise price of the option and/or tax withholding obligations related to the exercise of the option are paid in the form of shares or by a reduction in the number of shares otherwise deliverable.

An SAR is the right to receive payment of an amount equal to the excess of the fair market value of a share of Common Stock on the date of exercise of the SAR over the base price of the SAR. The base price will be established by the Committee at the time of grant of the SAR and generally cannot be less than the fair market value of a share of Common Stock on the date of grant. SARs may be granted in connection with other awards or independently. The maximum term of an SAR is ten years from the date of grant.

The other types of awards that may be granted under the 2001 Plan include, without limitation, stock bonuses, restricted stock, and performance shares.

**Performance-Based Awards.** The Committee may grant awards that are intended to be performance-based awards within the meaning of Section 162(m) of the Code ("Performance-Based Awards"). Performance-Based Awards are in addition to any of the other types of awards that may be granted under the Plan (including options and SARs which may also qualify as performance-based awards for Section 162(m) purposes). Performance-Based Awards may be in the form of restricted stock, performance stock, phantom stock or other rights.

The vesting or payment of Performance-Based Awards will depend on the

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absolute or relative performance of Northrop Grumman on a consolidated, segment, subsidiary, division, or plant basis. The Committee will establish the criterion or criteria and target(s) on which performance will be measured. The Committee must establish criteria and targets in advance of applicable deadlines under the Code and while the attainment of the performance targets remains substantially uncertain. The criteria that the Committee may use for this purpose will include one or more of the following: revenue growth, net earnings (either before or after interest, taxes, depreciation, amortization and/or Net Pension Income (as defined below)), cash flow, return on equity or on assets or on net investment, cost containment or reduction, stock price appreciation, total stockholder return, or

28

EVA (as defined below). "Net Pension Income" means any positive difference between income from employee pension plan investments less the cost of employee pension benefits for the relevant period of time. "EVA" means operating profit after tax (which means net earnings after tax but before tax adjusted interest income and expense and goodwill amortization), less a charge for the use of capital (which is based on average total capital and the weighted average cost of capital). The performance measurement period with respect to an award may range from one to ten years.

Performance-Based Awards may be granted only to key employees of Northrop Grumman or a subsidiary. Performance goals will be adjusted to mitigate the unbudgeted impact of material, unusual or nonrecurring gains and losses, accounting charges or other extraordinary events not foreseen at the time the goals were set.

Performance-Based Awards may be paid in stock or in cash (in either case, subject to the limits described under the heading "Authorized Shares; Limits on Awards" above). Before any Performance-Based Award is paid, the Committee must certify that the performance target or targets have been satisfied. The Committee has discretion to determine the performance target or targets and any other restrictions or other limitations of Performance-Based Awards and may reserve discretion to reduce payments below maximum award limits.

Dividend Equivalents; Deferrals. The Committee may provide for the deferred payment of awards, and may determine the other terms applicable to deferrals. The Committee may provide that awards under the Plan, and/or deferrals, earn dividends or dividend equivalents based on the amount of dividends paid on outstanding shares of Common Stock.

Acceleration of Awards; Possible Early Termination of Awards. Generally, if Northrop Grumman is liquidated, all or substantially all of Northrop Grumman's assets are sold, or Northrop Grumman is merged, consolidated or reorganized and stockholders prior to the event do not continue to own more than 60% of the combined voting power of Northrop Grumman or a successor after the event, then, if outstanding Plan awards are not assumed or continued after the event, all options granted under the Plan will vest, SARs will be paid, and any other types of awards will vest or be paid. The Committee also has the discretion to establish other change in control provisions with respect to awards granted under the Plan. For example, the Committee could provide for the acceleration of vesting or payment of an award in connection with a change in control event that is not described above.

Transfer Restrictions. Subject to certain exceptions contained in Section 11 of the Plan, awards under the Plan are not transferable by the recipient other than by will or the laws of descent and distribution and are generally exercisable, during the recipient's lifetime, only by the recipient. Any amounts payable or shares issuable pursuant to an award will be paid only to

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the recipient or the recipient's beneficiary or representative.

Termination of or Changes to the 2001 Plan. The Board of Directors may amend or terminate the Plan at any time and in any manner. Stockholder approval for an amendment will be required only if the amendment increases the number of shares available under the Plan or if stockholder approval is otherwise required as a matter of law. (Adjustments as a result of stock splits or similar events will not be considered an amendment requiring stockholder approval.) Unless terminated earlier by the Board of Directors, the Plan will terminate on February 21, 2011. Outstanding awards generally may be amended, subject to the consent of the holder if the amendment materially and adversely affects the holder.

Securities Underlying Awards. The market value of a share of Common Stock as of [           , 2001] was [\$           ].

### Federal Income Tax Treatment of Awards Under the 2001 Plan

The federal income tax consequences of the 2001 Plan under current federal law, which is subject to change, are summarized in the following discussion of the general tax principles applicable to the 2001 Plan. This summary is not intended to be exhaustive and, among other considerations, does not describe state, local, or international tax consequences.

29

With respect to nonqualified stock options, Northrop Grumman is generally entitled to deduct and the optionee recognizes taxable income in an amount equal to the difference between the option exercise price and the fair market value of the shares at the time of exercise. With respect to ISOs, Northrop Grumman is generally not entitled to a deduction nor does the participant recognize income at the time of exercise. The current federal income tax consequences of other awards authorized under the Plan generally follow certain basic patterns: SARs are taxed and deductible in substantially the same manner as nonqualified stock options; nontransferable restricted stock subject to a substantial risk of forfeiture results in income recognition equal to the excess of the fair market value over the price paid (if any) only at the time the restrictions lapse (unless the recipient elects to accelerate recognition as of the date of grant); bonuses, cash and stock-based performance awards, dividend equivalents and other types of awards are generally subject to tax at the time of payment. Compensation otherwise effectively deferred is taxed when paid. In each of the foregoing cases, Northrop Grumman will generally have a corresponding deduction at the time the participant recognizes income.

If an award is accelerated under the 2001 Plan in connection with a change in control (as this term is used under the Code), Northrop Grumman may not be permitted to deduct the portion of the compensation attributable to the acceleration ("parachute payments") if it exceeds certain threshold limits under the Code (and certain related excise taxes may be triggered). Furthermore, the aggregate compensation in excess of \$1,000,000 attributable to awards that are not "performance-based" within the meaning of Section 162(m) of the Code may not be permitted to be deducted by Northrop Grumman in certain circumstances.

### Specific Benefits

The number, amount and type of awards to be received by or allocated to eligible persons under the Plan cannot be determined at this time. The Committee has not yet considered any specific awards under the Plan. If the Plan had been in effect in 2000, Northrop Grumman expects that its 2000 award

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grants would not have been substantially different for officers and employees than those actually made under the 1993 Plan. The only awards to executive officers of Northrop Grumman in 2000 were "re-load" options as described on page 19.

### Vote Required

The affirmative vote of a majority of the votes cast on the proposal, provided that the total votes cast on the proposal represents over 50% in interest of all securities entitled to vote on the proposal is required for approval of this proposal. Members of the Board of Directors who are employed by Northrop Grumman are eligible for awards under the 2001 Plan.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" THE ABOVE PROPOSAL.

30

### PROPOSAL FOUR: AUTHORIZATION OF ISSUANCE OF COMMON STOCK UPON CONVERSION OF SERIES B PREFERRED STOCK

In connection with the proposed acquisition of Litton, Northrop Grumman will issue up to 13,000,000 shares of Common Stock and 3,500,000 shares of Preferred Stock in exchange for shares of Litton Industries, Inc. common stock. The shares will be issued pursuant to an Offer to Purchase or Exchange filed with the Securities and Exchange Commission on February 1, 2001 by NNG as a part of a Registration Statement on Form S-4 (SEC file number 333-54800). The Offer and Registration Statement can be obtained, without charge (a) by calling Georgeson Shareholder Communications Inc. at (800) 223-2064, (b) by writing or calling Northrop Grumman at: Investor Relations, Northrop Grumman Corporation, 1840 Century Park East, Los Angeles, California 90067, (310) 201-3423, or (c) from the Securities and Exchange Commission's website at [www.sec.gov](http://www.sec.gov).

The Preferred Stock will be entitled to dividends at the rate of 9% annually, unless stockholders approve the issuance of common stock upon conversion of the preferred stock. If approved, the conversion price will be equal to 127% of the average closing price for Northrop Grumman's common stock for the five trading days ending two trading days prior to expiration of the Offer. If stockholder approval is obtained, the preferred stock dividend will be 7% annually and certain participating rights of holders of the preferred stock will be eliminated, as described below under "Liquidation," "Redemption," and "Change in Control."

The rules of the New York Stock Exchange generally require shareholder approval for the issuance of common stock (or securities convertible into common stock) in excess of 20% of the common stock outstanding. The total number of shares of Common Stock to be issued in the Litton acquisition will be slightly less than 20%, if the Preferred Stock is not convertible into common stock. However, this percentage would be exceeded if the Preferred Stock is convertible into Common Stock. Therefore, the Preferred Stock will not be convertible without the approval of stockholders.

The Board of Directors believes that it is the best interest of Northrop Grumman and its shareholders to authorize the issuance of Common Stock upon conversion of the Preferred Stock and recommends that stockholders vote FOR Proposal Four.

The affirmative vote of a majority of the votes cast on the proposal, provided that the total votes cast on proposal represents over 50% in interest of all securities entitled to vote on the proposal is required for approval of this proposal.

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### Description of Preferred Stock

The following is a summary of the rights, preferences and privileges of the Preferred Stock, as set forth in a Certificate of Designations, Preferences and Rights of Series B Preferred Stock of NNG to be filed with the Secretary of State of Delaware immediately prior to the acquisition of a majority of the outstanding stock of Litton. A copy of the certificate of designations is attached as Exhibit C. This summary is not a complete description such rights, preferences and privileges and the rights of holders of the Preferred Stock are governed by the precise language of the certificate designations, not this summary. All references to Northrop Grumman below are to NNG, as the new holding company for Northrop Grumman and Litton. As described above, NNG will change its name to "Northrop Grumman Corporation" upon completion of the Northrop reorganization and the acquisition of a majority of the outstanding stock of Litton.

#### Conversion

The conversion rights of the Preferred Stock are subject to shareholder approval of the issuance of the shares of Common Stock conversion of the Preferred Stock. No conversion rights may be exercised unless and until such shareholder approval is obtained.

Subject to shareholder approval, each share of Preferred Stock will be convertible, at any time, at the option of the holder into the right to receive shares of Common Stock. Initially, each share of Preferred Stock will be

31

convertible into the right to receive the number of shares of Common Stock equal to the liquidation value of \$100.00 per share of Preferred Stock divided by 127% of the average closing price of Common Stock for the five trading days ending two trading days prior to expiration of the Offer for Litton's outstanding stock.

The conversion ratio is subject to adjustment in the event of certain dividends and distributions; upon a subdivision or reclassification of the outstanding shares of Common Stock; a merger or consolidation of Northrop Grumman or the sale of substantially all of Northrop Grumman's assets; upon the liquidation of Northrop Grumman; upon the occurrence of certain specified distributions with respect to the Common Stock; and certain other events described in the Certificate of Designations.

If any adjustment in the number of shares of Common Stock into which each share of Preferred Stock may be converted would result in an increase or decrease of less than 1% in the number of shares of Common Stock into which each share of Preferred Stock is then convertible, the amount of the adjustment will be carried forward and the adjustment will be made at the time of and together with any subsequent adjustment, which, together with any adjustment amounts carried forward, would equal at least 1% of the number of shares of Common Stock into which each share of Preferred Stock is then convertible.

#### Liquidation

In any liquidation of Northrop Grumman, each share of Preferred Stock will be entitled to a liquidation preference of \$100.00 plus accrued but unpaid dividends, whether or not declared, before any distribution may be made on the Common Stock or any other class or series of capital stock of Northrop Grumman

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which is junior to the Preferred Stock. In any liquidation of Northrop Grumman, no distribution may be made on any shares of capital stock of Northrop Grumman ranking on a parity with the Preferred Stock as to dividends, redemption payments and rights upon liquidation dissolution or winding up of Northrop Grumman, unless the holders of Preferred Stock participate ratably in the distribution along with the Preferred Stock as to such matters. In the event shareholder approval of the issuance of Common Stock upon conversion of the Preferred Stock has not occurred, the amount payable in liquidation will be the greater of the amount described above and the amount that would be distributed if such share of Preferred Stock had been converted into Common Stock pursuant to the provision for conversion.

### Reacquired Shares

Any shares of Preferred Stock converted, redeemed, purchased or otherwise acquired by Northrop Grumman will be retired and canceled. The reacquired shares will become authorized but unissued shares of Preferred Stock, which Northrop Grumman may reissue at a later date.

### Rank

The Preferred Stock ranks with respect to payment of dividends, redemption payments and rights upon liquidation, dissolution or winding up, prior to the Common Stock and any class or series of preferred stock which by its terms ranks junior to the Preferred Stock. The Preferred Stock ranks on parity with each other class or series of preferred stock.

### Voting Rights

Holders of Preferred Stock have no voting rights except in certain specified circumstances described below or as required by applicable law. The affirmative vote of the holders of two-thirds of the aggregate number of outstanding shares of the Preferred Stock is required for an amendment of Northrop Grumman's restated certificate of incorporation, for a merger of Northrop Grumman or any other action which would:

- . authorize any class or series of stock ranking prior to the Preferred Stock as to dividends, redemption payments or rights upon liquidation, dissolution or winding up;

32

- . adversely alter the preference, special rights or powers given to the Preferred Stock; or
- . cause or permit the purchase or redemption of less than all of the Preferred Stock unless all dividends to which such shares are entitled have been declared and paid or provided for.

If accrued dividends on the Preferred Stock are not paid for six quarterly dividend periods (whether or not consecutive), a majority of the holders of the Preferred Stock, voting separately as a class, will have the right to elect two directors. If such holders exercise their right to elect two directors to Northrop Grumman's board, the size of Northrop Grumman's board will be increased by two members until the dividends in default are paid in full or payment for the past-due dividends is set aside.

### Dividends

Holders of Preferred Stock will be entitled to cumulative cash dividends,



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payable quarterly in April, July, October and January of each year. If the Preferred Stock has been issued prior to the Annual Meeting, the initial dividend rate per share will be \$7.00 per year. Commencing after the dividend payable in October 2001, the dividend rate per share will be \$7.00 per year if shareholder approval for the issuance of Common Stock upon conversion of the Preferred Stock has been obtained, or \$9.00 per year if it has not been obtained. The dividend rate per share will be reduced from \$9.00 per year to \$7.00 per year after shareholder approval of the issuance of Common Stock upon conversion of the Preferred Stock is obtained. If the Preferred Stock is issued after the Annual Meeting, the initial dividend rate will be \$7.00 per year if shareholder approval of the issuance of Common Stock upon conversion of the Preferred Stock has been obtained and \$9.00 per year if shareholder approval has not been obtained. If the dividend rate per share is set at \$9.00 per year, it will be reduced from \$9.00 per year to \$7.00 per year after shareholder approval of the issuance of Common Stock upon conversion of the Preferred Stock is obtained. Dividends are cumulative and payable in cash.

If dividends are payable and have not been paid or set apart in full, the deficiency must be fully paid or set apart for payment before:

- . distributions or dividends are paid on stock ranking junior to the Preferred Stock; and
- . the redemption, repurchase or other acquisition for consideration of any shares of capital stock of Northrop Grumman ranking junior to the Preferred Stock.

### Redemption

**Mandatory Redemption For Cash After Twenty Years.** Northrop Grumman is required to redeem all of the shares of Preferred Stock for cash twenty years and one day from the date of issuance of the Preferred Stock. The redemption price per share is equal to the liquidation value of \$100.00 per share of Preferred Stock plus accrued but unpaid dividends, whether or not declared, to the mandatory redemption date. In the event that shareholder approval of the issuance of Common Stock upon conversion of the Preferred Stock has not occurred by the mandatory redemption date, the amount payable for each share of Preferred Stock will be the greater of (a) the liquidation value of \$100.00 per share of Preferred Stock plus accrued but unpaid dividends to the redemption date, whether or not declared, and (b) the current market price on the redemption date of the number of shares of Common Stock which would be issued upon conversion of a share of Preferred Stock pursuant to the provision for conversion.

**Optional Redemption For Common Stock After Seven Years.** Northrop Grumman has the option to redeem shares of the Preferred Stock in exchange for Common Stock seven years from the date of the initial issuance of the Preferred Stock. Upon redemption, holders of Preferred Stock will receive the number of shares of Common Stock equal to the liquidation value of \$100.00 per share of Preferred Stock plus accrued but unpaid dividends to the redemption date divided by the current market price of the Common Stock on the redemption date. In the event that shareholder approval of the issuance of Common Stock upon conversion of the Preferred Stock has not occurred by the redemption date, the number to be divided in the above calculation will be the greater of the

amount described above and the current market price on the redemption date of the number of shares of Common Stock which would be issued if all shares of Preferred Stock were converted on the redemption date into Common Stock

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pursuant to the provision for conversion.

### Change in Control

Upon a fundamental change in control of Northrop Grumman, as defined below, holders of Preferred Stock have the right, which may be exercised during the period of 20 business days following notice from Northrop Grumman, to exchange their shares of Preferred Stock for Common Stock. Each share of Preferred Stock may be exchanged in such circumstances for that number of shares of Common Stock determined by dividing the liquidation value of \$100.00 per share of Preferred Stock, plus accrued but unpaid dividends to such date by the current market value of the Common Stock on the exchange date. In the event shareholder approval has not been obtained for the issuance of Common Stock upon conversion of the Preferred Stock, the number to be divided in the above calculation will be the greater of the amount described above or the current market price of the number of shares of Common Stock which would be issued if such share of Preferred Stock were converted into Common Stock pursuant to the provision for conversion.

A "fundamental change in control" is defined as any merger, consolidation, sale of all or substantially all of Northrop Grumman's assets, liquidation or recapitalization (other than solely a change in the par value of equity securities) of the Common Stock in which more than one-third of the previously outstanding Common Stock is exchanged for cash, property or securities other than capital stock of Northrop Grumman or another corporation.

If the fundamental change in control occurred as a result of a transaction (excluding certain dividends or distributions on, and reclassifications of, Common Stock) in which the previously outstanding Common Stock is changed into or exchanged for different securities of Northrop Grumman or securities of another corporation or interests in a non-corporate entity, the Common Stock that would otherwise have been issued to a holder of Preferred Stock for each share of Preferred Stock will be deemed instead to be the kind and amount of securities and property receivable upon completion of such transaction in respect of the Common Stock that would result in the fair market value of such securities and property, measured as of the exchange date, being equal to the liquidation value plus accrued and unpaid dividends. In the event that shareholder approval of the issuance of Common Stock upon conversion of the Preferred Stock has not occurred, the fair market value of the securities and property will instead be calculated to be equal to the greater of the amount described above, and the fair market value of the securities and property which would have been issued if such share of Preferred Stock had been converted into Common Stock, if conversion were permitted.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" THE ABOVE PROPOSAL.

34

### PROPOSAL FIVE: AMENDMENT TO CERTIFICATE OF INCORPORATION

The Board of Directors believes that it is in the best interest of Northrop Grumman and its shareholders to amend Article IV of the Certificate of Incorporation to increase the authorized capitalization of Northrop Grumman. Under the proposed amendment, the number of shares of Common Stock which Northrop Grumman is authorized to issue will be increased from 200,000,000 to 400,000,000 shares. At the close of business on April 9, 2001 there were \_\_\_\_\_ shares of Common Stock and no shares of Preferred Stock of Northrop Grumman outstanding. In addition, as of such date, \_\_\_\_\_ shares of Common Stock were reserved for issuance under Northrop Grumman's 1987 and 1993 Plans (collectively, the "Stock Plans"). If this proposal is approved and effected, Northrop Grumman will have available \_\_\_\_\_ additional authorized but unissued

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and unreserved shares of Common Stock.

The Board of Directors of Northrop Grumman believes that it is prudent to have such additional shares of Common Stock available for general corporate purposes including future public or private offerings, acquisitions of other businesses or properties, possible stock splits or stock dividends. Northrop Grumman has no current plans for the issuance of any shares of Common Stock, except pursuant to the Stock Plans and the acquisition of Litton Industries, Inc. as previously described. As Northrop Grumman has a sufficient number of existing authorized and unissued shares of Common Stock for purposes of the Stock Plans and the Litton acquisition, a failure to approve Proposal Five will not affect these uses.

Unless otherwise required by applicable law or regulation, all authorized but unissued and unreserved shares of Common Stock will be issuable, without any further authorization by the shareholders, on such terms and for such consideration as may be determined by the Board of Directors of Northrop Grumman. If applicable law or regulation does not require shareholder approval as a condition to the issuance of shares in any particular transaction, it is expected that such approval will not be sought.

The sale of a substantial number of shares of Common Stock to persons who have an understanding with Northrop Grumman concerning the voting of such shares, or the distribution or dividend of shares of Common Stock (or the right to receive Common Stock) to the shareholders of Northrop Grumman, may have the effect of discouraging unsolicited attempts to acquire control of Northrop Grumman. In addition, any issuance of additional shares of Common Stock could have the effect of diluting the earnings per share and book value per share of existing shares of Common Stock, and such additional shares could be used to dilute the stock ownership of a person seeking to obtain control of Northrop Grumman. Management and the Board of Directors have no knowledge of any effort by any person to obtain control of Northrop Grumman, and the Board of Directors has no present intention (i) of issuing any shares of Common Stock with the understanding that the purchasers would vote their shares in any particular way or (ii) of distributing shares or rights to Northrop Grumman's shareholders.

Northrop Grumman's shareholders are not entitled to preemptive or other rights to subscribe for shares of Common Stock which may be issued in the future.

If this proposal is approved, Article IV of Northrop Grumman's Articles of Incorporation will be amended to read in its entirety as set forth in Exhibit D hereto. This proposal has been unanimously approved by the Board of Directors.

### Vote Required

The affirmative vote of a majority of the outstanding shares of Common Stock is required for approval of this proposal.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" THE ABOVE PROPOSAL.

35

### PROPOSAL SIX: STOCKHOLDER PROPOSAL

The proponent of a stockholder proposal has stated that the proponent intends to present a proposal at the Annual Meeting. The name, address and number of shares held by the proponent will be furnished by Northrop Grumman upon request to the Corporate Secretary. The proposal and supporting

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statement, for which the Board of Directors accepts no responsibility, is set forth below. The Board of Directors opposes the proposal for the reasons stated after the proposal.

RESOLVED: Shareholders request that Northrop Grumman disclose all significant promises (including technology transfers) made to foreign governments or foreign firms in connection with foreign military sales, intended to offset their U.S. dollar cost of weapons purchased by foreign nations.

### WHAT ARE OFFSETS?

Offsets are agreements by U.S. weapons manufacturers and the U.S. government to direct some benefits--usually jobs or technology--back to the purchasing country as condition of sale. The value of offsets sometimes exceeds the weapons' cost.

Direct offsets transfer purchasing dollars and/or work and military technology (often through licensing or joint production) to the recipient country to produce a U.S. weapon system, its components, or sub-components.

Indirect offsets may involve investments in the purchasing country, counter-trade agreements to market foreign goods, or transfers of commercial technology.

U.S. taxpayers finance offsets by (1) paying for the research and development of weapons and (2) providing grants, loans and loan guarantees for the sale. Offsets also lead to the loss of U.S. jobs.

### ARE OFFSET AGREEMENTS PROPRIETARY?

The U.S. arms industry guards information on offsets closely, claiming "proprietary privilege." However, purchasing countries often disclose such information for their own political purposes, e.g., to convince their citizens that they are gaining some tangible benefits from the millions or billions of dollars spent on arms.

The proponents believe that insofar as U.S. arms manufacturers (1) engage in foreign policy by negotiating private offset agreements with foreign governments, and (2) export domestic jobs while claiming that foreign military sales create jobs, they forfeit their proprietary claims to this information. Sound public policy demands transparency and public debate on these matters.

### OFFSET EXAMPLES

In 1999, two U.S. companies offered lucrative production-sharing contracts with Israeli military manufacturers, in connection with Northrop Grumman's bidding on a contract with Israel.

Between 1993 and 1997, U.S. defense companies entered into new offset agreements valued at \$19 billion in support of \$35 billion worth of defense contracts. For every dollar a U.S. company received from an arms sale associated with offsets, it returned 54 cents worth of offset obligations to the purchasing country ("Offsets in Defense Trade 1999", Commerce Department)

1997 data shows that 13 U.S. prime military contractors reported 58 new offset agreements valued at \$3.85 billion in support of \$5.84 billion in export contracts. Aerospace is the sector most impacted by offsets. Between 1993 and 1997 about 90% of offset agreements and transactions were associated with aerospace exports. The 1999 Commerce Department concludes, "offsets provide substantial benefits to foreign firms, and in the process deny business to otherwise competitive U.S. firms."

ARMS EXPORTS DON'T CREATE JOBS

The faith-based proponents submit this resolution for Board consideration because arms exports do not create jobs. Current weapons proliferation and the export of jobs and technology through offsets raise profound moral and ethical, as well as fiscal, questions that shareholders should address.

MANAGEMENT'S POSITION

Northrop Grumman's offset arrangements enable it to compete in the international defense market. Competition for defense contracts with foreign governments has grown in recent years due to decreased defense spending and increased reliance on local and regional contractors to fulfill military needs. These factors confirm Northrop Grumman's belief that offset arrangements are a positive factor in a foreign government's decision to select a defense contractor. Any action by Northrop Grumman to alter the current offset programs would harm its ability to participate in this market.

Typically, the terms of offset arrangements are private and not subject to disclosure. In fact, the existing offset arrangements prohibit Northrop Grumman from disclosing the terms of the offset and disclosing the specific offset projects that will be implemented. Foreign governments disclose few details about offset programs. Even the U.S. Government has taken the position that offsets are private arrangements between the foreign government and the defense contractor. By disclosing information about offsets, Northrop Grumman would breach the majority of its existing offset arrangements and hinder its chances of receiving defense contracts from foreign governments.

Northrop Grumman's international sales provide the means for Northrop Grumman to create new jobs and maintain its current labor force. While offsets may occasionally result in the transfer of some jobs and technology overseas, the Company believes that international contracts allow it to maintain its production base, add new jobs in the United States, lower the per unit price of similar goods and services to the United States Government and ultimately benefit its employees and shareholders.

Approval of this proposal requires the affirmative vote of a majority of the votes cast on the proposal. Because the proposal is only a recommendation, its approval would not effectuate the changes it references. Offset disclosure would require separate approval by the Board of Directors.

THE BOARD UNANIMOUSLY RECOMMENDS THAT YOU VOTE "AGAINST" PROPOSAL NUMBER SIX.

PROPOSAL SEVEN: STOCKHOLDER PROPOSAL

The proponent of a stockholder proposal has stated that the proponent intends to present a proposal at the Annual Meeting. The name, address and number of shares held by the proponent will be furnished by the Company upon request to the Corporate Secretary. The proposal and supporting statement, for which the Board of Directors accepts no responsibility, is set forth below. The Board of Directors opposes the proposal for the reasons stated after this proposal.

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Recommend

### RESTORE SIMPLE-MAJORITY VOTE

Reinstate simple-majority vote which we believe will enhance shareholder value. Delete Northrop requirements for greater than a majority share vote to the fullest extent possible.

An 80% vote is now required to remove a Northrop Director with cause. This 80% requirement can equal 100% in elections with an 80% turn-out.

