NORTHROP GRUMMAN CORP /DE/
Form 10-Q
April 22, 2009

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

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2009

or

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

Commission File Number 1-16411

NORTHROP GRUMMAN CORPORATION
(Exact name of registrant as specified in its charter)

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

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

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

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

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

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

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting Company	o

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

Yes o No x

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of April 20, 2009, 323,468,808 shares of common stock were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (Unaudited)

	Three Months Ended March 31	
$ in millions, except per share amounts	**2009**	2008
Sales and Service Revenues		
Product sales	**$ 4,570**	$ 4,394
Service revenues	**3,750**	3,330
Total sales and service revenues	**$ 8,320**	$ 7,724
Cost of Sales and Service Revenues		
Cost of product sales	**3,635**	3,729
Cost of service revenues	**3,281**	2,793
General and administrative expenses	**749**	738
Operating income	**$ 655**	$ 464
Other (expense) income		
Interest expense	**(73)**	(77)
Other, net	**8**	22
Earnings from continuing operations before income taxes	**590**	409
Federal and foreign income taxes	**201**	146
Earnings from continuing operations	**389**	263
Income from discontinued operations, net of tax		1
Net earnings	**$ 389**	$ 264
Basic Earnings Per Share		
Continuing operations	**$ 1.19**	$ .78
Discontinued operations		
Basic earnings per share	**$ 1.19**	$ .78
Weighted-average common shares outstanding, in millions	**326.9**	338.8
Diluted Earnings Per Share		
Continuing operations	**$ 1.17**	$ .76
Discontinued operations		
Diluted earnings per share	**$ 1.17**	$ .76

Weighted-average diluted shares outstanding, in millions	**332.1**	349.3
Net earnings (from above)	**$ 389**	$ 264
Other comprehensive income		
Change in cumulative translation adjustment	**(14)**	3
Change in unrealized gain (loss) on marketable securities and cash flow hedges, net of tax	**7**	(2)
Change in unamortized benefit plan costs, net of tax	**53**	4
Other comprehensive income, net of tax	**46**	5
Comprehensive income	**$ 435**	$ 269

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

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CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (Unaudited)

$ in millions	**March 31, 2009**	December 31, 2008
Assets		
Cash and cash equivalents	**$ 882**	$ 1,504
Accounts receivable, net of progress payments	**4,416**	3,904
Inventoried costs, net of progress payments	**1,178**	1,003
Deferred income taxes	**520**	549
Prepaid expenses and other current assets	**256**	229
Total current assets	**7,252**	7,189
Property, plant, and equipment, net of accumulated depreciation of $3,925 in 2009 and $3,803 in 2008	**4,777**	4,810
Goodwill	**14,524**	14,518
Other purchased intangibles, net of accumulated amortization of $1,821 in 2009 and $1,795 in 2008	**921**	947
Pension and postretirement plan assets	**292**	290
Long-term deferred tax assets	**1,455**	1,510
Miscellaneous other assets	**921**	933
Total assets	**$ 30,142**	$ 30,197
Liabilities		
Notes payable to banks	**$ 24**	$ 24
Current portion of long-term debt	**565**	477
Trade accounts payable	**1,924**	1,943
Accrued employees compensation	**1,280**	1,284
Advance payments and billings in excess of costs incurred	**1,953**	2,036
Other current liabilities	**1,763**	1,660
Total current liabilities	**7,509**	7,424
Long-term debt, net of current portion	**3,352**	3,443
Pension and postretirement plan liabilities	**5,721**	5,823
Other long-term liabilities	**1,503**	1,587
Total liabilities	**18,085**	18,277
Commitments and Contingencies (Note 10)		
Shareholders Equity		
Common stock, $1 par value; 800,000,000 shares authorized; issued and outstanding: 2009 324,674,859; 2008 327,012,663	**325**	327
Paid-in capital	**9,482**	9,645
Retained earnings	**5,846**	5,590

Accumulated other comprehensive loss	**(3,596)**	(3,642)
Total shareholders equity	**12,057**	11,920
Total liabilities and shareholders equity	**$ 30,142**	$ 30,197

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Three Months Ended March 31,	
$ in millions	**2009**	2008
Operating Activities		
Sources of Cash Continuing Operations		
Cash received from customers		
Progress payments	**$ 1,174**	$ 1,608
Collections on billings	**6,326**	5,950
Other cash receipts	**51**	33
Total sources of cash continuing operations	**7,551**	7,591
Uses of Cash Continuing Operations		
Cash paid to suppliers and employees	**(7,530)**	(7,189)
Interest paid, net of interest received	**(98)**	(106)
Income taxes paid, net of refunds received	**(73)**	(52)
Excess tax benefits from stock-based compensation		(44)
Other cash payments	**(22)**	(3)
Total uses of cash continuing operations	**(7,723)**	(7,394)
Cash (used in) provided by continuing operations	**(172)**	197
Cash used in discontinued operations		(3)
Net cash (used in) provided by operating activities	**(172)**	194
Investing Activities		
Additions to property, plant, and equipment	**(162)**	(143)
Payments for outsourcing contract costs and related software costs	**(18)**	(35)
Decrease in restricted cash	**3**	26
Other investing activities, net	**1**	4
Net cash used in investing activities	**(176)**	(148)
Financing Activities		
Net (payments) borrowings under lines of credit	**(1)**	33
Proceeds from exercises of stock options and issuances of common stock	**8**	69
Dividends paid	**(131)**	(126)
Excess tax benefits from stock-based compensation		44
Common stock repurchases	**(150)**	(600)

