

NORTHROP GRUMMAN CORP /DE/

Form 10-Q

October 26, 2011

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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 September 30, 2011

or

..

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

(State or other jurisdiction of

incorporation or organization)

80-0640649

(I.R.S. Employer

Identification No.)

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2980 Fairview Park Drive, Falls Church, Virginia 22042

www.northropgrumman.com

(Address of principal executive offices and internet site)

(703) 280-2900

(Registrant's telephone number, including area code)

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

Yes

No

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

Yes

No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes

No

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

As of October 24, 2011, 261,280,569 shares of common stock were outstanding.

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Table of Contents**NORTHROP GRUMMAN CORPORATION****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|------------------------------------|---------|-----------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| <i>\$ in millions, except per share amounts</i> | | | | |
| Sales and Service Revenues | | | | |
| Product sales | \$3,780 | \$3,968 | \$11,352 | \$12,159 |
| Service revenues | 2,832 | 3,103 | 8,554 | 9,081 |
| Total sales and service revenues | 6,612 | 7,071 | 19,906 | 21,240 |
| Cost of Sales and Service Revenues | | | | |
| Cost of product sales | 2,700 | 2,918 | 8,204 | 8,986 |
| Cost of service revenues | 2,498 | 2,856 | 7,512 | 8,283 |
| General and administrative expenses | 589 | 574 | 1,713 | 1,819 |
| Operating income | 825 | 723 | 2,477 | 2,152 |
| Other (expense) income | | | | |
| Interest expense | (57) | (64) | (168) | (206) |
| Other, net | (13) | 13 | (8) | 10 |
| Earnings from continuing operations before income taxes | 755 | 672 | 2,301 | 1,956 |
| Federal and foreign income tax expense | 235 | 224 | 765 | 358 |
| Earnings from continuing operations | 520 | 448 | 1,536 | 1,598 |
| Earnings from discontinued operations, net of tax | | 49 | 34 | 79 |
| Net earnings | \$ 520 | \$ 497 | \$ 1,570 | \$ 1,677 |
| Basic Earnings Per Share | | | | |
| Continuing operations | \$ 1.89 | \$ 1.53 | \$ 5.43 | \$ 5.35 |
| Discontinued operations | | .16 | .12 | .27 |
| Basic earnings per share | \$ 1.89 | \$ 1.69 | \$ 5.55 | \$ 5.62 |
| Weighted-average common shares outstanding, in millions | 274.9 | 293.5 | 283.1 | 298.6 |
| Diluted Earnings Per Share | | | | |
| Continuing operations | \$ 1.86 | \$ 1.51 | \$ 5.34 | \$ 5.28 |
| Discontinued operations | | .16 | .11 | .26 |
| Diluted earnings per share | \$ 1.86 | \$ 1.67 | \$ 5.45 | \$ 5.54 |
| Weighted-average diluted shares outstanding, in millions | 279.3 | 297.6 | 287.9 | 302.5 |
| Net earnings (from above) | \$ 520 | \$ 497 | \$ 1,570 | \$ 1,677 |
| Other comprehensive (loss) income | | | | |
| Change in cumulative translation adjustment | (25) | 18 | 2 | (34) |
| Change in unrealized gain on marketable securities and cash flow hedges, net of tax | | | (2) | |
| Change in unamortized benefit plan costs, net of tax | 22 | 39 | 57 | 118 |
| Other comprehensive (loss) income, net of tax | (3) | 57 | 57 | 84 |
| Comprehensive income | \$ 517 | \$ 554 | \$ 1,627 | \$ 1,761 |

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

Table of Contents**NORTHROP GRUMMAN CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION****(Unaudited)**

| <i>\$ in millions</i> | September 30, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
| Assets | | |
| Cash and cash equivalents | \$ 2,946 | \$ 3,701 |
| Accounts receivable, net of progress payments | 3,328 | 3,329 |
| Inventoried costs, net of progress payments | 884 | 896 |
| Current deferred tax assets | 393 | 419 |
| Prepaid expenses and other current assets | 135 | 244 |
| Assets of discontinued operations | | 5,212 |
| Total current assets | 7,686 | 13,801 |
| Property, plant, and equipment, net of accumulated depreciation of \$3,897 in 2011 and \$3,712 in 2010 | 3,010 | 3,045 |
| Goodwill | 12,376 | 12,376 |
| Other purchased intangibles, net of accumulated amortization of \$1,641 in 2011 and \$1,613 in 2010 | 164 | 192 |
| Pension and post-retirement plan assets | 355 | 320 |
| Non-current deferred tax assets | 487 | 721 |
| Miscellaneous other assets | 1,022 | 1,076 |
| Total assets | \$25,100 | \$31,531 |
| Liabilities | | |
| Notes payable to banks | \$16 | \$10 |
| Current portion of long-term debt | 23 | 774 |
| Trade accounts payable | 1,338 | 1,573 |
| Accrued employees' compensation | 1,076 | 1,146 |
| Advance payments and billings in excess of costs incurred | 1,744 | 1,969 |
| Other current liabilities | 1,524 | 1,763 |
| Liabilities of discontinued operations | | 2,792 |
| Total current liabilities | 5,721 | 10,027 |
| Long-term debt, net of current portion | 3,936 | 3,940 |
| Pension and post-retirement plan liabilities | 2,591 | 3,089 |
| Other long-term liabilities | 901 | 918 |
| Total liabilities | 13,149 | 17,974 |

Commitments and Contingencies (Note 11)**Shareholders' Equity**

| | | |
|---|----------|----------|
| Common stock, \$1 par value; 800,000,000 shares authorized; issued and outstanding: 2011 265,540,830; 2010 290,956,752 | 266 | 291 |
| Paid-in capital | 4,460 | 7,778 |
| Retained earnings | 9,401 | 8,245 |
| Accumulated other comprehensive loss | (2,176) | (2,757) |
| Total shareholders' equity | 11,951 | 13,557 |
| Total liabilities and shareholders' equity | \$25,100 | \$31,531 |

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

Table of Contents**NORTHROP GRUMMAN CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

| <i>\$ in millions</i> | Nine Months Ended September 30 | |
|--|-----------------------------------|----------|
| | 2011 | 2010 |
| Operating Activities | | |
| Sources of Cash Continuing Operations | | |
| Cash received from customers | | |
| Progress payments | \$ 3,119 | \$ 3,149 |
| Collections on billings | 16,527 | 17,610 |
| Other cash receipts | 103 | 18 |
| Total sources of cash continuing operations | 19,749 | 20,777 |
| Uses of Cash Continuing Operations | | |
| Cash paid to suppliers and employees | (17,131) | (18,219) |
| Pension contributions | (572) | (415) |
| Interest paid, net of interest received | (205) | (248) |
| Income taxes paid, net of refunds received | (791) | (933) |
| Excess tax benefits from stock-based compensation | (24) | (12) |
| Other cash payments | | (34) |
| Total uses of cash continuing operations | (18,723) | (19,861) |
| Cash provided by continuing operations | 1,026 | 916 |
| Cash (used in) provided by discontinued operations | (232) | 150 |
| Net cash provided by operating activities | 794 | 1,066 |
| Investing Activities | | |
| Continuing Operations | | |
| Contribution received from the spin-off of Shipbuilding business | 1,429 | |
| Additions to property, plant, and equipment | (324) | (301) |
| Decrease in restricted cash | 34 | 5 |
| Other investing activities, net | 13 | 8 |
| Cash provided by (used in) investing activities by continuing operations | 1,152 | (288) |
| Cash used in investing activities by discontinued operations | (63) | (93) |
| Net cash provided by (used in) investing activities | 1,089 | (381) |
| Financing Activities | | |
| Common stock repurchases | (1,598) | (1,060) |
| Payments of long-term debt | (750) | (91) |
| Dividends paid | (414) | (408) |
| Proceeds from exercises of stock options and issuances of common stock | 97 | 112 |
| Excess tax benefits from stock-based compensation | 24 | 12 |
| Other financing activities, net | 3 | 3 |
| Net cash used in financing activities | (2,638) | (1,432) |
| Decrease in cash and cash equivalents | (755) | (747) |
| Cash and cash equivalents, beginning of period | 3,701 | 3,275 |
| Cash and cash equivalents, end of period | \$ 2,946 | \$ 2,528 |

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

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| <i>\$ in millions</i> | Nine Months Ended September 30 | |
|--|-----------------------------------|----------|
| | 2011 | 2010 |
| Reconciliation of Net Earnings to Net Cash Provided by Operating Activities | | |
| Net earnings | \$ 1,570 | \$ 1,677 |
| Net earnings from discontinued operations | (34) | (79) |
| Adjustments to reconcile to net cash provided by operating activities | | |
| Depreciation | 334 | 312 |
| Amortization of assets | 53 | 83 |
| Stock-based compensation | 97 | 103 |
| Excess tax benefits from stock-based compensation | (24) | (12) |
| (Increase) decrease in | | |
| Accounts receivable, net | (20) | (558) |
| Inventoried costs, net | 22 | (46) |
| Prepaid expenses and other current assets | 11 | (2) |
| Increase (decrease) in | | |
| Accounts payable and accruals | (848) | (417) |
| Deferred income taxes | 205 | 85 |
| Income taxes payable | 4 | (121) |
| Retiree benefits | (416) | (61) |
| Other, net | 72 | (48) |
| Cash provided by continuing operations | 1,026 | 916 |
| Cash (used in) provided by discontinued operations | (232) | 150 |
| Net cash provided by operating activities | \$ 794 | \$ 1,066 |
| Non-Cash Investing and Financing Activities | | |
| Share repurchases accrued in accounts payable | \$ 63 | \$ 6 |
| Capital expenditures accrued in accounts payable | 31 | 26 |
| Capital expenditures accrued in liabilities from discontinued operations | | 29 |

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

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| | Nine Months Ended | |
|---|-------------------|----------------------|
| | 2011 | September 30 2010 |
| <i>\$ in millions, except per share amounts</i> | | |
| Common Stock | | |
| At beginning of period | \$ 291 | \$ 307 |
| Common stock repurchased | (28) | (18) |
| Employee stock awards and options | 3 | 3 |
| At end of period | 266 | 292 |
| Paid-in Capital | | |
| At beginning of period | 7,778 | 8,657 |
| Common stock repurchased | (1,626) | (1,026) |
| Employee stock awards and options | 182 | 196 |
| Spin-off of Shipbuilding business | (1,874) | |
| At end of period | 4,460 | 7,827 |
| Retained Earnings | | |
| At beginning of period | 8,245 | 6,737 |
| Net earnings | 1,570 | 1,677 |
| Dividends declared | (414) | (409) |
| At end of period | 9,401 | 8,005 |
| Accumulated Other Comprehensive Loss | | |
| At beginning of period | (2,757) | (3,014) |
| Other comprehensive income, net of tax | 57 | 84 |
| Spin-off of Shipbuilding business | 524 | |
| At end of period | (2,176) | (2,930) |
| Total shareholders' equity | \$11,951 | \$13,194 |
| Cash dividends declared per share | \$ 1.47 | \$ 1.37 |

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

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Principles of Consolidation The unaudited condensed consolidated financial statements include the accounts of Northrop Grumman Corporation and its subsidiaries (Northrop Grumman or 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 rules of the Securities and Exchange Commission (SEC). These statements include all adjustments of normal recurring nature considered necessary by management for a fair presentation of the condensed consolidated financial position, results of operations, and cash flows. The results reported in these financial statements are not necessarily indicative of results that may be expected for the entire year. These financial statements should be read in conjunction with the information contained in the company's Annual Report on Form 10-K for the year ended December 31, 2010, and the audited consolidated financial statements, including the notes thereto, contained in the Form 8-K filed on June 17, 2011, which recast certain portions of the Form 10-K to reflect the spin-off of the Shipbuilding business as discontinued operations, as discussed below.

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.

Spin-off of Shipbuilding Business Effective as of March 31, 2011, the company completed the spin-off to its shareholders of Huntington Ingalls Industries (HII). HII operates the business that was previously the Shipbuilding segment (Shipbuilding) of the company prior to the spin-off. The spin-off was the culmination of the company's decision to explore strategic alternatives for Shipbuilding as it was determined to be in the best interests of shareholders, customers, and employees by allowing both the company and Shipbuilding to pursue more effectively their respective opportunities to maximize value. As a result of the spin-off, assets, liabilities and results of operations for the former Shipbuilding segment have been reclassified as discontinued operations for all periods presented. See Note 5 for further information.

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

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

| | \$(0,000) September 30, | \$(0,000) December 31, |
|--|----------------------------|---------------------------|
| <i>\$ in millions</i> | 2011 | 2010 |
| Cumulative translation adjustment | \$ 2 | \$ |
| Net unrealized gain on marketable securities and cash flow hedges, net of tax expense of \$2 as of September 30, 2011, and \$3 as of December 31, 2010 | 3 | 5 |
| Unamortized benefit plan costs, net of tax benefit of \$1,410 as of September 30, 2011, and \$1,801 as of December 31, 2010 | (2,181) | (2,762) |
| Total accumulated other comprehensive loss | \$(2,176) | \$(2,757) |

The changes in the unamortized benefit plan costs, net of tax, were \$57 million and \$118 million for the nine months ended September 30, 2011 and 2010, respectively, and are included in other comprehensive income in the

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condensed consolidated statements of operations. As a result of the spin-off of Shipbuilding, the company reduced accumulated other comprehensive loss by \$524 million as of March 31, 2011, for the after-tax unamortized benefit plan costs related to Shipbuilding.

Unamortized benefit plan costs consist primarily of net after-tax actuarial loss amounts totaling \$2,164 million and \$2,771 million as of September 30, 2011, and December 31, 2010, respectively. Net actuarial gains or losses principally arise from gains or losses on plan assets due to variations in the fair market value of the underlying assets and changes in the benefit obligation due to changes in actuarial assumptions. Net actuarial gains or losses are amortized to expense when they exceed ten percent of the greater of the plan assets or projected benefit obligations by benefit plan. The excess of gains or losses over the ten percent threshold are subject to amortization over ten years, which represents the approximate average future service period of employees.

2. ACCOUNTING STANDARDS UPDATES

Accounting standards updates effective after September 30, 2011, are not expected to have a material effect on the company's consolidated financial position or results of operations.

3. DIVIDENDS ON COMMON STOCK

Dividends on Common Stock In April 2011, the company's board of directors approved an increase to the quarterly common stock dividend from \$0.47 per share to \$0.50 per share, for shareholders of record as of May 31, 2011.

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

4. EARNINGS PER SHARE

Basic Earnings Per Share Basic earnings per share amounts from both continuing and discontinued operations are calculated by dividing the respective earnings by the weighted-average number of shares of common stock outstanding during each period.

Diluted Earnings Per Share Diluted earnings per share include the dilutive effect of stock options and other stock awards granted to employees under stock-based compensation plans. The dilutive effect of these securities totaled 4.4 million shares and 4.8 million shares for the three and nine months ended September 30, 2011. The dilutive effect of these securities totaled 4.1 million shares and 3.9 million shares for the three and nine months ended September 30, 2010. The weighted-average diluted shares outstanding for the three and nine months ended September 30, 2011, exclude anti-dilutive stock options to purchase approximately 3.6 million and 2.8 million shares, respectively, because such options have exercise prices in excess of the average market price of the company's common stock during the period. The weighted-average diluted shares outstanding for the three and nine months ended September 30, 2010, exclude anti-dilutive stock options to purchase approximately 4.5 million and 2.6 million shares, respectively.