Also, require that any future proposal impacting majority shareholder vote be put to shareholder vote - as a separate proposal. Simple-majority vote was the rule at Northrop for decades.

According to a Northrop December 3, 1999 press release - the directors, elected by the shareholders - will postpone for 3 years any possible action on this resolution and 2 other resolutions:

- . shareholder right to vote on poison pills
- . annual election of all directors.

The directors, elected by shareholders, gave no substantial reason for 3 years of procrastination on shareholder proposals that won impressive votes. Shareholder votes of 52%, 63% and 64% were reported.

The board's 3-year procrastination is an added incentive for shareholders to send a stronger vote at the 2001 shareholder meeting.

The Council of Institutional Investors (<http://www.cii.org>) expressed its concern to Northrop management regarding its failure to respond to these winning shareholder votes. Northrop is 83% owned by institutional investors.

To increase Northrop stock price:

Restore simple majority vote  
Yes on 7

### MANAGEMENT'S POSITION

The approval of a majority of the votes cast at a meeting, whether in person or by proxy, is required for most proposals submitted to a vote of the Company's stockholders. Consistent with Delaware law and the Company's Certificate of Incorporation, which has been approved by the stockholders of the Company, the vote of holders of at least 80% of the outstanding voting stock is required to authorize certain significant corporate actions.

These "super-majority" provisions, contrary to the proponent's assertions, do not preclude changes to corporate governance provisions. Super-majority provisions operate to ensure that fundamental changes within the Company may only be made when a broad consensus of stockholders agrees that such change is prudent.

38

Also, contrary to the proponent's assertions, the Board promptly focused its attention on this proposal immediately after their 1999 Annual Shareholders Meeting and concluded the provision continued to be in the best interests of the shareholder.

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Our super-majority provisions, like those contained in the governance documents of many public corporations, are designed to provide protection for all stockholders against self-interested actions by one or a few large stockholders. The provisions are not intended to, and do not, preclude unsolicited, non-abusive offers to acquire the Company at a fair price. They are designed, instead, to encourage any potential acquirer to negotiate directly with the Board. This is desirable because the Board is in the best position to evaluate the adequacy and fairness of proposed offers, to negotiate on behalf of all stockholders and to protect stockholders against abusive tactics during a takeover process.

Approval of this proposal requires the affirmative vote of a majority of the votes cast on the proposal. However, because the proposal is a recommendation, its approval would not effectuate the changes contemplated by the proposal. Elimination of the super-majority voting requirements would require amendment of the Company's Certificate of Incorporation, which requires approval by the Board and holders of at least 80% of the outstanding voting stock of the Company.

THE BOARD UNANIMOUSLY RECOMMENDS THAT YOU VOTE "AGAINST" PROPOSAL NUMBER SEVEN.

39

### PROPOSAL EIGHT: STOCKHOLDER PROPOSAL

The proponent of a stockholder proposal has stated that the proponent intends to present a proposal at the Annual Meeting. The name, address and number of shares held by the proponent will be furnished by the Company upon request to the Corporate Secretary. The proposal and supporting statement, for which the Board of Directors accepts no responsibility, is set forth below. The Board of Directors opposes the proposal for the reasons stated after this proposal.

### ELECT ALL DIRECTORS EACH YEAR

Northrop shareholders request the Board of Directors take all necessary steps to enact this resolution. This includes that less frequent than annual election of all directors requires a shareholder vote, as a separate resolution.

Why elect all directors each year?

Annual accountability to shareholders can improve the company response to these challenges:

The Pentagon may split the Joint Strike Fighter (JSF) project between Boeing and Lockheed, perhaps leaving Northrop in the cold.

Los Angeles Business Journal

Annual election of all Northrop directors is needed to address evidence of self-interest at the highest level of the company.

This led to a federal class action suit against Northrop officers and directors.

- . Northrop director independence is compromised by directors sitting on interlocking outside boards as cross-directors. This negatively impacts director commitment to Northrop. For example:

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Interlocking Directors -----	Company -----
Kresa & Slaughter	Avery Dennison
Kresa & Slaughter	Atlantic Richfield
Lutz & Robson	Exide

- . Robson and Slaughter also serve on key Board Committees, where independence is of greater importance.
- . Corporate governance experts say cross-directors tend to look out for each others' interest, rather than shareholder interest.

### Business Week

- . Attorney Peters sits on the Northrop board while her firm, Gibson, Dunn & Crutcher, collects fees from Northrop.
- . Peters also sits on the key Audit Committee - additionally compromised by the Kresa/Slaughter inter-lock cited above.
- . The American Bar Association discourages directors from serving at companies where they collect additional legal fees.
- . The Council of Institutional Investors (<http://www.cii.org/>) recommends independent directors on all key board committees.

40

The best boards continue to raise the bar, said Business Week.

Elect all Directors each year  
Yes on 8

### MANAGEMENT'S POSITION

The Board of Directors, as provided under the Company's Certificate of Incorporation and approved by the stockholders of the Company, is divided into three classes. Each class serves a term of three years, with one class, constituting approximately one-third of the Board, being elected each year at the Company's Annual Meeting of Stockholders. The Board consists of individuals with a broad range of experience and knowledge that is invaluable in considering issues important to the Company. This experience must be coupled with an in-depth understanding of our business, future plans and strategic posture in the defense industry. These characteristics are of particular importance to our Company due to its significant investments in research and development, which are essential to the Company's long-term growth.

It is in the best interest of the Company and our stockholders to maintain a high level of experience and continuity within the Board of Directors. Under the current system, after an election, at least two-thirds of the Board will have had at least one year of experience as a director of the Company. These Board members will have a heightened familiarity with our Company's business policies and practices. Thus, the current structure of the Board is specifically tailored to ensure this minimum level of experience and



continuity.

Our classified Board structure provides an additional benefit of reducing the likelihood of a sudden, unsolicited and possibly disadvantageous takeover. A classified board provides the Company with the time and the leverage to negotiate at arms length with parties seeking control of the Company. Essentially, a classified board gives the Board the opportunity to consider alternatives that are best for the Company and that maximize stockholder value. Classified boards do not preclude successful takeover offers; they enhance the Board's ability to negotiate for favorable terms. Declassification of the Board could eliminate these benefits and make the Company a target for unsolicited hostile overtures from parties seeking to benefit themselves at the expense of the Company and, more importantly, its stockholders.

Directors selected to a classified Board are no less accountable to stockholders than they would be if all directors were elected annually. Each year at least three directors must stand for election; this gives stockholders an opportunity to vote against management's slate of candidates.

The Board firmly disagrees with the proponent's assertion that, because of one or more Board member's service on an outside board, its oversight or ability to act in the best interest of the Company's stockholders is in question. Service on an outside board can provide the Board member with perspective and experience that potentially enhance the Board member's contributions to Board deliberations. Also, contrary to the proponent's assertions, the Board promptly focused its attention on the 1999 proposal after the Shareholders Meeting and concluded the provision continued to be in the best interests of the shareholders.

We note that Messrs. Kresa and Slaughter no longer serve as directors of Atlantic Richfield, Mr. Robson is no longer a director of Exide, and Ms. Peters has retired as a partner of Gibson, Dunn & Crutcher. We also note that the federal litigation cited by the proponent was dismissed with prejudice in orders entered in April 2000 and October 2000; the plaintiffs have filed timely appeals of those orders, which are pending.

Approval of this proposal requires the affirmative vote of a majority of the votes cast on the proposal. However, because the proposal is a recommendation, its approval would not effectuate the changes contemplated by the proposal. Elimination of the classified board would require amendment of the Company's Certificate of Incorporation and Bylaws, which requires approval by the Board and holders of at least 80% of the outstanding voting stock of the Company.

THE BOARD UNANIMOUSLY RECOMMENDS THAT YOU VOTE "AGAINST" PROPOSAL NUMBER EIGHT.

41

PROPOSAL NINE: STOCKHOLDER PROPOSAL

The proponent of a stockholder proposal has stated that the proponent intends to present a proposal at the Annual Meeting. The name, address and number of shares held by the proponent will be furnished upon request to the Corporate Secretary. The proposal and supporting statement, for which the Board of Directors accepts no responsibilities, is set forth below. The Board of Directors opposes the proposal for the reasons stated after this proposal.

RECOMMEND SHAREHOLDERS HAVE THE  
OPPORTUNITY TO VOTE ON POISON PILLS

Proposal

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RESOLVED: Recommend shareholders have the opportunity to vote on poison pills and the Company not adopt or maintain any poison pills designed to block the purchase of stock in excess of a specified amount, UNLESS this is approved by shareholders.

This recommendation includes, but is not limited to the poison pill adopted by the Board WITHOUT SHAREHOLDER APPROVAL in 1998. This Proposal, after adoption, is recommended not to be amended, modified or repealed, except by a shareholder vote as a separate un-bundled proposal.

A similar proposal on the subject of shareholder approval of poison pills won 64% shareholder approval at the 1999 shareholder meeting. Two additional shareholder proposals won majority or near-majority votes at that same meeting:

- |   |              |
|---|--------------|
| 1) Reinstate Simply Majority Shareholder Vote | 62% Approval |
| 2) Annual Election of All Directors           | 49% Approval |

Why submit Northrop's poison pill to a shareholder vote?

- . Poison pills give directors absolute veto power over any proposed business combination, no matter how beneficial it might be for the shareholders.

Power and Accountability  
By Nell Minow and Robert Monks

- . The Council of Institutional Investors ([www.cii.org](http://www.cii.org)) calls for shareholder approval of all poison pills.
- . The adoption of proposals winning majority vote is of greater significance to Northrop.

Recommend Shareholders to have the  
opportunity to vote on Poison Pills  
Yes on 9

### MANAGEMENT'S POSITION

The Board believes that the Company's shareholder rights plan is in the best interests of the stockholders and recommends that you vote against this proposal.

Northrop Grumman is one of more than 2,200 public companies that have a rights plan in place. Our shareholder rights plan (the "Rights Plan") was adopted by the Board as a means of preserving and maximizing value for the Company's shareholders, by encouraging potential acquirers to negotiate directly with the Board. Our Rights Plan provides the Board adequate flexibility to negotiate the highest possible bid from a potential acquirer. The Rights Plan enables the Board to evaluate any potential offer and to develop potential alternatives to maximize stockholder value.

The Rights Plan also is intended to protect shareholders against partial and two-tiered tender offers and creeping stock accumulation programs, tactics that do not treat all shareholders fairly and equally. Contrary to the proponent's assertions, the Rights Plan is not intended to prevent, nor does

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it prevent, bidders from making offers to acquire the Company at a price and on terms which would be in the best interests of all shareholders.

In 1997 Georgeson & Company Inc.'s Research Group analyzed data from 1992 through 1996 to determine the impact rights plans had on shareholder value. The Georgeson's research found that premiums paid to acquire target companies with rights plans were on average eight percentage points higher than premiums paid for target companies without rights plans. The Georgeson research estimates that stockholder rights plans contributed an additional \$13 billion in shareholder value during the 1992 - 1996 period, and that the stockholders of acquired companies without rights plans gave us \$14.5 billion in potential premiums. The economic benefit of shareholder rights plans prompted 361 companies to adopt or renew rights plan in 1999.

Pursuant to the terms of our Rights Plan, the Board may redeem the rights issued under the Rights Plan to permit an acquisition that adequately reflects the value of the Company and is in the best interests of the stockholders.

Approval of this proposal requires the affirmative vote of a majority of the votes cast on the proposal. However, because the proposal is a recommendation, its approval would not effectuate the changes contemplated by the proposal. Redemption of the existing Rights would require Board approval, and implementation of a stockholder approval requirement for future stockholder rights plans would require either Board approval or a shareholder amendment of the Company's Certificate of Incorporation, which requires approval by holders of at least 80% of the outstanding stock of the Company.

THE BOARD UNANIMOUSLY RECOMMENDS THAT YOU VOTE "AGAINST" PROPOSAL NUMBER 9.

43

### MISCELLANEOUS

#### Voting on Other Matters

Management is not aware of any other business to be transacted at the Annual Meeting other than proposals of stockholders that have been omitted from this proxy statement in accordance with rules of the Securities and Exchange Commission which may be sought to be presented. Northrop Grumman's Bylaws outline procedures, including minimum notice provisions, for stockholder nomination of directors and submission of other stockholder business to be transacted before the Annual Meeting. A copy of the pertinent Bylaw provisions is available on request to Corporate Secretary, Northrop Grumman Corporation, 1840 Century Park East, Los Angeles, California 90067. If any such stockholder proposals or other business to be transacted properly come before the Annual Meeting, it is intended that the shares represented by proxies will be voted in accordance with the judgment of the persons authorized to vote them.

#### Proposal of Stockholders

Copies of proposals which stockholders of Northrop Grumman wish to be included in Northrop Grumman's proxy statement relating to its Annual Meeting to be held in 2002 must be received by Northrop Grumman no later than December 17, 2001.

In addition, the Bylaws of the Corporation establish an advance notice requirement, for any proposal of business to be transacted at an annual meeting of stockholders. Written notice must be delivered to the Secretary of Northrop Grumman not less than 45 days nor more than 75 days prior to the first anniversary of the date on which Northrop Grumman first mailed its proxy materials for the 2001 Annual Meeting of Stockholders, provided, however, that

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if the date of the 2002 Annual Meeting of Stockholders is advanced more than 30 days prior to, or delayed more than 30 days after, the first anniversary of the date on which Northrop Grumman first mailed its proxy materials for the 2001 Annual Meeting of Stockholders, then such notice must be delivered on the later of the 90th day prior to the 2002 Annual Meeting of Stockholders or the 10th day following the day on which public announcement of the date of the 2002 Annual Meeting of Stockholders is first made. Such written notice must contain specified information concerning the matter to be brought before such meeting and concerning the stockholder proposing such a matter. Any stockholder desiring a copy of the Bylaws of Northrop Grumman will be furnished one without charge upon written request to the Secretary of Northrop Grumman.

Copies of such proposals should be sent to the Corporate Secretary, Northrop Grumman Corporation, 1840 Century Park East, Los Angeles, California 90067.

44

### Cost of Soliciting Proxies

The cost of soliciting proxies in the accompanying form will be paid by Northrop Grumman. In addition to solicitation by mail, arrangements will, where appropriate, be made with brokerage houses and other custodians, nominees and fiduciaries to send proxy materials to beneficial owners. Northrop Grumman will, upon request, reimburse them for reasonable expenses incurred. Northrop Grumman has retained Georgeson Shareholder Communications, Inc. of New York at an estimated fee of \$12,000 plus reasonable disbursements. Officers, directors and regular employees of Northrop Grumman may request the return of proxies personally, by means of materials prepared for stockholders and employee-stockholders or by telephone or telegram to the extent deemed appropriate by the Board of Directors. No additional compensation will be paid to such individuals for this activity. The extent to which this solicitation will be necessary will depend upon how promptly proxies are received; therefore, stockholders are urged to return their proxies without delay.

/s/ John H. Mullan  
John H. Mullan  
Corporate Vice President and  
Secretary

April 16, 2001

NOTICE: NORTHROP GRUMMAN FILED AN ANNUAL REPORT ON FORM 10-K ON MARCH 1, 2001 AND 10-K/AS ON MARCH 2, AND MARCH 3, 2001. STOCKHOLDERS OF RECORD ON APRIL 9, 2001 MAY OBTAIN A COPY OF THESE REPORTS WITHOUT CHARGE FROM THE CORPORATE SECRETARY, NORTHROP GRUMMAN CORPORATION, 1840 CENTURY PARK EAST, LOS ANGELES, CALIFORNIA 90067.

45

EXHIBIT A

NORTHROP GRUMMAN CORPORATION  
AUDIT COMMITTEE CHARTER  
AS AMENDED MAY 16, 2000

### Purpose

The Audit Committee of the Board of Directors is organized to assist the Board in fulfilling its oversight responsibilities by reviewing financial reports and other financial information provided by the company to the shareholders

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and the Securities and Exchange Commission; the company's internal control structure; the company's internal and external audit processes; and any other matters relating to the company's accounting and financial reporting process.

### Organization

The Audit Committee is comprised of at least three directors as determined by the Board of Directors, each of whom shall be Independent Outside Directors (as defined by the Corporation's Bylaws).

### Meetings

The Audit Committee shall meet at least four times annually, or more frequently as circumstances dictate. The Committee shall conduct its meetings with the following regularly invited guests: the Chairman of the Board, President and Chief Executive Officer, the Corporate Vice President and Chief Financial Officer, the Vice President and Controller, the Corporate Vice President and General Counsel, the Corporate Vice President and Secretary, the Vice President of Internal Audit, and the independent auditors.

A majority of the members of the Audit Committee shall constitute a quorum for any meeting. Any action of a majority of the members of the Audit Committee present at any meeting at which a quorum is present shall be an action of the Audit Committee.

### Responsibilities

The responsibilities of the Audit Committee are to:

1. Review and update this Charter periodically, at least annually, as conditions dictate.
2. Recommend to the Board of Directors for its action the appointment or discharge of the Corporation's independent auditors, based upon the Committee's judgment of the independence of the auditors (taking into account the fees charged both for audit and non-audit services) and the quality of its audit work. If the auditors must be replaced, the Committee shall recommend to the Board of Directors for its action the appointment of new auditors until the next annual meeting of stockholders.
3. Review and approve each professional service, considered to be consulting services (other than audit and tax related services) to be provided by the company's independent audit firm.
4. Review with the independent auditors and the internal auditors the scope and plan of their respective audits and the degree of coordination of those plans.
5. Meet with the independent auditors at appropriate times to review, among other things, the results of the audit and any certification, report, or opinion which the auditors propose to render in connection with the Corporation's financial statements. The review should cover key issues that the auditors considered during their work, leading to their expression of an opinion on the financial statements of the company.
6. Meet with the Corporation's chief internal auditor at least once a year to review his comments concerning the adequacy of the Corporation's system of internal controls and such other matters as the Committee may deem appropriate.

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7. Meet with the independent auditors and internal auditors, without management present, to discuss any items of significance and to ensure that the independent auditors and internal auditors have unrestricted access to the Audit Committee.
8. Review the Company's annual report filed with the Securities and Exchange Commission (SEC) on SEC Form 10-K, including the Management's Discussion and Analysis of Financial Condition and Results of Operations.
9. Direct the auditors and the internal audit staff to inquire into and report to it with respect to any of the Corporation's contracts, transactions or procedures, or the conduct of the Corporate Office, or any other unit, or any other matter having to do with the Corporation's business and affairs. If authorized by the Board of Directors, the Committee may initiate special investigations in these regards.
10. The Committee has such other duties as may be lawfully delegated to it from time to time by the Board of Directors.

2

EXHIBIT B

### NORTHROP GRUMMAN 2001 LONG-TERM INCENTIVE STOCK PLAN

#### 1. Purpose

The purpose of the Northrop Grumman 2001 Long-Term Incentive Stock Plan (the "Plan") is to promote the long-term success of Northrop Grumman Corporation (the "Company") and to increase stockholder value by providing its officers and selected employees with incentives to create excellent performance and to continue service with the Company, its subsidiaries and affiliates. Both by encouraging such officers and employees to become owners of the common stock of the Company and by providing actual ownership through Plan awards, it is intended that Plan participants will view the Company from an ownership perspective.

#### 2. Term

The Plan shall become effective upon the approval by the stockholders of the Company (the "Effective Time"). Unless previously terminated by the Company's Board of Directors (the "Board"), the Plan shall terminate at the close of business on the day before the tenth anniversary of the Board's approval of the Plan. After termination of the Plan, no future awards may be granted but previously granted awards (and the Committee's (as such term is defined in Section 3) authority with respect thereto) shall remain outstanding in accordance with their applicable terms and conditions and the terms and conditions of the Plan.

#### 3. Plan Administration

(a) The Plan shall be administered by the Compensation and Management Development Committee (or its successor) of the Board. Subject to the following provisions of this Section 3(a), the Compensation and Management Development Committee (or its successor) may delegate different levels of authority to make grants under the Plan to different committees, provided that each such committee consists of one or more members of the Board. With respect to awards intended to satisfy the requirements for performance-based compensation under Section 162(m) of the Internal Revenue Code of 1986, as

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amended (the "Code"), the Plan shall be administered by a committee consisting of two or more outside directors (as this requirement is applied under Section 162(m) of the Code). Transactions in or involving awards intended to be exempt under Rule 16b-3 under the Securities Exchange Act of 1934, as amended (the "1934 Act"), must be duly and timely authorized by the Board or a committee of non-employee directors (as this term is used in or under Rule 16b-3). (The appropriate acting body, be it the Compensation and Management Development Committee or another duly authorized committee of directors, is referred to as "Committee".)

(b) The Committee shall have full and exclusive power to interpret the Plan and to adopt such rules, regulations and guidelines for carrying out the Plan as it may deem necessary or proper, all of which power shall be executed in the best interests of the Company and in keeping with the objectives of the Plan. This power includes, but is not limited to, selecting award recipients, establishing all award terms and conditions and adopting modifications, amendments and procedures, including subplans and the like as may be necessary to comply with provisions of the laws and applicable regulatory rulings of countries in which the Company (or its subsidiaries or affiliates, as applicable) operates in order to assure the viability of awards granted under the Plan and to enable participants employed in such countries to receive advantages and benefits under the Plan and such laws and rulings. In no event other than as contemplated by Section 6, however, shall the Committee or its designee have the right to cancel or amend outstanding stock options for the purpose of repricing, replacing or regranting such options with a purchase price that is less than the purchase price of the original option.

(c) In making any determination or in taking or not taking any action under the Plan, the Committee may obtain and may rely on the advice of experts, including employees of and professional advisors to the Company. Any action taken by, or inaction of, the Committee relating to or pursuant to the Plan shall be within the absolute discretion of that entity or body and shall be conclusive and binding on all persons.

1

#### 4. Eligibility

Any key employee of the Company shall be eligible to receive one or more awards under the Plan. "Key Employee" shall also include any former key employee of the Company eligible to receive an assumed or replacement award as contemplated in Sections 5 and 8. For purposes of this Section 4, "Company" includes any entity that is directly or indirectly controlled by the Company or any entity in which the Company has a significant equity interest, as determined by the Committee.

#### 5. Shares of Common Stock Subject to the Plan and Grant Limits

(a) Subject to Section 6 of the Plan, the aggregate number of additional shares of common stock of the Company ("Common Stock") which may be issued or transferred pursuant to awards under the Plan shall not exceed the sum of: (i) 8,000,000 shares; plus (ii) any shares of Common Stock which as of the Effective Time are available or become available for issuance under the Company's 1993 Long-Term Incentive Stock Plan (the "Prior Plan") and which are not thereafter issued; plus (iii) any shares of Common Stock which the Company repurchases with proceeds received from option exercises. For purposes of the Plan, (x) any shares of Common Stock which are forfeited back to the Company under the Plan or the Prior Plan (including, without limitation, any shares reserved but not actually issued with respect to restricted performance stock rights granted under the Prior Plan), and (y) any shares which have been exchanged by a participant as full or partial payment to the Company in

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connection with any award under the Plan or the Prior Plan, as well as any shares exchanged by a Participant or withheld by the Company to satisfy the tax withholding obligations related to an award under the Plan or the Prior Plan, shall be available for issuance under the Plan in subsequent periods.

(b) In no event, however, shall more than 3,000,000 shares of Common Stock available for issuance pursuant to the Plan be issued pursuant to stock awards granted under Section 8(c) of the Plan. The maximum number of shares of Common Stock that may be delivered pursuant to stock options qualified as incentive stock options under Section 422 of the Code ("ISOs") is 4,000,000 shares.

(c) In instances where a stock appreciation rights ("SAR") or other award is settled in cash or a form other than shares, the shares that would have been issued had there been no cash or other settlement shall not be counted against the shares available for issuance under the Plan. If an SAR or other award that was granted under the Prior Plan and outstanding at the Effective Time is settled in cash or a form other than shares, the shares that would have been issued had there been no cash or other settlement shall, notwithstanding anything to the contrary in the Prior Plan, not be counted against the shares available for issuance under the Prior Plan for purposes of determining the shares available for issuance under the Plan. The payment of cash dividends and dividend equivalents in conjunction with outstanding awards shall not be counted against the shares available for issuance under the Plan. Any shares that are issued by the Company, and any awards that are granted by, or become obligations of, the Company, through the assumption by the Company or an affiliate of, or in substitution for, outstanding awards previously granted by an acquired company (or previously granted by a predecessor employer (or direct or indirect parent thereof) in the case of persons that become employed by the Company (or a subsidiary or affiliate) in connection with a business or asset acquisition or similar transaction) shall not be counted against the shares available for issuance under the Plan.

(d) Any shares issued under the Plan may consist in whole or in part of authorized and unissued shares or of treasury shares, and no fractional shares shall be issued under the Plan. Cash may be paid in lieu of any fractional shares in settlements of awards under the Plan.

(e) In no event shall the total number of shares of Common Stock that may be awarded to any eligible participant during any three year period pursuant to stock option grants and SAR grants hereunder exceed 900,000 shares. In no event shall "Performance-Based Awards" under Section 8(c)(ii) (other than stock options or SARs, and without giving effect to any related dividend equivalents) that are granted to any eligible participant during any three consecutive years relate to or provide for payment of more than 300,000 shares of Common Stock.

2

(f) Adjustments to the Plan's aggregate share limit pursuant to clause (ii), (iii), (x) and/or (y) of Section 5(a), as well as the provision of Section 5(c), are subject to any applicable limitations under Section 162(m) of the Code with respect to awards intended as performance-based compensation thereunder. The limits set forth in Sections 5(b) and 5(e) shall apply with respect to all Plan awards regardless of whether the underlying shares are attributable to the fixed 8,000,000 shares made available for Plan award purposes or shares available but not issued under the prior Plan.

### 6. Adjustments and Reorganizations

(a) In the event of any stock dividend, stock split, combination or exchange



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of shares, merger, consolidation, spin-off, recapitalization or other distribution (other than normal cash dividends) of Company assets to stockholders, or any other change affecting shares or share price, the Committee shall make such proportionate adjustments, if any, as the Committee in its discretion may deem appropriate to reflect such change with respect to (i) the aggregate number and type of shares that may be issued under the Plan; (ii) the grant limits established under the Plan; (iii) each outstanding award made under the Plan (including, without limitation, any applicable performance targets or criteria with respect thereto); and (iv) the exercise price per share for any outstanding stock options, SARs or similar awards under the Plan. Any adjustment affecting an award intended as performance-based compensation under Section 162(m) of the Code shall be made consistent with the requirements of Section 162(m).

