NORTHROP GRUMMAN CORP /DE/
Form 10-Q
October 24, 2007

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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, 2007

or

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

Commission file number 1-16411

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

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

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

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

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

Yes x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

Yes o No x

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of October 22, 2007, 338,361,747 shares of common stock were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions, except per share	**2007**	2006	**2007**	2006
Sales and Service Revenues				
Product sales	**$ 4,310**	$ 4,404	**$ 13,015**	$ 13,550
Service revenues	**3,618**	3,025	**10,179**	8,550
Total sales and service revenues	**7,928**	7,429	**23,194**	22,100
Cost of Sales and Service Revenues				
Cost of product sales	**3,236**	3,518	**9,987**	10,631
Cost of service revenues	**3,094**	2,576	**8,635**	7,406
General and administrative expenses	**791**	786	**2,326**	2,222
Operating margin	**807**	549	**2,246**	1,841
Other Income (Expense)				
Interest income	**6**	13	**19**	29
Interest expense	**(84)**	(86)	**(256)**	(263)
Other, net	**2**	1	**(22)**	(9)
Income from continuing operations before income taxes	**731**	477	**1,987**	1,598
Federal and foreign income taxes	**241**	169	**641**	482
Income from continuing operations	**490**	308	**1,346**	1,116
Loss from discontinued operations, net of tax	**(1)**	(6)	**(10)**	(27)
Net income	**$ 489**	$ 302	**$ 1,336**	$ 1,089
Basic Earnings (Loss) Per Share				
Continuing operations	**$ 1.44**	$ .89	**$ 3.93**	$ 3.23
Discontinued operations		(.01)	**(.03)**	(.08)
Basic earnings per share	**$ 1.44**	$ .88	**$ 3.90**	$ 3.15
Weighted average common shares outstanding, in millions	**340.2**	344.7	**342.9**	345.8
Diluted Earnings (Loss) Per Share				
Continuing operations	**$ 1.41**	$ .88	**$ 3.84**	$ 3.17
Discontinued operations		(.02)	**(.03)**	(.08)

Diluted earnings per share	**$ 1.41**	$ .86	**$ 3.81**	$ 3.09
Weighted average diluted shares outstanding, in millions	**352.6**	351.0	**355.4**	352.1

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

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NORTHROP GRUMMAN CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF FINANCIAL POSITION
(Unaudited)

$ in millions	**September 30, 2007**	December 31, 2006
Assets:		
Cash and cash equivalents	**$ 713**	$ 1,015
Accounts receivable, net of progress payments of $38,611 in 2007 and $34,085 in 2006	**3,666**	3,562
Inventoried costs, net of progress payments of $1,394 in 2007 and $1,225 in 2006	**1,102**	1,176
Deferred income taxes	**691**	706
Prepaid expenses and other current assets	**282**	266
Total current assets	**6,454**	6,725
Property, plant, and equipment, net of accumulated depreciation of $3,330 in 2007 and $3,005 in 2006	**4,539**	4,525
Goodwill	**17,658**	17,219
Other purchased intangibles, net of accumulated amortization of $1,654 in 2007 and $1,555 in 2006	**1,109**	1,139
Pension and postretirement benefits asset	**1,357**	1,349
Other assets	**1,106**	1,052
Total assets	**$ 32,223**	$ 32,009
Liabilities:		
Notes payable to banks	**$ 40**	$ 95
Current portion of long-term debt	**111**	75
Trade accounts payable	**1,540**	1,682
Accrued employees compensation	**1,273**	1,176
Advance payments and billings in excess of costs incurred	**1,532**	1,571
Income tax payable	**6**	535
Other current liabilities	**1,698**	1,619
Total current liabilities	**6,200**	6,753
Long-term debt, net of current portion	**3,886**	3,992
Mandatorily redeemable preferred stock	**350**	350
Pension and postretirement benefits liability	**3,385**	3,302
Other long-term liabilities	**1,637**	997
Total liabilities	**15,458**	15,394
Commitments and Contingencies (Note 10)		
Shareholders Equity:		
	338	346

Common stock, $1 par value; 800,000,000 shares authorized; issued and outstanding: 2007 338,217,941; 2006 345,921,809				
Paid-in capital		**10,643**		11,346
Retained earnings		**7,063**		6,183
Accumulated other comprehensive loss		**(1,279)**		(1,260)
Total shareholders equity		**16,765**		16,615
Total liabilities and shareholders equity	**$**	**32,223**	$	32,009

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

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NORTHROP GRUMMAN CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Net income	**$ 489**	$ 302	**$ 1,336**	$ 1,089
Other Comprehensive Income (Loss)				
Change in cumulative translation adjustment	**3**		**6**	17
Change in unrealized loss on marketable securities, net of tax benefit of $1 and $0 for the three months ended September 30, 2007, and 2006, and $0 and $3 for the nine months ended September 30, 2007, and 2006, respectively	**(2)**	(2)	**(1)**	(7)
Reclassification adjustment on write-down of marketable securities, net of tax of $1 and $6 for the three and nine months ended September 30, 2006, respectively		1		9
Amortization of unamortized benefit plan costs, net of tax of $5 and $14 for the three and nine months ended September 30, 2007	**7**		**22**	
Other comprehensive income (loss), net of tax	**8**	(1)	**27**	19
Comprehensive income	**$ 497**	$ 301	**$ 1,363**	$ 1,108

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

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NORTHROP GRUMMAN CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30	
$ in millions	**2007**	2006
Operating Activities		
Sources of Cash Continuing Operations		
Cash received from customers		
Progress payments	**$ 5,384**	$ 5,044
Collections on billings	**18,015**	16,942
Proceeds from insurance carriers related to operations	**125**	46
Other cash receipts	**83**	82
Total sources of cash-continuing operations	**23,607**	22,114
Uses of Cash Continuing Operations		
Cash paid to suppliers and employees	**(20,357)**	(19,589)
Interest paid	**(300)**	(309)
Income taxes paid	**(684)**	(555)
Excess tax benefits from stock-based compensation	**(73)**	(52)
Other cash payments	**(22)**	(43)
Total uses of cash-continuing operations	**(21,436)**	(20,548)
Cash provided by continuing operations	**2,171**	1,566
Cash used in discontinued operations	**(15)**	(81)
Net cash provided by operating activities	**2,156**	1,485
Investing Activities		
Proceeds from sale of businesses, net of cash divested		43
Payment for businesses purchased	**(685)**	
Proceeds from sale of property, plant, and equipment	**16**	10
Additions to property, plant, and equipment	**(431)**	(493)
Payments for outsourcing contract and related software costs	**(89)**	(43)
Proceeds from insurance carriers related to capital expenditures	**3**	90
Payment for purchase of investment		(35)
Decrease in restricted cash	**45**	
Other investing activities, net	**(5)**	(14)
Net cash used in investing activities	**(1,146)**	(442)
Financing Activities		
Net (payments) borrowings under lines of credit	**(63)**	36