Share Repurchases The table below summarizes the company's share repurchases during the periods:

| Repurchase Program Authorization Date | Amount Authorized (in millions) | Average Price Per Share ⁽²⁾ | Total | | Shares Repurchased (in millions) Nine Months Ended September 30 | |
|--|---------------------------------------|---|------------------------------------|----------------|--|------|
| | | | Shares Retired (in millions) | Date Completed | 2011 | 2010 |
| December 19, 2007 | \$3,600 | \$59.82 | 60.2 | August 2010 | | 15.7 |
| June 16, 2010 ⁽¹⁾ | 4,245 | 58.24 | 32.4 | | 28.4 | 2.1 |
| | | | | | 28.4 | 17.8 |

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- (1) On June 16, 2010, the company's board of directors authorized a share repurchase program of up to \$2 billion of the company's common stock. On April 25, 2011, after the company had repurchased shares totaling \$245 million, the company's board of directors authorized an increase to the remaining share repurchase authorization to \$4.0 billion. As of September 30, 2011, the company had \$2.4 billion remaining under this authorization for share repurchases.
- (2) Includes commissions paid and calculated as the average price paid per share under the respective repurchase program.

Under the outstanding share repurchase authorization, the company entered into an accelerated share repurchase agreement with Goldman Sachs & Co. (Goldman Sachs) on May 2, 2011, to repurchase 15.6 million shares of common stock at an initial price of \$64.17 per share for a total of \$1.0 billion. Under this agreement, Goldman Sachs immediately borrowed shares that were sold to and canceled by the company. Subsequently, Goldman Sachs began purchasing shares in the open market to settle its share borrowings. The cost of the company's initial share repurchase was subject to adjustment based on the actual cost of the shares subsequently purchased by Goldman Sachs. On August 16, 2011, Goldman Sachs completed its share repurchases and paid the company a cash refund of \$19 million for the final price adjustment, which was recorded as an adjustment to paid-in capital. The final average purchase price of the shares repurchased under the agreement was \$62.54 per share, including commissions and certain other fees.

Additional 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. Under these programs, additional share repurchases took place during the quarter ended September 30, 2011 after the completion of the accelerated share repurchase program with Goldman Sachs. 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 program authorizations.

5. BUSINESS DISPOSITIONS

Spin-off of Shipbuilding Business Effective March 31, 2011, the company completed the spin-off to its shareholders of HII. The company made a pro rata distribution to its shareholders of one share of HII common stock for every six shares of the company's common stock held on the record date of March 30, 2011, or 48.8 million shares of HII common stock. There was no gain or loss recognized by the company as a result of the spin-off transaction. In connection with the spin-off, HII issued \$1,200 million in senior notes and entered into a credit facility with third-party lenders that included a \$650 million revolver and a \$575 million term loan. HII used a portion of the proceeds of the debt and credit facility to fund a \$1,429 million cash contribution to the company.

Prior to the completion of the spin-off, the company and HII entered into a Separation and Distribution Agreement dated March 29, 2011, and several other agreements that govern the post-separation relationship. These agreements generally provide that each party is responsible for its respective assets, liabilities and obligations following the spin-off, including employee benefits, intellectual property, information technology, insurance, and tax-related assets and liabilities. The agreements also describe the company's commitments to provide HII with certain transition services for up to one year following the spin-off and the costs incurred for such services to be reimbursed by HII. This transitional support is intended to enable HII to establish its stand alone processes to assume full responsibility for various activities that were previously provided by the company and does not constitute significant continuing support of HII's operations.

In connection with the spin-off, the company incurred \$28 million and \$21 million of non-deductible transaction costs for the nine months ended September 30, 2011 and 2010, respectively, which have been included in discontinued operations. The company has incurred total transaction costs in connection with the spin-off of approximately \$60 million.

National Security Technologies Deconsolidation Effective January 1, 2011, the company reduced its participation in the National Security Technologies joint venture (NSTec). As a result of the reduced participation in the joint venture, the company no longer consolidates NSTec's results in the company's condensed consolidated financial

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statements. NSTec's sales that were included in the company's consolidated sales and service revenues for the nine months ended September 30, 2010 were \$451 million.

Sale of Advisory Services Division In December 2009, the company sold its Advisory Services Division (ASD) for \$1.65 billion in cash to an investor group led by General Atlantic, LLC and affiliates of Kohlberg Kravis Roberts & Co. L.P. and recognized a gain of \$15 million, net of taxes. During the nine months ended September 30, 2010, favorable adjustments totaling \$13 million, net of taxes, were recorded to reflect the purchase price adjustment called for under the sale agreement and the utilization of additional capital loss carry-forwards. ASD was a business unit comprised of the assets and liabilities of TASC, Inc., its wholly-owned subsidiary TASC Services Corporation, and certain contracts carved out from other Northrop Grumman businesses also in the Information Systems segment that provided systems engineering technical assistance and other analysis and advisory services.

Discontinued Operations Earnings for the Shipbuilding business and gains from previous divestitures, reported as discontinued operations, are presented in the following table:

| | \$00,000 | \$00,000 | \$00,000 | \$00,000 | \$00,000 |
|---|------------------------------------|----------|-----------------------------------|----------|----------|
| | Three Months Ended September 30 | | Nine Months Ended September 30 | | |
| <i>\$ in millions</i> | 2011 | 2010 | 2011 | 2010 | |
| Sales and service revenues | \$ | \$1,666 | \$1,646 | \$4,980 | |
| Earnings from discontinued operations | | 75 | 59 | 121 | |
| Income tax expense | | (34) | (26) | (57) | |
| Earnings, net of tax | | 41 | 33 | 64 | |
| Gain (loss) on divestiture | | (1) | 2 | 10 | |
| Income tax benefit (expense) | | 9 | (1) | 5 | |
| Gain on divestitures, net of tax | | 8 | 1 | 15 | |
| Earnings from discontinued operations, net of tax | \$ | \$49 | \$34 | \$79 | |

The major classes of assets and liabilities included in discontinued operations for the Shipbuilding business are presented in the following table:

| <i>\$ in millions</i> | \$0,000 December 31, 2010 |
|--|---------------------------------|
| Assets | |
| Current assets | \$1,315 |
| Property, plant, and equipment, net | 1,997 |
| Goodwill | 1,141 |
| Other assets | 759 |
| Total assets of discontinued operations | \$5,212 |
| Liabilities | |
| Trade accounts payable | \$ 274 |
| Other current liabilities | 955 |
| Current liabilities | 1,229 |
| Long-term liabilities | 1,563 |
| Total liabilities of discontinued operations | \$2,792 |

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

The following table presents segment sales and service revenues for the three and nine months ended September 30, 2011, and 2010:

| | \$00,000 | \$00,000 | \$00,000 | \$00,000 | \$00,000 |
|---|--------------------|----------------|-------------------|-----------------|----------|
| | Three Months Ended | | Nine Months Ended | | |
| | September 30 | | September 30 | | |
| <i>\$ in millions</i> | 2011 | 2010 | 2011 | 2010 | |
| Sales and service revenues | | | | | |
| Aerospace Systems | \$2,572 | \$2,706 | \$ 7,900 | \$ 8,244 | |
| Electronic Systems | 1,905 | 1,874 | 5,504 | 5,740 | |
| Information Systems | 1,955 | 2,123 | 6,011 | 6,310 | |
| Technical Services | 680 | 871 | 2,024 | 2,435 | |
| Intersegment eliminations | (500) | (503) | (1,533) | (1,489) | |
| Total sales and service revenues | \$6,612 | \$7,071 | \$19,906 | \$21,240 | |

The following table presents segment operating income reconciled to total operating income for the three and nine months ended September 30, 2011 and 2010:

| | \$00,000 | \$00,000 | \$00,000 | \$00,000 | \$00,000 |
|---|--------------------|--------------|-------------------|----------------|----------|
| | Three Months Ended | | Nine Months Ended | | |
| | September 30 | | September 30 | | |
| <i>\$ in millions</i> | 2011 | 2010 | 2011 | 2010 | |
| Operating income | | | | | |
| Aerospace Systems | \$304 | \$303 | \$ 936 | \$ 934 | |
| Electronic Systems | 293 | 261 | 814 | 751 | |
| Information Systems | 187 | 190 | 570 | 578 | |
| Technical Services | 55 | 56 | 160 | 157 | |
| Intersegment eliminations | (62) | (50) | (198) | (163) | |
| Total segment operating income | 777 | 760 | 2,282 | 2,257 | |
| Non-segment factors affecting operating income | | | | | |
| Unallocated corporate expenses | (48) | (34) | (96) | (99) | |
| Net pension adjustment | 100 | (1) | 302 | 2 | |
| Royalty income adjustment | (4) | (2) | (11) | (8) | |
| Total operating income | \$825 | \$723 | \$2,477 | \$2,152 | |

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

Net Pension Adjustment The net pension adjustment reflects the difference between pension expense determined in accordance with GAAP and pension expense allocated to the operating segments determined in accordance with CAS. The increase in net pension adjustment for the three and nine months ended September 30, 2011, as compared to the same periods in 2010, is primarily due to decreased GAAP pension expense resulting from higher estimated investment income on greater plan investment assets as of the beginning of the year.

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

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The company's effective tax rates on income from continuing operations were 31.1 percent and 33.2 percent for the three and nine months ended September 30, 2011, respectively, compared to 33.3 percent and 18.3 percent for the three and nine months ended September 30, 2010, respectively. In the third quarter of 2011, the company recognized net tax benefits of \$14 million, primarily due to finalizing the research and development tax credits and manufacturing deductions claimed upon filing the 2010 tax return. In the second quarter of 2010, the company received final approval from the Internal Revenue Service (IRS) and the U.S. Congressional Joint Committee on Taxation of the IRS examination of the company's tax returns for the years 2004 through 2006. As a result of the settlement, the company recognized net tax benefits of approximately \$298 million (of which \$66 million was in cash), which were recorded as a reduction to the company's provision for income taxes. In connection with the settlement, the company also reduced its liability for uncertain tax positions, including previously accrued interest, by \$311 million. The company's effective tax rates for the three and nine months ended September 30, 2011 and 2010, differ from the statutory federal rate primarily due to manufacturing deductions and research and development credits, and, in 2010, for the tax settlement with the IRS.

The company recognizes accrued interest and penalties related to uncertain tax positions in federal and foreign income tax expense. The company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The IRS is currently conducting an examination of the company's tax returns for the years 2007 through 2009. Open tax years related to state and foreign jurisdictions remain subject to examination, but are not considered material.

8. GOODWILL AND OTHER PURCHASED INTANGIBLE ASSETS**Goodwill**

The carrying amounts of goodwill at both September 30, 2011, and December 31, 2010, were as follows:

| | Aerospace | Electronic | Information | Technical | |
|-----------------------|-----------|------------|-------------|-----------|-----------------|
| <i>\$ in millions</i> | Systems | Systems | Systems | Services | Total |
| Goodwill | \$3,801 | \$2,402 | \$5,248 | \$925 | \$12,376 |

Accumulated goodwill impairment losses at September 30, 2011, and December 31, 2010, totaled \$570 million at the Aerospace Systems segment.

Purchased Intangible Assets

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

| <i>\$ in millions</i> | September 30, 2011 | | | December 31, 2010 | | |
|----------------------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Contract and program intangibles | \$1,705 | \$(1,554) | \$151 | \$1,705 | \$(1,531) | \$174 |
| Other purchased intangibles | 100 | (87) | 13 | 100 | (82) | 18 |
| Total | \$1,805 | \$(1,641) | \$164 | \$1,805 | \$(1,613) | \$192 |

The company's purchased intangible assets are subject to amortization and have been amortized on a straight-line basis over an original aggregate weighted-average period of 18 years. Aggregate amortization expense for the three and nine months ended September 30, 2011, was \$10 million and \$28 million, respectively. Aggregate amortization expense for the three and nine months ended September 30, 2010, was \$17 million and \$53 million, respectively.

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The table below shows expected amortization for purchased intangibles for the remainder of 2011 and for the next five years:

\$ in millions

| | |
|--------------------------------|------|
| Year ending December 31 | |
| 2011 (October 1 - December 31) | \$ 9 |
| 2012 | 36 |
| 2013 | 29 |
| 2014 | 16 |
| 2015 | 15 |
| 2016 | 11 |

9. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents fair value information for those assets and liabilities measured at fair value on a recurring basis as of September 30, 2011, and December 31, 2010:

\$ in millions

| Financial Assets (Liabilities) | September 30, 2011 | | December 31, 2010 | |
|---|--------------------|------------|-------------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Marketable Securities ⁽¹⁾ | | | | |
| Trading | \$ 215 | \$ 215 | \$ 320 | \$ 320 |
| Available-for-Sale | 6 | 6 | 10 | 10 |
| Derivatives | 9 | 9 | 11 | 11 |
| Long-term debt, including current portion | \$(3,975) | \$(4,760) | \$(4,724) | \$(5,100) |

(1) Includes \$1 million and \$68 million in prepaid and other current assets and \$220 million and \$262 million in miscellaneous other assets at September 30, 2011, and December 31, 2010, respectively.

There were no material transfers of financial instruments between the three levels of fair value hierarchy during the nine months ended September 30, 2011, and the year ended December 31, 2010.

The carrying amounts of all other financial instruments not shown above approximate fair value due to their short term nature.

Investments in Marketable Securities The company holds a portfolio of marketable securities, primarily consisting of equity securities that are classified as either trading or available-for-sale and can be liquidated without restriction. These assets are recorded at fair value and are valued using Level 1 inputs. In June 2011, the company sold marketable securities classified as trading securities for \$69 million, resulting in a \$3 million realized gain recorded in other, net in the condensed consolidated statements of operations.

Derivative Financial Instruments and Hedging Activities The company utilizes derivative financial instruments to manage exposure to interest rate risk and foreign currency exchange rate risk. The company does not use derivative financial instruments for trading or speculative purposes, nor does it use leveraged financial instruments. Foreign currency forward contracts are used to manage foreign currency exchange rate risk related to receipts from customers and payments to suppliers denominated in foreign currencies.

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The table below summarizes the notional values of our derivative portfolio as of September 30, 2011, and December 31, 2010:

| <i>\$ in millions</i> | 2011 | 2010 |
|-------------------------------------|--------|--------|
| Designated as cash flow hedges: | | |
| Foreign currency buy | \$ 39 | \$ 40 |
| Foreign currency sell | 116 | 86 |
| Interest rate swaps | | 200 |
| Not designated as cash flow hedges: | | |
| Foreign currency buy | 2 | 8 |
| Foreign currency sell | 77 | 75 |
| Total notional value | \$ 234 | \$ 409 |

Derivative financial instruments are recognized as assets or liabilities in the financial statements and measured at fair value, and substantially all of these instruments are valued using Level 2 inputs. Where model-derived valuations are appropriate, the company utilizes the income approach to determine fair value and uses the applicable London Interbank Offered Rate (LIBOR) swap rate as the discount rate. While all other changes in the fair value of derivative financial instruments are recorded in earnings from continuing operations, the effective portion of the changes in the fair value of derivative financial instruments that qualify and are designated as effective cash flow hedges are recorded in other comprehensive income. Credit risk related to derivative financial instruments is considered minimal and is managed by requiring high credit standards for counterparties and through periodic settlements of positions.

For derivative financial instruments not designated as hedging instruments, as well as the ineffective portion of cash flow hedges, the gains or losses resulting from changes in the fair value are reported in Other, net in the condensed consolidated statements of operations. Unrealized gains or losses on the effective cash flow hedges are reclassified from other comprehensive income to earnings from continuing operations upon the settlement of the underlying transactions. The derivative fair values and related unrealized gains and losses at September 30, 2011, and December 31, 2010, were not material.