(b) Notwithstanding anything to the contrary in Section 6(a), the provisions of this Section 6(b) shall apply to an outstanding Plan award if a Change in Control (as defined in Section 6(e)) occurs. If the Company undergoes a Change in Control triggered by clause (iii) of the definition thereof and the Company is not the surviving entity and the successor to the Company (if any) (or a parent thereof) does not agree in writing prior to the occurrence of the Change in Control to continue and assume the award following the Change in Control, or if for any other reason the award would not continue after the Change in Control, then upon the Change in Control: (i) if the award is a stock option, it shall vest fully and completely, any and all restrictions on exercisability or otherwise shall lapse, and it shall be fully exercisable; (ii) if the award is an SAR, it shall vest fully and completely, any and all restrictions on such SAR shall lapse, and such SAR shall be converted completely into cash at a price per share-unit equal to the higher of (x) the highest price paid for a share of Common Stock, as reported in the New York Stock Exchange Composite Transactions, during the 120 days prior to and including the date of the Change in Control, and (y) the highest price paid (on a national stock exchange or as quoted in the NASDAQ National Market Issues) for a share of stock of the corporation or other entity with which or into which the Company is merged, or if such corporation or other entity is not publicly traded, then the highest price paid on an exchange or as quoted in the NASDAQ National Market Issues for a share of stock of a publicly traded corporation or other entity that owns 50% or more (directly or indirectly) of such corporation or other entity on the date of the Change in Control (subject to adjustment pursuant to Section 6(a)); and (iii) if such award is an award or grant under Section 8(c) of the Plan, it shall immediately vest fully and completely, and all restrictions shall lapse, provided, however, that if the award is performance-based, the earnout or payout of the award, as applicable, shall be computed based on the performance terms of the award and based on actual performance achieved to the date of the Change in Control. No acceleration of vesting, exercisability and/or payment of an outstanding Plan award shall occur in connection with a Change in Control if either (i) the Company is the surviving entity, or (ii) the successor to the Company (if any) (or a parent thereof) agrees in writing prior to the Change in Control to assume the award; provided, however, that individual awards may provide for acceleration under these circumstances as contemplated by Section 6(c) below. Notwithstanding the foregoing provisions of this Section 6(b), no acceleration of vesting, exercisability and/or payment of an outstanding Plan award shall occur in connection with a Change in Control event that would, but for such acceleration, be accounted for under generally accepted accounting principles in effect on the date of such Change in Control as a pooling of interests transaction to the extent that such acceleration would render pooling accounting unavailable with respect to the transaction. If a stock option or other award is fully vested or becomes fully vested as provided in this paragraph (or would have become fully vested but for the pooling provision set forth in the preceding sentence) but is not exercised or paid prior to a Change in Control triggered by clause

(iii) of the definition thereof and the Company is not the surviving entity and the successor to the Company (if any) (or a parent thereof) does not agree in writing prior to the occurrence of the Change in Control to continue and assume the award following the Changes in Control, or if for any other reason the award would not continue after the Change in Control, then the Committee may provide for the settlement in cash of the award (such settlement to be calculated as though the award was paid or exercised simultaneously with the Change in Control and based upon the then Fair Market Value of a share of Common Stock and subject, in the case of an SAR or performance-based award, to the Change in Control payment provisions set forth above). An option or other award so settled by the Committee shall automatically terminate. If, in such circumstances, the Committee does not provide for the cash settlement of an option or other award, then upon the Change in Control such option or award shall terminate, subject to any provision that has been made by the Committee through a plan of reorganization or otherwise for the survival, substitution or exchange of such option or right; provided that the option or award holder shall be given reasonable notice of such intended termination and, subject to the pooling provision set forth above, an opportunity to exercise the option or award (to the extent an award other than an option must be exercised in order for the participant to realize the intended benefits) prior to or upon the Change in Control.

(c) Notwithstanding the provisions of Section 6(b), awards issued under the Plan may contain specific provisions regarding the consequences of a Change in Control and, if contained in an award, those provisions shall be controlling in the event of any inconsistency. (For example, and without limitation, an award may provide that (i) acceleration of vesting will occur automatically upon a Change in Control, or (ii) acceleration will occur in connection with a Change in Control if the participant is terminated by the Company without cause or the participant terminates employment for good reason.) The occurrence of a particular Change in Control under the Plan shall have no effect on any award granted under the Plan after the date of that Change in Control.

(d) The Committee may make adjustments pursuant of Section 6(a) and/or deem and acceleration of vesting of awards pursuant to Section 6(b) to occur sufficiently prior to an event if necessary or deemed appropriate to permit the participant to realize the benefits intended to be conveyed with respect to the shares underlying the award; provided, however, that, the Committee may reinstate the original terms of an award if the related event does not actually occur.

(e) A "Change in Control" of the Company shall be deemed to have occurred as of the first day that any one or more of the following conditions shall have been satisfied:

(i) Any Person (other than those Persons in control of the Company as of the Effective Time, or other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company) becomes the Beneficial Owner, directly or indirectly, of securities of the Company representing twenty-five percent (25%) or more of the combined voting power of the Company's then outstanding securities, and for purposes of this subsection (i) "Person" or "group" shall not include underwriters acquiring newly-issued voting securities (or securities convertible into voting securities) directly from the Company with a view towards distribution.

(ii) On any day after the Effective Time (the "Measurement Date") Continuing Directors cease for any reason to constitute a majority of the Board. A director is a "Continuing Director" if he or she either:

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(1) was a member of the Board on the applicable Initial Date (an "Initial Director"); or

(2) was elected to the Board, or was nominated for election by the Company's stockholders, by a vote of at least two-thirds (2/3) of the Initial Directors then in office.

A member of the Board who was not a director on the applicable Initial Date shall be deemed to be an Initial Director for purposes of clause (2) above if his or her election, or nomination for election by the Company's stockholders, was approved by a vote of at least two-thirds (2/3) of the Initial Directors (including directors elected after the applicable Initial Date who are deemed to be Initial Directors by application of this provision) then in office. "Initial Date" means the later of (1) the Effective Time or (2) the date that is two (2) years before the Measurement Date.

4

(iii) The Company is liquidated; all or substantially all of the Company's assets are sold in one or a series of related transactions; or the Company is merged, consolidated, or reorganized with or involving any other corporation, other than a merger, consolidation, or reorganization that results in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than sixty percent (60%) of the combined voting power of the voting securities of the Company (or such surviving entity) outstanding immediately after such merger, consolidation, or reorganization. Notwithstanding the foregoing, an event described in this clause (iii) that occurred prior to the Effective Time shall not constitute a Change in Control.

"Beneficial Owner" shall have the meaning ascribed to such term in Rule 13d-3 of the General Rules and Regulations under the 1934 Act. "Person" shall have the meaning ascribed to such term in Section 3(a)(9) of the 1934 Act and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d) thereof.

### 7. Fair Market Value

"Fair Market Value" for all purposes under the Plan shall mean the closing price of a share of Common Stock as reported on the composite tape for securities listed on the New York Stock Exchange (the "Exchange") for the date in question. If no sales of Common Stock were made on the Exchange on that date, the closing price of a share of Common Stock as reported on said composite tape for the preceding day on which sales of Common Stock were made on the Exchange shall be substituted.

### 8. Awards

The Committee shall determine the type or types of award(s) to be made to each participant. Awards may be granted singly, in combination or in tandem. Awards also may be made in combination or in tandem with, in replacement of, as alternatives to, or as the payment form for grants or rights under any other employee or compensation plan of the Company, including the plan of any acquired entity. The types of awards that may be granted under the Plan are:

(a) Stock Options--A grant of a right to purchase a specified number of

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shares of Common Stock during a specified period as determined by the Committee. The purchase price per share for each option shall be not less than 100% of Fair Market Value on the date of the grant, except that, in the case of a stock option granted retroactively in tandem with or as a substitution for another award, the exercise or designated price may be no lower than the Fair Market Value of a share on the date such other award was granted. A stock option may be in the form of an ISO which, in addition to being subject to applicable terms, conditions and limitations established by the Committee, complies with Section 422 of the Code. If an ISO is granted, the aggregate Fair Market Value (determined on the date the option is granted) of Common Stock subject to an ISO granted to a participant by the Committee which first becomes exercisable in any calendar year shall not exceed \$100,000.00 (otherwise, the intended ISO, to the extent of such excess, shall be rendered a nonqualified stock option). ISOs may only be granted to key employees of the Company or a subsidiary. The maximum term of each option (ISO or nonqualified) shall be ten (10) years. The price at which shares of Common Stock may be purchased under a stock option shall be paid in full at the time of the exercise in cash or such other method permitted by the Committee, including (i) tendering (either actually or by attestation) Common Stock; (ii) surrendering a stock award valued at Fair Market Value on the date of surrender; (iii) authorizing a third party to sell the shares (or a sufficient portion thereof) acquired upon exercise of a stock option and assigning the delivery to the Company of a sufficient amount of the sale proceeds to pay for all the shares acquired through such exercise; or (iv) any combination of the above. The Committee may grant stock options that provide for the award of a new option when the exercise price of the option and/or tax withholding obligations related to the exercise of the option have been paid by tendering shares of Common Stock to the Company or by the Company's reduction of the number of shares otherwise deliverable to the optionee. Any new option grant contemplated by the preceding sentence (the re-load grant) would cover the number of shares tendered by the optionee or withheld by the Company with the option purchase price set at the then current Fair Market Value and would never extend beyond the remaining term of the originally exercised option.

5

(b) SARs--A right to receive a payment, in cash and/or Common Stock, equal to the excess of the Fair Market Value of a specified number of shares of Common Stock on the date the SAR is exercised over the Fair Market Value on the date the SAR was granted as set forth in the applicable award agreement, except that, in the case of a SAR granted retroactively in tandem with or as a substitution for another award, the exercise or designated price may be no lower than the Fair Market Value of a share on the date such other award was granted. The maximum term of an SAR shall be ten (10) years.

(c) Other Awards--Other awards, granted or denominated in Common Stock or units of Common Stock, may be granted under the Plan. Awards not granted or denominated in Common Stock or units of Common Stock (cash awards) also may be granted consistent with clause (ii) below.

(i) All or part of any stock award may be subject to conditions and restrictions established by the Committee, and set forth in the award agreement, which may include, but are not limited to, continuous service with the Company (or a subsidiary or affiliate), achievement of specific business objectives, and other measurements of individual, business unit or Company performance. Unless the Committee otherwise provides, awards under this Section 8(c) to employees of the Company or a subsidiary that are either granted or become vested, exercisable or payable based on attainment of one or more of the performance goals related to the business criteria identified below, shall be deemed to be intended as Performance-Based

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Awards under Section 8(c)(ii).

(ii) Without limiting the generality of the foregoing, and in addition to stock options and SAR grants, other performance-based awards within the meaning of Section 162(m) of the Code ("Performance-Based Awards"), whether in the form of restricted stock, performance stock, phantom stock or other rights, the vesting of which depends on the absolute or relative performance of the Company on a consolidated, segment, subsidiary, division, or plant basis with reference to revenue growth, net earnings (either before or after interest, taxes, depreciation, amortization and/or Net Pension Income (as defined below)), cash flow, return on equity or on assets or on net investment, cost containment or reduction, stock price appreciation, total stockholder return, or EVA (as defined below) relative to preestablished performance goals, may be granted under the Plan. The applicable business criteria and the specific performance goals for Performance-Based Awards must be approved by the Committee in advance of applicable deadlines under the Code and while the performance relating to such goals remains substantially uncertain. The applicable performance period may range from one to ten years. Performance targets shall, to the extent determined by the Committee to be equitable and appropriate, be adjusted to mitigate the unbudgeted impact of material, unusual or nonrecurring gains and losses, accounting charges or other extraordinary events not foreseen at the time the targets were set. In no event shall share-based Performance-Based Awards granted to any eligible person under this Plan exceed the limit set forth in Section 5(e). In no event shall grants to any eligible person under this Plan of Performance-Based Awards payable only in cash in any calendar year and not related to shares provide for payment of more than \$3,000,000. Except as otherwise permitted under Section 162(m) of the Code, before any Performance-Based Award is paid, the Committee must certify that the performance goal and any other material terms of the performance-Based Award were in fact satisfied. The Committee shall have discretion to determine the conditions, restrictions or other limitations, in accordance with the terms of the Plan and Section 162(m) of the Code, on the payment of individual Performance-Based Awards. The Committee may reserve by express provision in any award agreement the right to reduce the amount payable in accordance with any standards or on any other basis (including the Committee's discretion), as the Committee may impose. Performance-Based Awards may be granted only to key employees of the Company or a subsidiary. "EVA" means operating profit after tax (which means net earnings after tax but before tax adjusted interest income and expense and goodwill amortization), less a charge for the use of capital (which is based on average total capital and the weighted cost of capital). "Net Pension Income" means any positive difference between income from employee pension plan investments less the cost of employee pension benefits for the relevant period of time.

6

### 9. Dividends and Dividend Equivalents

The Committee may provide that any awards under the Plan earn dividends or dividend equivalents. Such dividends or dividend equivalents may be paid currently or may be credited to a participant's account. Any crediting of dividends or dividend equivalents may be subject to such restrictions and conditions as the Committee may establish, including reinvestment in additional shares or share equivalents.

### 10. Deferrals and Settlements

Payment of awards may be in the form of cash, Common Stock, other awards or combinations thereof as the Committee shall determine, and with such

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restrictions as it may impose. The Committee may also require or permit participants to elect to defer the issuance of shares of the settlement of awards in cash under rules and procedures as it may establish under the Plan. It may also provide that deferred settlements include the payment or crediting of interest on the deferral amounts, or the payment of crediting of dividend equivalents where the deferral amounts are denominated in shares.

### 11. Transferability and Exercisability

Unless otherwise expressly provided in (or pursuant to) this Section 11, by applicable law or by the award agreement, (i) all awards are non-transferable and shall not be subject in any manner to sale, transfer, anticipation, alienation, assignment, pledge, encumbrance or charge; (ii) awards shall be exercised only by the holder; and (iii) amounts payable or shares issuable pursuant to an award shall be delivered only to (or for the account of) the holder. The foregoing exercise and transfer restrictions shall not apply to: (a) transfers to the Company; (b) the designation of a beneficiary to receive benefits in the event of the participant's death or, if the participant has died, transfers to or exercise by the participant's beneficiary, or, in the absence of a validly designated beneficiary, transfers by will or the laws of descent and distribution; (c) transfers pursuant to a qualified domestic relations order (as defined in the Code) (in the case of ISOs, to the extent such transfers are permitted by the Code); (d) if the participant has suffered a disability, permitted transfers to or exercises on behalf of the holder by his or her legal representative; or (e) the authorization by the Committee of "cashless exercise" procedures. The Committee by express provision in the award or an amendment thereto may permit an award (other than an ISO) to be transferred to, exercised by and paid to certain persons or entities related to the participant, including but not limited to members of the participant's family, charitable institutions, or trusts or other entities whose beneficiaries or beneficial owners are members of the participant's family and/or charitable institutions, or to such other persons or entities as may be expressly approved by the Committee, pursuant to such conditions and procedures as the Committee may establish. Any permitted transfer shall be subject to the condition that the Committee receive evidence satisfactory to it that the transfer is being made for estate and/or tax planning purposes (or to a "blind trust" in connection with the participant's termination of employment with the Company (or a subsidiary or affiliate) to assume a position with a governmental, charitable, educational or similar non-profit institution) and on a basis consistent with the Company's lawful issue of securities.

### 12. Award Agreements

Awards under the Plan shall be evidenced by agreements that set forth the terms, conditions and limitations for each award which may include the term of an award, the provisions applicable in the event the participant's employment terminates, and the Company's authority to unilaterally or bilaterally amend, modify, suspend, cancel or rescind any award; provided, however, that such authority shall not extend to the reduction of the exercise price of a previously granted option, except as provided in Section 6 hereof. The Committee need not require the execution of any such agreement, in which case acceptance of the award by the respective participant shall constitute agreement to the terms of the award.

### 13. Plan Amendment

The plan may only be amended by a disinterested majority of the Board of Directors as it deems necessary or appropriate to better achieve the purpose of the Plan, except that no such amendment shall be made without the approval of the Company's stockholders which would increase the number of shares

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available for issuance under the Plan (except for increases or adjustments expressly contemplated by Sections 5 and 6).

7

### 14. Tax Withholding

The Company shall have the right to deduct from any settlement of an award made under the Plan, including the delivery or vesting of shares, a sufficient amount to cover withholding (at the flat percentage rates applicable to supplemental wages) of any Federal, state or local taxes required by law or to take such other action as may be necessary to satisfy any such withholding obligations. The Committee may permit shares to be used to satisfy required tax withholding and such shares shall be valued at the Fair Market Value as of the settlement date of the applicable award.

### 15. Other Company Benefit and Compensation Programs

Unless otherwise specifically determined by the Committee, settlements of awards received by participants under the Plan shall not be deemed a part of a participant's regular, recurring compensation for purposes of calculating payments or benefits from any benefit plan or severance program of the Company (or a subsidiary or affiliate), or any severance pay law of any country. Further, the Company may adopt other compensation programs, plans or arrangements as it deems appropriate or necessary.

### 16. Unfunded Plan

Unless otherwise determined by the Committee, the Plan shall be unfunded and shall not create (or be construed to create) a trust or a separate fund or funds. The Plan shall not establish any fiduciary relationship between the Company and any participant or other person. To the extent any person holds any rights by virtue of a grant awarded under the Plan, such rights (unless otherwise determined by the Committee) shall be no greater than the rights of an unsecured general creditor of the Company.

### 17. Future Rights

No person shall have any claim or rights to be granted an award under the Plan, and no participant shall have any rights under the Plan to be retained in the employ of the Company (or any subsidiary or affiliate).

### 18. Governing Law; Severability; Legal Compliance

The validity, construction and effect of the Plan, any award agreements or other documents setting forth the terms of an award, and any actions taken or relating to the Plan shall be determined in accordance with the laws of the State of California and applicable Federal law. If any provision of the Plan, any award agreement, or any other document setting forth the terms of an award shall be held by a court of competent jurisdiction to be invalid and unenforceable, the remaining provisions of the Plan or such other document shall continue in effect.

The Plan, the granting and vesting of awards under the Plan and the issuance and delivery of Common Stock and/or the payment of money under the Plan or under awards granted hereunder are subject to compliance with all applicable federal and state laws, rules and regulations (including but not limited to state and federal securities and banking laws) and to such approvals by any listing, regulatory or governmental authority as may, in the opinion of counsel for the Company, be necessary or advisable in connection therewith. Any securities delivered under the Plan shall be subject to such restrictions

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as the Company may deem necessary or desirable to assure compliance with all applicable legal requirements.

### 19. Successors and Assigns

The Plan shall be binding on all successors and assigns of a participant, including, without limitation, the estate of such participant and the executor, administrator or trustee of such estate, or any receiver or trustee in bankruptcy or representative of the participant's creditors.

### 20. Rights as a Stockholder

Except as otherwise provided in the award agreement, a participant shall have no rights as a stockholder until he or she becomes the holder of record of shares of Common Stock.

8

EXHIBIT C

#### FORM OF CERTIFICATE OF DESIGNATIONS, PREFERENCES AND RIGHTS OF SERIES B CONVERTIBLE PREFERRED STOCK OF NORTHROP GRUMMAN CORPORATION

Pursuant to Section 151 of the General Corporation Law of the State of Delaware, Northrop Grumman Corporation, a Delaware corporation (the "Corporation"), certifies that pursuant to the authority contained in Article FOURTH of its Certificate of Incorporation, and in accordance with the provisions of Section 151 of the General Corporation Law of the State of Delaware, its Board of Directors has adopted the following resolution creating a series of its Preferred Stock, par value \$1.00 per share, designated as Series B Convertible Preferred Stock:

RESOLVED, that a series of the authorized Preferred Stock, par value \$1.00 per share, of the Corporation be hereby created, and that the designation and amount thereof and the voting powers, preferences and relative, participating, optional and other special rights of the shares of such series, and the qualifications, limitations or restrictions thereof are as follows:

Section 1. Designation and Amount. The shares of such series shall be designated as the "Series B Convertible Preferred Stock" (the "Series B Convertible Preferred Stock") and the number of shares constituting such series shall be 3,500,000.

Section 2. Dividends. The holders of shares of Series B Convertible Preferred Stock shall be entitled to receive cumulative cash dividends when, as and if declared by the Board of Directors out of any funds legally available therefor, at the rate per year herein specified, payable quarterly at the rate of one-fourth of such amount on the fifteenth day (or, if such day is not a business day, on the first business day thereafter) of January, April, July and October in each year. The rate of dividends shall [initially] be [\$9.00] per year per share/1/. [Thereafter, the rate of dividends shall be reduced to \$7.00 per year per share after the first quarterly dividend payment following the date, if any, on which the stockholders of the Corporation shall have approved the issuance of all common stock, par value \$1.00 per share, of the Corporation ("Common Stock") issuable upon conversion of the Series B Convertible Preferred Stock (such stockholder approval being referred to herein as the "Stockholder Approval").] [Thereafter, the rate of dividends shall be increased to \$9.00 per share per year after the October 2001 dividend payment date if the stockholders of the Corporation shall not have, prior to



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that time, approved the issuance of all Common Stock issuable upon conversion of the Series B Convertible Preferred Stock.] [The rate of dividends shall be decreased to \$7.00 per share after the first quarterly dividend payment date after Stockholder Approval is obtained.] Cash dividends upon the Series B Convertible Preferred Stock shall commence to accrue and shall be cumulative from the date of issuance.

If the dividend for any dividend period shall not have been paid or set apart in full for the Series B Convertible Preferred Stock, the deficiency shall be fully paid or set apart for payment before (i) any distributions or dividends, other than distributions or dividends paid in stock ranking junior to the Series B Convertible Preferred Stock as to dividends, redemption payments and rights upon liquidation, dissolution or winding up of

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/1/ If the initial date of issue is after the 2001 annual meeting of stockholders, this provision will be modified to reflect the vote at such meeting. If Stockholder Approval was obtained, the dividend rate shall be \$7.00 per year and the provision relating to future Stockholder Approval will be deleted. If Stockholder Approval was not obtained, the initial dividend rate shall be \$9.00 per year and the provision for a future downward adjustment following Stockholder Approval will be retained.

If the initial date of issue is before the 2001 annual meeting, the initial dividend rate shall be \$7.00 per year. If Stockholder Approval is obtained at the 2001 annual meeting, the dividend rate shall remain at such level. If Stockholder Approval is not obtained at the 2001 annual meeting, the dividend rate shall increase to \$9.00 per year, after the October 2001 dividend payment date, subject to future downward adjustment if Stockholder Approval is obtained.

1

the Corporation, shall be paid upon or set apart for Common Stock or stock of any other class or series of Preferred Stock ranking junior to the Series B Convertible Preferred Stock as to dividends, redemption payments or rights upon liquidation, dissolution or winding up of the Corporation; and (ii) any Common Stock or shares of Preferred Stock of any class or series ranking junior to the Series B Convertible Preferred Stock as to dividends, redemption payments or rights upon liquidation, dissolution or winding up of the Corporation shall be redeemed, repurchased or otherwise acquired for any consideration other than stock ranking junior to the Series B Preferred Stock as to dividends, redemption payments and rights upon liquidation, dissolution or winding up of the Corporation. No distribution or dividend shall be paid upon, or declared and set apart for, any shares of Preferred Stock ranking on a parity with the Series B Convertible Preferred Stock as to dividends, redemption payments or rights upon liquidation, dissolution or winding up of the Corporation for any dividend period unless at the same time a like proportionate distribution or dividend for the same or similar dividend period, ratably in proportion to the respective annual dividends fixed therefor, shall be paid upon or declared and set apart for all shares of Preferred Stock of all series so ranking then outstanding and entitled to receive such dividend.

Section 3. Voting Rights. Except as provided herein or as may otherwise be required by law, the holders of shares of Series B Convertible Preferred Stock shall not be entitled to any voting rights as stockholders with respect to such shares.

(a) So long as any shares of Series B Convertible Preferred Stock shall be outstanding, the Corporation shall not, without the affirmative vote of the holders of at least two-thirds of the aggregate number of shares of Series B

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Convertible Preferred Stock at the time outstanding, by an amendment to the Restated Certificate of Incorporation, by merger or consolidation, or in any other manner:

(i) authorize any class or series of stock ranking prior to the Series B Convertible Preferred Stock as to dividends, redemption payments or rights upon liquidation, dissolution or winding up of the Corporation;

(ii) alter or change the preferences, special rights, or powers given to the Series B Convertible Preferred Stock so as to affect such class of stock adversely, but nothing in this clause (ii) shall require such a class vote (x) in connection with any increase in the total number of authorized shares of Common Stock or Preferred Stock; (y) in connection with the authorization or increase in the total number of authorized shares of any class of stock ranking on a parity with the Series B Convertible Preferred Stock; or (z) in connection with the fixing of any of the particulars of shares of any other series of Preferred Stock ranking on a parity with the Series B Convertible Preferred Stock that may be fixed by the Board of Directors as provided in Article FOURTH of the Certificate of Incorporation; or

(iii) directly or indirectly purchase or redeem less than all of the Series B Convertible Preferred Stock at the time outstanding unless the full dividends to which all shares of the Series B Convertible Preferred Stock then outstanding shall then be entitled shall have been paid or declared and a sum sufficient for the payment thereof set apart.

(b) If and whenever accrued dividends on the Series B Convertible Preferred Stock shall not have been paid or declared and a sum sufficient for the payment thereof set aside for six quarterly dividend periods (whether or not consecutive), then and in such event, the holders of the Series B Convertible Preferred Stock, voting separately as a class, shall be entitled to elect two directors at any annual meeting of the stockholders or any special meeting held in place thereof, or at a special meeting of the holders of the Series B Convertible Preferred Stock called as hereinafter provided. Such right of the holders of the Series B Convertible Preferred Stock to elect two directors may be exercised until the dividends in default on the Series B Convertible Preferred Stock shall have been paid in full or funds sufficient therefor set aside; and when so paid or provided for, then the right of the holders of the Series B Convertible Preferred Stock to elect such number of directors shall cease, but subject always to the same provisions for the vesting of such voting rights in the case of any such future default or defaults. At any time after such voting power shall have so vested in the holders of the Series B Convertible Preferred Stock, the Secretary of the Corporation may, and upon the written request of the holders of record of ten percent (10%) or more in amount of the Series B Convertible Preferred Stock then outstanding addressed to him at the principal executive office of the Corporation shall, call a special meeting of the holders of the Series B Convertible Preferred Stock for the election of the directors to be elected by them as hereinafter provided, to

2

be held within sixty (60) days after delivery of such request and at the place and upon the notice provided by law and in the bylaws of the Corporation for the holding of meetings of stockholders; provided, however, that the Secretary shall not be required to call such special meeting in the case of any such request received less than ninety (90) days before the date fixed for the next ensuing annual meeting of stockholders. If at any such annual or special meeting or any adjournment thereof the holders of at least a majority of the Series B Convertible Preferred Stock then outstanding and entitled to vote

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thereat shall be present or represented by proxy, then, by vote of the holders of at least a majority of the Series B Convertible Preferred Stock present or so represented at such meeting, the then authorized number of directors of the Corporation shall be increased by two, and the holders of the Series B Convertible Preferred Stock shall be entitled to elect the additional directors so provided for. The directors so elected shall serve until the next annual meeting or until their respective successors shall be elected and shall qualify; provided, however, that whenever the holders of the Series B Convertible Preferred Stock shall be divested of voting power as above provided, the terms of office of all persons elected as directors by the holders of the Series B Convertible Preferred Stock as a class shall forthwith terminate and the number of the Board of Directors shall be reduced accordingly.

(c) If, during any interval between any special meeting of the holders of the Series B Convertible Preferred Stock for the election of directors to be elected by them as provided in this Section 3 and the next ensuing annual meeting of stockholders, or between annual meetings of stockholders for the election of directors, and while the holders of the Series B Convertible Preferred Stock shall be entitled to elect two directors, the number of directors who have been elected by the holders of the Series B Convertible Preferred Stock shall, by reason of resignation, death, or removal, be less than the total number of directors subject to election by the holders of the Series B Convertible Preferred Stock, (i) the vacancy or vacancies in the directors elected by the holders of the Series B Convertible Preferred Stock shall be filled by the remaining director then in office, if any, who was elected by the holders of the Series B Convertible Preferred Stock, although less than a quorum, and (ii) if not so filled within sixty (60) days after the creation thereof, the Secretary of the Corporation shall call a special meeting of the holders of the Series B Convertible Preferred Stock and such vacancy or vacancies shall be filled at such special meeting. Any director elected to fill any such vacancy by the remaining director then in office may be removed from office by vote of the holders of a majority of the shares of the Series B Convertible Preferred Stock. A special meeting of the holders of the Series B Convertible Preferred Stock may be called by a majority vote of the Board of Directors for the purpose of removing such director. The Secretary of the Corporation shall, in any event, within ten (10) days after delivery to the Corporation at its principal office of a request to such effect signed by the holders of at least ten percent (10%) of the outstanding shares of the Series B Convertible Preferred Stock, call a special meeting for such purpose to be held within sixty (60) days after delivery of such request; provided, however, that the Secretary shall not be required to call such a special meeting in the case of any such request received less than ninety (90) days before the date fixed for the next ensuing annual meeting of stockholders.