Principal payments of long-term debt	**(96)**	(522)
Proceeds from exercises of stock options and issuance of common stock	**246**	372
Dividends paid	**(378)**	(298)
Excess tax benefits from stock-based compensation	**73**	52
Common stock repurchases	**(1,094)**	(825)
Net cash used in financing activities	**(1,312)**	(1,185)
Decrease in cash and cash equivalents	**(302)**	(142)
Cash and cash equivalents, beginning of period	**1,015**	1,605
Cash and cash equivalents, end of period	**$ 713**	$ 1,463

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	Nine Months Ended September 30	
$ in millions	**2007**	2006
Reconciliation of Net Income to Net Cash Provided by Operating Activities		
Net Income	**$ 1,336**	$ 1,089
Adjustments to reconcile to net cash provided by operating activities		
Depreciation	**416**	415
Amortization of assets	**106**	104
Stock-based compensation	**135**	155
Excess tax benefits from stock-based compensation	**(73)**	(52)
Loss on disposals of property, plant, and equipment	**14**	8
Amortization of long-term debt premium	**(8)**	(11)
(Gain) loss on investments	**(22)**	15
Decrease (increase) in		
Accounts receivable	**(4,500)**	(3,924)
Inventoried costs	**(95)**	(158)
Prepaid expenses and other current assets	**(17)**	(15)
Increase (decrease) in		
Progress payments	**4,694**	3,821
Accounts payable and accruals	**(35)**	15
Deferred income taxes	**25**	105
Income taxes payable	**59**	(122)
Retiree benefits	**96**	68
Other non-cash transactions, net	**40**	53
Cash provided by continuing operations	**2,171**	1,566
Cash used in discontinued operations	**(15)**	(81)
Net cash provided by operating activities	**$ 2,156**	$ 1,485
Non-Cash Investing and Financing Activities		
Sale of businesses		
Investment in unconsolidated affiliate	**$ 30**	
Liabilities assumed by purchaser		$ 18
Purchase of businesses		
Fair value of assets acquired, including goodwill	**$ 892**	
Cash paid for businesses purchased	**(685)**	
Non-cash consideration given for businesses purchased	**(60)**	
Liabilities assumed	**$ 147**	

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

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CONSOLIDATED CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
(Unaudited)

	Nine Months Ended September 30	
$ in millions, except per share	**2007**	2006
Common Stock		
At beginning of period	**$ 346**	$ 347
Common stock repurchased	**(14)**	(12)
Employee stock awards and options	**6**	10
At end of period	**338**	345
Paid-in Capital		
At beginning of period	**11,346**	11,571
Common stock repurchased	**(1,080)**	(813)
Employee stock awards and options	**377**	516
At end of period	**10,643**	11,274
Retained Earnings		
At beginning of period	**6,183**	5,055
Net income	**1,336**	1,089
Adjustment to initially apply FIN 48	**(66)**	
Dividends	**(390)**	(307)
At end of period	**7,063**	5,837
Accumulated Other Comprehensive Loss		
At beginning of period	**(1,260)**	(145)
Adjustment to deferred tax benefit recorded on adoption of SFAS 158	**(46)**	
Other comprehensive income	**27**	19
At end of period	**(1,279)**	(126)
Total shareholders equity	**$ 16,765**	$ 17,330
Cash dividends per share	**$ 1.11**	$ .86

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

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Unaudited)

1. BASIS OF PRESENTATION

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

The accompanying unaudited consolidated condensed financial statements of the company have been prepared by management in accordance with the instructions to Form 10-Q of the Securities and Exchange Commission. These statements include all adjustments considered necessary by management to present a fair statement of the company s consolidated financial position, results of operations, and cash flows. The results reported in these consolidated condensed financial statements should not be regarded as necessarily indicative of results that may be expected for the entire year. These financial statements should be read in conjunction with the Notes to Consolidated Financial Statements contained in the company s 2006 Annual Report on Form 10-K.

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

Accounting Estimates The company s consolidated condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The preparation of the financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of commitments and 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.

Financial Statement Reclassifications Certain amounts in the prior period financial statements and related notes have been reclassified to conform to the 2007 presentation, due to the sale and shut down of the Interconnect Technologies (ITD) businesses as described in Note 5 and the business operation realignments described in Note 6.

2. NEW ACCOUNTING STANDARDS

The disclosure requirements and cumulative effect of adoption of the Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48 *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* are presented in Note 14.

Other new pronouncements issued but not effective until after September 30, 2007, are not expected to have a significant effect on the company s consolidated financial position or results of operations

3. DIVIDENDS ON COMMON STOCK

On February 21, 2007, the company s board of directors approved a 23 percent increase to the quarterly dividend on common stock, from $.30 per share to $.37 per share, effective with the first quarter 2007 dividend.

On May 17, 2006 the company s board of directors approved a 15 percent increase to the quarterly dividend on common stock, from $.26 per share to $.30 per share, effective with the second quarter 2006 dividend.

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4. BUSINESS ACQUISITIONS

Essex On January 25, 2007, the company acquired Essex Corporation (Essex) for approximately $600 million, including the assumption of debt totaling $23 million and estimated transaction costs of $15 million. Essex provides signal processing services and products, and advanced optoelectronic imaging for U.S. government intelligence and defense customers. The operating results of Essex are reported in the Mission Systems segment. The assets, liabilities, and results of operations of Essex were not material to the company s consolidated financial position or results of operations, and thus pro-forma information is not presented.

AMSEC On July 13, 2007, the company and Science Applications International Corporation (SAIC) reorganized their joint venture AMSEC, LLC (AMSEC), by dividing AMSEC along customer and product lines. AMSEC is a full-service supplier that provides engineering, logistics and technical support services primarily to Navy ship and aviation programs. Under the reorganization plan, the company retained the ship engineering, logistics and technical service businesses under the AMSEC name (the AMSEC Businesses) and, in exchange, SAIC received the aviation, combat systems and strike force integration services businesses from AMSEC (the Divested Businesses). This reorganization was treated as a step acquisition for the acquisition of SAIC s interests in the AMSEC Businesses, with the company recognizing a pre-tax gain of $22 million during the third quarter of 2007 for the effective sale of its interests in the Divested Businesses. The operating results of the AMSEC Businesses and transaction gain have been reported in the Ships segment. Prior to the reorganization, the company accounted for AMSEC, LLC under the equity method. The assets, liabilities, and results of operations of the AMSEC Businesses were not material to the company s consolidated financial position or results of operations, and thus pro-forma information is not presented.

During the third quarter of 2007, the company acquired the remaining 60 percent of Scaled Composites, LLC for approximately $100 million in the aggregate. The assets, liabilities, and results of operations of the entities acquired were not material to the company s consolidated financial position or results of operations, and thus pro-forma information is not presented.

The consolidated condensed financial statements reflect preliminary estimates of the fair value of the assets acquired and liabilities assumed in the transactions noted above and the related allocation of the purchase price for the entities acquired. Management does not expect adjustments to these estimates, if any, to have a material effect on the company s financial position or results of operations.