Long-Term Debt The fair value of long-term debt is calculated using Level 2 inputs based on interest rates available for debt with terms and maturities similar to the company's existing debt arrangements. In February 2011, the company repaid notes with a face value of \$750 million and an interest rate of 7.125% upon their maturity.

10. INVESTIGATIONS, CLAIMS AND LITIGATION

Spin-Off of Shipbuilding Business As provided in the Separation and Distribution Agreement with HII described in Note 5, HII generally has responsibility for investigations, claims and litigation matters related to the Shipbuilding business. The company has therefore excluded from this report certain previously disclosed Shipbuilding-related investigations, claims and litigation matters that are the responsibility of HII. The company does not believe these HII matters are likely to have a material adverse effect on the company's consolidated financial position, results of operations, or cash flows.

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, compensatory or treble damages or non-monetary relief. U.S. Government regulations provide that certain allegations against a contractor may lead to suspension or debarment from future U.S. Government contracts or the use of export privileges for the company or one or more of its components. Suspension or debarment could have a material adverse effect on the company because of the company's reliance on government contracts and authorizations.

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

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The company is one of several defendants in litigation brought by the Orange County Water District in Orange County Superior Court in California on December 17, 2004, for alleged contribution to volatile organic chemical contamination of the County's shallow groundwater. The lawsuit includes counts against the defendants for violation of the Orange County Water District Act, the California Super Fund Act, negligence, nuisance, trespass and declaratory relief. Among other things, the lawsuit seeks unspecified damages for the cost of remediation, payment of attorney fees and costs, and punitive damages. Trial is scheduled to begin on February 10, 2012.

On March 27, 2007, the U.S. District Court for the Central District of California consolidated two Employee Retirement Income Security Act (ERISA) lawsuits that had been separately filed on September 28, 2006, and January 3, 2007, into In Re Northrop Grumman Corporation ERISA Litigation. The plaintiffs filed a consolidated Amended Complaint on September 15, 2010, alleging breaches of fiduciary duties by the Administrative Committees and the Investment Committees (as well as certain individuals who served on or supported those Committees) for two 401(k) Plans sponsored by Northrop Grumman Corporation. The company itself is not a defendant in the lawsuit. The plaintiffs claim that these alleged breaches of fiduciary duties caused the Plans to incur excessive administrative and investment fees and expenses to the detriment of the Plans' participants. On August 6, 2007, the District Court denied plaintiffs' motion for class certification, and the plaintiffs appealed the District Court's decision on class certification to the U.S. Court of Appeals for the Ninth Circuit. On September 8, 2009, the Ninth Circuit vacated the Order denying class certification and remanded the issue to the District Court for further consideration. As required by the Ninth Circuit's Order, the case was also reassigned to a different judge. By order dated March 29, 2011, the District Court granted the plaintiffs' motion for class certification. The District Court held a hearing on May 16, 2011 on various cross motions for summary judgment. The supplemental briefing requested by the District Court has been filed and the motions have been submitted. No trial date has been set. Based upon the information available to the company to date, the company believes that the defendants have substantive defenses to any potential claims but can give no assurance that they will prevail in this litigation.

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

Based upon the information available to the company to date, the company does not believe that the resolution of any of the specific litigation matters listed above is likely to have a material adverse effect on its consolidated financial position, results of operations or cash flows.

In addition to the matters discussed above, the company is a party to various investigations, lawsuits, claims and other legal proceedings that arise in the ordinary course of our business. Based on information available to the company, the company does not believe at this time that any of such additional matters will individually, or in the aggregate, have a material adverse effect on its financial position, results of operations or cash flows.

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11. COMMITMENTS AND CONTINGENCIES

Contract Performance Contingencies Contract profit margins may include estimates of revenues not contractually agreed to between the customer and the company for matters such as settlements in the process of negotiation, contract changes, claims and requests for equitable adjustment for previously unanticipated contract costs. These estimates are based upon management's best assessment of the underlying causal events and circumstances and are included in determining contract profit margins to the extent of expected recovery based on contractual entitlements and the probability of successful negotiation with the customer. As of September 30, 2011, the recognized amounts related to claims and requests for equitable adjustment are not material individually or in the aggregate.

Contract Terminations The company's U. S. Government contracts generally contain provisions that enable the customer to terminate a contract for default, or for the convenience of the government. In general, a partial or complete termination for default can result from a contractor's actual or anticipated failure to perform its contractual obligations. In most instances, the government is required to provide written notice to the contractor of the performance deficiency and allow the contractor a specified period of time to cure the deficiency or explain why the contract should not be terminated. If the contract is terminated for default, the contractor may not be entitled to recover any of its costs on partially completed work and may be liable to the government for any excess re-procurement costs of acquiring similar products or services from another contractor, and for certain other damages.

Termination of a contract for the convenience of the government may occur when the government concludes it is in the best interests of the U. S. Government that the contract be terminated. Under a termination for convenience, the contractor is typically paid in accordance with the contract's terms for costs incurred under the contract prior to the effective date of termination, plus a reasonable profit or fee and settlement expenses.

In either termination event, the amount the contractor ultimately receives in settlement on the contract is subject to negotiation and agreement with the U. S. Government. If the parties are unable to reach a settlement, the amount may be unilaterally determined by the government, subject to judicial review. If the contractor incurs costs in excess of the amount of funds obligated on the contract, it is at risk for reimbursement of those costs unless additional appropriated funds are available. Most, but not all, of the company's U. S. Government contracts provide funding for the customer's contract termination liabilities such that the company is not at risk for recovery of its properly determined contract termination claims. At September 30, 2011, the company had no substantial contract terminations in process for which the customer had insufficient termination funding.

Guarantees of Subsidiary Performance Obligations From time to time in the ordinary course of business, the company guarantees obligations of its subsidiaries under certain contracts. Generally, the company is liable under such an arrangement only if its subsidiary is unable to perform under its contract. Historically the company has not incurred any substantial liabilities as a result of these guarantees.

In addition, the company's subsidiaries may enter into joint ventures, teaming and other business arrangements (collectively, Business Arrangements) to support the company's products and services in domestic and international markets. The company generally strives to limit its exposure under these arrangements to its subsidiary's investment in the Business Arrangements, or to the extent of such subsidiary's obligations under the applicable contract. In some cases, however, the company may be required to guarantee performance by the Business Arrangements and, in such cases, the company generally obtains cross-indemnification from the other members of the Business Arrangements.

At September 30, 2011, the company is not aware of any existing event of default that would require it to satisfy any of these guarantees.

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

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Environmental Protection Agency, or similarly designated by other environmental agencies. To assess the potential impact on the company's financial statements, management estimates the range of reasonably possible remediation costs that could be incurred by the company, taking into account currently available facts on each site, as well as the current state of technology and prior 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 the range of reasonably possible future costs for environmental remediation sites is \$300 million to \$729 million. As of September 30, 2011, amounts accrued for probable environmental remediation costs are \$328 million, of which \$120 million is accrued in other current liabilities and \$208 million is accrued in other long-term liabilities in the condensed consolidated statements of financial position. These accruals do not include any litigation costs or potential liabilities to third parties related to environmental matters, nor do they include amounts recorded as asset retirement obligations. A portion of the environmental remediation costs is expected to be recoverable through overhead charges on government contracts and, accordingly, such amounts are deferred in inventoried costs (current portion) and miscellaneous other assets (non-current portion) in the condensed consolidated statements of financial position. Factors that could result in changes to the company's estimates include: modification of planned remedial actions, increases or decreases in the estimated time required to remediate, changes to the determination of legally responsible parties, discovery of more extensive contamination than anticipated, changes in laws and regulations affecting remediation requirements, and improvements in remediation technology. Should other PRPs not pay their allocable share of remediation costs, the company may have to incur costs in addition to those already estimated and accrued. In addition, there are some potential remediation sites where the costs of remediation cannot be reasonably estimated. Although management cannot predict whether new information gained as projects progress will materially affect the estimated liability accrued, management does not anticipate that future remediation expenditures will have a material adverse effect on the company's consolidated financial position, results of operations or cash flows.

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 obligations. At September 30, 2011, there were \$210 million of stand-by letters of credit, \$189 million of bank guarantees, and \$141 million of surety bonds outstanding.

Credit Facilities In September 2011, the company entered into two senior unsecured credit facilities (the Credit Agreements) in an aggregate principal amount of \$2 billion. The first Credit Agreement amended the company's \$2 billion five-year credit facility dated August 10, 2007, by reducing the aggregate principal amount available under the facility by \$500 million to \$1.5 billion and extending the maturity date to September 2016. The second Credit Agreement is a new 364-day revolving credit facility in an aggregate principal amount of \$500 million.

The Credit Agreements contain covenants substantially similar to those of the previous five-year credit facility, which restrict the company's ability to sell all or substantially all of its assets, merge or consolidate with another entity or undertake other fundamental changes and incur liens. The company also cannot permit the ratio of its consolidated debt to capitalization (as set forth in the Credit Agreements) to exceed 65 percent. The company was in compliance with all covenants under the Credit Agreements on September 30, 2011. At September 30, 2011, there was no balance outstanding under either of these facilities.

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

U.S. Government Cost Claims From time to time, the company is advised of claims and penalties concerning certain potential disallowed costs. When such findings are presented, the company and the U.S. Government representatives engage in discussions to enable the company to evaluate the merits of these claims, as well as to assess the amounts being claimed. Where appropriate, provisions are made to reflect the company's expected exposure to the matters raised by the U.S. Government representatives and such provisions are reviewed on a quarterly basis for sufficiency based on the most recent information available. The company believes that the

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outcome of any such matters would not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Operating Leases Rental expense for operating leases, excluding discontinued operations, for the three and nine months ended September 30, 2011, was \$111 million and \$326 million, respectively, and was \$106 million and \$343 million for the three and nine months ended September 30, 2010, 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.

Spin-off of Shipbuilding Business Under the Separation and Distribution Agreement with HII described in Note 5, from and after the spin-off transaction, HII assumed responsibility for certain commitments and contingencies related to the Shipbuilding business and agreed to indemnify the company for losses related to these commitments and contingencies. The company has therefore excluded from this report previously disclosed Shipbuilding-related commitments and contingencies now assumed by HII.

A subsidiary of the company has guaranteed HII's outstanding \$84 million Economic Development Revenue Bonds (Ingalls Shipbuilding, Inc. Project), Taxable Series 1999A. The immaterial fair value of this guarantee was recorded in other long-term liabilities. In addition, HII has assumed the responsibility for the payment and performance of all outstanding indebtedness, obligations and liabilities of the company under this guarantee, and has agreed to indemnify the company against all liabilities that may be incurred in connection with this guarantee.

12. RETIREMENT BENEFITS

The cost of the company's pension plans and post-retirement medical and life benefit plans is shown in the following table:

| | Three Months Ended September 30 | | | | Nine Months Ended September 30 | | | |
|--|---------------------------------|---------------|---------------------------|--------------|--------------------------------|---------------|---------------------------|--------------|
| | Pension Benefits | | Medical and Life Benefits | | Pension Benefits | | Medical and Life Benefits | |
| <i>\$ in millions</i> | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Components of Net Periodic Benefit Cost | | | | | | | | |
| Service cost | \$ 130 | \$ 133 | \$ 8 | \$ 8 | \$ 390 | \$ 399 | \$ 24 | \$ 24 |
| Interest cost | 305 | 304 | 29 | 30 | 915 | 912 | 87 | 90 |
| Expected return on plan assets | (423) | (380) | (16) | (14) | (1,269) | (1,140) | (48) | (42) |
| Amortization of: | | | | | | | | |
| Prior service cost (credit) | 6 | 9 | (13) | (13) | 18 | 27 | (39) | (39) |
| Net loss from previous years | 41 | 51 | 3 | 5 | 123 | 153 | 9 | 15 |
| Net periodic benefit cost | \$ 59 | \$ 117 | \$ 11 | \$ 16 | \$ 177 | \$ 351 | \$ 33 | \$ 48 |
| Defined contribution plans cost | \$ 64 | \$ 77 | | | \$ 225 | \$ 243 | | |

Employer Contributions The company's required minimum funding in 2011 for its pension plans and its medical and life benefit plans are approximately \$59 million and \$124 million, respectively. For the nine months ended September 30, 2011, contributions of \$572 million have been made to the company's pension plans, including voluntary pension contributions totaling \$500 million, and contributions of \$73 million have been made to the company's post-retirement medical and life benefit plans.

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. In addition

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to the 401(k) defined contribution benefit plan, non-represented employees hired after June 30, 2008, are eligible to participate in a company-sponsored defined contribution program in lieu of a defined benefit pension plan.

Spin-off of Shipbuilding Business As a result of the previously mentioned spin-off of HII discussed in Note 5, the company transferred certain pension and other post-retirement benefit plans related exclusively to Shipbuilding employees and the Shipbuilding portion of Northrop Grumman pension and other post-retirement benefit plans that included Shipbuilding employees. A re-measurement of plan assets and liabilities was performed for those plans that included both Shipbuilding and Northrop Grumman employees as of March 31, 2011, the effective date of the spin-off. The effect of this re-measurement on the company's consolidated financial position, results of operations and cash flows was not material.

13. STOCK COMPENSATION PLANS

On May 18, 2011, the shareholders of the company approved the company's 2011 Long Term Incentive Stock Plan (the 2011 Plan), which replaced the expired 2001 Long-Term Incentive Stock Plan (the 2001 Plan). At September 30, 2011, Northrop Grumman had stock-based compensation awards outstanding under the 2011 Plan and the 2001 Plan, which are applicable to employees, as well as under the 1993 Stock Plan for Non-Employee Directors and 1995 Stock Plan for Non-Employee Directors, as amended. Each of these plans was approved by the company's shareholders. In addition, as a result of prior acquisitions there are other stock-based compensation awards outstanding. Stock-based compensation awards authorized under these employee plans include stock options, stock appreciation rights, stock bonuses, restricted stock, restricted stock units, performance shares and similar rights to purchase or acquire shares.

Under the 2011 Plan, the company is authorized to issue or transfer shares of common stock pursuant to any of the types of awards mentioned above. At September 30, 2011, the aggregate number of shares that may be issued or transferred pursuant to awards under the 2011 Plan is 46.1 million shares, including 7.1 million shares from the 2001 Plan that were previously authorized and available to be issued at the date the 2001 Plan expired. In addition, in the event that outstanding awards under the 2001 plan expire or terminate without being exercised or paid, as the case may be, such shares (the Forfeited Shares) will become available for award under the 2011 Plan. Shares issued under the 2011 Plan other than for stock options, stock appreciation rights and the Forfeited Shares will be counted against the 2011 Plan's aggregate share limit as 4.5 shares for every one share actually issued in connection with the award; any shares issued for stock options, stock appreciation rights and the Forfeited Shares will be counted against the remaining shares on a one for one basis. The 2011 Plan provides equity-based award grants to non-employee directors.