### Section 4. Redemption.

(a) Shares of Series B Convertible Preferred Stock shall not be redeemable except as follows:

(i) All, but not less than all, of the shares of Series B Convertible Preferred Stock shall be redeemed for cash in an amount equal to (X) if prior to Stockholder Approval, the greater of (a) the Liquidation Value plus all accrued and unpaid dividends with respect to such shares, whether or not declared, and (b) the Current Market Price of the number of shares of Common Stock which would be issued to such holders if all shares of Series B Convertible Preferred Stock were converted into Common Stock on the Redemption Date pursuant to Section 8; and (Y) after Stockholder Approval, the Liquidation Value plus all dividends with respect to such shares, whether or not declared, accrued and unpaid as of the Redemption Date, as defined below, on the first day after the twentieth anniversary of

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the initial issuance of the Series B Convertible Preferred Stock.

(ii) All, but not less than all, of the shares of Series B Convertible Preferred Stock may be redeemed at the option of the Corporation at any time after the seventh anniversary of the initial issuance of the Series B Convertible Preferred Stock. Any redemption pursuant to this clause (ii) shall be solely for Common

3

Stock of the Corporation and at the Redemption Date each holder of shares of Series B Convertible Preferred Stock shall be entitled to receive, in exchange and upon surrender of the certificate therefor, that number of fully paid and nonassessable shares of Common Stock determined by dividing (X) if prior to Stockholder Approval, the greater of (a) the Liquidation Value plus all accrued and unpaid dividends with respect to such shares, whether or not declared, and (b) the Current Market Price of the number of shares of Common Stock which would be issued if all shares of Series B Convertible Preferred Stock were converted into Common Stock pursuant to Section 8 on the Redemption Date; or (Y) if after Stockholder Approval, the Liquidation Value plus all accrued and unpaid dividends with respect to such shares, whether or not declared thereon to the Redemption Date, by (Z) the Current Market Price of the Common Stock as of the Redemption Date; provided, however, that if prior to the Redemption Date there shall have occurred a Transaction, as defined in Section 8(b)(iii), the consideration deliverable in any such exchange shall be the Alternate Consideration as provided in Section 12.

(b) Notice of every mandatory or optional redemption shall be mailed at least thirty (30) days but not more than fifty (50) days prior to the Redemption Date to the holders of record of the shares of Series B Convertible Preferred Stock so to be redeemed at their respective addresses as they appear upon the books of the Corporation. Each such notice shall specify the date on which such redemption shall be effective (the "Redemption Date"), the redemption price or manner of calculating the redemption price and the place where certificates for the Series B Convertible Preferred Stock are to be surrendered for cancellation.

(c) On the date that redemption is being made pursuant to paragraph (a) of this Section 4, the Corporation shall deposit for the benefit of the holders of shares of Series B Convertible Preferred Stock the funds, or stock certificates for Common Stock, necessary for such redemption with a bank or trust company in the Borough of Manhattan, the City of New York, having a capital and surplus of at least \$1,000,000,000. Dividends paid on Common Stock held for the benefit of the holders of shares of Series B Convertible Preferred Stock hereunder shall be held for the benefit of such holders and paid over, without interest, on surrender of certificates for the Series B Convertible Preferred Stock. Any monies or stock certificates so deposited by the Corporation and unclaimed at the end of one year from the Redemption Date shall revert to the Corporation. After such reversion, any such bank or trust company shall, upon demand, pay over to the Corporation such unclaimed amounts or deliver such stock certificates and thereupon such bank or trust company shall be relieved of all responsibility in respect thereof and any holder of shares of Series B Convertible Preferred Stock shall look only to the Corporation for the payment of the redemption price. Any interest accrued on funds deposited pursuant to this paragraph (c) shall be paid from time to time to the Corporation for its own account.

(d) Upon the deposit of funds or certificates for Common Stock pursuant to paragraph (c) in respect of shares of Series B Convertible Preferred Stock being redeemed pursuant to paragraph (a) of this Section 4, notwithstanding

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that any certificates for such shares shall not have been surrendered for cancellation, the shares represented thereby shall on and after the Redemption Date no longer be deemed outstanding, and all rights of the holders of shares of Series B Convertible Preferred Stock shall cease and terminate, excepting only the right to receive the redemption price therefor. Nothing in this Section 4 shall limit the right of a holder to convert shares of Series B Convertible Preferred Stock pursuant to Section 8 at any time prior to the Redemption Date, even if such shares have been called for redemption pursuant to Section 4(a).

(e) In connection with any redemption pursuant to clause (ii) of paragraph (a) of this Section 4, no fraction of a share of common stock shall be issued, but in lieu thereof the Corporation shall pay a cash adjustment in respect of such fractional interest in an amount equal to such fractional interest multiplied by the Current Market Price per share of Common Stock on the Redemption Date.

### Section 5. Fundamental Change in Control.

(a) Not later than 10 business days following a Fundamental Change in Control, as defined below, the Corporation shall mail notice to the holders of Series B Convertible Preferred Stock stating that a Fundamental Change in Control has occurred and advising such holders of their right to exchange (the "Exchange Right")

4

any and all shares of Series B Convertible Preferred Stock for shares of Common Stock as provided herein; provided, however, that if prior to the Exchange Date (as defined below) there shall have occurred a Transaction, as defined in Section 8(b)(iii), the consideration deliverable in any such exchange shall be the Alternate Consideration as provided in Section 12. Such notice shall state: (i) the date on which such exchanges shall be effective (the "Exchange Date"), which shall be the 21st business day from the date of giving such notice; (ii) the number of shares of Common Stock (or Alternate Consideration) for which each share of Series B Convertible Preferred Stock may be exchanged; and (iii) the method by which each holder may give notice of its exercise of the Exchange Right; and (iv) the method and place for delivery of certificates for Series B Convertible Preferred Stock in connection with exchanges pursuant hereto. For a period of twenty (20) business days following the notice provided herein, each holder of Series B Convertible Preferred Stock may exercise the Exchange Right as provided herein.

(b) Pursuant to the Exchange Right, each share of Series B Convertible Preferred Stock shall be exchanged for that number of shares of Common Stock determined by dividing an amount equal to (X) if prior to Stockholder Approval, the greater of (a) the Liquidation Value plus all dividends accrued and unpaid with respect to such share as of the Exchange Date, whether or not declared, and (b) the Current Market Price of the number of shares of Common Stock which would be issued if such share of Series B Convertible Preferred Stock were converted into Common Stock pursuant to Section 8 on the Exchange Date; or (Y) if after Stockholder Approval, the Liquidation Value plus all dividends accrued and unpaid with respect to such share as of the Exchange Date, whether or not declared, in each case by the Current Market Price per share of Common Stock as of the Exchange Date.

(c) The holder of any share of Series B Convertible Preferred Stock may exercise the Exchange Right by surrendering for such purpose to the Corporation, at its principal office or at such other office or agency maintained by the Corporation for that purpose, a certificate or certificates representing the shares of Series B Convertible Preferred Stock to be

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exchanged accompanied by a written notice stating that such holder elects to exercise the Exchange Right as to all or a specified number of such shares in accordance with this Section 5 and specifying the name or names in which such holder wishes the certificate or certificates for shares of Common Stock to which such holder is entitled to be issued and such other customary documents as are necessary to effect the exchange. In case such notice shall specify a name or names other than that of such holder, such notice shall be accompanied by payment of all transfer taxes payable upon the issuance in such name or names of shares of Common Stock to which such holder has become entitled. Other than such taxes, the Corporation will pay any and all issue and other taxes (other than taxes based on income) that may be payable in respect of any issue or delivery of shares of Common Stock to which such holder has become entitled on exchange of shares of Series B Convertible Preferred Stock pursuant hereto. As promptly as practicable, and in any event within five (5) business days after the surrender of such certificate or certificates and the receipt of such notice relating thereto and, if applicable, payment of all transfer taxes (or the demonstration to the satisfaction of the Corporation that such taxes have been paid), the Corporation shall deliver or cause to be delivered certificates representing the number of validly issued, fully paid and nonassessable shares of Common Stock to which the holder of shares of Series B Convertible Preferred Stock so exchanged shall be entitled.

(d) From and after the Exchange Date, a holder of shares of Series B Convertible Preferred Stock who has elected to exchange such shares for Common Stock as herein provided shall have no voting or other rights with respect to the shares of Series B Convertible Preferred Stock subject thereto, other than the right to receive the Common Stock provided herein upon delivery of the certificate or certificates evidencing shares of Series B Convertible Preferred Stock.

(e) In connection with the exchange of any shares of Series B Convertible Preferred Stock, no fraction of a share of Common Stock shall be issued, but in lieu thereof the Corporation shall pay a cash adjustment in respect of such fractional interest in an amount equal to such fractional interest multiplied by the Current Market Price per share of Common Stock on the Exchange Date.

5

(f) The Corporation shall at all times reserve and keep available out of its authorized and unissued Common Stock, solely for the purpose of the Exchange Rights provided herein, such number of shares of Common Stock as shall from time to time be sufficient to effect the exchange provided herein. The Corporation shall from time to time, in accordance with the laws of Delaware, increase the authorized amount of Common Stock if at any time the number of authorized shares of Common Stock remaining unissued shall not be sufficient to permit the exchange of all then outstanding shares of Series B Convertible Preferred Stock.

(g) As used herein, the term "Fundamental Change in Control" shall mean any merger, consolidation, sale of all or substantially all of the Corporation's assets, liquidation or recapitalization (other than solely a change in the par value of equity securities) of the Common Stock in which more than one-third of the previously outstanding Common Stock shall be changed into or exchanged for cash, property or securities other than capital stock of the Corporation or another corporation ("Non Stock Consideration"). For purposes of the preceding sentence, any transaction in which shares of Common Stock shall be changed into or exchanged for a combination of Non Stock Consideration and capital stock of the Corporation or another corporation shall be deemed to have involved the exchange of a number of shares of Common Stock for Non Stock Consideration equal to the total number of shares exchanged multiplied by a fraction in which the numerator is the Fair Market Value of the Non Stock

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Consideration and the denominator is the Fair Market Value of the total consideration in such exchange, each as determined by a resolution of the Board of Directors of the Corporation.

Section 6. **Reacquired Shares.** Any shares of Series B Convertible Preferred Stock converted, redeemed, exchanged, purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof. All such shares shall upon their cancellation, and upon the filing of an appropriate certificate with the Secretary of State of the State of Delaware, become authorized but unissued shares of Preferred Stock, par value \$1.00 per share, of the Corporation and may be reissued as part of another series of Preferred Stock, par value \$1.00 per share, of the Corporation subject to the conditions or restrictions on issuance set forth herein.

Section 7. **Liquidation, Dissolution or Winding Up.**

(a) Except as provided in paragraph (b) of this Section 7, upon any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, no distribution shall be made (i) to the holders of shares of capital stock of the Corporation ranking junior as to dividends, redemption payments and rights upon liquidation, dissolution or winding up of the Corporation to the Series B Convertible Preferred Stock unless, prior thereto, the holders of shares of Series B Convertible Preferred Stock shall have received (X) if prior to Stockholder Approval, the greater of (a) the Liquidation Value plus all accrued and unpaid dividends with respect to such shares, whether or not declared, and (b) the amount which would be distributed to such holders if all shares of Series B Convertible Preferred Stock had been converted into Common Stock pursuant to Section 8; and (Y) after Stockholder Approval, the Liquidation Value plus all accrued and unpaid dividends with respect to such shares, whether or not declared or (ii) to the holders of shares of capital stock ranking on a parity with the Series B Convertible Preferred Stock as to dividends, redemption payments and rights upon liquidation, dissolution or winding up of the Corporation, except distributions made ratably on the Series B Convertible Preferred Stock and all such parity stock in proportion to the total amounts to which the holders of all such shares are entitled upon such liquidation, dissolution or winding up. The Liquidation Value shall be \$100.00 per share.

(b) If the Corporation shall commence a voluntary case under the Federal bankruptcy laws or any other applicable Federal or State bankruptcy, insolvency or similar law, or consent to the entry of an order for relief in an involuntary case under any such law or to the appointment of a receiver, liquidator, assignee, custodian, trustee, sequestrator (or other similar official) of the Corporation or of any substantial part of its property, or make an assignment for the benefit of its creditors, or admit in writing its inability to pay its debts generally as they become due, or if a decree or order for relief in respect of the Corporation shall be entered by a court having jurisdiction in the premises in an involuntary case under the Federal bankruptcy laws or any other applicable Federal or State bankruptcy, insolvency or similar law, or appointing a receiver, liquidator, assignee, custodian, trustee, sequestrator (or other similar official) of the Corporation or of any substantial part of its property, or

ordering the winding up or liquidation of its affairs, and on account of any such event the Corporation shall liquidate, dissolve or wind up, no distribution shall be made (i) to the holders of shares of capital stock of the Corporation ranking junior to the Series B Convertible Preferred Stock as to dividends, redemption payments and rights upon liquidation, dissolution or

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winding up of the Corporation unless, prior thereto, the holders of shares of Series B Convertible Preferred Stock shall have received (X) if prior to Stockholder Approval, the greater of (a) the Liquidation Value plus all accrued and unpaid dividends with respect to such shares, whether or not declared, and (b) the amount which would be distributed to such holders if all shares of Series B Convertible Preferred Stock had been converted into Common Stock pursuant to Section 8; and (Y) after Stockholder Approval, the Liquidation Value plus all accrued and unpaid dividends with respect to such shares, whether or not declared, or (ii) to the holders of shares of capital stock ranking on a parity with the Series B Convertible Preferred Stock as to dividends, redemption payments and rights upon liquidation, dissolution or winding up of the Corporation, except distributions made ratably on the Series B Convertible Preferred Stock and all such parity stock in proportion to the total amounts to which the holders of all such shares are entitled upon such liquidation, dissolution or winding up.

(c) Neither the consolidation, merger or other business combination of the Corporation with or into any other Person or Persons nor the sale of all or substantially all of the assets of the Corporation shall be deemed to be a liquidation, dissolution or winding up of the Corporation for purposes of this Section 7.

Section 8. Conversion. Subject to the condition that the Stockholder Approval shall first have been obtained, each share of Series B Convertible Preferred Stock shall be convertible, at any time, at the option of the holder thereof into the right to receive shares of Common Stock, on the terms and conditions set forth in this Section 8.

(a) Subject to the provisions for adjustment hereinafter set forth, each share of Series B Convertible Preferred Stock shall be converted into the right to receive a number of fully paid and nonassessable shares of Common Stock, which shall be equal to the Liquidation Value divided by the Conversion Price, as herein defined. Initially the Conversion Price shall be 127% of \$ .2/ The Conversion Price shall be subject to adjustment as provided in this Section 8.

(b) The Conversion Price shall be subject to adjustment from time to time as follows:

(i) In case the Corporation shall at any time or from time to time declare a dividend, or make a distribution, on the outstanding shares of Common Stock in shares of Common Stock or subdivide or reclassify the outstanding shares of Common Stock into a greater number of shares or combine or reclassify the outstanding shares of Common Stock into a smaller number of shares of Common Stock, or shall declare, order, pay or make a dividend or other distribution on any other class or series of capital stock, which dividend or distribution includes Common Stock then, and in each such case, the Conversion Price shall be adjusted to equal the number determined by multiplying (A) the Conversion Price immediately prior to such adjustment by (B) a fraction, the denominator of which shall be the number of shares of Common Stock outstanding immediately after such dividend, distribution, subdivision or reclassification, and the numerator of which shall be the number of shares of Common Stock outstanding immediately before such dividend, distribution, subdivision or reclassification. An adjustment made pursuant to this clause (i) shall become effective (A) in the case of any such dividend or distribution, immediately after the close of business on the record date for the determination of holders of shares of Common Stock entitled to receive such dividend or distribution, or (B) in the case of any such subdivision, reclassification or combination, at the close of business on the day upon which such corporate action becomes effective.



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(ii) In case the Corporation shall at any time or from time to time declare, order, pay or make a dividend or other distribution (including, without limitation, any distribution of stock, evidences of indebtedness or other securities, cash or other property or rights or warrants to subscribe for securities of

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/2/ The blank will be filled with an amount equal to the Average Parent Price, as defined in the Amended and Restated Agreement and Plan of Merger.

7

the Corporation or any of its Subsidiaries by way of distribution, dividend or spinoff, but excluding regular ordinary cash dividends as may be declared from time to time by the Corporation) on its Common Stock, other than a distribution or dividend of shares of Common Stock that is referred to in clause (i) of this paragraph (b), then, and in each such case, the Conversion Price shall be adjusted to equal the number determined by multiplying (A) the Conversion Price immediately prior to the record date fixed for the determination of stockholders entitled to receive such dividend or distribution by (B) a fraction, the denominator of which shall be the Current Market Price per share of Common Stock on the last Trading Day on which purchasers of Common Stock in regular way trading would be entitled to receive such dividend or distribution and the numerator of which shall be the Current Market Price per share of Common Stock on the first Trading Day on which purchasers of Common Stock in regular way trading would not be entitled to receive such dividend or distribution (the "Ex-dividend Date"); provided that the fraction determined by the foregoing clause (B) shall not be greater than 1. An adjustment made pursuant to this clause (ii) shall be effective at the close of business on the Ex-dividend Date. If the Corporation completes a tender offer or otherwise repurchases shares of Common Stock in a single transaction or a related series of transactions, provided such tender offer or offer to repurchase is open to all or substantially all holders of Common Stock (not including open market or other selective repurchase programs), the Conversion Price shall be adjusted as though (A) the Corporation had effected a reverse split of the Common Stock to reduce the number of shares of Common Stock outstanding from (x) the number outstanding immediately prior to the completion of the tender offer or the first repurchase for which the adjustment is being made to (y) the number outstanding immediately after the completion of the tender offer or the last repurchase for which the adjustment is being made and (B) the Corporation had paid a dividend on the Common Stock outstanding immediately after completion of the tender offer or the last repurchase for which the adjustment is being made in an aggregate amount equal to the aggregate consideration paid by the Corporation pursuant to the tender offer or the repurchases for which the adjustment is being made (the "Aggregate Consideration"); provided that in no event shall the Conversion Price be increased as a result of the foregoing adjustment. In applying the first two sentences of this Section 8(b)(ii) to the event described in clause (B) of the preceding sentence, the Current Market Price of the Common Stock on the date immediately following the closing of any such tender offer or on the date of the last repurchase shall be taken as the value of the Common Stock on the Ex-dividend Date, and the value of the Common Stock on the day preceding the Ex-dividend Date shall be assumed to be equal to the sum of (x) the value on the Ex-dividend Date and (y) the per share amount of the dividend described in such clause (B) computed by dividing the Aggregate Consideration by the number of shares of Common Stock outstanding after the completion of such tender offer or repurchase. In the event that any of the consideration paid by the Corporation in any tender offer or repurchase to which this Section 8(b)(ii) applies is in a form other than cash, the value of such consideration shall be determined by an independent investment banking firm of nationally recognized standing to be selected by the Board of Directors of the Corporation.

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(iii) In case at any time the Corporation shall be a party to any transaction (including, without limitation, a merger, consolidation, sale of all or substantially all of the Corporation's assets, liquidation or recapitalization (other than solely a change in the par value of equity securities) of the Common Stock and excluding any transaction to which clause (i) or (ii) of this paragraph (b) applies) in which the previously outstanding Common Stock shall be changed into or exchanged for different securities of the Corporation or common stock or other securities of another corporation or interests in a noncorporate entity or other property (including cash) or any combination of any of the foregoing (each such transaction being herein called the "Transaction"), then each share of Series B Convertible Preferred Stock then outstanding shall thereafter be convertible into, in lieu of the Common Stock issuable upon such conversion prior to consummation of such Transaction, the kind and amount of shares of stock and other securities and property receivable (including cash) upon the consummation of such Transaction by a holder of that number of shares of Common Stock into which one share of Series B Convertible Preferred Stock would have been convertible (without giving effect to any restriction on convertibility) immediately prior to such Transaction including, on a pro rata basis, the cash, securities or property received by holders of Common Stock in any such transaction. The Corporation shall not be a party to a Transaction that does not expressly contemplate and provide for the foregoing.

8

(iv) If any event occurs as to which the foregoing provisions of this Section 8(b) are not strictly applicable but the failure to make any adjustment to the Conversion Price or other conversion mechanics would not fully and equitably protect the conversion rights of the Series B Preferred Stock in accordance with the essential intent and principles of such provisions, then in each such case the Board of Directors of the Corporation shall make such appropriate adjustments to the Conversion Price or other conversion mechanics (on a basis consistent with the essential intent and principles established in this Section 8) as may be necessary to fully and equitably preserve, without dilution or diminution, the conversion rights of the Series B Convertible Preferred Stock.

(c) If any adjustment required pursuant to this Section 8 would result in an increase or decrease of less than 1% in the Conversion Price, the amount of any such adjustment shall be carried forward and adjustment with respect thereto shall be made at the time of and together with any subsequent adjustment, which, together with such amount and any other amount or amounts so carried forward, shall aggregate at least 1% of the Conversion Price.

(d) The Board of Directors may at its option increase the number of shares of Common Stock into which each share of Series B Convertible Preferred Stock may be converted, in addition to the adjustments required by this Section 8, as shall be determined by it (as evidenced by a resolution of the Board of Directors) to be advisable in order to avoid or diminish any income deemed to be received by any holder for federal income tax purposes of shares of Common Stock or Series B Convertible Preferred Stock resulting from any events or occurrences giving rise to adjustments pursuant to this Section 8 or from any other similar event.

(e) The holder of any shares of Series B Convertible Preferred Stock may exercise his right to receive in respect of such shares the shares of Common Stock or other property or securities, as the case may be, to which such holder is entitled by surrendering for such purpose to the Corporation, at its principal office or at such other office or agency maintained by the

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Corporation for that purpose, a certificate or certificates representing the shares of Series B Convertible Preferred Stock to be converted, accompanied by a written notice stating that such holder elects to convert all or a specified number of such shares in accordance with this Section 8 and specifying the name or names in which such holder wishes the certificate or certificates for shares of Common Stock or other property or securities, as the case may be, to which such holder is entitled to be issued and such other customary documents as are necessary to effect the conversion. In case such notice shall specify a name or names other than that of such holder, such notice shall be accompanied by payment of all transfer taxes payable upon the issuance in such name or names of shares of Common Stock or other property or securities, as the case may be, to which such holder has become entitled. Other than such taxes, the Corporation will pay any and all issue and other taxes (other than taxes based on income) that may be payable in respect of any issue or delivery of shares of Common Stock or such other property or securities, as the case may be, to which such holder has become entitled on conversion of Series B Convertible Preferred Stock pursuant hereto. As promptly as practicable, and in any event within five (5) business days after the surrender of such certificate or certificates and the receipt of such notice relating thereto and, if applicable, payment of all transfer taxes (or the demonstration to the satisfaction of the Corporation that such taxes have been paid), the Corporation shall deliver or cause to be delivered certificates representing the number of validlght">-

52

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52

Dividends paid on common shares

(211  
)

(292  
)

-

-

-

-

(503  
)

-

(503  
)

Dividend withholding tax reduction

-

1

-

-

-

-

1

-

1

Coupons on non-cumulative subordinated notes

-

(28

)

-

-

-

-

(28

)

-

(28

)

**Coupons on perpetual securities**

-

(111

)

-

-

-

-

(111

)

-

(111  
)

Share options and incentive plans

-

(7  
)

-

-

-

(27  
)

(33  
)

-

(33  
)

**At end of period**

**8,387**

**8,075**

**6,471**

(1,532  
)

1,283

3,800

26,485

9

26,494

<sup>1</sup> For a breakdown of share capital please refer to note 17.

<sup>2</sup> Issued capital and reserves attributable to equity holders of Aegon N.V.

Amounts for 2015 have been restated to reflect the voluntary change in accounting policies for deferred cost of reinsurance that was adopted by Aegon effective January 1, 2016. Furthermore a voluntary change in insurance accounting for business in United Kingdom was adopted by Aegon effective January 1, 2016 as well. Refer to note 2.1 Voluntary changes in accounting policies for details about these changes.

Unaudited

**Table of Contents****6 Condensed Consolidated Interim Financial Statements Q4 2016****Condensed consolidated cash flow statement**

<i>EUR millions</i>	FY 2016	FY 2015
<b>Cash flow from operating activities</b>	<b>3,311</b>	<b>914</b>
Purchases and disposals of intangible assets	(22)	(52)
Purchases and disposals of equipment and other assets	(66)	(83)
Purchases, disposals and dividends of subsidiaries, associates and joint ventures	(990)	749
<b>Cash flow from investing activities</b>	<b>(1,078)</b>	<b>615</b>
Issuance and purchase of (treasury) shares	(623)	(213)
Dividends paid	(306)	(292)
Issuances, repurchases and coupons of perpetuals	(140)	(148)
Issuances, repurchases and coupons of non-cumulative subordinated notes	(38)	(38)
Issuances and repurchases subordinated perpetual liabilities (participations)	8	-
Issuances and repayments of borrowings	641	(2,095)
<b>Cash flow from financing activities</b>	<b>(457)</b>	<b>(2,785)</b>
<b>Net increase / (decrease) in cash and cash equivalents</b>	<b>1,776</b>	<b>(1,257)</b>
Net cash and cash equivalents at January 1	9,593	10,649
Effects of changes in foreign exchange rates	(23)	200
<b>Net cash and cash equivalents at end of period</b>	<b>11,346</b>	<b>9,593</b>
Cash and cash equivalents	11,347	9,594
Cash and cash equivalents classified as Assets held for sale	-	-
Bank overdrafts classified as other liabilities	(1)	-
<b>Net cash and cash equivalents</b>	<b>11,346</b>	<b>9,593</b>

Unaudited



**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

7

**Notes to the Condensed consolidated interim financial statements****Amounts in EUR millions, unless otherwise stated**

Aegon N.V., incorporated and domiciled in the Netherlands, is a public limited liability company organized under Dutch law and recorded in the Commercial Register of The Hague under number 27076669 and with its registered address at Aegonplein 50, 2591 TV, The Hague, the Netherlands. Aegon N.V. serves as the holding company for the Aegon Group and has listings of its common shares in Amsterdam and New York.

Aegon N.V. (or the Company) and its subsidiaries (Aegon or the Group) have life insurance and pensions operations in more than 20 countries in the Americas, Europe and Asia and are also active in savings and asset management operations, accident and health insurance, general insurance and to a limited extent banking operations. Headquarters are located in The Hague, the Netherlands. The Group employs over 29,000 people worldwide.

**1. Basis of presentation**

The Condensed consolidated interim financial statements as at, and for the three months period and year ended, December 31, 2016, have been prepared in accordance with IAS 34 Interim Financial Reporting, as adopted by the European Union (hereafter IFRS). They do not include all of the information required for a full set of financial statements prepared in accordance with IFRS and should therefore be read together with the 2015 consolidated financial statements of Aegon N.V. as included in Aegon's Annual Report for 2015 and the disclosures provided in note 2.1 of this report which disclose the impact of voluntary changes in accounting policies that were made by Aegon effective January 1, 2016. Aegon's Annual Report for 2015 is available on its website (aegon.com).