5. BUSINESS DISPOSITIONS

2007 During the second quarter, management announced its decision to exit the remaining ITD business reported within the Electronics segment. Sales for this business for the nine months ended September 30, 2007, and 2006, were $14 million and $27 million, respectively. The shut-down was completed during the third quarter of 2007 and costs associated with the shutdown were not material. The results of this business are reported as discontinued operations in the consolidated condensed statements of income, net of applicable income taxes, for all periods presented.

2006 The company sold the assembly business unit of ITD during the first quarter of 2006 and Winchester Electronics (Winchester) during the second quarter of 2006 for net cash proceeds of $26 million and $17 million, respectively, and recognized after-tax gains of $4 million and $2 million, respectively, in discontinued operations. The results of operations of the assembly business unit of ITD are reported as discontinued operations in the consolidated condensed statements of income, net of applicable income taxes. The results of operations of Winchester, reported in the Electronics segment, were not material to any of the periods presented and have therefore not been reclassified as

discontinued operations.

During the second quarter of 2006, the Enterprise Information Technology business, formerly reported in the Information Technology segment, was shut down and costs associated with the exit activities were not material. The results of operations of this business are reported as discontinued operations in the consolidated condensed statements of income, net of applicable income taxes.

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6. SEGMENT INFORMATION

Effective January 1, 2007, the company realigned businesses among its operating segments that possess similar customers, expertise, and capabilities. The realignment more fully leverages existing capabilities and enhances development and delivery of highly integrated services. The realignment primarily involved the transfer of the Radio Systems business from the Space Technology segment to the Mission Systems segment and the transfer of the UK Airborne Warning and Control System program from the Information Technology segment to the Technical Services segment. On July 1, 2006, certain logistics, services and technical support programs were transferred from Electronics, Integrated Systems, Mission Systems, and Space Technology to Technical Services. The sales and segment operating margin in the following tables have been revised, where applicable, to reflect these realignments for all periods presented.

The following table presents segment sales and service revenues for the three and nine months ended September 30, 2007, and 2006.

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Sales and Service Revenues				
Information & Services				
Mission Systems	**$ 1,459**	$ 1,340	**$ 4,363**	$ 4,087
Information Technology	**1,107**	1,023	**3,288**	2,928
Technical Services	**573**	526	**1,644**	1,340
Total Information & Services	**3,139**	2,889	**9,295**	8,355
Aerospace				
Integrated Systems	**1,255**	1,317	**3,761**	4,116
Space Technology	**750**	699	**2,273**	2,170
Total Aerospace	**2,005**	2,016	**6,034**	6,286
Electronics	**1,673**	1,665	**4,980**	4,756
Ships	**1,469**	1,238	**3,984**	3,808
Intersegment eliminations	**(358)**	(379)	**(1,099)**	(1,105)
Total sales and service revenues	**$ 7,928**	$ 7,429	**$ 23,194**	$ 22,100

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The following table presents segment operating margin reconciled to total operating margin for the three and nine months ended September 30, 2007, and 2006.

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Operating Margin				
Information & Services				
Mission Systems	**$ 144**	$ 131	**$ 423**	$ 400
Information Technology	**72**	92	**248**	256
Technical Services	**28**	34	**88**	96
Total Information & Services	**244**	257	**759**	752
Aerospace				
Integrated Systems	**145**	137	**454**	426
Space Technology	**59**	66	**187**	184
Total Aerospace	**204**	203	**641**	610
Electronics	**211**	198	**579**	552
Ships	**183**	76	**396**	273
Intersegment eliminations	**(25)**	(35)	**(82)**	(87)
Total segment operating margin	**817**	699	**2,293**	2,100
Non-segment factors affecting operating margin				
Unallocated expenses	**(41)**	(148)	**(139)**	(235)
Net pension adjustment	**31**	(2)	**92**	(24)
Total operating margin	**$ 807**	$ 549	**$ 2,246**	$ 1,841

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

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, 2007, and 2006, pension expense determined in accordance with GAAP was $89 million and $112 million, respectively, and pension expense determined in accordance with CAS amounted to $120 million and $110 million, respectively. For the nine months ended September 30, 2007, and 2006, pension expense determined in accordance with GAAP was $263 million and $337 million, respectively, and pension expense determined in accordance with CAS was $355 million and $313 million, respectively.

7. EARNINGS PER SHARE

Basic Earnings Per Share Basic earnings per share are calculated by dividing net income by the weighted average number of shares of common stock outstanding during each period.

Diluted Earnings Per Share Diluted earnings per share includes the dilutive effect of stock options and other stock awards granted to employees under stock-based compensation plans and, for 2007, the company s mandatorily redeemable convertible series B preferred stock (6.4 million dilutive shares). For the three and nine months ended September 30, 2006, the effect of the mandatorily redeemable convertible series B preferred stock was not dilutive to earnings per share.

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The weighted average diluted shares outstanding for the three and nine months ended September 30, 2007, exclude the anti-dilutive effects of stock options to purchase approximately 36,000 and 72,000 shares, respectively, since such options have an exercise price 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, 2006, exclude the anti-dilutive effects of stock options to purchase approximately 8,000 and 32,000 shares, respectively.

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

	Three Months Ended September 30		Nine Months Ended September 30	
in millions, except per share	**2007**	2006	**2007**	2006
Diluted Earnings per Share				
Income from continuing operations	**$ 490**	$ 308	**$ 1,346**	$ 1,116
Add dividends on mandatorily redeemable convertible preferred stock	**6**		**18**	
Income available to common shareholders from continuing operations	**$ 496**	$ 308	**$ 1,364**	$ 1,116
Weighted-average common shares outstanding	**340.2**	344.7	**342.9**	345.8
Dilutive effect of stock options, awards and mandatorily redeemable convertible preferred stock	**12.4**	6.3	**12.5**	6.3
Weighted-average diluted shares outstanding	**352.6**	351.0	**355.4**	352.1
Diluted earnings per share from continuing operations	**$ 1.41**	$ .88	**$ 3.84**	$ 3.17

Share Repurchases On December 14, 2006, the company s board of directors authorized a share repurchase program of up to $1 billion of its outstanding common stock. This authorization was in addition to $176 million remaining on the company s previous $1.5 billion share repurchase authorization, which commenced in November 2005.

Since November 2005 the company has entered into four separate accelerated share repurchase agreements with two different banks (the Banks) to repurchase shares of common stock. In each case, shares were immediately borrowed by the Banks that were then sold to and canceled by the company. Subsequently, shares were purchased in the open market by the Banks to settle their share borrowings. The cost of the company s share repurchases is subject to adjustment based on the actual cost of the shares subsequently purchased by the Banks. If an additional amount was owed by the company upon settlement, the price adjustment could have been settled, at the company s option, in cash or in shares of common stock.