Shipbuilding Spin-off Adjustments As a result of the spin-off of Shipbuilding, effective March 31, 2011, all outstanding stock-based compensation awards related to HII employees and retirees were assumed by HII. Also effective with the spin-off, the share amounts for all remaining Northrop Grumman outstanding stock options and stock awards, and the strike price for stock options were adjusted to maintain the aggregate intrinsic value of the grants at the date of the spin-off pursuant to the terms of the company's applicable stock-based compensation plans. Taking into account the change in the value of the company's common stock as a result of the distribution of the HII shares to the company's shareholders, the conversion ratio for the remaining stock options and stock awards was 1.09. For stock options, the net effect of these adjustments resulted in an increase to the stock options outstanding due to the limited number of stock options applicable to and assumed by HII for Shipbuilding employees. For stock awards, the net effect was a decrease in stock awards outstanding as the number of shares assumed by HII for Shipbuilding employees exceeded the impact of the adjustment to the remaining Northrop Grumman employees. The Shipbuilding spin-off adjustments are reflected in the stock option and stock award tables below.

Compensation Expense

Total pre-tax stock-based compensation expense for the nine months ended September 30, 2011, and 2010, was \$97 million and \$99 million, respectively, of which \$10 million and \$22 million related to stock options and \$87 million and \$77 million related to stock awards, respectively. Tax benefits recognized in the condensed

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consolidated statements of operations for stock-based compensation during the nine months ended September 30, 2011, and 2010, were \$39 million in each period. In addition, the company realized tax benefits of \$18 million and \$13 million from the exercise of stock options and \$32 million and \$34 million from the issuance of stock awards in the nine months ended September 30, 2011, and 2010, respectively. As a result of the spin-off of HII described in Note 5, stock-based compensation for HII employees of \$3 million and \$11 million has been recorded in discontinued operations for the nine months ended September 30, 2011 and 2010, respectively.

At September 30, 2011, there was \$181 million of unrecognized compensation expense related to unvested awards granted under the company's stock-based compensation plans, of which \$16 million relate to stock options and \$165 million relate to stock awards. These amounts are expected to be charged to expense over a weighted-average period of 1.4 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 dividend yield represents the current annual dividend yield at the time stock options are awarded. 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 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.

The significant weighted-average assumptions relating to the valuation of the company's stock options granted during the nine months ended September 30, 2011 and 2010, were as follows:

| | 2011 | 2010 |
|------------------------------|------|------|
| Dividend yield | 2.7% | 2.9% |
| Volatility rate | 25% | 25% |
| Risk-free interest rate | 2.4% | 2.3% |
| Expected option life (years) | 6 | 6 |

The company grants stock options primarily to executives, and the expected term of six years is based on these employees' exercise behavior. In 2009, the company granted stock options to non-executives and assigned an expected term of five years for valuing these stock options. The company believes that this stratification of expected terms best represents future expected exercise behavior between the two employee groups. The shorter expected life of non-executive employee stock options had an insignificant effect on the weighted average expected option life for the nine months ended September 30, 2011, and 2010.

Using the Black-Scholes option pricing model, the weighted-average grant date fair value of stock options granted during the nine months ended September 30, 2011 and 2010, was \$14 and \$11 per share, respectively.

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Stock option activity for the nine months ended September 30, 2011, 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, 2011 | 13,221 | \$55 | 3.8 years | \$149 |
| Granted | 805 | 63 | | |
| Exercised | (2,277) | 44 | | |
| Canceled and forfeited | (86) | 57 | | |
| Shipbuilding spin-off adjustments | 150 | 59 | | |
| Outstanding at September 30, 2011 | 11,813 | \$53 | 3.6 years | \$ 48 |
| Vested and expected to vest in the future at September 30, 2011 | 11,785 | \$53 | 3.6 years | \$ 48 |
| Exercisable at September 30, 2011 | 9,028 | \$52 | 3.0 years | \$ 42 |

The total intrinsic value of stock options exercised during the nine months ended September 30, 2011, and 2010, was \$44 million and \$32 million, respectively. Intrinsic value is measured as the excess of the fair market value at the date of exercise (for stock options exercised) or at September 30, 2011 (for outstanding options), over 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, generally three years. The fair value of performance-based 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 for performance-based stock awards, the amount of shares ultimately expected to vest is estimated at each reporting date based on management's expectations regarding the relevant performance criteria. The fair value of market-based stock awards is determined at the grant date using a Monte Carlo simulation model.

Stock award activity for the nine months ended September 30, 2011, was as follows:

| | Stock Awards (in thousands) | Weighted- Average Grant Date Fair Value | Weighted- Average Remaining Contractual Term |
|-----------------------------------|---------------------------------------|---|--|
| Outstanding at January 1, 2011 | 4,300 | \$53 | 1.5 years |
| Granted | 1,640 | 63 | |
| Vested | (56) | 65 | |
| Forfeited | (322) | 50 | |
| Shipbuilding spin-off adjustments | (252) | 47 | |
| Outstanding at September 30, 2011 | 5,310 | \$53 | 1.2 years |

There were 2.2 million stock awards granted in the nine months ended September 30, 2010, with a weighted-average grant date fair value of \$60 per share. During the nine months ended September 30, 2011 and 2010, the company issued 1.4 million and 1.3 million shares, respectively, to employees in settlement of prior year stock awards that became fully vested, which had total fair values at issuance of \$87 million and \$76 million, respectively, and grant date fair values of \$101 million and \$91 million, respectively. The differences between the fair values at issuance and the grant date fair values reflect the effects of performance adjustments (described above) and changes in the fair market value of the company's common stock.

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NORTHROP GRUMMAN CORPORATION

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Northrop Grumman Corporation

Falls Church, Virginia

We have reviewed the accompanying condensed consolidated statement of financial position of Northrop Grumman Corporation and subsidiaries as of September 30, 2011, and the related condensed consolidated statements of operations for the three-month and nine-month periods ended September 30, 2011 and 2010, and of cash flows and of changes in shareholders' equity for the nine-month periods ended September 30, 2011 and 2010. These interim financial statements are the responsibility of the Corporation's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial position of Northrop Grumman Corporation and subsidiaries as of December 31, 2010, and the related consolidated statements of operations, cash flows and changes in shareholders' equity for the year then ended (not presented herein); and in our report dated February 8, 2011 (June 16, 2011, as to the reclassification of the Shipbuilding segment as discontinued operations as described in Note 1), we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated statement of financial position as of December 31, 2010 is fairly stated, in all material respects, in relation to the consolidated statement of financial position from which it has been derived.

/s/ Deloitte & Touche LLP

McLean, Virginia

October 25, 2011

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NORTHROP GRUMMAN CORPORATION

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

OVERVIEW

Northrop Grumman Corporation (herein referred to as Northrop Grumman, the company, we, us, or our) provides technologically advanced, innovative products, services, and integrated solutions in aerospace, electronics, information and services to our global customers. We participate in many high-priority defense and government services technology programs in the United States (U.S.) and abroad as a prime contractor, principal subcontractor, partner, or preferred supplier. We conduct most of our business with the U.S. Government, principally the Department of Defense (DoD). We also conduct business with local, state, and foreign governments and domestic and international commercial customers.

The following discussion should be read along with the unaudited condensed consolidated financial statements included in this Form 10-Q, as well as our Annual Report on Form 10-K for the year ended December 31, 2010, and the Form 8-K filed on June 17, 2011, which recast certain portions of our 2010 Form 10-K to reflect the spin-off of our Shipbuilding business as discontinued operations. The Form 10-K and Form 8-K dated June 17, 2011, provide a more thorough discussion of our products and services, industry outlook, and business trends. See further discussions in the Consolidated Operating Results and Segment Operating Results sections that follow.

Business Outlook and Operational Trends Except as discussed below under Economic Opportunities, Challenges, and Risks and in Part II, Item 1A, of this report, there have been no material changes to our products and services, industry outlook, or business trends from those disclosed in our 2010 Form 10-K other than the spin-off of our Shipbuilding business to our shareholders effective March 31, 2011, which is reflected in our Form 8-K dated June 17, 2011.

Economic Opportunities, Challenges, and Risks Our industry's business environment continues to be shaped by policy and budget decisions and the economic conditions of our primary customer, the U.S. Government. Recent actions of Congress and the Administration indicate an ongoing emphasis on federal budget deficit reduction. Near-term budget decisions by the Administration and Congress may considerably reduce discretionary spending, of which defense constitutes the majority share. Defense spending is nevertheless expected to remain a national priority within future federal budgets, and we anticipate remaining a valued provider of critical capabilities and services.

In August 2011, Congress and the Administration enacted the Budget Control Act of 2011 (the Budget Act) in order to raise the federal debt ceiling and reduce spending. The Budget Act consists of two parts and could have a significant impact on future defense spending levels. The first part mandates sizeable reductions in defense spending over the next decade. These spending level reductions are generally consistent with spending reductions President Obama and his advisors have previously discussed. The second part of the Budget Act requires a Congressional Joint Committee to propose major deficit reductions achieved through spending reductions, revenue increases, and/or entitlement reform. If this proposal is not enacted by January 15, 2012, then under the Budget Act, very substantial, across-the-board, spending reductions would be applied to discretionary spending from fiscal year 2013 through fiscal year 2021. Any of these reductions could have a significant impact on our business and financial results. Currently, we are unable to predict the likelihood of this occurring or the extent to which any reductions would impact total funding and/or individual funding for programs in which we participate.

Uncertainty over forthcoming budget plans and national security spending levels may prove challenging for our customer community, as well as our industry. We understand the DoD is finalizing a strategic review intended to guide its budgeting decisions. Of interest will be the size and scope of the DoD's adjustments to its current plans and the degree to which new budget reductions may affect each of investment spending, operations and support funding.

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NORTHROP GRUMMAN CORPORATION

We expect U.S. force levels and war-time budget resources committed to Iraq and Afghanistan to continue to draw down. As spending on counterinsurgency warfare is reduced, there is rising industry interest in the extent to which the DoD may re-evaluate the role and structure of the military.

The U.S. is expected to continue to maintain a range of powerful military capabilities to support U.S. national security interests, even amidst economic difficulties and reductions in defense spending levels, and will continue to need many of the sophisticated capabilities that we provide. Our development portfolio includes such key areas as long range strike, missile defense, cybersecurity, unmanned systems, defense electronics, information systems, satellite communications, directed energy applications, restricted programs, and intelligence surveillance and reconnaissance capabilities, among others. As a result, we believe we are well positioned to help the DoD meet its critical future capability requirements for protecting U.S. security in the years ahead.

For additional discussion of risks that may impact our business and industry, see Part II, Item 1A, of this report.

Cybersecurity Our industry and the broader national security community are subject to various cybersecurity threats including, but not limited to, attempts to gain unauthorized access to sensitive information. We proactively work to assess and mitigate the evolving risks. In addition, Northrop Grumman has partnered with various industry and government participants, including the DoD, to collaborate around increased awareness and enhanced protections against cybersecurity threats. For additional discussion of the risks that we face due to security threats, including cybersecurity threats, see Part II, Item 1A, of this report.

Green Initiatives We could be affected by future laws or regulations related to climate change concerns and other actions known as green initiatives. In 2009, we established a goal of reducing our greenhouse gas emissions over a five-year period through December 31, 2014. In 2010, we established goals for water usage and solid waste generation. To comply with laws, regulations and green initiatives, including our goals, we have incurred and expect to incur capital and operating costs, but at this time, such costs have not had, and we do not expect that such costs will have, a material adverse effect on our financial position, results of operations or cash flows.

Recent Developments in U.S. Government Cost Accounting Standards (CAS) Pension Recovery Rules On May 10, 2010, the CAS Board published a Notice of Proposed Rulemaking (NPRM) that if adopted would provide a framework to partially harmonize the CAS rules with the Pension Protection Act of 2006 (PPA) funding requirements. The NPRM would harmonize these rules by mitigating the mismatch between CAS costs and PPA-amended Employee Retirement Income Security Act (ERISA) minimum funding requirements. Until the final rule is published, and to the extent that the final rule does not completely eliminate mismatches between ERISA funding requirements and CAS pension costs, government contractors maintaining defined benefit pension plans will continue to experience a timing mismatch between required contributions and pension expenses recoverable under CAS. The final rule is currently expected to be issued in 2012 and to apply to contracts starting the year following the award of the first CAS covered contract after the effective date of the new rule. This would mean the rule would apply to our contracts in 2013. We anticipate that contractors will be entitled to an equitable adjustment for any additional CAS contract costs resulting from the final rule.

Notable Events Notable events or activities during the nine months ended September 30, 2011, included the following:

- n We completed the spin-off of our Shipbuilding business (Huntington Ingalls Industries or HII) and this business is now reported within discontinued operations.

- n In connection with the spin-off of HII, we received a cash contribution of \$1,429 million.

- n We reduced our participation in the National Security Technologies (NSTec) joint venture, which resulted in a \$1,745 million reduction in contract backlog.

n We repaid notes with a face value of \$750 million.

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n We increased the quarterly common stock dividend, from \$0.47 per share to \$0.50 per share.

n We repurchased 15.6 million shares of common stock under an accelerated share repurchase agreement totaling \$981 million and have also repurchased 12.8 million shares of common stock on the open market for \$673 million.

CRITICAL ACCOUNTING POLICIES, ESTIMATES, AND JUDGMENTS

There have been no material changes to our Critical Accounting Policies, Estimates, or Judgments from those discussed in our Form 8-K dated June 17, 2011, that recast certain portions of our 2010 Form 10-K.

CONSOLIDATED OPERATING RESULTS

Selected financial highlights are presented in the table below:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|---------|-------------------|----------|
| | September 30 | | September 30 | |
| | 2011 | 2010 | 2011 | 2010 |
| <i>\$ in millions, except per share amounts</i> | | | | |
| Sales and service revenues | \$6,612 | \$7,071 | \$19,906 | \$21,240 |
| Cost of sales and service revenues | 5,198 | 5,774 | 15,716 | 17,269 |
| General and administrative expenses | 589 | 574 | 1,713 | 1,819 |
| Operating income | 825 | 723 | 2,477 | 2,152 |
| Interest expense | (57) | (64) | (168) | (206) |
| Other, net | (13) | 13 | (8) | 10 |
| Federal and foreign income tax expense | 235 | 224 | 765 | 358 |
| Discontinued operations | | 49 | 34 | 79 |
| Diluted earnings per share from continuing operations | 1.86 | 1.51 | 5.34 | 5.28 |
| Cash provided by continuing operations | 948 | 816 | 1,026 | 916 |

Operating Performance Assessment and Reporting

We manage and assess the performance of our businesses based on our performance on individual contracts and programs obtained generally from government organizations using the financial measures referred to below, with consideration given to the Critical Accounting Policies, Estimates, and Judgments described in our Form 8-K dated June 17, 2011, that recast certain portions of our 2010 Form 10-K. Our portfolio of long-term contracts is largely flexibly-priced, which means that sales tend to fluctuate in concert with costs across our large portfolio of active contracts, with operating income being a critical measure of operational performance. Due to the Federal Acquisition Regulation (FAR) rules that govern our business, most types of costs are allowable, and we do not focus on individual cost groupings (such as cost of sales or general and administrative costs) as much as we do on total contract costs, which are a key factor in determining contract operating income. As a result, in evaluating our operating performance, we look primarily at changes in sales and service revenues, and operating income, including the effects of significant changes in operating income as a result of changes in contract estimates and the use of the cumulative catch-up method of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP). Unusual fluctuations in operating performance driven by changes in a specific cost element across multiple contracts, however, are described in our analysis. Based on this approach and the nature of our operations, the discussion of results of operations generally focuses around our four segments versus distinguishing between products and services. Our Aerospace Systems and Electronic Systems segments generate predominantly product sales, while the Information Systems and Technical Services segments generate predominantly service revenues.