The Condensed consolidated interim financial statements have been prepared in accordance with the historical cost convention as modified by the revaluation of investment properties and those financial instruments (including derivatives) and financial liabilities that have been measured at fair value. Certain amounts in prior periods may have been reclassified to conform to the current year presentation. Except for the voluntary accounting changes implemented as of the first of January 2016, these reclassifications had no effect on net income, shareholders' equity or earnings per share. The Condensed consolidated interim financial statements as at, and for the period ended December 31, 2016, were approved by the Executive Board on February 16, 2017.

The Condensed consolidated interim financial statements are presented in euro (EUR) and all values are rounded to the nearest million unless otherwise stated. The consequence is that the rounded amounts may not add up to the rounded total in all cases.

The published figures in these Condensed consolidated interim financial statements are unaudited.

Unaudited

**Table of Contents**

8	Condensed Consolidated Interim Financial Statements Q4 2016
---	---

**2. Significant accounting policies**

All accounting policies and methods of computation applied in the Condensed consolidated interim financial statements are the same as those applied in the 2015 consolidated financial statements, except for the newly applied accounting policies as described in note 2.1.

*New IFRS accounting standards effective*

The following standards, interpretations, amendments to standards and interpretations became effective in 2016:

- t IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception;
- t IFRS 11 Joint Arrangements Amendment Accounting for Acquisition of Interests in Joint Operations;
- t IFRS 14 Regulatory Deferral Accounts;
- t IAS 1 Amendment Disclosure Initiative;
- t IAS 27 Separate Financial Statements Amendment Equity method in Separate Financial Statements;
- t IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortization;
- t Annual improvements 2012-2014 Cycle.

None of these revised standards and interpretations had a significant effect on the Condensed consolidated interim financial statements as at and for the three months period and year ended December 31, 2016.

For a complete overview of IFRS standards, published before January 1, 2016, that will be applied in future years, and were not early adopted by the Group, please refer to Aegon's Annual Report for 2015.

*Future adoption of IFRS accounting standards*

The IASB has issued an amendment related to IFRS 4 Insurance Contracts. The objective of these amendments is to address the temporary accounting consequences of the different effective dates of IFRS 9 - Financial Instruments and the forthcoming insurance contracts Standard. The amendments permit entities whose predominant activities are connected with insurance, to defer the application of IFRS 9 until 2021 (the temporary exemption); and permit all issuers of insurance contracts to recognise in other comprehensive income, rather than profit or loss, the volatility that could arise when IFRS 9 is applied before the new insurance contracts Standard is issued (the overlay approach). Aegon has decided to make use of the temporary exemption to defer the application of IFRS 9 until 2021, as it meets the underlying qualifying criteria for doing so.

For these amendments EFRAG has issued a positive endorsement advice to the EU and expects the EU to come to a final endorsement decision in 2017.

*Taxes*

Taxes on income for the year, ended December 31, 2016, are calculated using the tax rate that is estimated to be applicable to total annual earnings.

*Judgments and critical accounting estimates*

Preparing the Condensed consolidated interim financial statements requires management to make judgments, estimates and assumptions, including the likelihood, timing or amount of future transactions or events, that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from the estimates made.

In preparing the Condensed consolidated interim financial statements, significant judgments made by management in applying the Group's accounting policies and the key sources of estimating uncertainty were not significantly different than those that were applied to the consolidated financial statements as at and for the year ended December 31, 2015, other than mentioned in the following paragraph Actuarial assumptions and model updates .

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

9

*Actuarial assumption and model updates*

Actuarial assumptions are reviewed and updated periodically, typically in the third quarter, based on historical experience and observable market data, including market transactions such as acquisitions and reinsurance transactions. As of Q3 2016 reporting of assumption updates has been changed in Aegon's segment reporting. The results from assumption updates will be reported as part of Other income / (charges), refer to note 3.2. Performance measure.

*Exchange rates*

Assets and liabilities are translated at the closing rates on the reporting date. Income, expenses and capital transactions (such as dividends) are translated at average exchange rates or at the prevailing rates on the transaction date, if more appropriate. The following exchange rates are applied for the Condensed consolidated interim financial statements:

## Closing exchange rates

			USD	GBP
December 31, 2016	1	EUR	1.0548	0.8536
December 31, 2015	1	EUR	1.0863	0.7370
Weighted average exchange rates				

			USD	GBP
Year ended				
December 31, 2016	1	EUR	1.1069	0.8187
Year ended				
December 31, 2015	1	EUR	1.1100	0.7256

**2.1 Voluntary changes in accounting policies**

On January 13, 2016, Aegon adopted voluntary changes in accounting policies, effective January 1, 2016, which are applied retrospectively for all periods presented. Firstly, Aegon adopted a group-wide accounting policy for reinsurance transactions that are entered into as part of a plan to exit a business. Also, Aegon made two voluntary accounting policy changes that better reflect its business strategy after restructuring in the United Kingdom. The changes in the United Kingdom do not impact other reporting units within Aegon as these are changes specific to Aegon UK. However, these changes do increase alignment with other reporting units within Aegon.

In the paragraphs below, details are provided for the changes in accounting policies including the impact on shareholders equity and net income.

[Accounting related to certain reinsurance transactions](#)

Aegon adopted one single group-wide accounting policy for reinsurance transactions that are entered into as part of a plan to exit a business. The previous accounting policy recorded a deferred cost of reinsurance which was subsequently amortized. Under the new accounting policy, when the Company enters into a reinsurance contract as part of a plan to exit a business, an immediate gain or loss will be recognized in the income statement.

For purposes of this accounting policy, a business is defined as designated insurance liabilities to be disposed of through reinsurance transactions . The insurance liabilities are designated according to their homogenous risk profiles, possible examples include but are not limited to geographical area, product type, distribution channel, policyholder profiles, and policy form or riders.

Unaudited

**Table of Contents**

10	Condensed Consolidated Interim Financial Statements Q4 2016
----	---

The accounting policy on Deferred cost of reinsurance effective as of January 1, 2016 is as follows:

A deferred cost of reinsurance is established when Aegon enters into a reinsurance transaction, except for reinsurance transactions that are entered into as part of a plan to exit a business. When Aegon enters into a reinsurance contract as part of a plan to exit a business, an immediate loss is recognized in the income statement. Upon reinsurance, Aegon is not relieved of its legal liabilities, so the reserves relating to the underlying reinsured contracts will continue to be reported in the consolidated statement of financial position during the contractual term of the underlying contracts.

When losses on buying reinsurance are deferred, the amortization is based on the assumptions of the underlying insurance contracts. The amortization is recognized in the income statement.

#### **Insurance accounting for business in United Kingdom**

In January 2016, Aegon announced the restructuring of its business and operations in the UK. This involves splitting the Aegon UK business into three components: the annuity business, the traditional pension book and the new digital solutions platform. By extracting the digital solutions platform from the rest of the business, management aims to ensure the focus and separate culture required to successfully build a viable and sustainably growing business over the longer term.

Aegon adopts two voluntary accounting policy changes that better reflect its business strategy after restructuring in the United Kingdom, only affecting Aegon UK. The changes involve the aggregation level at which the liability adequacy test is carried out and the definition of when a substantially modified contract will be derecognized.

The adjusted accounting policy effective on Liability adequacy testing as of January 1, 2016 for Aegon as a group and including insurance accounting for business in United Kingdom is as follows:

At each reporting date, the adequacy of the life insurance liabilities (including life insurance contracts for account of policyholders), net of VOBA (Value of business acquired) and DPAC (Deferred policy acquisition costs), is assessed using a liability adequacy test.

All tests performed within the Group are based on current estimates of all contractual future cash flows, including related cash flows from policyholder options and guarantees. A number of valuation methods are applied, including discounted cash flow methods, option pricing models and stochastic modelling. Aggregation levels are set either on geographical jurisdiction or at the level of portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio. Specifically, in the Netherlands the liability adequacy test is performed on a consolidated basis for all life and non-life business, whereas in the Americas and the UK it is performed at the level of the portfolio of contracts. To the extent that the tests involve discounting of future cash flows, the interest rate applied is based on market rates or is based on management's expectation of the future return on investments. These future returns on investments take into account management's best estimate related to the actual investments and, where applicable, reinvestments of these investments at maturity. Aegon the Netherlands, as required locally, adjusts the outcome of the liability adequacy test for the difference between the fair value and the book value of the assets that are

measured at amortized cost in the balance sheet.

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

11

To the extent that the account balances are insufficient to meet future benefits and expenses, any resulting deficiency is recognized in the income statement, initially by impairing the DPAC and VOBA and subsequently by establishing an insurance liability for the remaining loss, unless shadow loss recognition has taken place. In the Netherlands, in situations where market interest rates for the valuation of debt securities leads to a change in the revaluation reserve, and where the result of using the same assumptions for the liabilities could lead to a deficiency in the liability adequacy test that should be recognized in the income statement, shadow loss recognition is applied. Shadow loss recognition is applied to the extent that the deficiency of the insurance liabilities relates to the revaluation of debt securities as a result of movements in interest rates, the addition to the insurance liabilities is then off set against the revaluation reserve. If in subsequent periods such a deficiency of the insurance liability is no longer applicable, shadow loss recognition is reversed via the revaluation reserve.

The adequacy of the non-life insurance liability is tested at each reporting date. Changes in expected claims that have occurred, but that have not been settled, are reflected by adjusting the liability for claims and future benefits. The reserve for unexpired risk is increased to the extent that the future claims and expenses in respect of current insurance contracts exceed the future premiums plus the current unearned premium reserve.

*Level of aggregation*

The previous accounting policy for the level of aggregation for the liability adequacy test in the United Kingdom was on a geographical basis, therefore the total Aegon UK book was considered as one population. After the announced restructuring, Aegon's business in the United Kingdom has been split into different portfolios that are managed independently from one another. Management is of the opinion that the liability adequacy test should be disaggregated to a portfolio level to reflect this change in strategy. This change in the definition of portfolio for Aegon UK better aligns with other reporting units in the Group where insurance contracts are grouped consistent with the Company's manner of acquiring, servicing and measuring the profitability of its insurance contracts.

*Substantial modification*

The previous accounting policy for Aegon's business in the United Kingdom is to derecognize insurance contracts when legal extinguishment occurs. As the annuity business, the traditional pension book and the new digital solutions platform will be managed separately post-restructuring, Aegon has decided to change its accounting policy for Aegon UK to one that considers criteria from IAS 39 contract modification. Under these criteria a change should be significant enough to be considered an extinguishment of the existing contract and the issuance of a new contract. Aegon considers that this change in accounting policy is preferred as introducing a more sophisticated approach to contract modification is consistent with how the business will be managed post-restructuring. Furthermore, it will provide the user with information that is more relevant and that reliably reflects the economic substance of our transactions with our upgraded policyholders, as required by IFRS 4 and IAS 8, in relation to the nature of contract modifications. The change in accounting policy on Substantial modification effective as of January 1, 2016 is as follows: Within the United States, the Netherlands and the United Kingdom, substantially modified contracts are accounted for as extinguishment of the original liability and the recognition of a new liability.



Unaudited

**Table of Contents**

## 12 Condensed Consolidated Interim Financial Statements Q4 2016

Details of the impact of the adjustments on comparative periods are provided in the following tables:

**Impact of voluntary changes in accounting policies on condensed consolidated income statement**

		FY 2015 (as previously reported)	<sup>1</sup> Change in accounting policy		FY 2015 (restated)
	Notes		Deferred cost of reinsurance	Insurance accounting in UK	
<i>EUR millions</i>					
Premium income	4	20,311	-	2,614	22,925
Benefits and expenses	8	33,325	(36)	2,763	36,052
Impairment charges / (reversals)	9	(22)	-	1,274	1,251
Income tax (expense) / benefit		(134)	(26)	270	111
<b>Impact on net income</b>			<b>10</b>	<b>(1,153)</b>	
<b>Earnings per share (EUR per share)</b>	17				
Basic earnings per common share		0.23	-	(0.54)	(0.31)
Basic earnings per common share B		0.01	-	(0.01)	(0.01)
Diluted earnings per common share		0.23	-	(0.54)	(0.31)
Diluted earnings per common share B		0.01	-	(0.01)	(0.01)
<b>Earnings per share calculation</b>	17				
Net income / (loss) attributable to equity holders of Aegon N.V.		619	10	(1,153)	(524)
Coupons on other equity instruments		(139)	-	-	(139)
Earnings attributable to common shares and common shares B		479	10	(1,153)	(663)
Weighted average number of common shares outstanding (in million)		2,101	-	-	2,101
Weighted average number of common shares B outstanding (in million)		584	-	-	584

<sup>1</sup>As reported in Aegon's 2015 Annual Report dated March 25, 2016.

### Impact of voluntary changes in accounting policies on condensed consolidated income statement

		Q4 2015 (as previously reported)		Q4 2015 (restated)	
		Change in accounting policy		Insurance	
	Notes	Deferred cost of reinsurance	accounting in UK		
<i>EUR millions</i>					
Premium income	4	4,901	-	508	5,409
Benefits and expenses	8	13,305	(7)	541	13,839
Impairment charges / (reversals)	9	(40)	-	1,274	1,234
Income tax (expense) / benefit		(52)	(6)	247	189
<b>Impact on net income</b>			<b>1</b>	<b>(1,059)</b>	
<b>Earnings per share (EUR per share)</b>	17				
Basic earnings per common share		0.21	-	(0.50)	(0.29)
Basic earnings per common share B		0.01	-	(0.01)	(0.01)
Diluted earnings per common share		0.21	-	(0.50)	(0.29)
Diluted earnings per common share B		0.01	-	(0.01)	(0.01)
<b>Earnings per share calculation</b>	17				
Net income / (loss) attributable to equity holders of Aegon N.V.		477	1	(1,059)	(581)
Coupons on other equity instruments		(35)	-	-	(35)
Earnings attributable to common shares and common shares B		442	1	(1,059)	(616)
Weighted average number of common shares outstanding (in million)		2,109	-	-	2,109
Weighted average number of common shares B outstanding (in million)		585	-	-	585

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

13

**Impact of voluntary changes in accounting policies on condensed consolidated statement of comprehensive income**

	FY 2015 (as previously reported)	<sup>1)</sup> Change in accounting policy		FY 2015 (restated)
		Deferred cost of reinsurance	Insurance accounting in UK	
<i>EUR millions</i>				
Net income	619	10	(1,153)	(523)
<b>Items that may be reclassified subsequently to profit or loss:</b>				
Movement in foreign currency translation and net foreign investment hedging reserves	1,414	(12)	18	1,419
<b>Impact on comprehensive income</b>		<b>(2)</b>	<b>(1,135)</b>	
<b>Total comprehensive income / (loss) attributable to:</b>				
Equity holders of Aegon N.V.	234	(2)	(1,135)	(903)
Non-controlling interests	-	-	-	-

<sup>1</sup> As reported in Aegon's 2015 Annual Report dated March 25, 2016.**Impact of voluntary changes in accounting policies on condensed consolidated statement of comprehensive income**

	Q4 2015 (as previously reported)	Change in accounting policy		Q4 2015 (restated)
		Deferred cost of reinsurance	Insurance accounting in UK	
<i>EUR millions</i>				
Net income	478	1	(1,059)	(580)

**Items that may be reclassified subsequently to profit or loss:**

Movement in foreign currency translation and net foreign investment hedging reserves	337	(3)	17	350
<b>Impact on comprehensive income</b>		<b>(2)</b>	<b>(1,042)</b>	
<b>Total comprehensive income / (loss) attributable to:</b>				
Equity holders of Aegon N.V.	(129)	(2)	(1,042)	(1,174)
Non-controlling interests	1	-	-	1

Unaudited

**Table of Contents**

14	Condensed Consolidated Interim Financial Statements Q4 2016
----	---

**Impact of voluntary changes in accounting policies on the condensed consolidated statement of financial position**

		December 31, 2015 (as previously reported) <sup>1)</sup>	Change in accounting policy Insurance Deferred cost of reinsurance	accounting in UK	December 31, 2015 (restated)
<i>EUR millions</i>	Notes				
<b>Assets</b>					
Intangible assets	11	2,110	-	(210)	1,901
Deferred expenses	16	12,547	(358)	(1,192)	10,997
<b>Equity and liabilities</b>					
Shareholders' equity		23,931	(112)	(1,135)	22,684
Insurance contracts		123,042	-	-	123,042
Investment contracts		17,718	-	-	17,718
Other liabilities		21,940	(247)	(266)	21,427

<sup>1)</sup> As reported in Aegon's 2015 Annual Report dated March 25, 2016.

**Impact of voluntary changes in accounting policies on condensed consolidated statement of changes in equity**

		December 31, 2015 (as previously reported) <sup>1)</sup>	Change in accounting policy Insurance Deferred cost of reinsurance	accounting in UK	December 31, 2015 (restated)
<i>EUR millions</i>					
Share capital		8,387	-	-	8,387
Retained earnings		9,319	(91)	(1,153)	8,075
Revaluation reserves		6,471	-	-	6,471

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Remeasurement of defined benefit plans	(1,532)	-	-	(1,532)
Other reserves	1,286	(21)	18	1,283
<b>Shareholders' equity</b>	<b>23,931</b>	<b>(112)</b>	<b>(1,135)</b>	<b>22,684</b>

<sup>1</sup> As reported in Aegon's 2015 Annual Report dated March 25, 2016.

Unaudited

Table of Contents

Condensed Consolidated Interim Financial Statements Q4 2016

15

**3. Segment information****3.1 Income statement**

The following table presents Aegon's segment results after reflecting the voluntary changes in accounting policies (as presented in note 2.1) that came into effect as of January 1, 2016 and the impact of the change in the measurement of actuarial and economic assumption updates, as described in 3.2 and implemented in Q3 2016. Also refer to paragraph 3.4 for an overview of the impact on the comparative numbers of the changes in Aegon's segment reporting in 2016.

	Americas	Netherlands	Kingdom	Europe	Portugal	Europe	Asia	Management	Eliminations	Eliminations	Joint ventures and associates	Consolidated	
<i>EUR millions</i>													
<b>Three months ended December 31, 2016</b>													
<b>Underlying earnings before tax</b>	<b>388</b>	<b>134</b>	<b>23</b>	<b>14</b>	<b>3</b>	<b>174</b>	<b>13</b>	<b>35</b>	<b>(54)</b>	<b>(3)</b>	<b>554</b>	<b>17</b>	<b>571</b>
Fair value items	(226)	202	(31)	-	(1)	171	(11)	-	53	-	(13)	(22)	(35)
Realized gains / (losses) on investments	(18)	47	4	-	1	52	2	-	-	-	36	(1)	35
Impairment charges	(3)	(8)	-	(1)	-	(9)	-	(5)	-	-	(17)	-	(17)
Impairment reversals	8	8	-	-	-	8	-	-	-	-	16	-	16
Other income / (charges)	(27)	34	(20)	(23)	-	(9)	-	(1)	(1)	-	(38)	-	(38)
Run-off businesses	(1)	-	-	-	-	-	-	-	-	-	(1)	-	(1)
<b>Income / (loss) before</b>	<b>121</b>	<b>418</b>	<b>(24)</b>	<b>(10)</b>	<b>3</b>	<b>387</b>	<b>5</b>	<b>28</b>	<b>(2)</b>	<b>(3)</b>	<b>536</b>	<b>(5)</b>	<b>531</b>



<b>tax</b>													
Income tax (expense) / benefit	35	(91)	19	(8)	(2)	(81)	(14)	(10)	4	-	(66)	5	(61)
<b>Net income / (loss)</b>	<b>157</b>	<b>326</b>	<b>(4)</b>	<b>(18)</b>	<b>1</b>	<b>306</b>	<b>(9)</b>	<b>18</b>	<b>2</b>	<b>(3)</b>	<b>470</b>	<b>-</b>	<b>470</b>
<i>Inter-segment underlying earnings</i>	(53)	(25)	(17)	(3)	-	(45)	18	60	20				
<b>Revenues</b>													
Life insurance gross premiums	1,958	400	2,739	102	58	3,299	309	-	-	(21)	5,546	(112)	5,433
Accident and health insurance	548	29	8	-	-	37	24	-	(4)	-	605	(1)	604
General insurance	-	36	-	44	23	103	-	-	1	(1)	103	(23)	80
<b>Total gross premiums</b>	<b>2,506</b>	<b>465</b>	<b>2,746</b>	<b>147</b>	<b>81</b>	<b>3,439</b>	<b>333</b>	<b>-</b>	<b>(2)</b>	<b>(22)</b>	<b>6,254</b>	<b>(137)</b>	<b>6,118</b>
Investment income	970	487	396	12	16	910	62	1	102	(101)	1,944	(16)	1,927
Fee and commission income	408	88	30	9	4	131	15	157	-	(62)	649	(42)	607
Other revenues	2	-	-	-	1	1	-	-	1	-	4	(1)	3
<b>Total revenues</b>	<b>3,886</b>	<b>1,040</b>	<b>3,172</b>	<b>168</b>	<b>101</b>	<b>4,482</b>	<b>410</b>	<b>157</b>	<b>101</b>	<b>(185)</b>	<b>8,851</b>	<b>(197)</b>	<b>8,654</b>
<i>Inter-segment revenues</i>	-	-	-	-	-	1	20	62	103				

											Joint		
	Central & Spain					Holding and			ventures and				
	The	United	Eastern	&		Asset	other		Segments	associates			
<i>EUR millions</i>	Americas	Netherlands	Kingdom	Europe	Portugal	Europe	Asia	Management	Eliminations	total	Eliminations	Consolidated	
<b>Three months ended December 31, 2015</b>													

<b>Underlying earnings before tax</b>	<b>291</b>	<b>135</b>	<b>(9)</b>	<b>13</b>	<b>3</b>	<b>142</b>	<b>3</b>	<b>38</b>	<b>(39)</b>	<b>-</b>	<b>435</b>	<b>8</b>	<b>443</b>
Fair value items	(64)	(71)	(28)	-	-	(99)	6	-	(1)	-	(159)	(15)	(174)

Realized gains / (losses) on investments	(22)	33	46	1	-	79	1	-	-	-	58	-	58
Impairment charges	(11)	(8)	-	(1)	-	(9)	-	-	-	-	(20)	(21)	(41)
Impairment reversals	83	2	-	-	-	2	-	-	-	-	84	-	84
Other income / (charges)	(10)	93	(1,260)	(2)	17	(1,152)	(18)	(1)	-	-	(1,181)	21	(1,160)
Run-off businesses	21	-	-	-	-	-	-	-	-	-	21	-	21
<b>Income / (loss) before tax</b>	<b>288</b>	<b>183</b>	<b>(1,251)</b>	<b>12</b>	<b>19</b>	<b>(1,038)</b>	<b>(8)</b>	<b>37</b>	<b>(40)</b>	<b>-</b>	<b>(762)</b>	<b>(7)</b>	<b>(769)</b>
Income tax (expense) / benefit	(43)	(43)	263	(2)	(1)	216	-	(12)	20	-	182	7	189
<b>Net income / (loss)</b>	<b>245</b>	<b>140</b>	<b>(988)</b>	<b>9</b>	<b>18</b>	<b>(821)</b>	<b>(8)</b>	<b>25</b>	<b>(20)</b>	<b>-</b>	<b>(580)</b>	<b>-</b>	<b>(580)</b>
<i>Inter-segment underlying earnings</i>	<i>(58)</i>	<i>(13)</i>	<i>(16)</i>	<i>(3)</i>	<i>-</i>	<i>(33)</i>	<i>19</i>	<i>70</i>	<i>2</i>				
<b>Revenues</b>													
Life insurance gross premiums	1,844	483	1,940	108	49	2,579	356	-	1	(27)	4,752	(106)	4,646
Accident and health insurance	560	36	10	-	-	47	23	-	2	(2)	630	(1)	629
General insurance	-	92	-	41	22	155	-	-	1	-	156	(22)	134
<b>Total gross premiums</b>	<b>2,404</b>	<b>612</b>	<b>1,950</b>	<b>149</b>	<b>71</b>	<b>2,781</b>	<b>379</b>	<b>-</b>	<b>4</b>	<b>(29)</b>	<b>5,538</b>	<b>(129)</b>	<b>5,409</b>
Investment income	919	558	612	11	10	1,191	53	1	102	(102)	2,165	(12)	2,153
Fee and commission income	417	91	24	9	4	127	12	173	-	(75)	654	(47)	607
Other revenues	1	-	-	-	1	-	-	(1)	5	-	5	(1)	3
<b>Total revenues</b>	<b>3,741</b>	<b>1,260</b>	<b>2,586</b>	<b>168</b>	<b>85</b>	<b>4,099</b>	<b>444</b>	<b>172</b>	<b>111</b>	<b>(206)</b>	<b>8,362</b>	<b>(188)</b>	<b>8,173</b>
<i>Inter-segment revenues</i>	<i>7</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>26</i>	<i>69</i>	<i>104</i>				

Unaudited

**Table of Contents**

## 16 Condensed Consolidated Interim Financial Statements Q4 2016

<i>EUR millions</i>	Americas	The Netherlands	Central & United Kingdom	Eastern Europe	Spain & Portugal	Europe	Management	Asset	other	Eliminations	Segment total	Joint ventures and associates	Consolidated
<b>Year ended December 31, 2016</b>													
<b>Underlying earnings before tax geographically</b>	<b>1,249</b>	<b>534</b>	<b>59</b>	<b>55</b>	<b>8</b>	<b>655</b>	<b>21</b>	<b>149</b>	<b>(162)</b>	-	<b>1,913</b>	<b>48</b>	<b>1,960</b>
Fair value items	(521)	(33)	(7)	-	(1)	(41)	(9)	-	(74)	-	(645)	(72)	(717)
Realized gains / (losses) on investments	(13)	189	153	-	(1)	342	8	3	-	-	340	(6)	334
Impairment charges	(72)	(29)	-	1	-	(27)	(1)	(5)	(7)	1	(113)	-	(112)
Impairment reversals	42	17	-	-	-	17	-	-	-	(1)	58	-	58
Other income / (charges)	(100)	44	(678)	(23)	-	(658)	(5)	(2)	(6)	-	(771)	-	(771)
Run-off businesses	54	-	-	-	-	-	-	-	-	-	54	-	54
<b>Income / (loss) before tax</b>	<b>638</b>	<b>721</b>	<b>(474)</b>	<b>34</b>	<b>6</b>	<b>288</b>	<b>14</b>	<b>145</b>	<b>(249)</b>	-	<b>836</b>	<b>(31)</b>	<b>805</b>
Income tax expense) / benefit	(80)	(155)	18	(15)	(8)	(161)	(27)	(48)	65	-	(250)	31	(219)
<b>Net income / (loss)</b>	<b>558</b>	<b>566</b>	<b>(456)</b>	<b>19</b>	<b>(2)</b>	<b>127</b>	<b>(13)</b>	<b>97</b>	<b>(183)</b>	-	<b>586</b>	-	<b>586</b>
<b>Inter-segment underlying earnings</b>	<b>(194)</b>	<b>(95)</b>	<b>(87)</b>	<b>(14)</b>	<b>(1)</b>	<b>(197)</b>	<b>74</b>	<b>234</b>	<b>84</b>				
<b>Revenues</b>													
Life insurance gross premiums	7,363	2,015	9,888	399	191	12,493	1,121	-	6	(84)	20,898	(498)	20,400
Accident and health insurance	2,204	210	36	1	73	320	104	-	(4)	-	2,624	(15)	2,609
General insurance	-	266	-	179	92	536	-	-	5	(5)	536	(92)	444
	<b>9,567</b>	<b>2,491</b>	<b>9,924</b>	<b>578</b>	<b>355</b>	<b>13,348</b>	<b>1,225</b>	-	<b>7</b>	<b>(89)</b>	<b>24,058</b>	<b>(606)</b>	<b>23,453</b>