The table below summarizes the accelerated share repurchase transactions:

				Dollar Amount of

Agreement Date	Shares Repurchased (in millions)	Purchase Price Per Share	Completion Date	Final Price Adjustment (in millions)	Final Average Purchase Price Per Share	Shares Repurchased (in millions)
November 4, 2005	9.1	$ 55.15	March 1, 2006	$ 37	$ 59.05	$ 537
March 6, 2006	11.6	64.78	May 26, 2006	37	68.01	788
February 21, 2007	8.0	75.29	June 7, 2007	(8)	73.86	592
July 30, 2007	6.5	77.12	September 17, 2007	2	77.27	502

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.

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The company retires its common stock upon repurchase and has not made any purchases of common stock other than in connection with these publicly announced repurchase programs.

As of September 30, 2007, the company has $82 million authorized for share repurchases.

8. GOODWILL AND OTHER PURCHASED INTANGIBLE ASSETS

Goodwill

The changes in the carrying amounts of goodwill for the nine months ended September 30, 2007, were as follows:

$ in millions	Balance as of December 31, 2006	Goodwill Transferred in Segment Realigment	Goodwill Acquired	Adjustment to initially apply FIN 48	Fair Value Adjustments to Net Assets Acquired	**Balance as of September 30, 2007**
Mission Systems	$ 3,883	$ 346	$ 525	$ (22)	$ (55)	**$ 4,677**
Information Technology	2,219			(7)	(30)	**2,182**
Technical Services	787	34		(3)	(9)	**809**
Integrated Systems	976		46		(1)	**1,021**
Space Technology	3,254	(380)	41	(18)	(45)	**2,852**
Electronics	2,516			(1)	(6)	**2,509**
Ships	3,584		54	(12)	(18)	**3,608**
Total	$ 17,219	$	$ 666	$ (63)	$ (164)	**$ 17,658**

Fair Value Adjustments to Net Assets Acquired The fair value adjustments were primarily due to the favorable settlement of Internal Revenue Service (IRS) audits and a claim for a tax refund.

Purchased Intangible Assets

The table below summarizes the company s purchased intangible assets:

	September 30, 2007			December 31, 2006		
$ in millions	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Contract and program intangibles	**$ 2,663**	**$ (1,584)**	**$ 1,079**	$ 2,594	$ (1,487)	$ 1,107
Other purchased intangibles	**100**	**(70)**	**30**	100	(68)	32
Total	**$ 2,763**	**$ (1,654)**	**$ 1,109**	$ 2,694	$ (1,555)	$ 1,139

The company s purchased intangible assets are subject to amortization and are being amortized on a straight-line basis over an aggregate weighted average period of 21 years. Aggregate amortization expense for the three and nine months ended September 30, 2007, was $33 and $99 million, respectively.

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The table below shows expected amortization for purchased intangibles for the remainder of 2007 and for the next five years:

$ in millions	
Year Ended December 31	
2007 (October 1 December 31)	$ 33
2008	122
2009	112
2010	92
2011	53
2012	52

9. LITIGATION

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

As previously disclosed, in October 2005, the U.S. Department of Justice and a classified U.S. Government customer apprised the company of potential substantial claims relating to certain microelectronic parts produced by the Space and Electronics Sector of former TRW Inc., now a component of the company. The relationship, if any, between the potential claims and a civil False Claims Act case that remains under seal in the U.S. District Court for the Central District of California remains unclear to the company. In the third quarter of 2006, the parties commenced settlement discussions. While the company continues to believe that it did not breach the contracts in question and that it acted appropriately in this matter, the company proposed to settle the claims and any associated matters and recognized a pre-tax charge of $112.5 million in the third quarter of 2006 to cover the cost of the settlement proposal and associated investigative costs. The company extended the offer in an effort to avoid litigation and in recognition of the value of the relationship with this customer. The U.S. Government has advised the company that if settlement is not reached it will pursue its claims through litigation. Because of the highly technical nature of the issues involved and their classified status and because of the significant disagreement between the company and the U.S. Government as to the U.S. Government s theories of liability and damages (including a material difference between the U.S. Government s damage theories and the company s offer), final resolution of this matter could take a considerable amount of time, particularly if litigation should ensue. If the U.S. Government were to pursue litigation and were to be ultimately successful on its theories of liability and damages, which could be trebled under the Federal False Claims Act, the effect upon the company s consolidated financial position, results of operations, and cash flows would materially exceed the amount provided by the company. Based upon the information available to the company to date, the company believes that it has substantive defenses but can give no assurance that its views will prevail. Accordingly, the ultimate disposition of this matter cannot presently be determined.

As previously disclosed, on May 17, 2007, the U.S. Coast Guard issued a revocation of acceptance under the Deepwater Program for eight converted 123-foot patrol boats (the vessels) based on alleged hull buckling and shaft

alignment problems. By letter dated June 5, 2007, the Coast Guard stated that the revocation of acceptance also was based on alleged nonconforming topside equipment on the vessels. On August 13, 2007, the company submitted a response to the Coast Guard, maintaining that the revocation of acceptance was improper. The contract value associated with the eight converted vessels is approximately $85 million. The Coast Guard has not specified the amount of damages sought in connection with the eight vessels. Based upon the information

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available to the company to date, the company believes that it has substantive defenses but can give no assurance that its views will prevail. However, the company believes, but can give no assurance, that the outcome of this matter would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Based upon the available information regarding matters that are subject to U.S. Government investigations, other than as set out above, the company believes, but can give no assurance, that the outcome of any such matters would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

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

As previously disclosed, the company is a defendant in litigation brought by Cogent Systems, Inc. (Cogent) in Los Angeles Superior Court in California on April 20, 2005, for unspecified damages for alleged unauthorized use of Cogent technology relating to fingerprint recognition. On September 10, 2007, the company and Cogent announced that they had reached an agreement to settle the litigation. The agreement is subject to completion of definitive documents. Under the terms of the agreement, the company has agreed to pay Cogent $25 million to settle the litigation. The company also has agreed to pay Cogent $15 million for a non-exclusive license to use specified Cogent state-of-the-art automated fingerprint identification software in certain existing programs. The company and Cogent also have agreed to enter into a five-year research and development, service and products agreement, under which the company will pay Cogent $20 million for products and services over the term of the agreement. This settlement will end the litigation and allow the companies to work together on a strategic alliance to provide customers with state-of-the-art fingerprint identification technology and other biometric solutions. A substantial portion of the costs to settle this matter had been provided for earlier in 2007, and accordingly, the resolution of this matter did not have a material effect on the financial statements for the quarter ended September 30, 2007.