Table of Contents**NORTHROP GRUMMAN CORPORATION****Sales and Service Revenues**

Sales and service revenues consist of the following:

| <i>\$ in millions</i> | Three Months Ended | | Nine Months Ended | |
|----------------------------|--------------------|---------|-------------------|----------|
| | September 30 | | September 30 | |
| | 2011 | 2010 | 2011 | 2010 |
| Product sales | \$3,780 | \$3,968 | \$11,352 | \$12,159 |
| Service revenues | 2,832 | 3,103 | 8,554 | 9,081 |
| Sales and service revenues | \$6,612 | \$7,071 | \$19,906 | \$21,240 |

Sales and service revenues for the three months ended September 30, 2011, decreased \$459 million, as compared with the same period in 2010, reflecting lower sales at Aerospace Systems, Information Systems, and Technical Services. Sales and service revenues for the nine months ended September 30, 2011, decreased \$1,334 million, as compared with the same period in 2010, reflecting lower sales in all operating segments.

Product sales for the three months ended September 30, 2011, decreased \$188 million, as compared with the same period in 2010, primarily due to lower sales volume on space and manned aircraft programs at the Aerospace Systems segment, partially offset by higher sales volume on intelligence, marine and targeting systems at the Electronic Systems segment. Product sales for the nine months ended September 30, 2011, decreased \$807 million, as compared with the same period in 2010, primarily due to lower sales volume on space and aircraft programs at the Aerospace Systems segment and lower sales volume in land and self protection systems at the Electronic Systems segment.

Service revenues for the three months ended September 30, 2011 decreased \$271 million, as compared with the same period in 2010, primarily due to the reduced participation by our Technical Services segment in the NSTec joint venture effective January 1, 2011, resulting in no sales recorded for the joint venture in 2011, compared to \$163 million in the same period in 2010, as well as lower sales volume on defense and civil systems at the Information Systems segment. Service revenues for the nine months ended September 30, 2011 decreased \$527 million, as compared with the same period in 2010, primarily due to the reduced participation by the Technical Services segment in the NSTec joint venture, as described above, for which \$451 million of service revenue was recorded in the same period in 2010, as well as lower sales volume on defense and civil systems at the Information Systems segment.

Cost of Sales and Service Revenues and General and Administrative Expenses

Cost of sales and service revenues and general and administrative expenses are comprised of the following:

| <i>\$ in millions</i> | Three Months Ended | | Nine Months Ended | |
|--|--------------------|---------|-------------------|----------|
| | September 30 | | September 30 | |
| | 2011 | 2010 | 2011 | 2010 |
| Cost of sales and service revenues | | | | |
| Cost of product sales | \$2,700 | \$2,918 | \$ 8,204 | \$ 8,986 |
| <i>% of product sales</i> | 71.4% | 73.5% | 72.3% | 73.9% |
| Cost of service revenues | 2,498 | 2,856 | 7,512 | 8,283 |
| <i>% of service revenues</i> | 88.2% | 92.0% | 87.8% | 91.2% |
| General and administrative expenses | 589 | 574 | 1,713 | 1,819 |
| <i>% of total sales and service revenues</i> | 8.9% | 8.1% | 8.6% | 8.6% |
| | \$5,787 | \$6,348 | \$17,429 | \$19,088 |

Cost of sales and service revenues and general and administrative expenses

Cost of Product Sales and Service Revenues The decrease in cost of product sales as a percentage of product sales for the three and nine months ended September 30, 2011, as compared with the same periods in 2010, is primarily due to performance improvements in Aerospace Systems and Electronic Systems.

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The decrease in cost of service revenues as a percentage of service revenues for the three and nine months ended September 30, 2011, as compared with the same periods in 2010, is primarily due to the effects of reduced participation in the NSTec joint venture by our Technical Services segment. Effective January 1, 2011, the company reduced its participation in this joint venture, and as a result no longer consolidates sales or cost of sales for the joint venture.

General and Administrative Expenses In accordance with industry practice and the regulations that govern the cost accounting requirements for government contracts, most general corporate expenses incurred at both the segment and corporate locations are considered allowable and allocable costs on government contracts. For most components of the company, these costs are allocated to contracts in progress on a systematic basis and contract performance factors include this cost component as an element of cost. General and administrative expenses as a percentage of total sales and service revenues increased to 8.9 percent for the three months ended September 30, 2011, from 8.1 percent for the same period in 2010, primarily due to indirect costs remaining relatively constant while sales in the 2011 period declined. General and administrative expenses as a percentage of total sales and service revenues for the nine months ended September 30, 2011, is comparable to the same period in 2010.

See Segment Operating Results below for further information.

Operating Income

We consider operating income to be an important measure for evaluating our operating performance and, as is typical in the industry, we define operating income as revenues less the related cost of producing the revenues and general and administrative expenses. We also further evaluate operating income for each of the business segments in which we operate.

We internally manage our operations by reference to segment operating income. Segment operating income is defined as operating income before unallocated corporate expenses and net pension adjustment, neither of which affect the operating results of segments, and the reversal from segment operating income of royalty income, which is classified as other, net for financial reporting purposes. Segment operating income is one of the key metrics we use to evaluate operating performance. Segment operating income is not, however, a measure of financial performance under GAAP, and may not be defined and calculated by other companies in the same manner.

The table below reconciles segment operating income to total operating income:

| <i>\$ in millions</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--------------------------------|------------------------------------|-------|-----------------------------------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Segment operating income | \$777 | \$760 | \$2,282 | \$2,257 |
| Unallocated corporate expenses | (48) | (34) | (96) | (99) |
| Net pension adjustment | 100 | (1) | 302 | 2 |
| Royalty income adjustment | (4) | (2) | (11) | (8) |
| Total operating income | \$825 | \$723 | \$2,477 | \$2,152 |

Segment Operating Income Segment operating income for the three months ended September 30, 2011, increased \$17 million, or 2 percent, as compared with the same period in 2010. Segment operating income was 11.8 percent and 10.7 percent of sales and service revenues for the three months ended September 30, 2011 and 2010, respectively. Segment operating income for the nine months ended September 30, 2011, increased \$25 million, or 1 percent, as compared with the same period in 2010. Segment operating income was 11.5 percent and 10.6 percent of sales and service revenues for the nine months ended September 30, 2011 and 2010, respectively. Performance improvements at Aerospace Systems and Electronic Systems and the effects of the reduced participation in the NSTec joint venture at Technical Services more than offset the reduction in segment operating income resulting from lower sales volume at all four segments and contributed to the rate improvement in 2011. See Segment Operating Results below for further information.

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NORTHROP GRUMMAN CORPORATION

Unallocated Corporate Expenses Unallocated corporate expenses generally include the portion of corporate expenses not considered allowable or allocable under applicable CAS and FAR rules, and therefore not allocated to the segments, such as management and administration, legal, environmental, certain compensation and retiree benefits, and other expenses. Unallocated corporate expenses for the three months ended September 30, 2011, increased by \$14 million as a result of a provision for deferred state income taxes. Unallocated corporate expenses for the nine months ended September 30, 2011, are comparable to the same period in 2010.

Net Pension Adjustment Net pension adjustment reflects the difference between pension expense determined in accordance with GAAP and pension expense allocated to the operating segments determined in accordance with CAS. For the three months ended September 30, 2011 and 2010, the net pension adjustment resulted in income of \$100 million and expense of \$1 million, respectively. For the nine months ended September 30, 2011 and 2010, the net pension adjustment resulted in income of \$302 million and \$2 million, respectively. The increase in net pension adjustment for 2011 is primarily due to decreased GAAP pension expense, primarily resulting from higher estimated investment income on greater plan investment assets as of the beginning of the year.

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

Interest Expense

Interest expense for the three and nine months ended September 30, 2011, decreased \$7 million and \$38 million, respectively, as compared with the same periods in 2010, primarily due to a lower weighted average interest rate resulting from our debt refinancing in November 2010.

Other, net

Other, net for the three months and nine months ended September 30, 2011, decreased \$26 million and \$18 million, respectively, as compared with the same periods in 2010, primarily due to a valuation adjustment related to an investment in an unconsolidated affiliate in the Electronic Systems segment, and lower returns on investments in marketable securities used as a funding source for non-qualified employee benefits.

Federal and Foreign Income Tax Expense

Our effective tax rate on earnings from continuing operations for the three and nine months ended September 30, 2011, was 31.1 percent and 33.2 percent, compared with 33.3 percent and 18.3 percent for the three and nine months ended September 30, 2010. For 2011, our effective tax rates differ from the statutory federal rate from recognized net tax benefits of \$14 million, primarily due to finalizing the research and development tax credits and manufacturing deductions claimed upon filing the 2010 tax return. For 2010, our effective tax rates differ from the statutory federal rate primarily due to manufacturing deductions, research and development credits, and the tax settlement with the Internal Revenue Service (IRS). In the second quarter of 2010, we recognized net tax benefits of approximately \$298 million, primarily as a result of a final settlement with the IRS and the U.S. Congressional Joint Committee on Taxation related to our tax returns for the years ended 2004 through 2006. Excluding the effect of the tax settlement with the IRS in 2010, our effective tax rate on earnings from continuing operations for the nine months ended September 30, 2010, was 33.5 percent. See Note 7 to the condensed consolidated financial statements in Part I, Item 1.

Discontinued Operations

Earnings from discontinued operations for the nine months ended September 30, 2011 and 2010, were primarily attributable to the Shipbuilding business, which was spun off to our shareholders on March 31, 2011. Earnings from discontinued operations for the nine months ended September 30, 2011, decreased \$45 million as compared with the same period in 2010.

Earnings from discontinued operations for the nine months ended September 30, 2010, also include a \$15 million after-tax adjustment to the gain on the December 2009 sale of our Advisory Services Division to reflect purchase price adjustments and the utilization of additional capital loss carry-forwards.

Diluted Earnings Per Share From Continuing Operations

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Diluted earnings per share from continuing operations for the three months ended September 30, 2011, was \$1.86 per share, as compared with \$1.51 per share for the same period in 2010. Earnings per share are based on weighted

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average diluted shares outstanding of 279.3 million for the three months ended September 30, 2011, and 297.6 million for the same period in 2010.

Diluted earnings per share from continuing operations for the nine months ended September 30, 2011, was \$5.34 per share, as compared with \$5.28 per share for the same period in 2010. Earnings per share are based on weighted average diluted shares outstanding of 287.9 million for the nine months ended September 30, 2011, and 302.5 million for the same period in 2010. See Note 4 to the condensed consolidated financial statements in Part I, Item 1.

The tax settlement with the IRS in the second quarter of 2010 for approximately \$298 million discussed above increased our diluted earnings per share from continuing operations on a net basis by approximately \$.99 per share for the nine months ended September 30, 2010.

Cash Provided By Continuing Operations

For the three months ended September 30, 2011, cash provided by continuing operations was \$948 million, as compared with \$816 million in the same period in 2010. The increase of \$132 million reflects lower working capital requirements and lower discretionary pension contributions in the 2011 period.

For the nine months ended September 30, 2011, cash provided by continuing operations was \$1,026 million, as compared to \$916 million for the same period in 2010. The increase of \$110 million reflects lower interest and net income taxes paid, partially offset by higher discretionary pension contributions in the 2011 period.

SEGMENT OPERATING RESULTS**Basis of Presentation**

We are aligned into four reportable segments: Aerospace Systems, Electronic Systems, Information Systems, and Technical Services.

| <i>\$ in millions</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--|------------------------------------|---------|-----------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Sales and Service Revenues | | | | |
| Aerospace Systems | \$2,572 | \$2,706 | \$ 7,900 | \$ 8,244 |
| Electronic Systems | 1,905 | 1,874 | 5,504 | 5,740 |
| Information Systems | 1,955 | 2,123 | 6,011 | 6,310 |
| Technical Services | 680 | 871 | 2,024 | 2,435 |
| Intersegment eliminations | (500) | (503) | (1,533) | (1,489) |
| Total sales and service revenues | \$6,612 | \$7,071 | \$19,906 | \$21,240 |
| Operating Income | | | | |
| Aerospace Systems | \$ 304 | \$ 303 | \$ 936 | \$ 934 |
| Electronic Systems | 293 | 261 | 814 | 751 |
| Information Systems | 187 | 190 | 570 | 578 |
| Technical Services | 55 | 56 | 160 | 157 |
| Intersegment eliminations | (62) | (50) | (198) | (163) |
| Total Segment Operating Income | \$ 777 | \$ 760 | \$ 2,282 | \$ 2,257 |
| Non-segment factors affecting operating income | | | | |
| Unallocated corporate expenses | (48) | (34) | (96) | (99) |
| Net pension adjustment | 100 | (1) | 302 | 2 |
| Royalty income adjustment | (4) | (2) | (11) | (8) |
| Total operating income | \$ 825 | \$ 723 | \$ 2,477 | \$ 2,152 |

Table of Contents**NORTHROP GRUMMAN CORPORATION****Sales and Service Revenues**

Period-to-period sales reflect performance under new and ongoing contracts. Changes in sales and service revenues are typically expressed in terms of volume. Unless otherwise described, volume generally refers to increases (or decreases) in reported revenues incurred due to varying production activity levels, delivery rates, or service levels on individual contracts. Volume changes will typically carry a corresponding operating income change based on the margin rate for a particular contract.

Segment Operating Income

Segment operating income reflects the aggregate performance results of contracts within a business area or segment. Excluded from this measure are certain costs not directly associated with contract performance, including the portion of corporate expenses such as management and administration, legal, environmental, certain compensation costs and other retiree benefits, and other expenses not considered allowable or allocable under applicable CAS regulations and the FAR, and therefore not allocated to the segments. Changes in segment operating income are typically expressed in terms of volume, as discussed above, or performance.

Performance refers to changes in contract margin rates for the period. These changes typically relate to profit recognition associated with revisions to total estimated costs at completion of the contract (EAC) that reflect improved (or deteriorated) operating performance on a particular contract. Operating income changes are accounted for on a cumulative to date basis at the time an EAC change is recorded. We identify favorable and unfavorable adjustments above a threshold level to determine our qualitative discussion of performance results and, where material, we disclose the effects of such adjustments on a contract or program basis. Overall, our contract performance adjustments generally reflect margin improvements over the life of a contract as performance risks are reduced or eliminated. Thus we would expect that our aggregate cumulative adjustments would be favorable.

Operating income may also be affected by, among other things, the effects of workforce stoppages, natural disasters such as earthquakes, resolution of disputed items with the customer, recovery of insurance proceeds, and other discrete events. At the completion of a long-term contract, any originally estimated costs not incurred or reserves not fully utilized (such as warranty reserves) could also impact contract earnings. Where such items have occurred, and the effects are material, a separate description is provided.

Contract Descriptions

For convenience, a brief description of certain programs discussed in this Form 10-Q is included in the [Glossary of Programs](#) section that follows.