	Americas	The Netherlands	Central & Eastern Europe	Spain & Portugal	Europe	Management	Active	Eliminations	Segment total	Joint ventures and associates	Consolidated		
<b>Total gross premiums</b>													
Investment income	3,717	2,135	1,661	45	45	3,886	232	3	406	(403)	7,841	(54)	7,788
Fee and commission income	1,651	350	95	36	14	495	61	632	-	(242)	2,596	(188)	2,408
Other revenues	4	-	-	-	2	2	-	1	3	-	11	(4)	7
<b>Total revenues</b>	<b>14,940</b>	<b>4,976</b>	<b>11,680</b>	<b>659</b>	<b>416</b>	<b>17,732</b>	<b>1,517</b>	<b>636</b>	<b>416</b>	<b>(734)</b>	<b>34,507</b>	<b>(852)</b>	<b>33,655</b>
Inter-segment revenues	-	3	-	-	-	3	79	243	409				
<i>EUR millions</i>													
<b>Year ended December 31, 2015</b>													
<b>Underlying earnings before tax geographically</b>	<b>1,278</b>	<b>537</b>	<b>(27)</b>	<b>37</b>	<b>12</b>	<b>559</b>	<b>20</b>	<b>170</b>	<b>(163)</b>	<b>2</b>	<b>1,867</b>	<b>34</b>	<b>1,901</b>
Fair value items	(691)	7	(25)	-	-	(18)	7	-	(68)	-	(771)	(59)	(830)
Realized gains / (losses) on investments	(74)	306	103	2	-	411	7	3	-	-	346	(8)	338
Impairment charges	(43)	(25)	-	(2)	-	(27)	-	-	-	-	(70)	(21)	(91)
Impairment reversals	114	5	-	-	-	5	-	-	-	-	119	-	119
Other income / (charges)	(913)	27	(1,247)	(2)	17	(1,205)	(61)	(1)	-	-	(2,180)	21	(2,159)
Run-off businesses	88	-	-	-	-	-	-	-	-	-	88	-	88
<b>Income / (loss) before tax</b>	<b>(241)</b>	<b>857</b>	<b>(1,196)</b>	<b>35</b>	<b>29</b>	<b>(275)</b>	<b>(27)</b>	<b>172</b>	<b>(230)</b>	<b>2</b>	<b>(601)</b>	<b>(33)</b>	<b>(634)</b>
Income tax expense) / benefit	6	(196)	268	(11)	(7)	54	(3)	(50)	71	-	78	33	111
<b>Net income / (loss)</b>	<b>(235)</b>	<b>661</b>	<b>(928)</b>	<b>24</b>	<b>22</b>	<b>(221)</b>	<b>(30)</b>	<b>121</b>	<b>(159)</b>	<b>2</b>	<b>(523)</b>	<b>-</b>	<b>(523)</b>
Inter-segment underlying earnings	(220)	(55)	(63)	(14)	-	(131)	77	264	10				
<b>Revenues</b>													
Life insurance gross premiums	7,046	2,240	8,465	477	174	11,356	1,713	-	4	(106)	20,013	(431)	19,583
Accident and health insurance	2,266	234	47	1	64	345	105	-	6	(6)	2,717	(14)	2,703
General insurance	-	473	-	164	80	717	-	-	2	-	720	(80)	640
	<b>9,312</b>	<b>2,947</b>	<b>8,512</b>	<b>642</b>	<b>317</b>	<b>12,419</b>	<b>1,819</b>	<b>-</b>	<b>13</b>	<b>(112)</b>	<b>23,450</b>	<b>(524)</b>	<b>22,925</b>

<b>Total gross premiums</b>													
Investment income	3,680	2,277	2,331	45	41	4,693	194	7	392	(391)	8,576	(51)	8,525
Fee and commission income	1,704	351	98	39	13	501	62	650	-	(284)	2,633	(195)	2,438
Other revenues	9	-	-	-	2	2	-	-	7	-	19	(5)	14
<b>Total revenues</b>	<b>14,705</b>	<b>5,575</b>	<b>10,941</b>	<b>726</b>	<b>373</b>	<b>17,615</b>	<b>2,076</b>	<b>657</b>	<b>412</b>	<b>(787)</b>	<b>34,677</b>	<b>(775)</b>	<b>33,902</b>
Inter-segment revenues	24	2	-	-	-	2	101	261	399				
<i>Impact from 2016 assumption and model updates</i>													

In 2016 a charge of EUR 118 million (2015: EUR 131 million charge) has been recorded in other income/ (charges) in respect of model and assumption updates. The impact is mainly attributable to Aegon's business in the Americas and the Netherlands. Assumption changes and model updates in the Americas from long-term care led to a net negative impact of EUR 100 million. These were the result of experience updates including morbidity, termination rates and utilization assumptions. For the other business lines in the Americas, assumption changes and model updates largely offset each other. The main items were the refinement of modelling of crediting rates on indexed universal life policies and management actions, which together offset lower lapse assumptions on certain secondary guarantee universal life insurance blocks. A review of expenses led to an update of the expense assumption in VA Europe leading to a loss of DAC recoverability resulting in a EUR 31 million adverse impact. In the Netherlands, model updates in the guarantee provision resulted in a benefit of EUR 56 million.

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

17

**3.2 Performance measure**

Aegon's segment information is prepared by consolidating on a proportionate basis Aegon's joint ventures and associated companies.

*Performance measure*

A performance measure of reporting segments utilized by the Company is underlying earnings before tax. Underlying earnings before tax reflects Aegon's profit from underlying business operations and excludes components that relate to accounting mismatches that are dependent on market volatility, updates to best estimate actuarial and economic assumptions and model updates or events that are considered outside the normal course of business. As of Q3 2016 results from assumption updates will no longer be reported as part of underlying earnings but as part of Other income / (charges) refer to the paragraph below Change in measurement of Performance measure below.

Aegon believes that its performance measure, underlying earnings before tax, provides meaningful information about the underlying results of Aegon's business, including insight into the financial measures that Aegon's senior management uses in managing the business. Among other things, Aegon's senior management is compensated based in part on Aegon's results against targets using underlying earnings before tax. While many other insurers in Aegon's peer group present substantially similar performance measures, the performance measures presented in this document may nevertheless differ from the performance measures presented by other insurers. There is no standardized meaning to these measures under IFRS or any other recognized set of accounting standards.

The reconciliation from underlying earnings before tax to income before tax, being the most comparable IFRS measure, is presented in the tables in this note.

The items that are excluded from underlying earnings before tax as described further below are: fair value items, realized gain or losses on investments, impairment charges/reversals, other income or charges, run-off businesses and share in earnings of joint ventures and associates.

*Change in measurement of Performance measure*

As of Q3 2016, Aegon changed the measurement of underlying earnings before tax to exclude the impact of actuarial assumption updates. In addition, the impact from updates to actuarial assumptions, as well as model updates and updates to economic assumptions previously recorded in fair value items, are recorded in Other income / (charges) as of this quarter. The impact of assumption updates are reflected as part of other income/(charges) rather than as part of underlying earnings before tax or fair value items. Following this change all management best estimate assumptions, both actuarial and economic, will continue to be reflected in underlying earnings. However, updates to these assumptions, often representing the present value of multiple performance years, either retrospectively or prospectively, will not. Actuarial assumption updates result from experience studies or market observable data (e.g. third party expert judgments), which are usually performed on an annual basis. These experience studies and judgments may or may not result in resetting management's expectations in regard to actuarial assumptions (e.g.

mortality rates, lapse rates, expenses, management actions etc.), deviating from initial or historic assumptions applied in determining the Company's financial results. The impact of such updates could be either positive or negative on the Company's financial results. Since Q3 2015, management already reported the impact of model updates in other income/(charges). By presenting the impacts from assumption and model updates in one place, management believes it increases the transparency of Aegon's results.

Unaudited

**Table of Contents**

## 18 Condensed Consolidated Interim Financial Statements Q4 2016

For segment reporting purposes, the impact of this change in measurement for assumption updates on full year 2015 would have been an increase in Aegon Group consolidated underlying earnings before tax of EUR 77 million and a decrease in fair value items of EUR 151 million, resulting in an increase in other income/ (charges) of EUR 74 million. There is no impact on net income in any of the reporting periods. Comparative numbers have been restated in Aegon's segment reporting note, enabling a like for like comparison. The presentation of the items in the IFRS income statement will remain unchanged and continue to be part of the line "Policyholder claims and benefits". Refer to paragraph 3.4.3. for the impact for year ended December 31, 2015.

*Fair value items*

Fair value items include the over- or underperformance of investments and guarantees held at fair value for which the expected long-term return is included in underlying earnings before tax.

In addition, hedge ineffectiveness on hedge transactions, fair value changes on economic hedges without natural offset in earnings and for which no hedge accounting is applied and fair value movements on real estate are included under fair value items.

Certain assets held by Aegon are carried at fair value and managed on a total return basis, with no offsetting changes in the valuation of related liabilities. These include assets such as investments in hedge funds, private equities, real estate (limited partnerships), convertible bonds and structured products. Underlying earnings before tax exclude any over- or underperformance compared to management's long-term expected return on assets. Based on current holdings and asset returns, the long-term expected return on an annual basis is 8-10%, depending on asset class, including cash income and market value changes. The expected earnings from these asset classes are net of deferred policy acquisition costs (DPAC) where applicable.

In addition, certain products offered by Aegon Americas contain guarantees and are reported on a fair value basis and the total return annuities and guarantees on variable annuities. The earnings on these products are impacted by movements in equity markets and risk-free interest rates. Short-term developments in the financial markets may therefore cause volatility in earnings. Included in underlying earnings before tax is a long-term expected return on these products and excluded is any over- or underperformance compared to management's expected return.

The fair value movements of certain guarantees and the fair value change of derivatives that hedge certain risks on these guarantees of Aegon the Netherlands, VA Europe (included in United Kingdom) and Japan are excluded from underlying earnings before tax, and the long-term expected return for these guarantees is set at zero. In addition, fair value items include market related results on our loyalty bonus reserves in the United Kingdom. The value of these reserves are directly related to policyholder investments which value is directly impacted by movements in equity and bond markets.

Holding and other activities include certain issued bonds that are held at fair value through profit or loss (FVTPL). The interest rate risk on these bonds is hedged using swaps. The fair value movement resulting from changes in Aegon's credit spread used in the valuation of these bonds are excluded from underlying earnings before tax and



reported under fair value items.

*Realized gains or losses on investments*

Includes realized gains and losses on available-for-sale investments, mortgage loans and other loan portfolios.

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

19

*Impairment charges/reversals*

Impairment charges include impairments on available-for-sale debt securities, shares including the effect of deferred policyholder acquisition costs, mortgage loans and other loan portfolios at amortized cost, joint ventures and associates. Impairment reversals include reversals on available-for-sale debt securities.

*Other income or charges*

Other income or charges includes: a) items which cannot be directly allocated to a specific line of business; b) the impact of assumption and model updates used to support calculations of our liabilities for insurance and investment contracts sold to policyholders and related assets; and c) items that are outside the normal course of business, including restructuring charges. In the Condensed consolidated interim financial statements, these restructuring charges are included in operating expenses. Actuarial assumption and model updates are recorded in Claims and Benefits in the IFRS income statement.

*Run-off businesses*

Includes underlying results of business units where management has decided to exit the market and to run-off the existing block of business. Currently, this line includes results related to the run-off of the institutional spread-based business, structured settlements blocks of business, bank-owned and corporate-owned life insurance (BOLI/COLI) business, and the sale of the life reinsurance business in the United States. Aegon has other blocks of business for which sales have been discontinued and of which the earnings are included in underlying earnings before tax.

*Share in earnings of joint ventures and associates*

Earnings from Aegon's joint ventures in the Netherlands, Mexico, Spain, Portugal, China and Japan and Aegon's associates in India, Brazil, the Netherlands, United Kingdom, Mexico and France are reported on an underlying earnings before tax basis.

Unaudited

**Table of Contents**

20

Condensed Consolidated Interim Financial Statements Q4 2016

**3.3 Investments**

Amounts included in the tables on investments are presented on an IFRS basis.

	EUR millions										
	Holdings									Total	
	Asset and other					Eliminations				EUR	
<b>December 31, 2016</b>	Americas	The Netherlands	United Kingdom	Central & Eastern Europe	Spain & Portugal	Europe	Asia	Management	activities		
<b>Investments</b>											
Shares	793	334	84	35	4	457	-	2	62	-	1,314
Debt securities	70,766	23,741	2,036	633	683	27,093	5,310	-	-	-	103,169
Loans	10,820	28,627	-	303	45	28,975	18	-	-	-	39,812
Other financial assets	9,924	358	115	10	-	483	-	88	23	-	10,519
Investments in real estate	743	1,238	-	3	15	1,256	-	-	-	-	1,999
<b>Investments general account</b>	<b>93,046</b>	<b>54,298</b>	<b>2,236</b>	<b>983</b>	<b>747</b>	<b>58,264</b>	<b>5,328</b>	<b>90</b>	<b>85</b>	<b>-</b>	<b>156,813</b>
Shares	-	9,689	15,503	295	13	25,499	-	-	-	(7)	25,492
Debt securities	4,779	15,434	9,847	235	10	25,526	-	-	-	-	30,305
Unconsolidated investment funds	102,534	-	36,600	879	64	37,543	-	-	-	-	140,077
Other financial assets	27	2,862	4,150	9	1	7,022	-	-	-	-	7,049
Investments in real estate	-	-	686	-	-	686	-	-	-	-	686
<b>Investments for account of policyholders</b>	<b>107,341</b>	<b>27,985</b>	<b>66,786</b>	<b>1,418</b>	<b>88</b>	<b>96,276</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(7)</b>	<b>203,610</b>
<b>Investments on balance sheet</b>	<b>200,387</b>	<b>82,283</b>	<b>69,021</b>	<b>2,401</b>	<b>834</b>	<b>154,540</b>	<b>5,328</b>	<b>90</b>	<b>85</b>	<b>(7)</b>	<b>360,423</b>
<b>Off balance sheet investments third parties</b>	<b>240,072</b>	<b>952</b>	<b>5,333</b>	<b>3,154</b>	<b>507</b>	<b>9,946</b>	<b>2,734</b>	<b>130,889</b>	<b>-</b>	<b>(864)</b>	<b>382,776</b>
	<b>440,458</b>	<b>83,235</b>	<b>74,354</b>	<b>5,556</b>	<b>1,342</b>	<b>164,487</b>	<b>8,061</b>	<b>130,979</b>	<b>85</b>	<b>(871)</b>	<b>743,200</b>

**Total revenue generating investments****Investments**

Available-for-sale	77,918	23,044	2,152	660	687	26,544	5,289	87	23	-	109,860
Loans	10,820	28,627	-	303	45	28,975	18	-	-	-	39,812
Financial assets at fair value through profit or loss	110,906	29,374	66,183	1,436	88	97,080	21	4	62	(7)	208,066
Investments in real estate	743	1,238	686	3	15	1,942	-	-	-	-	2,685
<b>Total investments on balance sheet</b>	<b>200,387</b>	<b>82,283</b>	<b>69,021</b>	<b>2,401</b>	<b>834</b>	<b>154,540</b>	<b>5,328</b>	<b>90</b>	<b>85</b>	<b>(7)</b>	<b>360,423</b>
Investments in joint ventures	7	877	-	-	495	1,373	134	99	-	-	1,614
Investments in associates	95	21	8	2	-	30	21	125	(1)	-	270
Other assets	31,003	15,260	12,718	293	170	28,426	3,122	293	31,107	(30,338)	63,627
<b>Consolidated total assets</b>	<b>231,493</b>	<b>98,441</b>	<b>81,747</b>	<b>2,696</b>	<b>1,500</b>	<b>184,370</b>	<b>8,604</b>	<b>607</b>	<b>31,192</b>	<b>(30,345)</b>	<b>425,935</b>

EUR millions

## Holdings

December 31, 2015	Central & Eastern Spain & Portugal					Asset and other			Total		
	Americas	The Netherlands	United Kingdom	Europe	Portugal	Europe	Asia	Management activities	Eliminations	EUR	
<b>Investments</b>											
Shares	652	136	506	38	2	682	-	2	124	-	1,460
Debt securities	65,284	23,370	13,185	525	636	37,715	4,391	-	-	-	107,390
Loans	10,062	28,007	-	340	62	28,409	19	-	88	-	38,577
Other financial assets	10,783	335	160	6	2	503	-	72	18	-	11,376
Investments in real estate	840	1,148	-	2	-	1,150	-	-	-	-	1,990
<b>Investments general account</b>	<b>87,620</b>	<b>52,996</b>	<b>13,850</b>	<b>911</b>	<b>702</b>	<b>68,459</b>	<b>4,409</b>	<b>74</b>	<b>230</b>	<b>-</b>	<b>160,792</b>
Shares	-	9,174	17,274	247	12	26,707	-	-	-	(8)	26,699
Debt securities	4,967	14,642	11,728	256	13	26,640	-	-	-	-	31,606
Unconsolidated investment funds	96,187	17	37,622	959	61	38,658	-	-	-	-	134,845
Other financial assets	10	2,923	3,115	6	1	6,044	-	-	-	-	6,054
Investments in real estate	-	-	1,022	-	-	1,022	-	-	-	-	1,022
<b>Investments for account of policyholders</b>	<b>101,164</b>	<b>26,756</b>	<b>70,760</b>	<b>1,468</b>	<b>87</b>	<b>99,070</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(8)</b>	<b>200,226</b>

<b>Investments on balance sheet</b>	<b>188,784</b>	<b>79,752</b>	<b>84,610</b>	<b>2,379</b>	<b>789</b>	<b>167,529</b>	<b>4,409</b>	<b>74</b>	<b>230</b>	<b>(8)</b>	<b>361,019</b>
<b>Off balance sheet investments third parties</b>	<b>212,704</b>	<b>897</b>	<b>3,899</b>	<b>2,855</b>	<b>508</b>	<b>8,158</b>	<b>2,317</b>	<b>127,329</b>	<b>-</b>	<b>(1,069)</b>	<b>349,440</b>
<b>Total revenue generating investments</b>	<b>401,487</b>	<b>80,648</b>	<b>88,509</b>	<b>5,234</b>	<b>1,297</b>	<b>175,687</b>	<b>6,727</b>	<b>127,404</b>	<b>230</b>	<b>(1,077)</b>	<b>710,458</b>
<b>Investments</b>											
Available-for-sale	72,761	22,479	13,534	545	638	37,195	4,370	65	18	-	114,409
Loans	10,062	28,007	-	340	62	28,409	19	-	88	-	38,577
Financial assets at fair value through profit or loss	105,121	28,119	70,054	1,493	88	99,753	21	9	124	(8)	205,020
Investments in real estate	840	1,148	1,022	2	-	2,171	-	-	-	-	3,012
<b>Total investments on balance sheet</b>	<b>188,784</b>	<b>79,752</b>	<b>84,610</b>	<b>2,379</b>	<b>789</b>	<b>167,529</b>	<b>4,409</b>	<b>74</b>	<b>230</b>	<b>(8)</b>	<b>361,019</b>
Investments in joint ventures	7	837	-	-	505	1,341	101	109	3	-	1,561
Investments in associates	75	19	9	-	-	28	12	126	-	-	242
Other assets	27,396	17,349	5,204	322	124	22,984	3,070	304	31,020	(31,881)	52,908
<b>Consolidated total assets</b>	<b>216,262</b>	<b>97,956</b>	<b>89,822</b>	<b>2,701</b>	<b>1,417</b>	<b>191,882</b>	<b>7,592</b>	<b>613</b>	<b>31,254</b>	<b>(31,889)</b>	<b>415,729</b>

Unaudited

**Table of Contents****3.4 Changes to Aegon's segment reporting**

During 2016 Aegon made changes which affected its segment reporting:

- t Change to Aegon's operating segments (paragraph 3.4.1)
- t Voluntary changes in accounting policies (paragraph 3.4.2)
- t Change in measurement of underlying earnings before tax (paragraph 3.4.3)

**3.4.1 Change to Aegon's operating segments**

Aegon's most recent segment reporting was established in 2010 considering the requirements outlined in IFRS 8 Operating Segments. IFRS 8 requires operating segments to be defined in line with how the chief operating decision maker (CODM, i.e. Aegon's Executive Board) manages the business. Between 2010 and 2015 Aegon had the following reportable segments: Americas, The Netherlands, United Kingdom, New Markets and Holdings and other activities. New Markets was established to aggregate Aegon's emerging businesses and global / European initiatives which is a combination of the following operating segments: Central & Eastern Europe, Asia, Spain & Portugal, Asset Management and Variable Annuities Europe (VA Europe). Under IFRS 8 these operating segments were aggregated as one reportable segment due to their respective size.

Given that Aegon changed its managerial view to geographical areas and underlying businesses have developed since 2010, Aegon has evolved the way it manages its businesses including the internal managerial reports it uses to manage the businesses. Alignment of segment reporting with those changes and developments have been put in place in 2016 reflecting Aegon's announcements related to its strategic plan. Accordingly as of January 1, 2016 Aegon adopted refinements to its segment reporting including presenting the operating segments as described above and introducing a separate presentation of the asset management business. The following will be reported from 2016 onwards:

- t Americas: one operating segment which covers business units in the United States, Brazil and Mexico, including any of the units' activities located outside these countries;
- t Europe: which covers the following operating segments: the Netherlands, United Kingdom (including VA Europe), Central & Eastern Europe and Spain & Portugal;
- t Asia: one operating segment which covers businesses operating in Hong Kong, China, Japan, India and Indonesia including any of the units' activities located outside these countries;
- t Asset Management: one operating segment which covers business activities from Aegon Asset Management;
- t Holding and other activities: one operating segment which includes financing, employee and other administrative expenses of holding companies.

For Europe, the underlying businesses (the Netherlands, United Kingdom including VA Europe, Central & Eastern Europe and Spain & Portugal) are separate operating segments which under IFRS 8 cannot be aggregated, therefore further details will be provided for these operating segments.

The change in segment reporting does not have an impact on the financial position, results of operations or cash flows of Aegon.

Unaudited

**Table of Contents**

## 22 Condensed Consolidated Interim Financial Statements Q4 2016

The following table presents Aegion's segment results as reported in the 2015 Condensed Consolidated Interim Financial Statements:

<i>EUR millions</i>	Americas	The Netherlands	United Kingdom	Holding and New Markets	other activities	Eliminations	Segment Total	Joint ventures and associates elimination	Consolidated
<b>Year ended</b>									
<b>December 31, 2015</b>									
<b>Underlying earnings before tax</b>	<b>1,200</b>	<b>537</b>	<b>125</b>	<b>236</b>	<b>(163)</b>	<b>2</b>	<b>1,939</b>	<b>34</b>	<b>1,973</b>
Fair value items	(589)	55	(27)	8	(68)	-	(620)	(59)	(679)
Realized gains / (losses) on investments	(74)	306	95	20	-	-	346	(8)	338
Impairment charges	(43)	(25)	-	(2)	-	-	(70)	(21)	(91)
Impairment reversals	114	5	-	-	-	-	119	-	119
Other income / (charges)	(938)	(22)	27	(47)	-	-	(980)	21	(959)
Run-off businesses	52	-	-	-	-	-	52	-	52
<b>Income / (loss) before tax</b>	<b>(277)</b>	<b>857</b>	<b>220</b>	<b>215</b>	<b>(230)</b>	<b>2</b>	<b>786</b>	<b>(33)</b>	<b>754</b>
Income tax (expense) / benefit	31	(196)	(2)	(71)	71	-	(167)	33	(134)
<b>Net income / (loss)</b>	<b>(246)</b>	<b>661</b>	<b>218</b>	<b>144</b>	<b>(159)</b>	<b>2</b>	<b>619</b>	<b>-</b>	<b>619</b>
<i>Inter-segment underlying earnings</i>	(220)	(55)	(75)	339	10				
<b>Revenues</b>									
Life insurance gross premiums	7,046	2,240	5,650	2,565	4	(106)	17,400	(431)	16,969
Accident and health insurance	2,266	234	47	170	6	(6)	2,717	(14)	2,703
General insurance	-	473	-	244	2	-	720	(80)	640
<b>Total gross premiums</b>	<b>9,312</b>	<b>2,947</b>	<b>5,697</b>	<b>2,979</b>	<b>13</b>	<b>(112)</b>	<b>20,836</b>	<b>(524)</b>	<b>20,311</b>
Investment income	3,680	2,277	2,327	291	387	(385)	8,576	(51)	8,525
	1,704	351	43	813	-	(278)	2,633	(195)	2,438



Fee and commission  
income

Other revenues	9	-	-	2	7	-	19	(5)	14
<b>Total revenues</b>	<b>14,705</b>	<b>5,575</b>	<b>8,067</b>	<b>4,086</b>	<b>406</b>	<b>(776)</b>	<b>32,064</b>	<b>(775)</b>	<b>31,289</b>

*Inter-segment*

<i>revenues</i>	24	2	-	356	393				
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The following table presents Aegion's segment result after adoption of the refinements of its segment reporting:

	Central & Eastern Europe										Joint ventures and associates		Consolidated
	Americas	The Netherlands	United Kingdom	Spain & Portugal	Europe	Asia	Management	Activities	Eliminations	Terminations	Terminations		
<i>EUR millions</i>													
<b>Year ended</b>													
<b>December 31,</b>													
<b>2015</b>													
<b>Underlying earnings before tax</b>	<b>1,200</b>	<b>537</b>	<b>123</b>	<b>37</b>	<b>12</b>	<b>709</b>	<b>20</b>	<b>170</b>	<b>(162)</b>	<b>2</b>	<b>1,939</b>	<b>34</b>	<b>1,973</b>
Fair value items	(589)	55	(25)	-	-	30	7	-	(67)	-	(620)	(59)	(679)
Realized gains / (losses) on investments	(74)	306	103	2	-	411	7	3	-	-	346	(8)	338
Impairment charges	(43)	(25)	-	(2)	-	(27)	-	-	-	-	(70)	(21)	(91)
Impairment reversals	114	5	-	-	-	5	-	-	-	-	119	-	119
Other income / (charges)	(938)	(22)	27	(2)	17	20	(61)	(1)	-	-	(980)	21	(959)
Run-off businesses	52	-	-	-	-	-	-	-	-	-	52	-	52
<b>Income / (loss) before tax</b>	<b>(277)</b>	<b>857</b>	<b>227</b>	<b>35</b>	<b>29</b>	<b>1,148</b>	<b>(27)</b>	<b>172</b>	<b>(230)</b>	<b>2</b>	<b>786</b>	<b>(33)</b>	<b>754</b>
Income tax (expense) / benefit	31	(196)	(3)	(11)	(7)	(216)	(3)	(50)	70	-	(167)	33	(134)
<b>Net income / (loss)</b>	<b>(246)</b>	<b>661</b>	<b>225</b>	<b>24</b>	<b>22</b>	<b>932</b>	<b>(30)</b>	<b>121</b>	<b>(159)</b>	<b>2</b>	<b>619</b>	<b>-</b>	<b>619</b>
<i>Inter-segment underlying earnings</i>	(220)	(55)	(63)	(14)	-	(131)	77	264	10				
<b>Revenues</b>													
Life insurance gross premiums	7,046	2,240	5,852	477	174	8,742	1,714	-	4	(106)	17,400	(431)	16,969