Net cash used in financing activities	**(274)**	(580)
Decrease in cash and cash equivalents	**(622)**	(534)
Cash and cash equivalents, beginning of period	**1,504**	963
Cash and cash equivalents, end of period	**$ 882**	$ 429

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$ in millions	Three Months Ended March 31, **2009**	2008
Reconciliation of Net Earnings to Net Cash (Used in) Provided by Operating Activities		
Net Earnings	**$ 389**	$ 264
Adjustments to reconcile to net cash (used in) provided by operating activities		
Depreciation	**137**	136
Amortization of assets	**38**	62
Stock-based compensation	**35**	44
Excess tax benefits from stock-based compensation		(44)
Decrease (increase) in		
Accounts receivable	**(1,762)**	(2,080)
Inventoried costs	**(355)**	(266)
Prepaid expenses and other current assets	**(33)**	(15)
Increase (decrease) in		
Progress payments	**1,431**	1,642
Accounts payable and accruals	**(230)**	254
Deferred income taxes	**45**	26
Income taxes payable	**131**	112
Retiree benefits	**(5)**	31
Other non-cash transactions, net	**7**	31
Cash (used in) provided by continuing operations	**(172)**	197
Cash used in discontinued operations		(3)
Net cash (used in) provided by operating activities	**$ (172)**	$ 194
Non-Cash Investing and Financing Activities		
Mandatorily redeemable convertible preferred stock converted into common stock		$ 304

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

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CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)

	Three Months Ended March 31	
$ in millions, except per share	**2009**	2008
Common Stock		
At beginning of period	**$ 327**	$ 338
Common stock repurchased	**(4)**	(8)
Conversion of preferred stock		6
Employee stock awards and options	**2**	3
At end of period	**325**	339
Paid-in Capital		
At beginning of period	**9,645**	10,661
Common stock repurchased	**(161)**	(592)
Conversion of preferred stock		298
Employee stock awards and options	**(2)**	71
At end of period	**9,482**	10,438
Retained Earnings		
At beginning of period	**5,590**	7,387
Net earnings	**389**	264
Adoption of new accounting standards		(3)
Dividends declared	**(133)**	(130)
At end of period	**5,846**	7,518
Accumulated Other Comprehensive Loss		
At beginning of period	**(3,642)**	(699)
Other comprehensive income, net of tax	**46**	5
At end of period	**(3,596)**	(694)
Total shareholders equity	**$ 12,057**	$ 17,601
Cash dividends declared per share	**$ .40**	$ .37

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. BASIS OF PRESENTATION

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

The accompanying unaudited condensed consolidated financial statements of the company have been prepared by management in accordance with the instructions to Form 10-Q of the Securities and Exchange Commission. These statements include all adjustments of normal recurring nature considered necessary by management for a fair presentation of the condensed consolidated financial position, results of operations, and cash flows. The results reported in these financial statements are not necessarily indicative of results that may be expected for the entire year. These financial statements should be read in conjunction with the audited consolidated financial statements, including the notes thereto contained in the company s 2008 Annual Report on Form 10-K.

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

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

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

$ in millions	**March 31, 2009**	December 31, 2008
Cumulative translation adjustment	**$ (4)**	$ 10
Unrealized loss on marketable securities and cash flow hedges, net of tax benefit of $16 as of March 31, 2009 and $20 as of December 31, 2008	**(25)**	(32)
Unamortized benefit plan costs, net of tax benefit of $2,322 as of March 31, 2009 and $2,358 as of December 31, 2008	**(3,567)**	(3,620)
Total accumulated other comprehensive loss	**$ (3,596)**	$ (3,642)

Financial Statement Reclassifications Certain amounts in the prior period notes to the condensed consolidated financial statements have been reclassified to reflect the business operations realignments effective in 2009 (see Note 6).

2. NEW ACCOUNTING STANDARDS

Adoption of New Accounting Standards

The disclosure requirements of SFAS No. 157 *Fair Value Measurements*, which took effect on January 1, 2008, are presented in Note 3. On January 1, 2009, the company implemented the previously deferred provisions of SFAS No. 157 for nonfinancial assets and liabilities recorded at fair value, as required.