AEROSPACE SYSTEMS**Business Description**

Aerospace Systems is a leading designer, developer, integrator, and producer of manned and unmanned aircraft, spacecraft, high-energy laser systems, microelectronics and other systems and subsystems critical to maintaining the nation's security and leadership in technology. Aerospace Systems' customers, which are primarily government agencies, use these systems in many different mission areas, including: intelligence, surveillance and reconnaissance (ISR); communications; battle management; strike operations; electronic warfare; missile defense; earth observation; space science; and space exploration. The segment consists of four business areas: Strike & Surveillance Systems (S&SS); Space Systems (SS); Battle Management & Engagement Systems (BM&ES); and Advanced Programs & Technology (AP&T).

| <i>\$ in millions</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|----------------------------|------------------------------------|---------|-----------------------------------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Sales and service revenues | \$2,572 | \$2,706 | \$7,900 | \$8,244 |
| Segment operating income | 304 | 303 | 936 | 934 |

| | | | | |
|---|--------------|--------------|--------------|--------------|
| <i>As a percentage of segment sales</i> | 11.8% | 11.2% | 11.8% | 11.3% |
|---|--------------|--------------|--------------|--------------|

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Sales and Service Revenues

Aerospace Systems revenue for the three months ended September 30, 2011, decreased \$134 million, or 5 percent, as compared with the same period in 2010. The decrease is primarily due to \$144 million lower sales in SS and \$51 million lower sales in S&SS, partially offset by higher sales in AP&T and BM&ES. The lower sales in SS are primarily due to reduced funding for weather satellite programs and the James Webb Space Telescope (JWST), as well as lower volume for several other space programs. The lower sales in S&SS are primarily due to lower volume on the F-35 manned aircraft program. The lower F-35 program volume reflects the adoption of units-of-delivery revenue recognition beginning with low rate initial production lot 5. The higher sales in AP&T are primarily due to higher volume on restricted programs. The higher sales in BM&ES are primarily due to higher volume on E-2D Advanced Hawkeye programs.

Aerospace Systems revenue for the nine months ended September 30, 2011, decreased \$344 million, or 4 percent, as compared with the same period in 2010. The decrease is primarily due to \$309 million lower sales in SS and \$180 million lower sales in S&SS, partially offset by higher sales in BM&ES and AP&T. The lower sales in SS are primarily due to reduced funding for weather satellite programs and the JWST program, as well as lower volume for several other space programs. The lower sales in S&SS are primarily due to lower volume on F-35 and restricted programs. The higher sales in BM&ES are primarily due to higher volume on Joint Surveillance Target Attack Radar System and Broad Area Maritime Surveillance (BAMS) Unmanned Aircraft Systems, partially offset by lower volume on E-2 Hawkeye programs. The higher sales in AP&T are primarily due to higher volume on restricted programs, offset by lower volume on the Navy Unmanned Combat Air Systems (N-UCAS) program.

Segment Operating Income

Operating income at Aerospace Systems for the three months ended September 30, 2011, was comparable to the same period in 2010, and operating income as a percentage of sales was 11.8 percent, up from 11.2 percent in the same period in 2010. The slight increase in operating income and increase as a percentage of sales is primarily due to program performance improvements on certain S&SS programs and \$7 million lower amortization expense on purchased intangibles, partially offset by an unfavorable adjustment for performance incentives on a space program, and an approximately \$10 million reduction of operating income from the lower net sales volume described above.

Operating income at Aerospace Systems for the nine months ended September 30, 2011, was comparable to the same period in 2010, and operating income as a percentage of sales was 11.8 percent, up from 11.3 percent in the same period in 2010. The slight increase in operating income and increase as a percentage of sales is primarily due to program performance improvements on certain SS and S&SS programs and \$21 million lower amortization expense on purchased intangibles, partially offset by an unfavorable adjustment for performance incentives on a space program, and an approximately \$33 million reduction of operating income from the lower net sales volume described above.

ELECTRONIC SYSTEMS

Business Description

Electronic Systems is a leader in the design, development, manufacture, and support of solutions for sensing, understanding, anticipating, and controlling the environment for our global military, civil, and commercial customers and their operations. Electronic Systems provides a variety of defense electronics and systems, airborne fire control radars, situational awareness systems, early warning systems, airspace management systems, navigation systems, communications systems, marine systems, space systems, and logistics services. The segment consists of

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five business areas: Intelligence, Surveillance & Reconnaissance Systems; Land & Self Protection Systems; Naval & Marine Systems; Navigation Systems; and Targeting Systems.

| <i>\$ in millions</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|------------------------------------|---------|-----------------------------------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Sales and service revenues | \$1,905 | \$1,874 | \$5,504 | \$5,740 |
| Segment operating income | 293 | 261 | 814 | 751 |
| <i>As a percentage of segment sales</i> | 15.4% | 13.9% | 14.8% | 13.1% |

Sales and Service Revenues

Electronic Systems revenue for the three months ended September 30, 2011, increased \$31 million, or 2 percent, as compared with the same period in 2010. The increase is primarily due to \$24 million higher sales in Intelligence, Surveillance & Reconnaissance Systems, \$18 million higher sales in Naval & Marine Systems, \$17 million higher sales in Targeting Systems, partially offset by lower sales in Land & Self Protection Systems. The higher sales in Intelligence, Surveillance & Reconnaissance Systems are primarily due to higher volume on a space program and certain other restricted programs, partially offset by lower sales on postal automation programs. The higher sales in Naval & Marine Systems are primarily due to higher volume on the Virginia Class Submarine program. The higher sales in Targeting Systems are primarily due to higher volume on the ASQ-236 radar program. The lower sales in Land & Self Protection Systems are primarily due to lower volume on Vehicular Intercommunications Systems (VIS) program.

Electronic Systems revenue for the nine months ended September 30, 2011, decreased \$236 million, or 4 percent, as compared with the same period in 2010. The decrease is primarily due to \$326 million lower sales in Land & Self Protection Systems, partially offset by higher sales in Targeting Systems. The lower sales in Land & Self Protection Systems are primarily due to lower IDIQ volume on Large Aircraft Infrared Countermeasures and VIS programs. The higher sales in Targeting Systems are primarily due to higher volume on LITENING Gen 4 and ASQ-236 radar programs, partially offset by lower volume on F-16 programs.

Segment Operating Income

Operating income at Electronic Systems for the three months ended September 30, 2011, increased \$32 million, or 12 percent, as compared with the same period in 2010, and operating income as a percentage of sales increased to 15.4 percent from 13.9 percent in the same period in 2010. The higher operating income and increase as a percentage of sales is primarily due to an approximately \$3 million increase in operating income from higher sales volume described above and favorable program performance adjustments on a space program and an international radar program. For the quarter ended September 30, 2011, Electronic Systems recorded a \$25 million loss provision on its Flat Sequencing System (FSS) contract due to a dispute with the United States Postal Service (USPS).

Operating income at Electronic Systems for the nine months ended September 30, 2011, increased \$63 million, or 8 percent, as compared with the same period in 2010, and operating income as a percentage of sales increased to 14.8 percent from 13.1 percent in the same period in 2010. The higher operating income and increase as a percentage of sales is due to program performance improvements on certain Intelligence, Surveillance & Reconnaissance Systems and Land & Self Protection Systems programs, partially offset by an approximately \$52 million reduction of operating income from the lower sales volume described above.

INFORMATION SYSTEMS**Business Description**

Information Systems is a leading global provider of advanced solutions for the DoD, intelligence, federal civilian, state and local agencies, and international customers. Products and services are focused on the fields of command, control, communications, computers and intelligence; cybersecurity; air and missile defense; airborne reconnaissance; intelligence processing; decision support systems; information technology; and systems engineering

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and systems integration. The segment consists of three business areas: Defense Systems, Intelligence Systems, and Civil Systems.

| <i>\$ in millions</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|------------------------------------|---------|-----------------------------------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Sales and service revenues | \$1,955 | \$2,123 | \$6,011 | \$6,310 |
| Segment operating income | 187 | 190 | 570 | 578 |
| <i>As a percentage of segment sales</i> | 9.6% | 8.9% | 9.5% | 9.2% |

Sales and Service Revenues

Information Systems revenue for the three months ended September 30, 2011, decreased \$168 million, or 8 percent, as compared with the same period in 2010. The decrease is primarily due to \$124 million lower sales in Defense Systems and \$55 million lower sales in Civil Systems, partially offset by higher sales in Intelligence Systems. The lower sales in Defense Systems are primarily due to lower volume on Joint National Integration Center Research and Development Contract (JRDC), Force Protection Security System (FPS2), Saudi Arabian American Oil Company (ARAMCO), Network Centric Solutions Defense Knowledge Online (Netcents DKO), F-22, and several other programs, partially offset by higher volume on Encore II. The lower sales in Civil Systems are primarily due to the sale of the County of San Diego contract, which reduced sales by \$32 million as compared to the same period in 2010, and lower volume on certain other programs.

Information Systems revenue for the nine months ended September 30, 2011, decreased \$299 million, or 5 percent, as compared with the same period in 2010. The decrease is primarily due to \$198 million lower sales in Defense Systems and \$64 million lower sales in Civil Systems. The lower sales in Defense Systems are primarily due to lower volume on ARAMCO, FPS2, Netcents DKO, Systems and Software Engineering Support, Multi-Role Tactical Command Data Link, F-22, and several other programs, partially offset by higher volume on Encore II and Trailer Mounted Support System programs. The lower sales in Civil Systems are primarily due to the sale of the County of San Diego contract, which reduced sales by \$39 million as compared to the same period in 2010, and completion of the Treasury Communications System program in 2010.

Segment Operating Income

Operating income at Information Systems for the three months ended September 30, 2011, decreased \$3 million, or 2 percent, as compared with the same period in 2010, and operating income as a percentage of sales increased to 9.6 percent from 8.9 percent for the same period in 2010. These changes are primarily due to a \$15 million reduction of operating income from the lower sales volume described above, partially offset by program performance improvements on certain Civil Systems programs, including the effects of the sale of the County of San Diego contract in May 2011. For the quarter ended September 30, 2011, Information Systems recorded a \$15 million provision for overhead rates resulting from the declining sales base.

Operating income at Information Systems for the nine months ended September 30, 2011, decreased \$8 million, or 1 percent, as compared with the same period in 2010, and operating income as a percentage of sales increased to 9.5 percent from 9.2 percent for the same period in 2010. These changes are primarily due to a \$27 million reduction of operating income from the lower sales volume described above, partially offset by program performance improvements on certain Civil Systems programs and the effects of the sale of the County of San Diego contract in May 2011. In addition, operating income in the 2010 period benefited from an \$18 million favorable adjustment on the New York City Wireless program resulting from risk reduction.

TECHNICAL SERVICES**Business Description**

Technical Services is a leading provider of logistics, infrastructure, and sustainment support, and also provides a wide array of technical services, including training and simulation. The segment consists of three business areas: Defense and Government Services Division (DGSD); Training Solutions Division (TSD); and Integrated Logistics and Modernization Division (ILMD).

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| | \$1,955 | \$1,955 | \$1,955 | \$1,955 | \$1,955 |
|---|------------------------------------|----------------|-----------------------------------|----------------|----------------|
| | Three Months Ended September 30 | | Nine Months Ended September 30 | | |
| <i>\$ in millions</i> | 2011 | 2010 | 2011 | 2010 | 2010 |
| Sales and service revenues | \$680 | \$871 | \$2,024 | \$2,435 | \$2,435 |
| Segment operating income | 55 | 56 | 160 | 157 | 157 |
| <i>As a percentage of segment sales</i> | 8.1% | 6.4% | 7.9% | 6.4% | 6.4% |

Sales and Service Revenues

Technical Services revenue for the three months ended September 30, 2011, decreased \$191 million, or 22 percent, as compared with the same period in 2010. The decrease is primarily due to \$180 million lower sales in DGSD from the reduced participation in the NSTec joint venture. Effective January 1, 2011, the company reduced its participation in this joint venture, resulting in no sales recorded for the joint venture in the three months ended September 30, 2011, compared with sales of \$163 million for the same period in 2010.

Technical Services revenue for the nine months ended September 30, 2011, decreased \$411 million, or 17 percent, as compared with the same period in 2010. The decrease is primarily due to \$488 million lower sales in DGSD and \$74 million lower sales in TSD, partially offset by higher sales in ILM. The lower sales in DGSD are primarily due to the reduced participation in the NSTec joint venture. Effective January 1, 2011, the company reduced its participation in this joint venture, resulting in no sales recorded for the joint venture in the nine months ended September 30, 2011, compared with sales of \$451 million for the same period in 2010. The lower sales in TSD are primarily due to lower volume on Joint Warfighting Center and Africa Contingency Operations Training & Assistance programs and lower volume on Global Linguists Solutions program. The higher sales in ILM are primarily due to increased activity on the KC-10 Contractor Logistics Support (KC-10) program, which began in February 2010.

Segment Operating Income

Operating income at Technical Services for the three months ended September 30, 2011, decreased \$1 million, or 2 percent, as compared with the same period in 2010, and operating income as a percentage of sales increased to 8.1 percent from 6.4 percent for the same period in 2010. These changes are primarily due to program performance improvements and the effects of the change in participation in the NSTec joint venture.

Operating income at Technical Services for the nine months ended September 30, 2011, increased \$3 million, or 2 percent, as compared with the same period in 2010, and operating income as a percentage of sales increased to 7.9 percent from 6.4 percent for the same period in 2010. These changes are primarily due to program performance improvements on certain DGSD programs and the effects of the change in participation in the NSTec joint venture, partially offset by unfavorable program performance on certain ILM programs.

BACKLOG**Definition**

Total backlog includes both funded backlog (firm orders for which funding is contractually obligated by the customer) and unfunded backlog (firm orders for which funding is not currently contractually obligated by the customer). Unfunded backlog excludes unexercised contract options and unfunded IDIQ orders. For multi-year services contracts with non-federal government customers having no stated contract values, backlog includes only the amounts committed by the customer. Backlog is converted into sales as work is performed or deliveries are made. Total backlog at September 30, 2011, was approximately \$42.0 billion.

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Backlog consisted of the following at September 30, 2011, and December 31, 2010:

| <i>\$ in millions</i> | September 30, 2011 | | | December 31, 2010 | | |
|-----------------------|--------------------|----------|---------------|-------------------|----------|---------------|
| | Funded | Unfunded | Total Backlog | Funded | Unfunded | Total Backlog |
| Aerospace Systems | \$ 9,093 | \$ 9,004 | \$18,097 | \$ 9,185 | \$11,683 | \$20,868 |
| Electronic Systems | 7,844 | 2,043 | 9,887 | 8,093 | 2,054 | 10,147 |
| Information Systems | 5,142 | 5,346 | 10,488 | 4,711 | 5,879 | 10,590 |
| Technical Services | 2,831 | 650 | 3,481 | 2,763 | 2,474 | 5,237 |
| Total backlog | \$24,910 | \$17,043 | \$41,953 | \$24,752 | \$22,090 | \$46,842 |

New Awards

The estimated value of contract awards included in backlog during the nine months ended September 30, 2011, is \$18.2 billion. Significant new awards during this period include \$1.1 billion for E2-D Advanced Hawkeye program, \$866 million for Global Hawk program, \$640 million for B-2 program, \$573 million for F/A-18 program, \$516 million for F-35 program, and \$427 million for Defense Weather Satellite System program.

Backlog Adjustment

Total backlog as of September 30, 2011, was reduced by \$1.7 billion at Technical Services to reflect a change in the company's participation in the NSTec joint venture effective January 1, 2011, at which time the NSTec joint venture results were no longer consolidated into the company's consolidated financial statements. Total backlog was also reduced by an aggregate of \$1.5 billion at Aerospace Systems to reflect restructuring and termination of certain space programs.

LIQUIDITY AND CAPITAL RESOURCES

We endeavor to ensure the most efficient conversion of operating results into cash for deployment in growing our businesses and maximizing shareholder value. We actively manage our capital resources through working capital improvements, capital expenditures, strategic business acquisitions and divestitures, debt issuance and repayment, required and voluntary pension contributions, and returning cash to our shareholders through dividend payments and repurchases of common stock.

We use various financial measures to assist in capital deployment decision-making, including net cash provided by operations, free cash flow, net debt-to-equity, and net debt-to-capital. We believe these measures are useful to investors in assessing our financial performance.