Accident and health insurance	2,266	234	47	1	64	346	105	-	6	(6)	2,717	(14)	2,703
General insurance	-	473	-	164	80	717	-	-	2	-	720	(80)	640
<b>Total gross premiums</b>	<b>9,312</b>	<b>2,947</b>	<b>5,899</b>	<b>642</b>	<b>317</b>	<b>9,805</b>	<b>1,819</b>	<b>-</b>	<b>13</b>	<b>(112)</b>	<b>20,836</b>	<b>(524)</b>	<b>20,311</b>
Investment income	3,680	2,277	2,330	45	41	4,693	194	7	392	(391)	8,576	(51)	8,525
Fee and commission income	1,704	351	98	39	13	501	62	650	-	(284)	2,633	(195)	2,438
Other revenues	9	-	-	0	2	2	-	-	7	-	19	(5)	14
<b>Total revenues</b>	<b>14,705</b>	<b>5,575</b>	<b>8,327</b>	<b>726</b>	<b>373</b>	<b>15,001</b>	<b>2,075</b>	<b>657</b>	<b>412</b>	<b>(787)</b>	<b>32,064</b>	<b>(775)</b>	<b>31,289</b>
<i>Inter-segment revenues</i>	24	2	-	-	-	2	101	262	399				

### 3.4.2 Voluntary changes in accounting policies

As described in paragraph 2.1, Aegon adopted voluntary changes in accounting policies, effective January 1, 2016. The following table presents the impact of the voluntary changes in accounting policies on the new segments:

EUR millions	Central & Eastern Europe										Segment Total	Joint ventures and associates	Consolidated
	Americas	Netherlands	The Netherlands	United Kingdom	East Europe	Spain & Portugal	Europe	Management	Other	Other			
<b>Year ended December 31, 2015</b>													
<b>Underlying earnings before tax</b>	-	-	(150)	-	-	(150)	-	-	-	-	(150)	-	(150)
Fair value items	-	-	-	-	-	-	-	-	-	-	-	-	-
Realized gains / (losses) on investments	-	-	-	-	-	-	-	-	-	-	-	-	-
Impairment charges	-	-	-	-	-	-	-	-	-	-	-	-	-
Impairment reversals	-	-	-	-	-	-	-	-	-	-	-	-	-
Other income / (charges)	-	-	(1,274)	-	-	(1,274)	-	-	-	-	(1,274)	-	(1,274)
Run-off businesses	36	-	-	-	-	-	-	-	-	-	36	-	36
<b>Income / (loss) before tax</b>	<b>36</b>	<b>-</b>	<b>(1,423)</b>	<b>-</b>	<b>-</b>	<b>(1,423)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(1,388)</b>	<b>-</b>	<b>(1,388)</b>
Income tax (expense) / benefit	(26)	-	270	-	-	270	-	-	-	-	245	-	245
<b>Net income / (loss)</b>	<b>10</b>	<b>-</b>	<b>(1,153)</b>	<b>-</b>	<b>-</b>	<b>(1,153)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(1,143)</b>	<b>-</b>	<b>(1,143)</b>
<i>Inter-segment underlying earnings</i>	-	-	-	-	-	-	-	-	-	-	-	-	-

**Revenues**

Life insurance gross premiums	-	-	2,614	-	-	2,614	-	-	-	-	2,614	-	2,614
Accident and health insurance	-	-	-	-	-	-	-	-	-	-	-	-	-
General insurance	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total gross premiums</b>	-	-	<b>2,614</b>	-	-	<b>2,614</b>	-	-	-	-	<b>2,614</b>	-	<b>2,614</b>
Investment income	-	-	-	-	-	-	-	-	-	-	-	-	-
Fee and commission income	-	-	-	-	-	-	-	-	-	-	-	-	-
Other revenues	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total revenues</b>	-	-	<b>2,614</b>	-	-	<b>2,614</b>	-	-	-	-	<b>2,614</b>	-	<b>2,614</b>
<i>Inter-segment revenues</i>	-	-	-	-	-	-	-	-	-	-	-	-	-

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

23

**3.4.3 Change in measurement of underlying earnings before tax**

As described in paragraph 3.2, Aegon made changes in the measurement of underlying earnings before tax by presenting the impacts from assumption updates as part of other income/ (charges) rather than as part of underlying earnings before tax or fair value items. In addition, the impact from updates to actuarial assumptions, as well as model updates and updates to economic assumptions both previously recorded in fair value items, are recorded in Other income / (charges) as of the third quarter 2016.

The following table presents the impact of the changes in measurement of actuarial assumption updates, as implemented in Q3 2016, on the comparative numbers for year ended December 31, 2015:

	Central & Eastern Europe										Asia	Management	Eliminations	Segment	Joint ventures and associates	Consolidated
	Americas	Netherlands	The United Kingdom	Spain & Portugal	Europe	Europe	Asia	Management	Eliminations	Segment	Joint ventures and associates	Consolidated				
<i>EUR millions</i>																
<b>Year ended</b>																
<b>December 31, 2015</b>																
<b>Underlying earnings before tax</b>	77	-	-	-	-	-	-	-	-	-	77	77				
Fair value items	(103)	(49)	-	-	-	(49)	-	-	-	-	(151)	(151)				
Realized gains / (losses) on investments	-	-	-	-	-	-	-	-	-	-	-	-				
Impairment charges	-	-	-	-	-	-	-	-	-	-	-	-				
Impairment reversals	-	-	-	-	-	-	-	-	-	-	-	-				
Other income / (charges)	25	49	-	-	-	49	-	-	-	-	74	74				
Run-off businesses	-	-	-	-	-	-	-	-	-	-	-	-				
<b>Income / (loss) before tax</b>	-	-	-	-	-	-	-	-	-	-	-	-				
Income tax (expense) / benefit	-	-	-	-	-	-	-	-	-	-	-	-				
<b>Net income / (loss)</b>	-	-	-	-	-	-	-	-	-	-	-	-				
<i>Inter-segment underlying earnings</i>	-	-	-	-	-	-	-	-	-	-	-	-				

**Revenues**

Life insurance gross premiums	-	-	-	-	-	-	-	-	-	-	-	-	-
Accident and health insurance	-	-	-	-	-	-	-	-	-	-	-	-	-
General insurance	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total gross premiums</b>	-	-	-	-	-	-	-	-	-	-	-	-	-
Investment income	-	-	-	-	-	-	-	-	-	-	-	-	-
Fee and commission income	-	-	-	-	-	-	-	-	-	-	-	-	-
Other revenues	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total revenues</b>	-	-	-	-	-	-	-	-	-	-	-	-	-
<i>Inter-segment revenues</i>	-	-	-	-	-	-	-	-	-	-	-	-	-

**4. Premium income and premiums paid to reinsurers**

<i>EUR millions</i>	Q4 2016	Q4 2015	FY 2016	FY 2015
<b>Premium income</b>				
Life	5,433	4,646	20,400	19,583
Non-Life	684	763	3,053	3,342
<b>Total</b>	<b>6,118</b>	<b>5,409</b>	<b>23,453</b>	<b>22,925</b>
<b>Premiums paid to reinsurers 1</b>				
Life	821	733	2,932	2,694
Non-Life	52	75	244	286
<b>Total</b>	<b>874</b>	<b>808</b>	<b>3,176</b>	<b>2,979</b>

1 Premiums paid to reinsurers are recorded within Benefits and expenses in the income statement - refer to note 8 - Benefits and expenses.

Premium income Life includes EUR 1,692 million for Q4 2016 and EUR 5,255 million full year 2016 (Q4 2015: EUR 764 million, full year 2015 EUR 3,575 million) of premiums related to insurance policies upgraded to the retirement platform in the UK.

**5. Investment income**

<i>EUR millions</i>	Q4 2016	Q4 2015	FY 2016	FY 2015
Interest income	1,573	1,761	6,479	7,087
Dividend income	321	365	1,180	1,306
Rental income	34	27	129	133
<b>Total investment income</b>	<b>1,927</b>	<b>2,153</b>	<b>7,788</b>	<b>8,525</b>
Investment income related to general account	1,407	1,520	5,737	6,099

Investment income for account of policyholders	520	633	2,051	2,426
<b>Total</b>	<b>1,927</b>	<b>2,153</b>	<b>7,788</b>	<b>8,525</b>

Unaudited

**Table of Contents**

24	Condensed Consolidated Interim Financial Statements Q4 2016
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**6. Results from financial transactions**

<i>EUR millions</i>	Q4 2016	Q4 2015	FY 2016	FY 2015
Net fair value change of general account financial investments at FVTPL other than derivatives	(21)	16	(42)	(35)
Realized gains /(losses) on financial investments	40	59	327	349
Gains /(losses) on investments in real estate	18	29	70	145
Net fair value change of derivatives	24	(3)	435	3
Net fair value change on for account of policyholder financial assets at FVTPL	344	5,246	15,121	(110)
Net fair value change on investments in real estate for account of policyholders	1	16	(26)	67
Net foreign currency gains /(losses)	9	2	41	(29)
Net fair value change on borrowings and other financial liabilities	13	4	21	9
Realized gains /(losses) on repurchased debt	-	1	1	2
<b>Total</b>	<b>429</b>	<b>5,369</b>	<b>15,949</b>	<b>401</b>

The decrease of the net fair value change on for account of policyholder financial assets at FVTPL in Q4 2016 compared to Q4 2015 is mainly driven by the equity markets and interest rate movements.

Net fair value change on for accounts of policyholder financial assets at FVTPL is offset by amounts in the Claims and benefits line reported in note 8 - Benefits and expenses.

**7. Other income**

Other income of EUR 66 million for 2016 includes the result on the sale of Transamerica Financial Advisors. This transaction has resulted in a gain of USD 58 million (EUR 52 million). Refer to note 21 Acquisitions / divestments.

**8. Benefits and expenses**

<i>EUR millions</i>	Q4 2016	Q4 2015	FY 2016	FY 2015
Claims and benefits	8,504	12,878	48,128	32,767
Employee expenses	583	587	2,287	2,280
Administration expenses	342	361	1,273	1,278

Deferred expenses	(288)	(370)	(1,203)	(1,533)
Amortization charges	313	383	1,065	1,261
Total	<b>9,453</b>	<b>13,839</b>	<b>51,550</b>	<b>36,052</b>

The following table provides an analysis of claims and benefits :

<i>EUR millions</i>	Q4 2016	Q4 2015	FY 2016	FY 2015
Benefits and claims paid life	7,592	5,702	23,877	23,130
Benefits and claims paid non-life	478	531	2,052	2,128
Change in valuation of liabilities for insurance contracts	601	5,266	16,193	7,880
Change in valuation of liabilities for investment contracts	(1,734)	(223)	(104)	(6,678)
Other	(5)	(14)	(45)	(17)
<b>Policyholder claims and benefits</b>	<b>6,932</b>	<b>11,261</b>	<b>41,974</b>	<b>26,443</b>
Premium paid to reinsurers	874	808	3,176	2,979
Profit sharing and rebates	10	6	49	31
Commissions	689	802	2,929	3,313
Total	<b>8,504</b>	<b>12,878</b>	<b>48,128</b>	<b>32,767</b>

The lines change in valuation of liabilities for insurance contracts and change in valuation of liabilities for investment contracts reflect changes in technical provisions resulting from fair value changes on for account of policyholder financial assets included in Results from financial transactions (note 6) of EUR 344 million (2015 Q4: EUR 5,246 million). In addition, the line change in valuation of liabilities for insurance contracts includes a decrease of technical provisions for life insurance contracts of EUR 1,115 million (2015 Q4: increase of EUR 243 million).

Claims and benefits include the impact of the assumption and model updates, refer to note 3.

Unaudited



**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

25

**9. Impairment charges/(reversals)**

<i>EUR millions</i>	Q4 2016	Q4 2015	FY 2016	FY 2015
<b>Impairment charges / (reversals) comprise:</b>				
Impairment charges on financial assets, excluding receivables <sup>1</sup>	18	42	117	95
Impairment reversals on financial assets, excluding receivables <sup>1</sup>	(16)	(84)	(58)	(119)
Impairment charges / (reversals) on non-financial assets and receivables	39	1,277	36	1,275
<b>Total</b>	<b>41</b>	<b>1,234</b>	<b>95</b>	<b>1,251</b>
<b>Impairment charges on financial assets, excluding receivables, from:</b>				
Shares	-	-	1	4
Debt securities and money market instruments	6	8	53	32
Loans	2	12	23	37
Other	10	-	33	-
Investments in joint ventures	-	21	-	21
Investments in associates	-	-	7	-
<b>Total</b>	<b>18</b>	<b>42</b>	<b>117</b>	<b>95</b>
<b>Impairment reversals on financial assets, excluding receivables, from:</b>				
Debt securities and money market instruments	(12)	(80)	(42)	(109)
Loans	(3)	(5)	(14)	(9)
Other	(1)	-	(2)	-
<b>Total</b>	<b>(16)</b>	<b>(84)</b>	<b>(58)</b>	<b>(119)</b>

<sup>1</sup> Impairment charges / (reversals) on financial assets, excluding receivables, are excluded from underlying earnings before tax for segment reporting (refer to note 3.1).

**10. Other charges**

Other charges in 2016 of EUR 700 million mainly relate to the book loss on the sale of the UK annuity portfolio (EUR 682 million). For more details on the sale of the UK annuity portfolio refer to note 19 Assets and Liabilities held for sale and note 21 Acquisitions/divestments. Other charges of EUR 774 million in 2015 is related to the book loss on the sale of Aegon's Canada life insurance business.

**11. Intangible assets**

<i>EUR millions</i>	Dec. 31, 2016	Dec. 31, 2015
Goodwill	294	299
VOBA	1,399	1,472
Future servicing rights	64	57
Software	50	61
Other	12	12
<b>Total intangible assets</b>	<b>1,820</b>	<b>1,901</b>

Intangible assets, except for goodwill, are predominantly impacted by periodic amortization of balances and changes in foreign exchange rates.

Unaudited

**Table of Contents**

## 26 Condensed Consolidated Interim Financial Statements Q4 2016

**12. Investments**

<i>EUR millions</i>	Dec. 31, 2016	Dec. 31, 2015
Available-for-sale (AFS)	109,860	114,409
Loans	39,812	38,577
Financial assets at fair value through profit or loss (FVTPL)	5,142	5,816
<b>Financial assets, for general account, excluding derivatives</b>	<b>154,814</b>	<b>158,803</b>
Investments in real estate	1,999	1,990
<b>Total investments for general account, excluding derivatives</b>	<b>156,813</b>	<b>160,792</b>

**Financial assets, for general account, excluding derivatives**

<i>EUR millions</i>	AFS	FVTPL	Loans	Total
Shares	824	490	-	1,314
Debt securities	101,054	2,115	-	103,169
Money market and other short-term investments	6,776	317	-	7,093
Mortgages loans	-	-	34,206	34,206
Private loans	-	-	3,166	3,166
Deposits with financial institutions	-	-	129	129
Policy loans	-	-	2,207	2,207
Other	1,206	2,219	104	3,529
<b>December 31, 2016</b>	<b>109,860</b>	<b>5,142</b>	<b>39,812</b>	<b>154,814</b>

	AFS	FVTPL	Loans	Total
Shares	820	640	-	1,460
Debt securities	105,151	2,239	-	107,390
Money market and other short-term investments	7,141	303	-	7,444
Mortgages loans	-	-	33,214	33,214
Private loans	-	-	2,847	2,847
Deposits with financial institutions	-	-	106	106
Policy loans	-	-	2,201	2,201
Other	1,297	2,635	210	4,141
<b>December 31, 2015</b>	<b>114,409</b>	<b>5,816</b>	<b>38,577</b>	<b>158,803</b>

**13. Investments for account of policyholders**

<i>EUR millions</i>	Dec. 31, 2016	Dec. 31, 2015
Shares	25,492	26,699
Debt securities	30,305	31,606
Money market and short-term investments	1,231	1,907
Deposits with financial institutions	2,951	1,222
Unconsolidated investment funds	140,077	134,845
Other	2,868	2,925
<b>Total investments for account of policyholders at fair value through profit or loss, excluding derivatives</b>	<b>202,924</b>	<b>199,204</b>
Investment in real estate	686	1,022
<b>Total investments for account of policyholders</b>	<b>203,610</b>	<b>200,226</b>

#### **14. Derivatives**

The movements in fair value of derivatives on both the asset and liability side of the condensed consolidated statement of financial position mainly result from changes in interest rates and other market movements during the period, as well as purchases and disposals.

Unaudited

Table of Contents

Condensed Consolidated Interim Financial Statements Q4 2016

27

**15. Fair value**

The following tables provide an analysis of financial instruments recorded at fair value on a recurring basis by level of the fair value hierarchy:

**Fair value hierarchy**

<i>EUR millions</i>	Level I	Level II	Level III	Total
<b>As at December 31, 2016</b>				
<b>Financial assets carried at fair value</b>				
<b>Available-for-sale investments</b>				
Shares	119	312	393	824
Debt securities	29,386	69,702	1,966	101,054
Money markets and other short-term instruments	-	6,776	-	6,776
Other investments at fair value	-	453	754	1,206
<b>Total Available-for-sale investments</b>	<b>29,504</b>	<b>77,243</b>	<b>3,112</b>	<b>109,860</b>
<b>Fair value through profit or loss</b>				
Shares	288	152	50	490
Debt securities	27	2,082	6	2,115
Money markets and other short-term instruments	-	317	-	317
Other investments at fair value	1	961	1,257	2,219
Investments for account of policyholders <sup>1</sup>	125,997	75,202	1,726	202,924
Derivatives	41	8,169	108	8,318
<b>Total Fair value through profit or loss</b>	<b>126,355</b>	<b>86,883</b>	<b>3,146</b>	<b>216,384</b>
<b>Total financial assets at fair value</b>	<b>155,860</b>	<b>164,126</b>	<b>6,259</b>	<b>326,244</b>
<b>Financial liabilities carried at fair value</b>				
Investment contracts for account of policyholders <sup>2</sup>	-	42,627	176	42,803
Borrowings <sup>3</sup>	-	610	-	610
Derivatives	64	6,347	2,467	8,878
<b>Total financial liabilities at fair value</b>	<b>64</b>	<b>49,584</b>	<b>2,643</b>	<b>52,290</b>

Note that the investment contracts for account of policyholders previously reported as Level I have been reclassified to Level II, as the value of these liabilities is directly derived from the fair value of the linked investments for account

of policyholders. The comparative numbers have been adjusted accordingly. These reclassifications had no effect on net income, shareholders' equity or earnings per share.

## Fair value hierarchy

<i>EUR millions</i>	Level I	Level II	Level III	Total
<b>As at December 31, 2015</b>				
<b>Financial assets carried at fair value</b>				
<b>Available-for-sale investments</b>				
Shares	29	498	293	820
Debt securities	28,701	72,307	4,144	105,151
Money markets and other short-term instruments	-	7,141	-	7,141
Other investments at fair value	31	337	928	1,297
<b>Total Available-for-sale investments</b>	<b>28,761</b>	<b>80,283</b>	<b>5,365</b>	<b>114,409</b>
<b>Fair value through profit or loss</b>				
Shares	254	385	-	640
Debt securities	16	2,217	6	2,239
Money markets and other short-term instruments	-	303	-	303
Other investments at fair value	2	1,368	1,265	2,635
Investments for account of policyholders <sup>1</sup>	121,227	76,232	1,745	199,204
Derivatives	54	11,270	222	11,545
<b>Total Fair value through profit or loss</b>	<b>121,552</b>	<b>91,775</b>	<b>3,239</b>	<b>216,566</b>
<b>Total financial assets at fair value</b>	<b>150,313</b>	<b>172,058</b>	<b>8,604</b>	<b>330,975</b>
<b>Financial liabilities carried at fair value</b>				
Investment contracts for account of policyholders <sup>2</sup>	-	40,209	156	40,365
Borrowings <sup>3</sup>	-	617	-	617
Derivatives	4	8,782	2,104	10,890
<b>Total financial liabilities at fair value</b>	<b>4</b>	<b>49,608</b>	<b>2,260</b>	<b>51,871</b>

<sup>1</sup> The investments for account of policyholders included in the table above represents only those investments carried at fair value through profit or loss.

<sup>2</sup> The investment contracts for account of policyholders included in the table above represents only those investment contracts carried at fair value.

<sup>3</sup> Total borrowings on the statement of financial position contain borrowings carried at amortized cost that are not included in the above schedule.

Unaudited

**Table of Contents**

28	Condensed Consolidated Interim Financial Statements Q4 2016
----	---

**Significant transfers between Level I, Level II and Level III**

Aegon's policy is to record transfers of assets and liabilities between Level I, Level II and Level III at their fair values as of the beginning of each reporting period.

The table below shows transfers between Level I and II for financial assets and financial liabilities recorded at fair value on a recurring basis during the year ended December 31, 2016.

**Fair value transfers***EUR millions*

	Full Year 2016		Full Year 2015	
	Transfers Level I to Level II	Transfers Level II to Level I	Transfers Level I to Level II	Transfers Level II to Level I
<b>Financial assets carried at fair value</b>				
<b>Available-for-sale investments</b>				
Debt securities	5	69	14	156
<b>Total</b>	<b>5</b>	<b>69</b>	<b>14</b>	<b>156</b>
<b>Fair value through profit or loss</b>				
Shares	-	-	-	40
Investments for account of policyholders	3	(1)	(3)	209
<b>Total</b>	<b>3</b>	<b>(1)</b>	<b>(3)</b>	<b>248</b>
<b>Total financial assets at fair value</b>	<b>8</b>	<b>68</b>	<b>11</b>	<b>405</b>

Transfers are identified based on transaction volume and frequency, which are indicative of an active market.

**Movements in Level III financial instruments measured at fair value**

The following table summarizes the change of all assets and liabilities measured at estimated fair value on a recurring basis using significant unobservable inputs (Level III), including realized and unrealized gains (losses) of all assets and liabilities and unrealized gains (losses) of all assets and liabilities still held at the end of the respective period.

**Roll forward of Level III financial instruments***EUR millions*

	January 2016	Total gains Total losses income	Total gain Total loss in OCI <sup>2</sup>	Purchases	Sales	Settlements	Net exchange differences	Transfers from Level I and Level II	Transfers to Level I and Level II	December 2016	Total Unrealized gains and losses
--	--------------	---------------------------------------	---	-----------	-------	-------------	--------------------------------	---	---	---------------	---

	statement <sup>1</sup>							II		for the period recorded in the P&L for instruments held at December 31, 2016 <sup>3</sup>	
<b>Financial assets carried at fair value available-for-sale investments</b>											
Shares	293	27	(7)	161	(92)	(1)	11	-	-	393	-
Debt securities	4,144	1	92	443	(262)	(287)	39	651	(2,854)	1,966	-
Other investments at fair value	928	(177)	20	240	(133)	(141)	18	-	(1)	754	-
	<b>5,365</b>	<b>(150)</b>	<b>105</b>	<b>845</b>	<b>(487)</b>	<b>(429)</b>	<b>68</b>	<b>651</b>	<b>(2,856)</b>	<b>3,112</b>	<b>-</b>
<b>Fair value through profit or loss</b>											
Shares	-	3	-	48	-	-	-	-	-	50	3
Debt securities	6	(1)	-	-	-	-	-	-	-	6	-
Other investments at fair value	1,265	(44)	-	178	(277)	-	35	419	(321)	1,257	(42)
Investments for account of policyholders	1,745	22	-	469	(395)	-	(35)	8	(88)	1,726	23
Derivatives	222	(285)	-	75	108	-	(12)	-	-	108	(287)
	<b>3,239</b>	<b>(305)</b>	<b>-</b>	<b>770</b>	<b>(564)</b>	<b>-</b>	<b>(11)</b>	<b>427</b>	<b>(409)</b>	<b>3,146</b>	<b>(303)</b>
<b>Financial liabilities carried at fair value</b>											
Investment contracts for account of policyholders	156	(14)	-	45	(12)	-	2	-	(2)	176	1
Derivatives	2,104	542	-	-	(207)	-	28	-	-	2,467	562
	<b>2,260</b>	<b>528</b>	<b>-</b>	<b>45</b>	<b>(219)</b>	<b>-</b>	<b>31</b>	<b>-</b>	<b>(2)</b>	<b>2,643</b>	<b>563</b>
<i>EUR millions</i>	January 2015	Total gains / losses in OCI <sup>2</sup>	Total gains / losses OCI <sup>2</sup>	Purchases	Sales	Settlements	Net exchange differences	Transfer to Level II	Transfer from Level I and Level II	December 2015	Total Unrealized gains and losses for the period recorded in the P&L



for  
instruments  
held  
at  
December  
31,  
2015  
3

**Financial assets carried  
at fair  
value available-for-sale  
investments**

Shares	280	32	30	92	(124)	(33)	16	-	-	293	-
Debt securities	3,803	(2)	29	842	(367)	(198)	212	182	(359)	4,144	-
Other investments at fair value	934	(206)	9	179	(72)	(18)	102	-	-	928	-
	<b>5,018</b>	<b>(176)</b>	<b>69</b>	<b>1,113</b>	<b>(563)</b>	<b>(249)</b>	<b>330</b>	<b>182</b>	<b>(359)</b>	<b>5,365</b>	-

**Fair value through  
profit or loss**

Debt securities	17	-	-	-	(2)	-	2	-	(9)	6	-
Other investments at fair value	1,237	(20)	-	179	(397)	-	139	291	(162)	1,265	17
Investments for account of policyholders	1,956	126	-	486	(773)	-	33	-	(83)	1,745	85
Derivatives	320	(173)	-	12	48	-	15	-	-	222	(176)
	<b>3,530</b>	<b>(67)</b>	-	<b>677</b>	<b>(1,124)</b>	-	<b>188</b>	<b>291</b>	<b>(255)</b>	<b>3,239</b>	<b>(74)</b>

**Financial liabilities  
carried at fair value**

Investment contracts for account of policyholders	165	3	-	12	(34)	-	14	-	(5)	156	3
Derivatives	3,010	(925)	-	-	(98)	-	116	-	-	2,104	(972)
	<b>3,175</b>	<b>(922)</b>	-	<b>13</b>	<b>(131)</b>	-	<b>131</b>	-	<b>(5)</b>	<b>2,260</b>	<b>(969)</b>

<sup>1</sup> Includes impairments and movements related to fair value hedges. Gains and losses are recorded in the line item results from financial transactions of the income statement.

<sup>2</sup> Total gains and losses are recorded in line items Gains/ (losses) on revaluation of available-for-sale investments and (Gains)/ losses transferred to the income statement on disposal and impairment of available-for-sale investment of the statement of other comprehensive income.

<sup>3</sup> Total gains / (losses) for the period during which the financial instrument was in Level III.

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

29

During 2016, Aegon transferred certain financial instruments from Level II to Level III of the fair value hierarchy. The reason for the change in level was that the market liquidity for these securities decreased, which led to a change in market observability of prices. Prior to transfer, the fair value for the Level II securities was determined using observable market transactions or corroborated broker quotes respectively for the same or similar instruments. The amount of assets and liabilities transferred to Level III was EUR 1,078 million (full year 2015: EUR 473 million). Since the transfer, all such assets have been valued using valuation models incorporating significant non market-observable inputs or uncorroborated broker quotes.

Similarly, during 2016, Aegon transferred EUR 3,267 million (full year 2015: EUR 619 million) of financial instruments from Level III to other levels of the fair value hierarchy. The change in level was mainly the result of a return of activity in the market for these securities and that for these securities the fair value could be determined using observable market transactions or corroborated broker quotes for the same or similar instruments.