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The disclosure requirements of SFAS No. 161 *Disclosures about Derivative Instruments and Hedging Activities,* which took effect on January 1, 2009, are presented in Note 3.

The accounting requirements of SFAS No. 141(R) *Business Combinations,* which took effect on January 1, 2009, were adopted but had no impact on the company s financial statements.

The accounting and presentation requirements of SFAS No. 160 *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51,* which took effect on January 1, 2009, had no impact on the financial statements as the company s non-controlling interests were not material.

Standards Issued But Not Yet Effective

Other new pronouncements issued but not effective until after March 31, 2009, are not expected to have a significant effect on the company s consolidated financial position or results of operations.

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

As of March 31, 2009, and December 31, 2008, respectively, there were marketable equity securities of $41 million and $44 million included in prepaid expenses and other current assets and $175 million and $180 million of marketable debt and equity securities included in miscellaneous other assets. These assets are recorded at fair value, substantially all of which are based upon quoted market prices in active markets. These investments can be liquidated without restriction. Other financial instruments recorded at fair value based on other observable inputs are not material. Pension plan assets are measured at fair value on their annual measurement date.

As of March 31, 2009, the company had interest rate swap agreements, forward starting swap agreements, and foreign currency exchange contracts, with notional values totaling $400 million, $400 million and $289 million, respectively. The interest rate swaps, forward starting swaps, and a portion of the foreign currency exchange contracts agreements were designated as hedging instruments under SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*, while the remainder of the foreign exchange contracts were not designated as hedging instruments.

The fair value of the forward starting swap agreements was a $45 million liability at March 31, 2009 and a $58 million liability at December 31, 2008 and included in other current liabilities. All other derivative fair values and related unrealized gains and losses at March 31, 2009 and for the three months then ended were not material.

Derivative financial instruments are recognized as assets or liabilities in the financial statements and measured at fair value. Changes in the fair value of derivative financial instruments that qualify and are designated as fair value hedges are recorded in earnings from continuing operations, while the effective portion of the changes in the fair value of derivative financial instruments that qualify and are designated as cash flow hedges are recorded in other comprehensive income. The company may use derivative financial instruments to manage its exposure to interest rate and foreign currency exchange risks and to balance its fixed and variable rate long-term debt portfolio. The company does not use derivative financial instruments for trading or speculative purposes, nor does it use leveraged financial instruments. Credit risk related to derivative financial instruments is considered minimal and is managed by requiring high credit standards for its counterparties and periodic settlements.

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

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4. CONVERSION OF PREFERRED STOCK

On February 20, 2008, the company s board of directors approved the redemption of the 3.5 million shares of mandatorily redeemable convertible preferred stock on April 4, 2008. Prior to the redemption date, substantially all of the preferred shares were converted into common stock at the election of shareholders. All remaining unconverted preferred shares were redeemed by the company on the redemption date. As a result of the conversion and redemption, the company issued approximately 6.4 million shares of common stock.

5. BUSINESS ACQUISITIONS AND DISPOSITIONS

Acquisitions
3001 In October 2008, the company acquired 3001 International, Inc. (3001) for approximately $92 million in cash. 3001 provides geospatial data production and analysis, including airborne imaging, surveying, mapping and geographic information systems for U.S. and international government intelligence, defense and civilian customers. The operating results of 3001 are reported in the Information Systems segment from the date of acquisition. The condensed consolidated financial statements reflect preliminary estimates of the fair value of the assets acquired and liabilities assumed and the related allocation of the purchase price for the entities acquired. Management does not expect adjustments to these estimates, if any, to have a material effect on the company s condensed consolidated financial position or results of operations.

Dispositions
Electro-Optical Systems In April 2008, the company sold its Electro-Optical Systems (EOS) business for $175 million in cash to L-3 Communications Corporation and recognized a gain of $19 million, net of taxes of $39 million. EOS, formerly a part of the Electronic Systems segment, produces night vision and applied optics products. Sales for this business for the three months ended March 31, 2008 were approximately $43 million. Operating results of this business are reported as discontinued operations in the condensed consolidated statements of operations and comprehensive income for all applicable periods presented.

6. SEGMENT INFORMATION

In January 2009, the company streamlined its organizational structure by reducing the number of operating segments from seven to five. The five segments are Information Systems, which combines the former Information Technology and Mission Systems segments; Aerospace Systems, which combines the former Integrated Systems and Space Technology segments; Electronic Systems; Shipbuilding; and Technical Services. These five segment are considered reportable segments in accordance with SFAS No. 131 *Disclosures about Segments of an Enterprise and Related Information*. Intersegment sales and intersegment operating (loss) income between the former Integrated Systems and Space Technology segments, and between the former Information Technology and Mission Systems segments have been eliminated as part of the realignment. The creation of the Information Systems and Aerospace Systems segments is intended to strengthen alignment with customers, improve the company s ability to execute on programs and win new business, and enhance cost competitiveness. Product sales are predominantly generated in the Aerospace Systems, Electronic Systems and Shipbuilding segments, while the majority of the company s service revenues are generated by the Information Systems and Technical Services segments.