As previously disclosed, the U.S. District Court for the Central District of California consolidated two separately filed ERISA lawsuits, which the plaintiffs seek to have certified as class actions, into the In Re Northrop Grumman Corporation ERISA Litigation. On August 7, 2007, the Court denied plaintiffs motion for class certification. The plaintiffs sought leave to file an appeal with the U.S. Court of Appeals for the Ninth Circuit on the issue of class certification. On September 28, 2007, the Ninth Circuit ordered that the trial court proceedings be stayed pending its decision on whether to grant appellate review, and on October 11, 2007, the Ninth Circuit granted such review. The decision to grant appellate review will delay the commencement of trial previously scheduled to begin on January 22, 2008. The company believes, but can give no assurance, that the outcome of these matters would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Insurance Recovery Property damage from Hurricane Katrina is covered by the company s comprehensive property insurance program. The insurance provider for coverage of property damage losses over $500 million, FM Global Insurance (FM Global), has advised management of a disagreement regarding coverage for certain losses above $500 million. As a result, the company has taken legal action against the insurance provider as the company believes that its insurance policies are enforceable and intends to pursue all of its available rights and remedies. In August 2007, the district court in which the litigation is pending issued an order finding that the excess insurance policy provided coverage for the company s Katrina related loss. FM Global has advised the company that it intends to appeal the decision. Based on the current status of the assessment and claim process, no assurances can be made as to the ultimate outcome of this matter (See Note 11).

Provisions for Legal & Investigative Matters Litigation accruals are recorded as charges to earnings when management, after taking into consideration the facts and circumstances of each matter, including any settlement offers, has determined that it is probable that a liability has been incurred and the amount of the loss can be

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reasonably estimated. The ultimate resolution of any exposure to the company may vary from earlier estimates as further facts and circumstances become known.

10. COMMITMENTS AND CONTINGENCIES

Contract Performance Contingencies Contract profit margins may include estimates of costs not contractually agreed to between the customer and the company for matters such as contract changes, negotiated settlements, claims and requests for equitable adjustment for previously unanticipated contract costs. These estimates are based upon management s best assessment of the underlying causal events and circumstances, and are included in determining contract profit margins to the extent of expected recovery based on contractual entitlements and the probability of successful negotiation with the customer. As of September 30, 2007, the amounts recorded are not material individually or in the aggregate.

In April 2007, the company was notified by the prime contractor on the Wedgetail contract that it anticipates the prime contractor s delivery dates will be late and this could subject the prime contractor to liquidated damages from the customer. Should liquidated damages be assessed, the company would share in a proportionate amount of those damages to a maximum of approximately $40 million. As of September 30, 2007, the company has not been notified by the prime contractor as to any claim for liquidated damages. Until such time as liquidated damages are assessed by the customer, it is not possible to determine the impact to the consolidated financial statements, if any, for this matter.

Environmental Matters In accordance with company policy on environmental remediation, the estimated cost to complete remediation has been accrued where it is probable that the company will incur such costs in the future to address environmental impacts at currently or formerly owned or leased operating facilities, or at sites where it has been named a Potentially Responsible Party (PRP) by the Environmental Protection Agency, or similarly designated by other environmental agencies. To assess the potential impact on the company s consolidated financial statements, management estimates the total reasonably possible remediation costs that could be incurred by the company, taking into account currently available facts on each site as well as the current state of technology and prior experience in remediating contaminated sites. These estimates are reviewed periodically and adjusted to reflect changes in facts and technical and legal circumstances. Management estimates that as of September 30, 2007, the range of reasonably possible future costs for environmental remediation sites was $205 million to $298 million, of which $232 million is accrued in other current liabilities. Factors that could result in changes to the company s estimates include: modification of planned remedial actions, increases or decreases in the estimated time required to remediate, discovery of more extensive contamination than anticipated, changes in laws and regulations affecting remediation requirements, and improvements in remediation technology. Should other PRPs not pay their allocable share of remediation costs, the company may have to incur costs in addition to those already estimated and accrued. Although management cannot predict whether new information gained as projects progress will materially affect the estimated liability accrued, management does not anticipate that future remediation expenditures will have a material adverse effect on the company s consolidated financial position, results of operations, or cash flows.

Income Tax Matters The company has exposure related to income tax matters arising from indemnifications of businesses divested. The company periodically assesses these exposures for all tax years that are open under the applicable statute of limitations and records a liability, including related interest charges, where it has determined that a liability has been incurred and the amount of the loss can be reasonably estimated. Liabilities under indemnification agreements for businesses divested are recorded at fair value at the inception of the indemnification and presented within income taxes payable. These primarily relate to indemnifications of foreign taxes as a result of the divestiture of TRW Auto in 2003 and total approximately $133 million and $145 million at September 30, 2007, and December 31, 2006, respectively. Management does not believe that the resolution of any of these income tax

exposures will have a material adverse effect on the company s consolidated financial position, results of operations, or cash flows.

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Co-Operative Agreements In 2003, Ships executed agreements with the states of Mississippi and Louisiana whereby Ships leases facility improvements and equipment from Mississippi and from a non-profit economic development corporation in Louisiana in exchange for certain commitments by Ships to these states.

As of September 30, 2007, Ships has met its obligations under the Mississippi agreement and remains obligated under the Louisiana agreement to maintain a minimum average of 5,200 full-time employees in the state of Louisiana at the end of any four-year period occurring between January 1, 2003, and December 31, 2010.

Failure by Ships to meet the Louisiana commitment would result in reimbursement by Ships to Louisiana in accordance with the agreement. As of September 30, 2007, Ships expects that all future commitments under the Louisiana agreement will be met based on its most recent business plan.

Financial Arrangements In the ordinary course of business, the company utilizes standby letters of credit and guarantees issued by commercial banks and surety bonds issued by insurance companies principally to guarantee the performance on certain contracts and to support the company s self-insured workers compensation plans. At September 30, 2007, there were $435 million of unused stand-by letters of credit, $149 million of bank guarantees, and $551 million of surety bonds outstanding.

In December 2006, Ships entered into a loan agreement with the Mississippi Business Finance Corporation (MBFC) under which Ships received access to $200 million from the issuance of Gulf Opportunity Zone Industrial Development Revenue Bonds by the MBFC. The loan accrues interest payable semi-annually at a fixed rate of 4.55 percent per annum. The company s obligation related to these bonds is recorded in Long-term debt in the consolidated condensed statements of financial position. The bonds are subject to redemption at the company s discretion on or after December 1, 2016, and mature on December 1, 2028. The bond issuance proceeds must be used to finance the construction, reconstruction, and renovation of the company s interest in certain ship manufacturing and repair facilities, or portions thereof, located in the state of Mississippi. As of September 30, 2007, approximately $125 million was used by Ships and the remaining $75 million was recorded in other assets as restricted cash in the consolidated condensed statement of financial position. Repayment of the bonds is guaranteed by the company.

Credit Facility On August 10, 2007, the company entered into an amended and restated credit agreement amending the company s $2 billion five-year credit facility dated August 5, 2005. The agreement extends the maturity date of the credit facility from August 5, 2010, to August 10, 2012 and provides for improved pricing terms, reduced facility fees, and full availability of the facility for letters of credit. At September 30, 2007, there was no balance outstanding under this facility.

Indemnifications The company has retained certain warranty, environmental, and other liabilities in connection with certain divestitures. Except as discussed in the following paragraph, 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.