The table below summarizes key components of cash flow provided by operating activities from continuing operations:

| <i>\$ in millions</i> | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------|-------------------|--------------|
| | September 30 | September 30 | September 30 | September 30 |
| | 2011 | 2010 | 2011 | 2010 |
| Net earnings | \$520 | \$497 | \$1,570 | \$ 1,677 |
| Net earnings from discontinued operations | | (49) | (34) | (79) |
| Other non-cash items ⁽¹⁾ | 286 | 231 | 665 | 571 |
| Retiree benefit funding less than (in excess of) expense | 24 | 74 | (416) | (61) |
| Trade working capital change | 118 | 63 | (759) | (1,192) |
| Cash provided by continuing operations | \$948 | \$816 | \$1,026 | \$ 916 |

- (1) Includes depreciation and amortization, stock-based compensation expense, and deferred income taxes.

Table of Contents**NORTHROP GRUMMAN CORPORATION****Free Cash Flow From Continuing Operations**

Free cash flow from continuing operations represents cash provided by operating activities from continuing operations less capital expenditures and outsourcing contract and related software costs. Outsourcing contract and related software costs are similar to capital expenditures in that the contract costs represent incremental external costs or certain specific internal costs that are directly related to the contract acquisition and transition/set-up. These outsourcing contract and related software costs are deferred and expensed over the contract life. We believe free cash flow from continuing operations is a useful measure for investors to consider. This measure is a key factor in our planning for and consideration of strategic acquisitions, stock repurchases and the payment of dividends.

Free cash flow from continuing operations is not a measure of financial performance under GAAP, and may not be defined and calculated by other companies in the same manner. This measure should not be considered in isolation, as a measure of residual cash flow available for discretionary purposes, or as an alternative to operating results presented in accordance with GAAP as indicators of performance.

For 2011 and the ensuing year, cash generated from continuing operations supplemented by borrowings under credit facilities and/or in the capital markets, if needed, is expected to be sufficient to service debt and contractual obligations, finance capital expenditures, fund required and voluntary pension contributions, continue acquisition of shares under our share repurchase program, and continue paying dividends to our shareholders. We continue to assess potential ramifications of the U.S. Government's spending reduction initiatives as previously discussed. These reductions could have a significant impact on our business and our overall financial results.

The table below reconciles cash provided by continuing operations to free cash flow from continuing operations:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------|-------------------|--------|
| | September 30 | | September 30 | |
| <i>\$ in millions</i> | 2011 | 2010 | 2011 | 2010 |
| Cash provided by continuing operations | \$ 948 | \$ 816 | \$1,026 | \$ 916 |
| Less: | | | | |
| Capital expenditures | (108) | (123) | (324) | (301) |
| Outsourcing contract and related software costs | (1) | (1) | (2) | (5) |
| Free cash flow from continuing operations | \$ 839 | \$ 692 | \$ 700 | \$ 610 |

Cash Flows

The following is a discussion of our major operating, investing and financing activities from continuing operations for the nine months ended September 30, 2011 and 2010, respectively, as classified in the condensed consolidated statements of cash flows in Part I, Item 1.

Operating Activities Cash provided by continuing operations for the nine months ended September 30, 2011, was \$1,026 million, as compared with \$916 million for the same period in 2010. The increase of \$110 million in cash provided by continuing operations is primarily due to lower income tax and interest payments and the sale of marketable securities in the 2011 period.

Investing Activities Net cash provided by investing activities from continuing operations for the nine months ended September 30, 2011, was \$1,152 million, as compared with \$288 million cash used in the same period of 2010. The \$1,440 million increase in net cash provided by investing activities from continuing operations is primarily due to the \$1,429 million contribution received from the spin-off of the Shipbuilding business in 2011.

Financing Activities Net cash used in financing activities for the nine months ended September 30, 2011, was \$2,638 million, as compared with \$1,432 million in the same period of 2010. The \$1,206 million increase in net cash used in financing activities is primarily due to higher debt repayments and common stock repurchases in 2011.

ACCOUNTING STANDARDS UPDATES

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See Note 2 to the condensed consolidated financial statements in Part I, Item 1 for information related to accounting standards updates.

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FORWARD-LOOKING STATEMENTS AND PROJECTIONS

This Form 10-Q and the information we are incorporating by reference contain statements, other than statements of historical fact, that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as expect, intend, may, could, plan, project, forecast, believe, estimate, outlook, anticipate, trends and similar expressions generally identify these forward-looking statements. Forward-looking statements are based upon assumptions, expectations, plans and projections that we believe to be reasonable when made. These statements are not guarantees of future performance and inherently involve a wide range of risks and uncertainties that are difficult to predict. Specific factors that could cause actual results to differ materially from those expressed or implied in the forward-looking statements include, but are not limited to, those identified under Risk Factors in our Forms 10-Q for the three months ended March 31, 2011, and six months ended June 30, 2011, as well as those identified in this report under Part II, Item 1A and other important factors disclosed in this report, and from time to time in our other filings with the SEC.

You are urged to consider the limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of predictions contained in such forward-looking statements. The forward-looking statements speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law.

CONTRACTUAL OBLIGATIONS

There have been no material changes to our contractual obligations from those discussed in our Form 8-K dated June 17, 2011, that recast certain portions of our 2010 Form 10-K to reflect the effects of the spin-off of the Shipbuilding business.

GLOSSARY OF PROGRAMS

Listed below are brief descriptions of the programs mentioned in this Form 10-Q.

| Program Name | Program Description |
|--|---|
| Africa Contingency | Provide peacekeeping training to militaries in African nations via the Department of State. The program is designed to improve the ability of African governments to respond quickly to crises by providing selected militaries with the training and equipment required to execute humanitarian or peace support operations. |
| Operations Training & Assistance (ACOTA) | |
| ASQ-236 | Design, develop, and test Radar Pod containing synthetic aperture radar that provides detailed maps for surveillance, coordinates generation and bomb impact assessment. This technology provides Combat Air Forces with the ability to precisely geo-locate points of interest and conduct continuous surveillance activities in all weather conditions. |
| B-2 Stealth Bomber | Maintain and upgrade the fleet of strategic, long-range multi-role bomber with war-fighting capability that combines long range, large payload, all-aspect stealth, and near-precision weapons in one aircraft. |
| Broad Area Maritime Surveillance (BAMS) Unmanned Aircraft System | A maritime derivative of the Global Hawk that provides persistent maritime ISR data collection and dissemination capability to the Maritime Patrol and Reconnaissance Force. |
| County of San Diego IT Outsourcing | Provide high-level IT consulting and services to San Diego County including data center, help desk, desktop, network, applications and cross-functional services. |

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| Program Name | Program Description |
|--|---|
| Defense Weather Satellite System (DWSS) | Design, develop, integrate, test and operate two satellites with sensors that will provide global and regional weather and environmental data for the DoD. |
| E-2 Hawkeye | Develop the next generation capabilities for the U.S. Navy's airborne battle management command and control mission system platform that provides airborne early warning detection, identification, tracking, targeting, and communication capabilities, including radar, mission computer, vehicle, and other system enhancements, to support the U.S Naval Battle Groups and Joint Forces, called the E-2D Advanced Hawkeye. |
| Encore II | Provide Military Agencies, the DoD, and other agencies of the Federal Government IT services and associated enabling products to satisfy IT activities at all operating levels, including hardware and software incidental to an overall IT solution. |
| F-22 | Joint venture with Raytheon to design, develop and produce the F-22 radar system. Northrop Grumman is responsible for the overall design of the AN/APG-77 and AN/APG-77(V) 1 radar systems, including the control and signal processing software and responsibility for the AESA radar systems integration and test activities. In addition, Northrop Grumman is responsible for overall design and integration of the F-22 Communication, Navigation, and Identification (CNI) system. |
| F-35 | Design, integration, and development of the center fuselage and weapons bay, communications, navigations, identification subsystem, systems engineering, and mission systems software and sensors, as well as provide ground and flight test support, modeling, simulation activities, and training courseware. |
| F/A-18 | Produce the center and aft fuselage sections, twin vertical stabilizers, and integrate all associated subsystems for the F/A-18 Hornet strike fighters. |
| Flat Sequencing System (FSS) | Build systems for the U.S. Postal Service designed to further automate the flat mail stream, which includes large envelopes, catalogs and magazines. |
| Force Protection Security System (FPS2) | Follow-on to the Integrated Base Defense Security System (IBDSS) program to provide the U.S. Air Force and other DoD customers with force protection security solutions, utilizing comprehensive and integrated technology to satisfy a wide array of security concerns both within and outside the continental U.S. |
| Global Hawk High-Altitude Long-Endurance (HALE) Systems | Develop, deliver and sustain the Global Hawk HALE unmanned aerial system and its derivatives to both domestic and international customers for ISR, including deployment of assets to support the global war on terror. |
| Global Linguists Solutions | Provide interpretation, translation and linguist services in support of Operation Iraqi Freedom. |
| James Webb Space Telescope (JWST) | Design, develop, integrate and test a space-based infrared telescope satellite to observe the formation of the first stars and galaxies in the universe. |
| Joint National Integration Center Research and Development Contract (JRDC) | Support the development and application of modeling and simulation, war gaming, test and analytic tools for air and missile defense. |

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| Program Name | Program Description |
|---|--|
| Joint Surveillance Target Attack Radar System (Joint STARS) | Detect, locate, classify, track, and target hostile ground movements, while communicating real-time information through secure data links with U.S. Air Force and Army command posts. |
| Joint Warfighting Center (JWFC) | Provide non-personal general and technical support to the USJFCOM Joint Force Trainer / JWFC to ensure the successful worldwide execution of the Joint Training and Transformation missions. |
| KC-10 Contractor Logistics Support (KC-10) | Provide support to the U.S. Air Force KC-10 tanker fleet, including depot maintenance, supply chain management, and maintenance and management at locations in the United States and worldwide. |
| Large Aircraft Infrared Countermeasures (LAIRCM) | Provide support and hardware for infrared countermeasures systems for the C-17 and C-130 aircrafts. The IDIQ contract will further allow for the purchase of LAIRCM hardware for foreign military sales and other government agencies. |
| LITENING Gen 4 | Design and develop self-contained multi-sensor targeting and surveillance system that enables aircrews to detect, acquire, auto-track and identify targets at extremely long ranges for weapons delivery and non-traditional ISR missions. |
| Multi-Role Tactical Common Data Link (MRTCDL) | Provide war fighters with critical real-time networking connectivity by enabling extremely fast exchange of data via ground, airborne and satellite networks. |
| National Security Technologies (NSTec) | Participate in a joint venture that manages and operates the Nevada National Security Site, providing infrastructure support, including oversight of the nuclear explosives safety team, supporting hazardous chemical spill testing, emergency response training and conventional weapons testing. |
| Navy Unmanned Combat Air System (N-UCAS) | Design, develop and demonstrate the first unmanned jet aircraft able to take off and land aboard an aircraft carrier. N-UCAS will demonstrate that a long-range, low-observable, unmanned aircraft can operate safely from aircraft carriers and refuel in-flight to achieve ultra-long endurance for several missions including strike and ISR. |
| Network Centric Solutions Defense Knowledge Online (Netcents DKO) | Maintain and enhance key user services such as Portal, E-mail, IM, Directory, Search, Go Mobile, SSO, Database, Army Home Page in support of the 2.3 million Army and DoD users. |
| New York City Wireless (NYCWIn) | Provide New York City's broadband public-safety wireless network. |
| Postal Automation | Supports sequencing and sorting of flats with the United States Postal Service (USPS) and both letters and flats within the international market. Postal Automation also supports the USPS to ensure the safety of the mail through its Biohazard Detection equipment. |
| Saudi Arabian American Oil Company (ARAMCO) | Provide an integrated security system at multiple sites with C2 connectivity to various regional C2 centers within Saudi Arabia. |
| Space Based Infrared System (SBIRS) | Design and develop space-based surveillance systems for missile warning, missile defense, battlespace characterization and technical intelligence. |

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| Program Name | Program Description |
|---|---|
| Systems and Software Engineering Support (SSES) | Provide life cycle software solutions and services that enable warfighting superiority and information dominance across the enterprise, by providing systems and software engineering and scientific support for a wide variety of Army and DoD customers. |
| Trailer Mounted Support System (TMSS) | Trailer Mounted Support System is a key part of the Army's Standard Integrated Command Post System program providing workspace, power distribution, lighting, environmental conditioning (heating and cooling) tables and a common grounding system for commanders and staff at all echelons. |
| Treasury Communications Systems | Provide telecommunications infrastructure for collaboration, communication and computing as required by the U.S. Department of Treasury. |
| Vehicular Intercommunications Systems (VIS) | Provide clear and noise-free communications between crewmembers inside combat vehicles and externally over as many as six combat net radios for the Army. The active noise-reduction features of VIS provide significant improvement in speech intelligibility, hearing protection, and vehicle crew performance. |
| Virginia Class Submarine (VCS) | Produce power and control systems along with advanced surveillance arrays for all Virginia Class Submarines. The Virginia Class is an advanced stealth multimission nuclear-powered submarine for deep ocean anti-submarine warfare and littoral operations. |

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rates We are exposed to market risk, primarily related to interest rates and foreign currency exchange rates. Financial instruments subject to interest rate risk include variable-rate short-term borrowings under the credit agreement and short-term investments. At September 30, 2011, substantially all outstanding borrowings were fixed-rate, long-term debt obligations of which a significant portion are not callable until maturity (other than make-whole calls). Our sensitivity to a 1 percent change in interest rates is tied to our \$2 billion credit agreement, which had no balance outstanding at September 30, 2011, or at December 31, 2010. See Note 11 to the condensed consolidated financial statements in Part I, Item 1.

Derivatives We do not hold or issue derivative financial instruments for trading purposes. We may enter into interest rate swap agreements to manage our exposure to interest rate fluctuations. At September 30, 2011, we had no interest rate swap agreements in effect and at December 31, 2010, we had one interest rate swap agreement in effect. See Note 9 to the condensed consolidated financial statements in Part I, Item 1.

Foreign Currency We enter into foreign currency forward contracts to manage foreign currency exchange rate risk related to receipts from customers and payments to suppliers denominated in foreign currencies. At September 30, 2011, and December 31, 2010, the amount of foreign currency forward contracts outstanding was not material. We do not consider the market risk exposure related to foreign currency exchange to be material to the condensed consolidated financial statements. See Note 9 to the condensed consolidated financial statements in Part I, Item 1.

Item 4. Controls and Procedures**Relocation of Corporate Office**

During the three months ended September 30, 2011, we relocated our corporate office in Los Angeles, California and corporate employees in Rosslyn, Virginia to our new corporate office in Falls Church, Virginia. These relocations included approximately one-third of the employees from the former California corporate office and most of the employees at the Rosslyn location. The Falls Church corporate office includes substantially all of our senior corporate leadership team. This relocation did not affect

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NORTHROP GRUMMAN CORPORATION

our accounting policies and procedures or underlying processes for the preparation of financial statements. We do not believe that this relocation had a material effect on our internal controls over financial reporting.