During the first quarter of 2009, the company realigned certain logistics, services, and technical support programs and assets from the Information Systems and Electronic Systems segments to the Technical Services segment. This realignment is intended to strengthen the company s core capability in aircraft and electronics maintenance, repair and overhaul, life cycle optimization, and training and simulation services.

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Sales and segment operating income in the following tables have been revised to reflect the above realignments for all periods presented.

During the first quarter of 2009, the company transferred certain optics and laser programs from Information Systems to Aerospace Systems. As the operating results of this business were not considered material, the prior year sales and operating income were not reclassified to reflect this business transfer.

The following table presents segment sales and service revenues for the three months ended March 31, 2009 and 2008.

	Three Months Ended March 31	
$ in millions	**2009**	2008
Sales and Service Revenues		
Information Systems	**$ 2,491**	$ 2,298
Aerospace Systems	**2,456**	2,361
Electronic Systems	**1,788**	1,545
Shipbuilding	**1,375**	1,264
Technical Services	**632**	558
Intersegment eliminations	**(422)**	(302)
Total sales and service revenues	**$ 8,320**	$ 7,724

The following table presents segment operating income reconciled to total operating income for the three months ended March 31, 2009 and 2008.

	Three Months Ended March 31	
$ in millions	**2009**	2008
Operating Income		
Information Systems	**$ 223**	$ 212
Aerospace Systems	**258**	252
Electronic Systems	**229**	209
Shipbuilding	**84**	(218)
Technical Services	**37**	29
Intersegment eliminations	**(40)**	(26)
Total segment operating income	**791**	458
Non-segment factors affecting operating income Unallocated expenses	**(53)**	(32)
Net pension adjustment	**(76)**	59
Royalty income adjustment	**(7)**	(21)

Total operating income	**$ 655**	$ 464

Shipbuilding Earnings Charge Relating to LHD-8 Contract Performance During the first quarter of 2008, the company recorded a pre-tax charge of $272 million for cost growth on the LHD-8 contract and an additional $54 million, primarily for schedule impacts on other ships and impairment of purchased intangibles at the Gulf Coast shipyards. During the second half of 2008, the LHD-8 program achieved several important risk retirement milestones toward its planned delivery date and as a result $63 million of the first quarter 2008 charge was reversed in the second half of 2008. In the three months ended March 31, 2009, the LHD-8 completed U.S. Navy acceptance sea trials ahead of schedule and, as a result, an additional $30 million of the first quarter 2008 charge was reversed.

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

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

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

7. EARNINGS PER SHARE

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

Diluted Earnings Per Share Diluted earnings per share include the dilutive effect of stock options and other stock awards granted to employees under stock-based compensation plans, and, for 2008, the company s mandatorily redeemable convertible preferred stock (See Note 4). The dilutive effect of these securities totaled 5.2 million shares and 10.5 million shares for the three months ended March 31, 2009 and 2008, respectively, including 4.5 million shares for the preferred stock in the three months ended March 31, 2008. The weighted-average diluted shares outstanding for the three months ended March 31, 2009 and 2008, exclude stock options to purchase approximately 13.4 million and 1.3 million shares, respectively, because such options have an exercise price in excess of the average market price of the company s common stock during the period.

Diluted earnings per share from continuing operations are calculated as follows:

	Three Months Ended March 31	
in millions, except per share	**2009**	2008
Diluted Earnings Per Share From Continuing Operations		
Earnings from continuing operations	**$ 389**	$ 263
Add dividends on mandatorily redeemable convertible preferred stock		1
Income from continuing operations available to common shareholders	**$ 389**	$ 264
Weighted-average common shares outstanding	**326.9**	338.8
Dilutive effect of stock options, awards and mandatorily redeemable convertible preferred stock	**5.2**	10.5
Weighted-average diluted common shares outstanding	**332.1**	349.3

Diluted earnings per share from continuing operations	**$ 1.17**	$ .76

Share Repurchases The table below summarizes the company s share repurchases beginning January 1, 2008:

				Shares Repurchased (in millions) Three Months Ended March 31,	
Authorization Date	Amount Authorized (in millions)	Average Price Per Share	Total Shares Retired (in millions)	**2009**	2008
December 19, 2007	$ 2,500	$ 67.05	25.7	**4.2**	7.6

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Share repurchases take place at management s discretion or under pre-established non-discretionary programs from time to time, depending on market conditions, in the open market, and in privately negotiated transactions. The company retires its common stock upon repurchase and has not made any purchases of common stock other than in connection with these publicly announced repurchase programs. As of March 31, 2009, the company has $780 million remaining under this authorization for share repurchases.