In May 2006, Goodrich Corporation (Goodrich) notified the company of its claims under indemnities assumed by the company in its December 2002 acquisition of TRW that related to the sale by TRW of its Aeronautical Systems business in October 2002. Goodrich seeks relief from increased costs and other damages of approximately $118 million. The parties are engaged in discussions to enable the company to evaluate and assess the amounts being claimed. If the parties are unable to reach a negotiated resolution of the claims, Goodrich will have the right to commence litigation and may seek significant additional damages relating to allegations of other incurred costs and lost profits. The ultimate disposition of any litigation could take an extended period of time due to the nature of the claims. At this time the company does not have sufficient information to determine the ultimate disposition of this

matter. If Goodrich were to pursue litigation and ultimately be successful on its claims, the effect upon the company s consolidated financial position, results of operations, or cash flows could be material.

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U.S. Government Claims During the second quarter of 2006, the U.S. Government advised the company of claims and penalties concerning certain potential disallowed costs. The parties are engaged in discussions to enable the company to evaluate the merits of these claims as well as to assess the amounts being claimed. The company believes, but can give no assurance, that the outcome of any such matters would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Related Party Transactions The company had no material related party transactions for any period presented.

11. HURRICANE KATRINA

Background On August 29, 2005, the company s operations in the Gulf Coast area of the United States were significantly impacted by Hurricane Katrina. The company s shipyards in Louisiana and Mississippi sustained significant windstorm damage from the hurricane.

As a result of the storm, the company has incurred costs to replace or repair destroyed or damaged assets, suffered losses under its contracts, and incurred substantial costs to clean up and recover its operations. As of the date of the storm, the company had a comprehensive insurance program that provided coverage for, among other things, property damage, business interruption impact on net profitability (referred to in this discussion generally as lost profits), and costs associated with clean-up and recovery.

Insurance Coverage Summary - The company s property insurance program at the time of loss was established in two layers of coverage. The primary (first) layer of coverage was provided by a syndicate of leading insurers and covered losses up to $500 million. The excess (second) layer of coverage was provided by a single insurer FM Global. This excess layer reimburses the company for losses above $500 million up to the policy limit of approximately $20 billion.

In prior years, the company has experienced damage from other storms and events and the company has had success in obtaining recovery from its insurers for covered damages. Based on its prior experience with processing insurance claims, the company has a well-defined process for developing, analyzing and preparing its claims for insurance recovery.

Accounting for Insurance Recoveries The company makes various assessments and estimates in determining amounts to record as insurance recoveries, including ascertaining whether damages are covered by insurance and assessing the viability and financial well-being of its insurers. The company and its insurers in the first layer of coverage reached an arrangement whereby the company submitted detailed requests for reimbursement of its clean-up, restoration and capital asset repair or replacement costs while its overall claim was in the process of being evaluated by the insurers. After such requests were reviewed by the insurers, progress payments against the overall coverage limits were approved by the insurers. Based on prior experience with insurance recoveries, and in reliance on the acceptance by the insurers of the company s claim reimbursement process, the company recognized a receivable from the insurers in the first layer of coverage as costs were incurred, and offset the receivable with progress payments as received. Since the submission of its claim, the company has accrued receivables from the insurers for amounts included in the claim relating to its asset impairment and clean-up and recovery costs, offset by progress payments made by the insurers as described above.

In accordance with U.S. government cost accounting regulations affecting the majority of the company s contracts, the cost of insurance premiums for all coverage other than coverage of profit is an allowable cost that may be charged to long-term contracts. Because the majority of long-term contracts at the shipyards are flexibly-priced, the government

customer would benefit from the majority of insurance recoveries in excess of the net book value of damaged assets and the costs for clean-up and recovery. In a similar manner, losses on property damage that are not recovered through insurance are required to be included in the company s overhead pools for allocation to long-term contracts under a systematic process. The company is currently in discussions with its government customers to determine an appropriate methodology to be used to account for these amounts for

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government contract purposes. The company anticipates that the ultimate outcome of such discussions will not have a material adverse affect on the consolidated financial statements.

The company has full entitlement to insurance recoveries related to lost profits; however, because of uncertainties concerning the ultimate determination of recoveries related to lost profits, in accordance with company policy no such amounts are recognized by the company until they are settled with the insurers. Furthermore, due to the uncertainties with respect to the company s disagreement with FM Global, no receivables have been recognized by the company in the accompanying consolidated condensed financial statements for insurance recoveries from the second insurance layer.

Insurance Claim The company s Hurricane Katrina insurance claim is continually being evaluated based on actions to date and an assessment of remaining recovery scope. The company updated its assessment during the third quarter of 2007 and, as a result, the company s aggregate claim for insurance recovery as a result of Hurricane Katrina is estimated to be $1.1 billion, consisting of clean-up and restoration costs of $278 million, property damages (including the value of destroyed assets not replaced) and other capital expenditures of $492 million and lost profits of $318 million. Certain amounts within the overall claim are still in the process of being finalized and the overall value of the claim may change from these amounts.

In June 2007, the company reached a final agreement with all but one of the insurers in its first layer of coverage under which the insurers agreed to pay their policy limits (less the policy deductible and certain other minor costs). As a result of the agreement regarding the claims from the first layer of coverage, the company received a total insurance recovery for damages to the shipyards of $466 million reflecting policy limits less certain minor costs. The company is continuing to seek recovery of its claim from the remaining insurer in the first layer that did not participate in the agreement. As a result of the agreement, the company received final cash payments totaling $113 million in the quarter ended June 30, 2007, of which $62 million has been attributed to the recovery of lost profits due to the storm and this amount was recognized in the consolidated condensed statement of income for that period as an adjustment to operating margin (cost of product sales) in the Ships segment. Through September 30, 2007, cumulative proceeds from the agreement have also been used to fund $126 million in capital expenditures for assets fully or partially damaged by the storm and $278 million in clean-up and restoration costs. Insurance recoveries received to date have enabled the company to recover the entire net book value of $98 million of assets totally or partially destroyed by the storm. To the extent that the company is unsuccessful in receiving the full value of its remaining claim relating to capital assets, the company will be responsible for funding the capital expenditures necessary to operate its shipyards. Through September 30, 2007, the company has incurred capital expenditures totaling $269 million related to assets damaged by Hurricane Katrina, of which approximately two-thirds represents the replacement cost of assets destroyed and the remainder represents the capitalized value of asset improvements that extended the useful life of assets damaged by the storm.

The company expects that its residual claim will be resolved separately with the remaining insurers in each of its two layers of coverage, and the company has pursued the resolution of its claim with that understanding. The insurer for the second layer of coverage has denied coverage for substantial portions of the company s claim and the parties are presently in litigation to resolve this matter. In August 2007, the district court in which the litigation is pending issued an order finding that the excess insurance policy provided coverage for the company s Katrina related loss. The insurer has advised the company that it intends to seek an appeal of the decision. (see Note 9).