Disclosure Controls and Procedures

Our principal executive officer (Chairman, Chief Executive Officer and President) and principal financial officer (Corporate Vice President and Chief Financial Officer) have evaluated the company's disclosure controls and procedures as of September 30, 2011, and have concluded that these controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit is accumulated and communicated to management, including the principal executive officer and the principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls over Financial Reporting

During the three months ended September 30, 2011, no change occurred in our internal controls over financial reporting that materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We have provided information about certain legal proceedings in which we are involved in Note 10 to the condensed consolidated financial statements in Part I, Item 1. The legal proceedings disclosed in Note 15 to the consolidated financial statements in Part II, Item 8 of our 2010 Form 10-K included matters relating to our former Shipbuilding business, which the company has recast in a Current Report on Form 8-K filed with the Securities and Exchange Commission (SEC) on June 17, 2011. As disclosed elsewhere in this report, we completed a spin-off of HII effective as of March 31, 2011, and our Shipbuilding business is now reported as discontinued operations. As provided in the Separation and Distribution Agreement with HII described in Note 5 of the condensed consolidated financial statements in Part I, Item 1, HII generally has responsibility for investigations, claims and litigation matters related to the Shipbuilding business. The company has therefore excluded from this report certain previously disclosed Shipbuilding-related investigations, claims and litigation matters that are the responsibility of HII.

In addition to the matters specifically disclosed in Note 10, we are a party to various investigations, lawsuits, claims and other legal proceedings that arise in the ordinary course of our business. Based on information available to us, we do not believe at this time that any of such additional matters will individually, or in the aggregate, have a material adverse effect on our financial position, results of operations or cash flows. For further information on the risks we face from existing and future investigations, lawsuits, claims and other legal proceedings, please see Risk Factors in Part II, Item 1A, of our Form 10-Q for the quarter ended March 31, 2011.

Item 1A. Risk Factors

The information presented below sets forth what we reasonably believe represent material changes to the risk factors described in our Forms 10-Q for the three months ended March 31, 2011, and six months ended June 30, 2011, and should be read in conjunction with the risk factors therein, and the information described in this report, our 2010 Form 10-K and the Form 8-K dated June 17, 2011, which recast certain portions of our 2010 Form 10-K to report the company's Shipbuilding business within discontinued operations.

n Significant delays or reductions in appropriations for our programs and federal government funding more broadly may negatively impact our business and programs and could have a material adverse effect on our financial position, results of operations or cash flows.

The funding of U.S. Government programs is subject to an annual congressional budget authorization and appropriation processes. For many programs, Congress appropriates funds on a fiscal year basis even though the program performance period may extend over several fiscal years. Consequently, programs are often partially funded initially and additional funds are committed only as Congress makes further appropriations. If we incur costs in excess of funds committed on a contract, we are more at risk for reimbursement of those costs until additional funds are appropriated. We cannot predict the extent to which total funding and/or funding for individual programs will be included, increased or reduced as part of the 2012 and subsequent budgets ultimately approved by Congress or in separate supplemental appropriations or continuing resolutions. In addition, although Congress has recently passed a continuing resolution to fund U.S. Government operations through November 18, 2011, it is unclear when additional short or long-term funding will be passed. The impact, severity and duration of the current U.S. economic situation and sweeping economic plans adopted or to be adopted by the U.S. Government, along with pressures on, and uncertainty surrounding, the federal budget, could adversely affect the funding for individual programs and delay purchasing or payment decisions by our customers. In the event that government funding for any of our programs becomes unavailable, or is reduced or delayed, our contract or subcontract under such program may be terminated or adjusted by the U.S. Government, which could have a material adverse effect on our financial position, results of operations, and/or cash flows.

As discussed previously, in August 2011, Congress passed the Budget Act which, while raising the existing statutory limit on the amount of permissible federal debt, also committed the U.S. Government to significantly

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reducing the federal deficit over ten years. The Budget Act caps discretionary spending through 2021, reducing federal spending by approximately \$940 billion relative to the fiscal year 2012 Presidential Submission and also establishes a joint committee of Congress responsible for identifying an additional \$1.5 trillion in deficit reductions by November 23, 2011. If at least \$1.2 trillion in deficit reductions are not identified by the joint committee and passed by Congress by January 15, 2012, then under the Budget Act, very substantial automatic spending cuts split between defense and non-defense programs will be triggered beginning in 2013 over a nine-year period. We are unable to predict whether the required spending cuts will be identified and approved prior to the January 2012 deadline as well as the impact either identified or automatic cuts would have on funding for our individual programs. In either event, long-term funding for various of the programs in which we participate could be reduced, delayed or cancelled. In addition, these cuts could adversely affect the viability of the suppliers and subcontractors under our programs. While we believe that our business is well-positioned in areas that the DoD has previously indicated remain areas of focus for future defense spending, the impact of the Budget Act remains uncertain and our business and industry could be materially adversely affected.

n Market volatility and adverse capital and credit market conditions may affect our ability to access cost-effective sources of funding and expose us to risks associated with the financial viability of suppliers and the ability of counterparties to perform on financial instruments.

Domestic and international financial and credit markets have experienced high levels of volatility and disruption, reducing the availability of credit for certain issuers. Historically, we have occasionally accessed these markets to support certain business activities, including acquisitions, capital expansion projects, refinancing existing debt and issuing letters of credit. In the future, we may not be able to obtain capital market financing or bank financing when needed on favorable terms, or at all, which could have a material adverse effect on our financial position, results of operations, or cash flows. We have also executed transactions with counterparties domestically and abroad in the financial services industry, including brokers and dealers, commercial banks, investment banks and other institutional parties. These transactions expose us to potential credit risk in the event of counterparty default.

A tightening of credit could also adversely affect our suppliers' ability to obtain financing. Delays in suppliers' ability to obtain financing, or the unavailability of financing, could cause us to be unable to meet our contract obligations and could adversely affect our financial position, results of operations, or cash flows. The inability of our suppliers to obtain financing could also result in the need for us to transition to alternate suppliers, which could result in significant incremental cost and delay.

n Our business could be negatively impacted by security threats, including cybersecurity threats, and other disruptions.

As a defense contractor, we face various security threats, including cybersecurity threats to gain unauthorized access to sensitive information; threats to the safety of our directors, officers, and employees; threats to the security of our facilities and infrastructure; and threats from terrorist acts. Although we utilize various procedures and controls to monitor these threats and mitigate our exposure to such threats, there can be no assurance that these procedures and controls will be sufficient in preventing security threats from materializing. If any of these events were to materialize, they could lead to losses of sensitive information, critical infrastructure, personnel or capabilities, essential to our operations and could have a material adverse effect on our reputation, financial position, results of operations, or cash flows.

Cybersecurity attacks in particular are evolving and include but are not limited to, malicious software, attempts to gain unauthorized access to data, and other electronic security breaches that could lead to disruptions in mission critical systems, unauthorized release of confidential or otherwise protected information and corruption of data. These events could damage our reputation and lead to financial losses from remedial actions, loss of business or potential liability.

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We also manage information technology systems for various customers. While we operate under information security policies and procedures for managing these systems, we generally face similar cybersecurity threats for these systems as for our own.

n We depend heavily on a single customer, the U.S. Government, for a substantial portion of our business, including programs subject to security classification restrictions on information. Changes in this customer's priorities and changes affecting its ability to do business with us could have a material adverse effect on our financial position, results of operations, or cash flows.

Our primary customer is the U.S. Government, from which we derived approximately 91% of our total revenues during the past several years. The federal government is considering significant changes to defense spending and other programs. We cannot predict the impact of potential changes in priorities due to military transformation and planning and/or the nature of hostility-related activity on existing, follow-on or replacement programs. A shift in government priorities to programs in which we do not participate and/or reductions in funding for or the termination of programs in which we do participate, unless offset by other programs and opportunities, could have a material adverse effect on our financial position, results of operations, or cash flows. In addition, uncertainty and other concerns resulting from previously announced proposed defense spending reductions and potential additional reductions, including under the Budget Act, have impacted and could continue to impact the manner in which our government customers manage programs and make procurement decisions, resulting in delays and reductions in payments and procurements. Similar challenges and uncertainty faced by some of our international government customers could also lead to delays and/or reductions.

In addition, the U.S. Government generally has the ability to terminate contracts, in whole or in part, without prior notice, for convenience or for default based on performance. In the event of termination for the U.S. Government's convenience, contractors are generally protected by provisions covering reimbursement for costs incurred on the contracts and profit on those costs but not the anticipated profit that would have been earned had the contract been completed. In some circumstances, however, a U.S. government contract does not have such termination protection. In those cases, we attempt to mitigate the termination risk through other means. To the extent such means are unavailable or do not fully address the costs incurred or profit on those costs, we could face significant losses from the termination for convenience of a contract that lacks termination protection. Termination by the U.S. Government of a contract for convenience could also result in the cancellation of future work on that program. Termination by the U.S. Government of a contract due to our default could require us to pay for re-procurement costs in excess of the original contract price, net of the value of work accepted from the original contract, as well as other damages. Termination of a contract due to our default may expose us to liability and could have a material adverse effect on our ability to compete for other contracts.

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

Purchases of Equity Securities The table below summarizes our repurchases of common stock during the three months ended September 30, 2011:

| Period | Total Number of Shares Purchased ⁽¹⁾ | Average Price Paid per Share ⁽²⁾ | Total Numbers of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate |
|----------------------------------|---|---|---|---|
| | | | | Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs (\$ in millions) |
| July 1 through July 31, 2011 | | | | \$3,000 |
| August 1 through August 31, 2011 | 3,535,900 | \$51.11 | 3,535,900 | 2,838 |

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| | | | | |
|--|-------------------|----------------|-------------------|------------------------------|
| September 1 through September 30, 2011 | 9,194,600 | 52.88 | 9,194,600 | 2,352 |
| Total | 12,730,500 | \$52.39 | 12,730,500 | \$2,352⁽¹⁾ |

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- (1) On June 16, 2010, the company's board of directors authorized a share repurchase program of up to \$2 billion of the company's common stock. On April 25, 2011, after the company had repurchased shares totaling \$245 million, the company's board of directors authorized an increase to the remaining share repurchase authorization to \$4.0 billion. As of September 30, 2011, the company had \$2.4 billion remaining under this authorization for share repurchases.
- (2) Includes commissions paid and calculated as the average price paid per share under the respective repurchase programs.

Under the outstanding share repurchase authorization, the company entered into an accelerated share repurchase agreement with Goldman, Sachs & Co. (Goldman Sachs) on May 2, 2011, to repurchase 15.6 million shares of common stock at an initial price of \$64.17 per share for a total of \$1.0 billion. Under this agreement, Goldman Sachs immediately borrowed shares that were sold to and canceled by the company. Subsequently, Goldman Sachs began purchasing shares in the open market to settle its share borrowings. The cost of the company's initial share repurchase was subject to adjustment based on the actual cost of the shares subsequently purchased by Goldman Sachs. On August 16, 2011, Goldman Sachs completed its share purchases and paid the company a cash refund of \$19 million for the final price adjustment, which was added back to the remaining authorization for share repurchases in the table above. The final average purchase price of the shares purchased under the agreement was \$62.54 per share, including net of commissions and certain other fees.

Additional 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. Under these programs, additional share repurchases took place during the quarter ended September 30, 2011 after the completion of the accelerated share repurchase program with Goldman Sachs. 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.

Issuances of Equity Securities Under TRW Plans In connection with our acquisition of TRW Inc., in December 2002 we assumed options granted under certain TRW stock-based compensation plans for an aggregate of 11.6 million shares of Northrop Grumman common stock (adjusted for our 2004 stock split and 2011 spin-off of our Shipbuilding business). Following completion of the TRW acquisition and assumption of these options, we filed an amendment to our registration statement on Form S-4 intended to register the shares related to the exercise of these options. As of July 25, 2011, options for approximately 11 million shares had been exercised, including options exercised from July 1, 2011 through July 25, 2011 for 18,526 shares at an average exercise price of \$34.72 per share, or \$0.6 million. At the time these options were exercised, the registration statement may not have been available and, therefore, these shares of common stock may be deemed to have been issued without registration. On July 26, 2011, the company filed a registration statement on Form S-8 to cover the exercise of all remaining options and shares issuable under these plans.

Item 3. Defaults Upon Senior Securities

No information is required in response to this item.

Item 5. Other Information

No information is required in response to this item.

Item 6. Exhibits

- 2.1 Agreement and Plan of Merger among Titan II, Inc. (formerly Northrop Grumman Corporation), Northrop Grumman Corporation (formerly New P, Inc.) and Titan Merger Sub Inc., dated March 29, 2011 (incorporated by reference to Exhibit 10.1 to Form 8-K dated March 29, 2011 and filed April 4, 2011)

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- 2.2 Separation and Distribution Agreement dated as of March 29, 2011, among Titan II, Inc. (formerly Northrop Grumman Corporation), Northrop Grumman Corporation (formerly New P, Inc.), Huntington Ingalls Industries, Inc., Northrop Grumman Shipbuilding, Inc. and Northrop Grumman Systems Corporation (incorporated by reference to Exhibit 10.2 to Form 8-K dated March 29, 2011 and filed April 4, 2011)
 - 10.1 Second Amended and Restated Credit Agreement dated as of September 8, 2011, among Northrop Grumman Corporation, as Borrower; Northrop Grumman Systems Corporation, as Guarantor; the Lenders party thereto; JPMorgan Chase Bank, N.A., as Administrative Agent, an Issuing Bank and a Swingline Lender; and Citibank, N.A., The Royal Bank of Scotland plc and Wells Fargo Bank, National Association, as Syndication Agents (incorporated by reference to Exhibit 10.1 to Form 8-K dated September 8, 2011 and filed September 13, 2011)
 - 10.2 364-Day Credit Agreement dated as of September 8, 2011, among Northrop Grumman Corporation, as Borrower; Northrop Grumman Systems Corporation, as Guarantor; the Lenders party thereto; JPMorgan Chase Bank, N.A., as Administrative Agent; and Citibank, N.A., The Royal Bank of Scotland plc and Wells Fargo Bank, National Association, as Syndication Agents (incorporated by reference to Exhibit 10.2 to Form 8-K dated September 8, 2011 and filed September 13, 2011)
 - +10.3 Northrop Grumman Legacy Officers Plan Matrix, Plan Year July 1, 2011 June 30, 2012 (incorporated by reference to Exhibit 10.16 to Form 10-Q filed July 27, 2011)
 - *+10.4 Non-Employee Director Compensation Term Sheet, effective as of April 1, 2011 (replacing previously filed Exhibit 10.17 to Form 10-Q filed July 27, 2011)
 - *12(a) Computation of Ratio of Earnings to Fixed Charges
 - *15 Letter from Independent Registered Public Accounting Firm
 - *31.1 Rule 13a-14(a)/15d-14(a) Certification of Wesley G. Bush (Section 302 of the Sarbanes-Oxley Act of 2002)
 - *31.2 Rule 13a-14(a)/15d-14(a) Certification of James F. Palmer (Section 302 of the Sarbanes-Oxley Act of 2002)
 - **32.1 Certification of Wesley G. Bush pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
 - **32.2 Certification of James F. Palmer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
 - **101 Northrop Grumman Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL (Extensible Business Reporting Language); (i) the Condensed Consolidated Statements of Operations, (ii) Condensed Consolidated Statements of Financial Position, (iii) Condensed Consolidated Statements of Cash Flows, (iv) Condensed Consolidated Statements of Changes in Shareholders Equity, and (v) Notes to Condensed Consolidated Financial Statements
- + Management contract or compensatory plan or arrangement
- * Filed with this report
- ** Furnished with this report

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NORTHROP GRUMMAN CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NORTHROP GRUMMAN CORPORATION

(Registrant)

By:

/s/ Kenneth N. Heintz
Kenneth N. Heintz

Corporate Vice President, Controller and

Chief Accounting Officer

(Principal Accounting Officer)

Date: October 25, 2011