8. GOODWILL AND OTHER PURCHASED INTANGIBLE ASSETS

Goodwill

The changes in the carrying amounts of goodwill for the three months ended March 31, 2009, were as follows:

$ in millions	Balance as of December 31, 2008	Goodwill Transfers	Goodwill Adjustments	**Balance as of March 31, 2009**
Information Systems	$ 6,399	$ (138)	$ (1)	**$ 6,260**
Aerospace Systems	3,748	41	7	**3,796**
Electronic Systems	2,428	(26)		**2,402**
Shipbuilding	1,141			**1,141**
Technical Services	802	123		**925**
Total	$ 14,518	$	$ 6	**$ 14,524**

Goodwill Transfers - During the first quarter of 2009, the company realigned certain logistics, services, and technical support programs and assets from the Information Systems and Electronic Systems segments to the Technical Services segment. As a result of this realignment, goodwill of approximately $123 million was reallocated between these segments. Additionally during the first quarter of 2009, the company transferred certain optics and laser programs from Information Systems to Aerospace Systems resulting in the reallocation of goodwill of approximately $41 million.

Purchased Intangible Assets

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

	March 31, 2009			December 31, 2008		
$ in millions	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Contract and program intangibles	**$ 2,642**	**$ (1,745)**	**$ 897**	$ 2,642	$ (1,720)	$ 922
Other purchased intangibles	**100**	**(76)**	**24**	100	(75)	25
Total	**$ 2,742**	**$ (1,821)**	**$ 921**	$ 2,742	$ (1,795)	$ 947

The company s purchased intangible assets are subject to amortization and are being amortized on a straight-line basis over an aggregate weighted-average period of 21 years. Aggregate amortization expense for the three months ended March 31, 2009, was $26 million.

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The table below shows expected amortization for purchased intangibles for the remainder of 2009 and for the next five years:

$ in millions	
Year ending December 31	
2009 (April 1 December 31)	$ 76
2010	91
2011	54
2012	53
2013	43
2014	34

9. LITIGATION

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

On April 2, 2009, the company reached an agreement with the U.S. Government to settle two previously disclosed legal matters. The first matter involved potentially substantial claims by the U.S. Department of Justice and a restricted U.S. Government customer relating to certain microelectronic parts produced by the Space and Electronics Sector of former TRW Inc., now a part of the company. In the third quarter of 2006, the company proposed to settle the claims and any associated matters and recognized a pre-tax charge of $112.5 million to cover the cost of the settlement proposal and associated investigative costs. While the company believes that it acted properly under its contracts and had substantive defenses to the claims, it also believes that the settlement agreement is in the best interests of all parties as it releases the company from the government s claims, avoids litigation and preserves a valued customer relationship. Under the terms of the settlement agreement, the U.S. Department of Justice valued its claims regarding the microelectronics matter at $325 million. The second matter covered by the settlement agreement involved a lawsuit filed by the company in 1996 against the U.S. Government in the U.S. Court of Federal Claims relating to the Tri-Service Standoff Attack Missile (TSSAM) program. As previously disclosed, the company received a termination for convenience notice on the program and sought recovery for uncompensated performance costs, investments and a reasonable profit on the program. Under the terms of the settlement agreement, the U.S. Department of Justice valued the company s TSSAM claims at $325 million. The settlement amounts for the two matters are equal and thereby offset each other. The financial impact of the settlement agreement, including its related cost, on the previously recorded accrual for the microelectronics claim and any adjustments for other legal matters will result in a net gain for the second quarter of 2009. The settlement agreement will not have a significant impact on the company s cash from operations.

As previously disclosed, in the second quarter of 2007, the U.S. Coast Guard issued a revocation of acceptance under the Deepwater Program for eight converted 123-foot patrol boats (the vessels) based on alleged hull buckling and shaft alignment problems and alleged nonconforming topside equipment on the vessels. The company submitted a written response that argued that the revocation of acceptance was improper, and in late December 2007, the Coast Guard advised Integrated Coast Guard Systems (the contractors joint venture for performing the Deepwater Program, the Joint Venture) that the Coast Guard was seeking $96.1 million from the Joint Venture as a result of the revocation of acceptance of the eight vessels delivered under the 123-foot conversion program. The majority of the costs associated with the 123-foot conversion effort are associated with

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the alleged structural deficiencies of the vessels, which were converted under contracts with the company and a subcontractor to the company. In May 2008, the Coast Guard advised the Joint Venture that the Coast Guard would support an investigation by the U.S. Department of Justice of the Joint Venture and its subcontractors instead of pursuing its $96.1 million claim independently. The Department of Justice had previously issued subpoenas related to the Deepwater Program, pursuant to which the company has provided responsive documents. On February 6, 2009, the U.S. Department of Justice notified the U.S. District Court for the Northern District of Texas that the U.S. Government is not intervening at this time in what was then a sealed False Claims Act complaint. On February 12, the Court unsealed the complaint filed by Michael J. DeKort, a former Lockheed Martin employee, against Integrated Coast Guard Systems, Lockheed Martin Corporation and the company, relating to the 123-foot conversion effort. Based upon the information available to the company to date, the company believes that it has substantive defenses to any potential claims but can give no assurance that the company will prevail in this litigation.