Aside from contract cost adjustments recognized immediately following the hurricane and the subsequent effects of lower contract margins thereafter resulting from hurricane related cost growth, delay and disruption to contracts-in-progress, no other Hurricane Katrina related losses have been, or are expected to be, experienced by the

company.

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12. RETIREMENT BENEFITS

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

	Three Months Ended September 30				Nine Months Ended September 30			
	Pension Benefits		Medical and Life Benefits		Pension Benefits		Medical and Life Benefits	
$ in millions	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006
Components of Net Periodic Benefit Cost								
Service cost	**$ 196**	$ 185	**$ 13**	$ 18	**$ 589**	$ 555	**$ 39**	$ 53
Interest cost	**314**	291	**41**	46	**938**	874	**123**	140
Expected return on plan assets	**(444)**	(393)	**(15)**	(12)	**(1,331)**	(1,179)	**(44)**	(38)
Amortization of:								
Prior service costs	**12**	9	**(17)**	(2)	**31**	27	**(49)**	(5)
Net loss from previous years	**11**	20	**7**	8	**36**	60	**19**	24
Net periodic benefit cost	**$ 89**	$ 112	**$ 29**	$ 58	**$ 263**	$ 337	**$ 88**	$ 174
Defined contribution plans cost	**$ 66**	$ 62			**$ 211**	$ 196		

Employer Contributions At a minimum, the company expects to make required contributions of approximately $139 million to its pension plans and approximately $183 million to its medical and life benefit plans in 2007. As of September 30, 2007, contributions of $126 million and $124 million have been made to the company s pension plans and its medical and life benefit plans, respectively.

13. STOCK-BASED COMPENSATION

At September 30, 2007, the company had stock-based awards outstanding under the following plans: the 2001 Long-Term Incentive Stock Plan and the 1993 Long-Term Incentive Stock Plan, both applicable to employees, the 1993 Stock Plan for Non-Employee Directors and the 1995 Stock Plan for Non-Employee Directors, as amended. All of these plans were approved by the company s shareholders. Share-based awards under the employee plans consist of stock option awards (Stock Options) and restricted stock awards (Stock Awards).

Compensation Expense Total pre-tax stock-based compensation for the nine months ended September 30, 2007, was $135 million, of which $9 million related to Stock Options and $126 million related to Stock Awards, respectively. Total pre-tax stock-based compensation for the nine months ended September 30, 2006, was $155 million, of which $8 million related to Stock Options and $147 million related to Stock Awards, respectively. Tax benefits recognized in the consolidated condensed statements of income for stock-based compensation during the nine months ended September 30, 2007, and 2006, were $53 million and $54 million, respectively. In addition, the company realized excess tax benefits of $51 million and $47 million, respectively, from the exercise of Stock Options and $22 million and $5 million, respectively, from the vesting of Stock Awards in the nine months ended September 30, 2007, and 2006.

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

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granted is derived from historical experience under the company s stock-based compensation plans and represents the period of time that awards granted are expected to be outstanding.

The significant weighted average assumptions relating to the valuation of the company s Stock Options for the nine months ended September 30, 2007, and 2006, were as follows:

	2007	2006
Dividend yield	**2.1%**	1.6%
Volatility rate	**20%**	25%
Risk-free interest rate	**4.7%**	4.6%
Expected option life (years)	**6.0**	6.0

The weighted average grant date fair value of Stock Options granted during the nine months ended September 30, 2007, and 2006, was $15 and $18 per share, respectively.

Stock Option activity for the nine months ended September 30, 2007, was as follows:

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($ in millions)
Outstanding at January 1, 2007	19,887,941	$ 49	5.0 years	$ 367
Granted	901,686	73		
Exercised	(5,196,877)	49		
Cancelled and forfeited	(12,346)	35		
Outstanding at September 30, 2007	**15,580,404**	**$ 51**	**4.8 years**	**$ 427**
Vested and expected to vest in the future at September 30, 2007	15,492,840	$ 51	4.8 years	$ 426
Exercisable at September 30, 2007	14,001,412	$ 49	4.3 years	$ 410
Available for grant at September 30, 2007	**11,913,711**			

The total intrinsic value of options exercised during the nine months ended September 30, 2007, and 2006, was $129 million and $134 million, respectively. Intrinsic value is measured using the fair market value at the date of exercise (for options exercised) or at September 30, 2007 (for outstanding options), less the applicable exercise price.

Stock Awards Compensation expense for Stock Awards is measured at the grant date based on fair value and recognized over the vesting period. The fair value of Stock Awards is determined based on the closing market price of

the company s common stock on the grant date. For purposes of measuring compensation expense, the amount of shares ultimately expected to vest is estimated at each reporting date based on management s expectations regarding the relevant performance criteria. In the table below, the share adjustment resulting from the final performance measure is considered granted in the period that the related grant is vested. During the nine months ended September 30, 2007, 2.6 million shares of common stock were issued to employees in settlement of prior year Stock Awards that were fully vested, with a total value upon issuance of $199 million and a grant date fair value of $125 million. During the nine months ended September 30, 2006, 2.4 million shares of common stock were issued to employees in settlement of prior year Stock Awards that were fully vested, with a total value upon issuance of $155 million and a grant date fair value of $132 million. There were 3.4 million Stock Awards granted in the nine months ended September 30, 2006, with a weighted average grant date fair value of $65 per share.

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Stock Award activity for the nine months ended September 30, 2007, was as follows:

	Stock Awards	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term
Outstanding at January 1, 2007	7,364,227	$ 57	1.3 years
Granted (including performance adjustment on shares vested)	2,635,661	64	
Vested	(2,637,703)	47	
Forfeited	(232,855)	62	
Outstanding at September 30, 2007	**7,129,330**	**$ 63**	**1.2 years**
Available for grant at September 30, 2007	**5,058,977**		

Unrecognized Compensation Expense At September 30, 2007, there was $246 million of unrecognized compensation expense related to unvested awards granted under the company s stock-based compensation plans, of which $19 million relates to Stock Options and $227 million relates to Stock Awards. These amounts are expected to be charged to expense over a weighted average period of 1.5 years.

14. INCOME TAXES

The company s effective tax rates on income from continuing operations were 32.3 percent and 30.2 percent for the nine months ended September 30, 2007 and 2006, respectively. During the nine months ended September 30, 2007, the company reached a partial settlement agreement with the IRS regarding its audit of the company s tax years ended 2001 2003. As a result, the company recognized a net tax benefit of $22 million due to the reversal of previously established expense provisions. During the nine months ended September 30, 2006, the company reached final approval with the IRS regarding its audit of the company s B-2 program for the years ended December 31, 1997 through December 31, 2000. As a result, the company recognized a net tax benefit of $48 million due to the reversal of previously established expense provisions. The company also recognized a net tax benefit of $18 million in 2006 related to tax credits associated with qualified wages paid to employees affected by Hurricane Katrina.