The following table presents information about the significant unobservable inputs used for recurring fair value measurements for certain Level III financial instruments.

**Overview of significant unobservable inputs**

<i>EUR millions</i>	Carrying amount December 31, 2016	Valuation technique <sup>1</sup>	Significant unobservable input <sup>2</sup>	Range (weighted average)
<b>Financial assets carried at fair value available-for-sale investments</b>				
Shares	262	Net asset value	n.a.	n.a.
	131	Other	n.a.	n.a.
	<b>393</b>			
Debt securities				
	1,389	Broker quote	n.a.	n.a.
	221	Discounted cash flow	Credit spread	1.30% - 3.37%(3.08%)
	355	Other	n.a.	n.a.
	<b>1,966</b>			
Other investments at fair value				
Tax credit investments	676	Discounted cash flow	Discount rate	5.6%
Investment funds	45	Net asset value	n.a.	n.a.
Other	32	Other	n.a.	n.a.

<b>December 31, 2016</b>	<b>754</b>				
<b>Fair value through profit or loss</b>					
Shares	50	Other		n.a.	n.a.
Debt securities	6	Other		n.a.	n.a.
	<b>56</b>				
Other investments at fair value					
Investment funds	1,252	Net asset value		n.a.	n.a.
Other	5	Other		n.a.	n.a.
	<b>1,257</b>				
Derivatives <sup>3</sup>					
Longevity swap	27	Discounted cash flow	Mortality		n.a.
Longevity swap	73	Discounted cash flow	Risk free rate	-/-0.21% - 1.67%(1.01%)	
Other	4	Other		n.a.	n.a.
<b>December 31, 2016</b>	<b>104</b>				
<b>Total financial assets at fair value <sup>3</sup></b>	<b>4,529</b>				
<b>Financial liabilities carried at fair value</b>					
Derivatives					
Embedded derivatives in insurance contracts	1,627	Discounted cash flow	Own Credit spread		0.40%
Other	840	Other		n.a.	n.a.
<b>Total financial liabilities at fair value</b>	<b>2,467</b>				

<sup>1</sup> Other in the table above (column Valuation technique) includes investments for which the fair value is uncorroborated and no broker quote is received.

<sup>2</sup> Not applicable (n.a.) has been included when no significant unobservable assumption has been identified and used.

<sup>3</sup> Investments for account of policyholders are excluded from the table above and from the disclosure regarding reasonably possible alternative assumptions. Policyholder assets, and their returns, belong to policyholders and do not impact Aegon's net income or equity. The effect on total assets is offset by the effect on total liabilities. Derivatives exclude derivatives for account of policyholders amounting to EUR 4 million.

Unaudited

**Table of Contents**

## 30 Condensed Consolidated Interim Financial Statements Q4 2016

The description of Aegon's methods of determining fair value is included in the consolidated financial statements for 2015. For reference purposes, the valuation techniques included in the table above are described in more detail on the following pages.

*Shares*

When available, Aegon uses quoted market prices in active markets to determine the fair value of its investments in shares. Fair values for unquoted shares are estimated using observations of the price/earnings or price/cash flow ratios of quoted companies considered comparable to the companies being valued. Valuations are adjusted to account for company-specific issues and the lack of liquidity inherent in an unquoted investment. Adjustments for illiquidity are generally based on available market evidence. In addition, a variety of other factors are reviewed by management, including, but not limited to, current operating performance, changes in market outlook and the third-party financing environment.

Available-for-sale shares include shares in a Federal Home Loan Bank (FHLB) for an amount of EUR 237 million (December 31, 2015: EUR 120 million) that are measured at par, which are reported as part of Other in the column Valuation technique. A FHLB has implicit financial support from the United States government. The redemption value of the shares is fixed at par and they can only be redeemed by the FHLB.

*Debt securities*

Aegon's portfolio of debt securities can be subdivided in Residential mortgage-backed securities (RMBS), Commercial mortgage-backed securities (CMBS), Asset-backed securities (ABS), Corporate bonds and Government debt. Below relevant details in the valuation methodology for these specific types of debt securities are described.

Valuations of RMBS, CMBS and ABS are monitored and reviewed on a monthly basis. Valuations per asset type are based on a pricing hierarchy which uses a waterfall approach that starts with market prices from indices and follows with third-party pricing services or brokers. The pricing hierarchy is dependent on the possibilities of corroboration of the market prices. If no market prices are available, Aegon uses internal models to determine fair value. Significant inputs included in the internal models are generally determined based on relative value analyses, which incorporate comparisons to instruments with similar collateral and risk profiles. Market standard models may be used to model the specific collateral composition and cash flow structure of each transaction.

Valuations of corporate bonds are monitored and reviewed on a monthly basis. The pricing hierarchy is dependent on the possibility of corroboration of market prices when available. If no market prices are available, valuations are determined by a discounted cash flow methodology using an internally calculated yield. The yield is comprised of a credit spread over a given benchmark. In all cases, the benchmark is an observable input. The credit spread contains both observable and unobservable inputs. Aegon starts by taking an observable credit spread from a similar bond of the given issuer, and then adjusts this spread based on unobservable inputs. These unobservable inputs may include subordination, liquidity and maturity differences. The weighted average credit spread used in valuation of corporate bonds has increased to 3.08% (December 31, 2015: 2.84%).

If available, Aegon uses quoted market prices in active markets to determine the fair value of its Government debt investments. If Aegon cannot make use of quoted market prices, market prices from indices or quotes from third-party pricing services or brokers are used.

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

31

*Tax credit investments*

The fair value of tax credit investments is determined by using a discounted cash flow valuation technique. This valuation technique takes into consideration projections of future capital contributions and distributions, as well as future tax credits and the tax benefits of future operating losses. The present value of these cash flows is calculated by applying a discount rate. In general, the discount rate is determined based on the cash outflows for the investments and the cash inflows from the tax credits/tax benefits (and the timing of those cash flows). These inputs are unobservable in the market place. The discount rate used in valuation of tax credit investments has decreased to 5.6% (December 31, 2015: 7.4%).

*Investment funds*

Investment funds include real estate funds, private equity funds and hedge funds. The fair values of investments held in non-quoted investment funds are determined by management after taking into consideration information provided by the fund managers. Aegon reviews the valuations each month and performs analytical procedures and trending analyses to ensure the fair values are appropriate.

*Derivatives*

Where quoted market prices are not available, other valuation techniques, such as option pricing or stochastic modeling, are applied. The valuation techniques incorporate all factors that a typical market participant would consider and are based on observable market data when available. Models are validated before they are used and calibrated to ensure that outputs reflect actual experience and comparable market prices.

Fair values for exchange-traded derivatives, principally futures and certain options, are based on quoted market prices in active markets. Fair values for over-the-counter (OTC) derivatives represent amounts estimated to be received from or paid to a third party in settlement of these instruments. These derivatives are valued using pricing models based on the net present value of estimated future cash flows, directly observed prices from exchange-traded derivatives, other OTC trades, or external pricing services. Most valuations are derived from swap and volatility matrices, which are constructed for applicable indices and currencies using current market data from many industry standard sources. Option pricing is based on industry standard valuation models and current market levels, where applicable. The pricing of complex or illiquid instruments is based on internal models or an independent third party. For long-dated illiquid contracts, extrapolation methods are applied to observed market data in order to estimate inputs and assumptions that are not directly observable. To value OTC derivatives, management uses observed market information, other trades in the market and dealer prices.

Some OTC derivatives are so-called longevity derivatives. The payout of longevity derivatives is linked to publicly available mortality tables. The derivatives are measured using the present value of the best estimate of expected payouts of the derivative plus a risk margin. The best estimate of expected payouts is determined using best estimate of mortality developments. Aegon determined the risk margin by stressing the best estimate mortality developments to quantify the risk and applying a cost-of-capital methodology. The most significant unobservable input for these

derivatives is the (projected) mortality development.

Aegon normally mitigates counterparty credit risk in derivative contracts by entering into collateral agreements where practical and in ISDA (International Swaps and Derivatives Association) master netting agreements for each of the Group's legal entities to facilitate Aegon's right to offset credit risk exposure. Changes in the fair value of derivatives attributable to changes in counterparty credit risk were not significant.

Unaudited

**Table of Contents**

## 32 Condensed Consolidated Interim Financial Statements Q4 2016

*Embedded derivatives in insurance contracts including guarantees*

All bifurcated guarantees for minimum benefits in insurance and investment contracts are carried at fair value. These guarantees include guaranteed minimum withdrawal benefits (GMWB) in the United States, United Kingdom and Japan which are offered on some variable annuity products and are also assumed from a ceding company; minimum investment return guarantees on insurance products offered in the Netherlands, including group pension and traditional products; variable annuities sold in Europe and Japan.

Since the price of these guarantees is not quoted in any market, the fair values of these guarantees are based on discounted cash flows calculated as the present value of future expected payments to policyholders less the present value of assessed rider fees attributable to the guarantees. Given the complexity and long-term nature of these guarantees which are unlike instruments available in financial markets, their fair values are determined by using stochastic models under a variety of market return scenarios. A variety of factors are considered including credit spread, expected market rates of return, equity and interest rate volatility, correlations of market returns, discount rates and actuarial assumptions. The most significant unobservable factor is discount rate. The credit spread used in the valuations of embedded derivatives in insurance contracts increased to 0.40% (December 31, 2015: 0.33%).

The expected returns are based on risk-free rates. Aegon added a premium to reflect the credit spread as required. The credit spread is set by using the credit default swap (CDS) spreads of a reference portfolio of life insurance companies (including Aegon), adjusted to reflect the subordination of senior debt holders at the holding company level to the position of policyholders at the operating company level (who have priority in payments to other creditors). Aegon's assumptions are set by region to reflect differences in the valuation of the guarantee embedded in the insurance contracts.

Since many of the assumptions are unobservable and are considered to be significant inputs to the liability valuation, the liability included in future policy benefits has been reflected within Level III of the fair value hierarchy.

*Effect of reasonably possible alternative assumptions*

The effect of changes in unobservable inputs on fair value measurement were not significantly different than those that were applied to the consolidated financial statements as at and for the year ended December 31, 2015.

**Fair value information about financial instruments not measured at fair value**

The following table presents the carrying values and estimated fair values of financial assets and liabilities, excluding financial instruments which are carried at fair value on a recurring basis.

**Fair value information about financial instruments not measured at fair value**



<i>EUR millions</i>	Total		Total	
	Carrying	estimated fair	Carrying	estimated fair
	amount December 31, 2016	value December 31, 2016	amount December 31, 2015	value December 31, 2015
<b>Assets</b>				
Mortgage loans - held at amortized cost	34,206	38,499	33,214	37,648
Private loans - held at amortized cost	3,166	3,569	2,847	3,165
Other loans - held at amortized cost	2,441	2,441	2,517	2,517
<b>Liabilities</b>				
Subordinated borrowings - held at amortized cost	767	844	759	828
Trust pass-through securities - held at amortized cost	156	141	157	146
Borrowings - held at amortized cost	12,543	12,935	11,829	12,194
Investment contracts - held at amortized cost	19,217	19,841	17,260	17,860

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

33

**Financial instruments for which carrying value approximates fair value**

Certain financial instruments that are not carried at fair value are carried at amounts that approximate fair value, due to their short-term nature and generally negligible credit risk. These instruments include cash and cash equivalents, short-term receivables and accrued interest receivable, short-term liabilities, and accrued liabilities. These instruments are not included in the table above.

**16. Deferred expenses**

<i>EUR millions</i>	Dec. 31, 2016	Dec. 31, 2015
Deferred policy acquisition costs (DPAC) for insurance contracts and investment contracts with discretionary participation features	10,882	10,457
Deferred cost of reinsurance	60	72
Deferred transaction costs for investment management services	481	467
<b>Total deferred expenses</b>	<b>11,423</b>	<b>10,997</b>

**17. Share capital**

<i>EUR millions</i>	Dec. 31, 2016	Dec. 31, 2015
Share capital - par value	319	328
Share premium	7,873	8,059
<b>Total share capital</b>	<b>8,193</b>	<b>8,387</b>
<b>Share capital - par value</b>		
Balance at January 1	328	327
Dividend	1	-
Shares withdrawn	(10)	-
<b>Balance</b>	<b>319</b>	<b>328</b>
<b>Share premium</b>		
Balance at January 1	8,059	8,270
Share dividend	(186)	(211)
<b>Balance</b>	<b>7,873</b>	<b>8,059</b>
<i>Basic and diluted earnings per share</i>		

EUR millions	Q4 2016	Q4 2015	FY 2016	FY 2015
<b>Earnings per share</b> (EUR per share)				
Basic earnings per common share	0.21	(0.29)	0.22	(0.31)
Basic earnings per common share B	0.01	(0.01)	0.01	(0.01)
Diluted earnings per common share	0.21	(0.29)	0.22	(0.31)
Diluted earnings per common share B	0.01	(0.01)	0.01	(0.01)
<b>Earnings per share calculation</b>				
Net income / (loss) attributable to equity holders of Aegon N.V.	470	(581)	586	(524)
Coupons on other equity instruments	(33)	(35)	(133)	(139)
Earnings attributable to common shares and common shares B	437	(616)	453	(663)
Earnings attributable to common shareholders	434	(612)	449	(659)
Earnings attributable to common shareholders B	3	(4)	3	(5)
Weighted average number of common shares outstanding (in millions)	2,033	2,109	2,048	2,101
Weighted average number of common shares B outstanding (in millions)	568	585	575	584

Unaudited

**Table of Contents**

## 34 Condensed Consolidated Interim Financial Statements Q4 2016

*Final dividend 2016*

It will be proposed to the Annual General Meeting of Shareholders on May 19, 2017, absent unforeseen circumstances, to pay a final dividend for the year 2016 of EUR 0.13 per common share. After taking into account the interim dividend 2016 of EUR 0.13 per common share, this will result in a total 2016 dividend of EUR 0.26 per common share. Proposed final dividend for the year and proposed total 2016 dividend per common share B amount to 1/40th of the dividend paid on common shares.

*Interim dividend 2016*

On August 11 Aegon has decided to pay an interim dividend 2016 in cash or stock at the election of the shareholder. The cash dividend amounted to EUR 0.13 per common share, the stock dividend amounted to one new Aegon common share for every 28 common shares held. Dividend paid on common shares B amounted to 1/40th of the dividend paid on common shares. 42% of shareholders elected to receive the stock dividend. The remaining 58% opted for cash dividend. The average share price calculated on this basis amounted to EUR 3.6190. The stock dividend and the cash dividend are approximately equal in value.

*Final dividend 2015*

The Annual General Meeting of Shareholders on May 20, 2016, approved a final dividend over 2015 of EUR 0.13 per common share payable in either cash or stock related to the second half of 2015. The stock dividend amounted to one new Aegon common share for every 30 common shares held. Dividend paid on common shares B amounted to 1/40th of the dividend paid on common shares. 43% of shareholders elected to receive the stock dividend. The remaining 57% opted for cash dividend. The average share price calculated on this basis amounted to EUR 3.9057. The stock dividend and the cash dividend are approximately equal in value.

*Share buyback*

To neutralize the dilutive effect of the 2015 final dividend paid in shares, Aegon executed a program to repurchase 29,258,662 common shares. Between July 4, 2016, and August 12, 2016, these common shares were repurchased at an average price of EUR 3.5054 per share. These shares will be held as treasury shares and will be used to cover future stock dividends.

As announced on January 13, 2016, Aegon also executed a share buyback program in which 83,116,535 common shares were repurchased. These common shares have been repurchased as part of a program to neutralize the dilutive effect of the cancellation of the preferred shares in 2013. The first tranche was completed on March 31, 2016. Aegon repurchased 41,082,683 common shares at an average price of EUR 4.8682 per share. Between April 1, 2016 and May 19, 2016, another 42,033,852 common shares were repurchased at an average price of EUR 4.7581 per share. It was decided at the Annual General Meeting of Shareholders on May 20, 2016, to cancel all repurchased shares under this program.

Furthermore in June 2016, Aegon repurchased 17,324,960 common shares B from Vereniging Aegon to keep the voting rights of Vereniging Aegon at the agreed level.

To neutralize the dilutive effect of the 2016 interim dividend paid in shares, Aegon executed a program to repurchase 30,765,224 common shares. Between October 3, 2016, and November 11, 2016, these common shares were repurchased at an average price of EUR 3.8406 per share. These shares will be held as treasury shares and will be used to cover future stock dividends.

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

35

**18. Borrowings**

<i>EUR millions</i>	Dec. 31, 2016	Dec. 31, 2015
Capital funding	2,386	2,015
Operational funding	10,766	10,430
<b>Total borrowings</b>	<b>13,153</b>	<b>12,445</b>

Included in borrowings is EUR 610 million relating to borrowings measured at fair value (December 31, 2015: EUR 617 million).

During 2016, Aegon redeemed EUR 450 million of ECB LTRO, EUR 225 million of ECB MRO, EUR 737 million of regular borrowings and repurchased the mortgage loans from SAECURE 9 and SAECURE 10 for EUR 1,658 million.

In addition, Aegon entered into a USD 3 billion new liquidity program from the Federal Home Loan Bank and issued a EUR 493 million covered bond.

On December 9, 2016 Aegon issued senior unsecured notes of EUR 500 million, due December 8, 2023. The notes were issued under Aegon's USD 6 billion debt issuance program at a price of 99.210%, and will carry a coupon of 1.00%.

**19. Assets and Liabilities held for sale**

The major type of assets included in the assets held for sale comprise of the reinsurance asset linked to the sale of Aegon UK's annuity portfolio. The liability included in the liabilities held for sale are the insurance liabilities related to this portfolio. The UK annuity portfolio was included in the United Kingdom segment. For details related to the sale of the UK annuity portfolio, refer to note 21 Acquisitions / divestments.

**20. Commitments and contingencies**

There have been no material changes in contingent assets and liabilities to those reported in Aegon's Annual Report for 2015.

**21. Acquisitions / divestments**

On January 18, 2016 Aegon Nederland N.V. sold its commercial non-life insurance business, which includes the proxy and co-insurance run-off portfolios. This business has an annual premium volume of approximately EUR 90 million. The total insurance liabilities from this business are EUR 334 million. The transaction was subsequently approved by the Dutch Central Bank (De Nederlandsche Bank) and the Dutch Authority for Consumers and Markets

(Autoriteit Consument & Markt). Aegon completed the sale on July 1, 2016, which resulted in a gain of EUR 11 million.

On May 3, 2016, Aegon announced it has agreed to buy BlackRock's UK defined contribution (DC) platform and administration business. Under the purchase agreement, Aegon will acquire approximately GBP 12 billion (EUR 15 billion) of assets and 350,000 customers from BlackRock, which serves institutional and retail clients. The transaction is subject to a Part VII transfer of the underlying assets and liabilities to Aegon, which is subject to regulatory and court approval.

On May 13, 2016, Aegon completed the sale of certain assets of Transamerica Financial Advisors, a full service independent broker-dealer and registered investment adviser, following regulatory approval. The transaction resulted in a pre tax gain of USD 58 million (EUR 52 million) recorded in the second quarter of 2016.

Unaudited

**Table of Contents****36 Condensed Consolidated Interim Financial Statements Q4 2016**

In the second quarter of 2016 Aegon sold its UK annuity portfolio in two parts. On April 11, 2016 Aegon announced the sale of around GBP 6 billion of the portfolio to Rothesay Life. On May 23, 2016 Aegon announced the sale of around GBP 3 billion of the portfolio to Legal & General. Aegon incurred a book loss on the transactions before tax of GBP 530 million (EUR 682 million), reported in the line other charges in the Condensed consolidated income statement. The transactions resulted in a tax benefit of GBP 41 million (EUR 53 million). Under the terms of the agreements, Aegon reinsured GBP 6.8 billion of liabilities to Rothesay Life and Legal & General, to be followed by a Part VII transfer<sup>1</sup>, which is subject to court approval. The loss on the reinsurance transaction is GBP 1.9 billion (EUR 2.4 billion) being the difference of the reinsurance premium paid and the reinsurance asset received related to the insurance liabilities. Upon disposal an amount of GBP 1.4 billion (EUR 1.8 billion) related to a positive revaluation reserve has been reclassified from Other Comprehensive Income into the income statement. Taking into account the results of the sale of the related bonds leads to abovementioned result on the transaction of GBP 530 million. The related net cash outflow amounted to GBP 647 million (EUR 831 million). Expenses related to the transaction, including cost of sale, amount to GBP 13 million (EUR 16 million).

On August 11, 2016 Aegon announced the acquisition of Cofunds from Legal & General for GBP 140 million (EUR 164 million). The purchase of the Cofunds Ltd business was done through a sale and purchase agreement to acquire all the shares and platform assets. On January 1st, 2017 Aegon completed the acquisition of Cofunds, following regulatory approval.

On September 22, 2016, Aegon completed the sale of 100% of its shares of Aegon Life Ukraine to TAS Group, and will exit the Ukrainian market. This transaction has no material impact on the consolidated numbers of Aegon.

*1 An insurance business transfer scheme under Part VII of the United Kingdom Financial Services and Markets Act 2000 allows an insurer to transfer policies as at a fixed time and date to another insurer, along with related contracts with other parties (including reinsurance).*

Unaudited



**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

37

**Disclaimers****Cautionary note regarding non-IFRS measures**

This document includes the following non-IFRS financial measures: underlying earnings before tax, income tax and income before tax. These non-IFRS measures are calculated by consolidating on a proportionate basis Aegon's joint ventures and associated companies. The reconciliation of these measures to the most comparable IFRS measure is provided in note 3 Segment information of Aegon's Condensed Consolidated Interim Financial Statements. Aegon believes that these non-IFRS measures, together with the IFRS information, provide meaningful information about the underlying operating results of Aegon's business including insight into the financial measures that senior management uses in managing the business.

**Forward-looking statements**

The statements contained in this document that are not historical facts are forward-looking statements as defined in the US Private Securities Litigation Reform Act of 1995. The following are words that identify such forward-looking statements: aim, believe, estimate, target, intend, may, expect, anticipate, predict, project, counting on, plan, continue, want, forecast, goal, should, would, is confident, will, and similar expressions as they relate to Aegon. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Aegon undertakes no obligation to publicly update or revise any forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which merely reflect company expectations at the time of writing. Actual results may differ materially from expectations conveyed in forward-looking statements due to changes caused by various risks and uncertainties. Such risks and uncertainties include but are not limited to the following:

- t Changes in general economic conditions, particularly in the United States, the Netherlands and the United Kingdom;
- t Changes in the performance of financial markets, including emerging markets, such as with regard to:
  - The frequency and severity of defaults by issuers in Aegon's fixed income investment portfolios;
  - The effects of corporate bankruptcies and/or accounting restatements on the financial markets and the resulting decline in the value of equity and debt securities Aegon holds; and
  - The effects of declining creditworthiness of certain private sector securities and the resulting decline in the value of sovereign exposure that Aegon holds;
- t Changes in the performance of Aegon's investment portfolio and decline in ratings of Aegon's counterparties;
- t Consequences of a potential (partial) break-up of the euro;
- t Consequences of the anticipated exit of the United Kingdom from the European Union;
- t The frequency and severity of insured loss events;
- t Changes affecting longevity, mortality, morbidity, persistence and other factors that may impact the profitability of Aegon's insurance products;

- t Reinsurers to whom Aegon has ceded significant underwriting risks may fail to meet their obligations;
- t Changes affecting interest rate levels and continuing low or rapidly changing interest rate levels;
- t Changes affecting currency exchange rates, in particular the EUR/USD and EUR/GBP exchange rates;
- t Changes in the availability of, and costs associated with, liquidity sources such as bank and capital markets funding, as well as conditions in the credit markets in general such as changes in borrower and counterparty creditworthiness;
- t Increasing levels of competition in the United States, the Netherlands, the United Kingdom and emerging markets;
- t Changes in laws and regulations, particularly those affecting Aegon's operations' ability to hire and retain key personnel, taxation of Aegon companies, the products Aegon sells, and the attractiveness of certain products to its consumers;
- t Regulatory changes relating to the pensions, investment, and insurance industries in the jurisdictions in which Aegon operates;
- t Standard setting initiatives of supranational standard setting bodies such as the Financial Stability Board and the International Association of Insurance Supervisors or changes to such standards that may have an impact on regional (such as EU), national or US federal or state level financial regulation or the application thereof to Aegon, including the designation of Aegon by the Financial Stability Board as a Global Systemically Important Insurer (G-SII);
- t Changes in customer behavior and public opinion in general related to, among other things, the type of products Aegon sells, including legal, regulatory or commercial necessity to meet changing customer expectations;
- t Acts of God, acts of terrorism, acts of war and pandemics;
- t Changes in the policies of central banks and/or governments;
- t Lowering of one or more of Aegon's debt ratings issued by recognized rating organizations and the adverse impact such action may have on Aegon's ability to raise capital and on its liquidity and financial condition;
- t Lowering of one or more of insurer financial strength ratings of Aegon's insurance subsidiaries and the adverse impact such action may have on the premium writings, policy retention, profitability and liquidity of its insurance subsidiaries;
- t The effect of the European Union's Solvency II requirements and other regulations in other jurisdictions affecting the capital Aegon is required to maintain;
- t Litigation or regulatory action that could require Aegon to pay significant damages or change the way Aegon does business;
- t As Aegon's operations support complex transactions and are highly dependent on the proper functioning of information technology, a computer system failure or security breach may disrupt Aegon's business, damage its reputation and adversely affect its results of operations, financial condition and cash flows;
- t Customer responsiveness to both new products and distribution channels;
- t Competitive, legal, regulatory, or tax changes that affect profitability, the distribution cost of or demand for Aegon's products;
- t Changes in accounting regulations and policies or a change by Aegon in applying such regulations and policies, voluntarily or otherwise, which may affect Aegon's reported results and shareholders' equity;
- t Aegon's projected results are highly sensitive to complex mathematical models of financial markets, mortality, longevity, and other dynamic systems subject to shocks and unpredictable volatility. Should assumptions to these models later prove incorrect, or should errors in those models escape the controls in place to detect them, future performance will vary from projected results;
- t The impact of acquisitions and divestitures, restructurings, product withdrawals and other unusual items, including Aegon's ability to integrate acquisitions and to obtain the anticipated results and synergies from acquisitions;
- t Catastrophic events, either manmade or by nature, could result in material losses and significantly interrupt Aegon's business;
- t Aegon's failure to achieve anticipated levels of earnings or operational efficiencies as well as other cost saving and excess capital and leverage ratio management initiatives; and
- t This press release contains information that qualifies, or may qualify, as inside information within the meaning of Article 7(1) of the EU Market Abuse Regulation.

Further details of potential risks and uncertainties affecting Aegon are described in its filings with the Netherlands Authority for the Financial Markets and the US Securities and Exchange Commission, including the Annual Report. These forward-looking statements speak only as of the date of this document. Except as required by any applicable law or regulation, Aegon expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in Aegon's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Unaudited

**Table of Contents**

Condensed Consolidated Interim Financial Statements Q4 2016

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10

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Aegon's Q4 2016 press release and Financial Supplement are available on [aegon.com](http://aegon.com).

## About Aegon

Aegon's roots go back more than 170 years to the first half of the nineteenth century. Since then, Aegon has grown into an international company, with businesses in more than 20 countries in the Americas, Europe and Asia. Today, Aegon is one of the world's leading financial services organizations, providing life insurance, pensions and asset management. Aegon's purpose is to help people achieve a lifetime of financial security. More information: [aegon.com](http://aegon.com).