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

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

Litigation Various claims and legal proceedings arise in the ordinary course of business and are pending against the company and its properties. Based upon the information available, the company believes that the resolution of any of these various claims and legal proceedings would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

As previously disclosed, the U.S. District Court for the Central District of California consolidated two separately filed Employee Retirement Income Security Act (ERISA) lawsuits, which the plaintiffs seek to have certified as class actions, into the In Re Northrop Grumman Corporation ERISA Litigation. On August 7, 2007, the Court denied plaintiffs motion for class certification, and the plaintiffs appealed the Court s decision on class certification to the U.S. Court of Appeals for the Ninth Circuit. On October 11, 2007, the Ninth Circuit granted appellate review, which delayed the commencement of trial previously scheduled to begin January 22, 2008. The company believes that the outcome of these matters would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Insurance Recovery As previously disclosed, the company is pursuing legal action against an insurance provider arising out of a disagreement concerning the coverage of certain losses related to Hurricane Katrina (see Note 10). The company commenced the action against Factory Mutual Insurance Company (FM Global) on November 4, 2005, which is now pending in the U.S. District Court for the Central District of California, Western Division. In August 2007, the district court issued an order finding that the excess insurance policy provided coverage for the company s

Katrina-related loss. In November 2007, FM Global filed a notice of appeal of the district court s order. On August 14, 2008, the U.S. Court of Appeals for the Ninth Circuit reversed the earlier summary judgment order in favor of the company, holding that the FM Global excess policy unambiguously excludes damage from the storm surge caused by Hurricane Katrina under its Flood exclusion. The Court of Appeals remanded the case to the district court to determine whether the California efficient proximate cause doctrine affords the company coverage under the policy even if the Flood exclusion of the

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policy is unambiguous. The company filed a Petition for Rehearing En Banc, or in the Alternative, For Panel Rehearing with the Court of Appeals on August 27, 2008. On April 2, 2009, the Court of Appeals denied the company s Petition for Rehearing and remanded the case to the district court. Based on the current status of the assessment and claim process, no assurances can be made as to the ultimate outcome of this matter.

Provisions for Legal & Investigative Matters Litigation accruals are recorded as charges to earnings when management, after taking into consideration the facts and circumstances of each matter, including any settlement offers, has determined that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The ultimate resolution of any exposure to the company may vary from earlier estimates as further facts and circumstances become known.

10. COMMITMENTS AND CONTINGENCIES

Contract Performance Contingencies Contract profit margins may include estimates of revenues not contractually agreed to between the customer and the company for matters such as contract changes, negotiated settlements, claims and requests for equitable adjustment for previously unanticipated contract costs. These estimates are based upon management s best assessment of the underlying causal events and circumstances, and are included in determining contract profit margins to the extent of expected recovery based on contractual entitlements and the probability of successful negotiation with the customer. As of March 31, 2009, the recognized amounts related to the aforementioned items are not material individually or in the aggregate.

Environmental Matters In accordance with company policy on environmental remediation, the estimated cost to complete remediation has been accrued where it is probable that the company will incur such costs in the future to address environmental impacts at currently or formerly owned or leased operating facilities, or at sites where it has been named a Potentially Responsible Party (PRP) by the Environmental Protection Agency, or similarly designated by other environmental agencies. To assess the potential impact on the company s consolidated financial statements, management estimates the total reasonably possible remediation costs that could be incurred by the company, taking into account currently available facts on each site as well as the current state of technology and prior experience in remediating contaminated sites. These estimates are reviewed periodically and adjusted to reflect changes in facts and technical and legal circumstances. Management estimates that as of March 31, 2009, the range of reasonably possible future costs for environmental remediation sites is $191 million to $269 million, of which $232 million is accrued in other current liabilities. Factors that could result in changes to the company s estimates include: modification of planned remedial actions, increases or decreases in the estimated time required to remediate, discovery of more extensive contamination than anticipated, changes in laws and regulations affecting remediation requirements, and improvements in remediation technology. Should other PRPs not pay their allocable share of remediation costs, the company may have to incur costs in addition to those already estimated and accrued. Although management cannot predict whether new information gained as projects progress will materially affect the estimated liability accrued, management does not anticipate that future remediation expenditures will have a material adverse effect on the company s consolidated financial position, results of operations, or cash flows.

Hurricane Impacts During the third quarter of 2008, the Gulf Coast shipyards were affected by Hurricane Gustav. As a result of the storm, the Gulf Coast shipyards experienced a shut-down for several days, and a resulting minor delay in ship construction throughout the yards; however the storm caused no significant physical damage to the yards. Shipbuilding s sales and operating income in 2008 were reduced by approximately $100 million and

$13 million, respectively, during the second half of 2008 due to lost production and additional costs resulting from the shut-down.

Also during the third quarter of 2008, a subcontractor s operations in Texas were severely impacted by Hurricane Ike. The subcontractor produces compartments for two of the LPD amphibious transport dock ships under construction at the Gulf Coast shipyards. As a result of the delays and cost growth caused by the subcontractor s

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resulting production impacts, Shipbuilding s 2008 operating income was reduced by approximately $23 million during the second half of 2008.

In August 2005, the company s Gulf Coast operations were significantly impacted by Hurricane Katrina and the company s shipyards in Louisiana and Mississippi sustained significant windstorm damage from the hurricane. As a result of the storm, the company incurred costs to replace or repair destroyed or damaged assets, suffered losses under its contracts, and incurred substantial costs to clean up and recover its operations. As of the date of the storm, the company had a comprehensive insurance program that provided coverage for, among other things, property damage, business interruption impact on net profitability, and costs associated with clean-up and recovery. The company has recovered a portion of its Hurricane Katrina claim and expects that its remaining claim will be resolved separately with the two remaining insurers, including FM Global (See Note 9).

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

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

Co-Operative Agreements In 2003, Shipbuilding executed agreements with the states of Mississippi and Louisiana whereby Shipbuilding leases facility improvements and equipment from Mississippi and from a non-profit economic development corporation in Louisiana in exchange for certain commitments by Shipbuilding to these states. As of March 31, 2009, Shipbuilding has fully met its obligations under the Mississippi agreement and has met all but one requirement under the Louisiana agreement. Failure by Shipbuilding to meet the remaining Louisiana commitment would result in reimbursement by Shipbuilding to Louisiana in accordance with the agreement. As of March 31, 2009, Shipbuilding expects that the remaining commitment under the Louisiana agreement will be met based on its most recent business plan.

Financial Arrangements In the ordinary course of business, the company uses standby letters of credit and guarantees issued by commercial banks and surety bonds issued principally by insurance companies to guarantee the performance on certain contracts and to support the company s self-insured workers compensation plans. At March 31, 2009, there were $460 million of unused stand-by letters of credit, $120 million of bank guarantees, and $456 million of surety bonds outstanding.

The company has also guaranteed a $200 million loan made to Shipbuilding in connection with the Gulf Opportunity Zone Industrial Revenue Bonds issued in December 2006. Under the loan agreement, the company guaranteed repayment of the principal and interest to the Trustee and the underlying bondholders.

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

U.S. Government Claims Annually, the company files cost submissions to the U.S. Government to support its claimed amounts of overhead, home office and other indirect costs. On occasions, these cost submissions result in

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questioned costs, claims and or penalty assertions by the U.S. Government which give rise to dispute resolution in various forms. The company believes it has adequately provided for the ultimate outcome of any such matters based on, among other considerations, its assessment of the relevant government regulations. The company does not believe that the outcome of any such matters would have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Operating Leases Rental expense for operating leases, excluding discontinued operations, for the three months ended March 31, 2009 and 2008 was $141 million and $139 million, respectively. These amounts are net of immaterial amounts of sublease rental income.

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

11. RETIREMENT BENEFITS

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

	Three Months Ended March 31			
	Pension Benefits		Medical and Life Benefits	
$ in millions	**2009**	2008	**2009**	2008
Components of Net Periodic Benefit Cost				
Service cost	**$ 165**	$ 181	**$ 12**	$ 14
Interest cost	**337**	334	**41**	41
Expected return on plan assets	**(389)**	(475)	**(12)**	(16)
Amortization of:				
Prior service cost (credit)	**12**	10	**(15)**	(16)
Net loss from previous years	**85**	6	**7**	5
Net periodic benefit cost	**$ 210**	$ 56	**$ 33**	$ 28
Defined contribution plans cost	**$ 82**	$ 75		

Employer Contributions In 2009, the company expects to contribute the required minimum funding level of approximately $126 million to its pension plans and approximately $178 million to its other postretirement benefit plans and also expects to make additional voluntary pension contributions totaling approximately $500 million. As of March 31, 2009, contributions of $227 million and $25 million have been made to the company s pension plans and its medical and life benefit plans, respectively.

Defined Contribution Plans The company also sponsors 401(k) defined contribution plans in which most employees are eligible to participate, including certain bargaining unit employees. Company contributions for most plans are based on a cash matching of employee contributions up to 4 percent of compensation. Certain hourly employees are covered under a target benefit plan. The company also participates in a multiemployer plan for certain of the

company s union employees. In addition to the 401(k) defined contribution benefit, non-union represented employees hired after June 30, 2008, are eligible to participate in a defined contribution program in lieu of a defined benefit pension plan. The company s contributions to these defined contribution plans for the three months ended March 31, 2009, and 2008, were $82 million, and $75 million, respectively.

12. STOCK COMPENSATION PLANS

At March 31, 2009, Northrop Grumman had stock-based compensation awards outstanding under the following plans: the 2001 Long-Term Incentive Stock Plan, the 1993 Long-Term Incentive Stock Plan, both applicable to employees, and the 1993 Stock Plan for Non-Employee Directors and 1995 Stock Plan for Non-Employee

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Directors as amended. All of these plans were approved by the company s shareholders. Share-based awards under the employee plans consist of stock option awards (Stock Options) and restricted stock awards (Stock Awards).

Compensation Expense

Total pre-tax stock-based compensation for the three months ended March 31, 2009, and 2008, was $35 million, and $44 million, respectively, of which $5 million, and $4 million related to Stock Options and $30 million, and $40 million, related to Stock Awards, respectively. Tax benefits recognized in the condensed consolidated statements of operations and comprehensive income for stock-based compensation during the three months ended March 31, 2009, and 2008, were $14 million, and $17 million, respectively. In addition, the company realized tax benefits of $245 thousand and $20 million from the exercise of Stock Options and $47 million and $94 million from the issuance of Stock Awards in the three months ended March 31, 2009 and 2008, respectively.

At March 31, 2009, there was $260 million of unrecognized compensation expense related to unvested awards granted under the company s stock-based compensation plans, of which $34 million relates to Stock Options and $226 million relates to Stock Awards. These amounts are expected to be charged to expense over a weighted-average period of 1.6 years.

Stock Options

The fair value of each of the company s Stock Option awards is estimated on the date of grant using a Black-Scholes option-pricing model that uses the assumptions noted in the table below. The fair value of the company s Stock Option awards is expensed on a straight-line basis over the vesting period of the options, which is generally three to four years. Expected volatility is based on an average of (1) historical volatility of the company s stock and (2) implied volatility from traded options on the company s stock. The risk-free rate for periods within the contractual life of the Stock Option award is based on the yield curve of a zero-coupon U.S. Treasury bond on the date the award is granted with a maturity equal to the expected term of the award. The company uses historical data to estimate future forfeitures. The expected term of awards granted is derived from historical experience under the company s stock-based compensation plans and represents the period of time that awards granted are expected to be outstanding.

The significant weighted-average assumptions relating to the valuation of the company s Stock Options for the three months ended March 31, 2009 and 2008, were as follows:

	2009	2008
Dividend yield	**3.3%**	1.8%
Volatility rate	**25%**	20%
Risk-free interest rate	**1.7%**	2.8%
Expected option life (years)	**6**	6

The weighted-average grant date fair value of Stock Options granted during the three months ended March 31, 2009 and 2008, was $7 and $15, per share, respectively.

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Stock Option activity for the three months ended March 31, 2009, was as follows:

	Shares Under Option (In thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($ in millions)
Outstanding at January 1, 2009	13,481	$ 54	4.2 years	$ 18
Granted	2,711	45		
Exercised	(226)	46		
Cancelled and forfeited	(258)	55		
Outstanding at March 31, 2009	**15,708**	**$ 53**	**4.5 years**	**$ 14**
Vested and expected to vest in the future at March 31, 2009	15,511	$ 52	4.3 years	$ 14
Exercisable at March 31, 2009	11,807	$ 52	3.6 years	$ 14
Available for grant at March 31, 2009	8,694			

The total intrinsic value of options exercised during the three months ended March 31, 2009 and 2008, was $618 thousand and $51 million, respectively. Intrinsic value is measured using the fair market value at the date of exercise (for options exercised) or at March 31, 2009 (for outstanding options), less the applicable exercise price.

Stock Awards

Compensation expense for Stock Awards is measured at the grant date based on fair value and recognized over the vesting period. The fair value of Stock Awards is determined based on the closing market price of the company s common stock on the grant date. For purposes of measuring compensation expense, the amount of shares ultimately expected to vest is estimated at each reporting date based on management s expectations regarding the relevant performance criteria. In the table below, the share adjustment resulting from the final performance measure is considered granted in the period that the related grant is vested. During the three months ended March 31, 2009, 2.5 million shares of common stock were issued to employees in settlement of prior year stock awards that were fully vested, with a total value upon issuance of $111 million and a grant date fair value of $161 million. During the three months ended March 31, 2008, 2.9 million shares of common stock were issued to employees in settlement of prior year stock awards that were fully vested, with a total value upon issuance of $233 million and a grant date fair value of $155 million. There were 1.6 million Stock Awards granted in the three months ended March 31, 2008, with a weighted-average grant date fair value of $75 per share.

Stock Award activity for the three months ended March 31, 2009, was as follows:

	Stock Awards (In thousands)	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Term
Outstanding at January 1, 2009	3,276		