The company adopted the provisions of FIN 48 *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109,* on January 1, 2007. As a result of the implementation of FIN 48, the company made a comprehensive review of its portfolio of uncertain tax positions in accordance with recognition standards established by FIN 48. In this regard, an uncertain tax position represents the company s expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return, that has not been reflected in measuring income tax expense for financial reporting purposes. As a result of this review, the company adjusted the estimated value of its uncertain tax positions on January 1, 2007, by recognizing additional liabilities totaling $66 million through a charge to retained earnings, and reducing the carrying value of uncertain tax positions resulting from prior acquisitions by $63 million through a reduction of goodwill. Upon the adoption of FIN 48, the estimated value of the company s uncertain tax positions was a liability of $514 million. If the company s positions are sustained by the taxing authority in favor of the company, approximately $331 million would be treated as a reduction of goodwill, and the balance of $183 million would reduce the company s effective tax rate. The company does not expect any material changes to the

estimated amount of the liability associated with its uncertain tax positions within the next twelve months.

The company recognizes accrued interest and penalties related to uncertain tax positions in federal and foreign income tax expense. As of January 1, 2007, the company had accrued approximately $55 million for the payment of tax-related interest and penalties.

The company files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. The IRS is currently examining the company s U.S. income tax returns for 1999 2006, including pre-

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acquisition activities of acquired companies. In addition, open tax years related to state and foreign jurisdictions remain subject to examination but are not considered material.

During the nine months ended September 30, 2007, the company s liability for uncertain tax positions decreased $57 million primarily due to a partial settlement agreement with the IRS for the tax years 2001 2003.

15. ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of accumulated other comprehensive loss were as follows:

$ in millions	**September 30, 2007**	December 31, 2006
Cumulative translation adjustment	**$ 28**	$ 22
Unrealized gain on marketable securities, net of tax of $1 as of September 30, 2007, and $1 as of December 31, 2006, respectively	**1**	2
Unamortized benefit plan costs, net of tax of $840 as of September 30, 2007, and $900 as of December 31, 2006, respectively	**(1,308)**	(1,284)
Total accumulated other comprehensive loss	**$ (1,279)**	$ (1,260)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Northrop Grumman Corporation
Los Angeles, California

We have reviewed the accompanying consolidated condensed statement of financial position of Northrop Grumman Corporation and subsidiaries (the Corporation) as of September 30, 2007, and the related consolidated condensed statements of income and comprehensive income for the three-month and nine-month periods ended September 30, 2007 and 2006, and the related consolidated condensed statements of cash flows and changes in shareholders equity for the nine-month periods ended September 30, 2007 and 2006. 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 consolidated condensed 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, 2006, and the related consolidated statements of income, comprehensive income, cash flows, and changes in shareholders equity for the year then ended (not presented herein); and in our report dated February 20, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated condensed statement of financial position as of December 31, 2006 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
Los Angeles, California
October 23, 2007

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

OVERVIEW

The following discussion should be read along with the unaudited consolidated condensed financial statements included in this Form 10-Q, as well as the company s 2006 Annual Report on Form 10-K filed with the Securities and Exchange Commission, which provides a more thorough discussion of the company s products and services, industry outlook, and business trends.

Northrop Grumman (the company) provides technologically advanced, innovative products, services, and solutions in information and services, aerospace, electronics, and shipbuilding. As a prime contractor, principal subcontractor, partner, or preferred supplier, the company participates in many high-priority defense and commercial technology programs for customers in the United States (U.S.) and abroad. The company conducts most of its business with the U.S. Government, principally the Department of Defense. The company also conducts business with foreign governments and has domestic and international commercial sales.

Overall Operating Performance Operating performance for the three and nine months ended September 30, 2007, compared to the same period in 2006 improved in almost every consolidated financial measure. Sales, operating margin, net income, and cash from operations all increased over the same period in 2006. Funded backlog at September 30, 2007, increased almost $4 billion over the same date in 2006. See discussion of consolidated results starting on page I-26 and discussion of results by reportable segment starting on page I-29.

Business Outlook and Operational Trends The company s shipyard operations in the Gulf Coast continue to be impacted from the effects of property damage and workforce shortages resulting from hurricanes in 2005 and a recent workforce stoppage due to union negotiations. While operational issues continue to exist, management believes it has an executable recovery plan in place and sales and operating margin related to these operations have continued to improve.

Other than the matter discussed above, there have been no material changes to the company s products and services, industry outlook, or business trends from those disclosed in the company s 2006 Annual Report on Form 10-K.

Notable Events - Notable events or activity during the three months ended September 30, 2007, affecting the company s consolidated financial results included the following:

Cogent Settlement see Note 9 to the consolidated condensed financial statements in Part I, Item 1.

Execution and completion of the fourth accelerated share repurchase agreement see Note 7 to the consolidated condensed financial statements in Part I, Item 1.

Business acquisitions and dispositions see Notes 4 and 5 to the consolidated condensed financial statements in Part I, Item 1.

Other notable events or activity during the nine months ended September 30, 2007, included the following:

$62 million operating margin gain related to settlement with certain insurance providers in connection with claims arising from Hurricane Katrina see Note 11 to the consolidated condensed financial statements in Part I, Item 1.

$50 million pre-tax operating margin charge for legal and investigative provisions.

$27 million pre-tax operating margin charge recorded for the F-16 Block 60 fixed-price development combat avionics program due to a higher estimate of software integration costs to complete the Falcon Edge electronic warfare suite.

$27 million favorable adjustment related to the settlement of prior years overhead costs.

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$55 million pre-tax operating margin charge related to LHD 8 due to a schedule extension and subsystem cost growth see page I-40.

Execution and completion of the third accelerated share repurchase agreement see Note 7 to the consolidated condensed financial statements in Part I, Item 1.

Acquisition of Essex Corporation (Essex) see Note 4 to the consolidated condensed financial statements in Part I, Item 1.

Adoption of Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48 *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* see Note 14 to the consolidated condensed financial statements in Part I, Item 1.

CRITICAL ACCOUNTING POLICIES, ESTIMATES, AND JUDGMENTS

Changes in Critical Accounting Policies There have been no changes in the company s critical accounting policies during the three and nine months ended September 30, 2007, except for a change in the measurement and recording of tax contingency accruals in accordance with FIN 48. The expanded disclosure requirements of FIN 48 are presented in Note 14 to the consolidated condensed financial statements in Part I, Item I.

FIN 48 prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Only tax positions meeting the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of this Interpretation. FIN 48 also provides guidance on accounting for derecognition, interest and penalties, and classification and disclosure of matters related to uncertainty in income taxes. As in the past, changes in accruals associated with uncertainties arising from pre-acquisition years for acquired businesses are charged or credited to goodwill. Adjustments to other tax accruals are generally recorded in earnings in the period they are determined.

Prior to January 1, 2007, the company recorded accruals for tax contingencies and related interest when it was probable that a liability had been incurred and the amount of the contingency could be reasonably estimated based on specific events such as an audit or inquiry by a taxing authority.

Use of Estimates The company s consolidated condensed financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of commitments and 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.

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CONSOLIDATED OPERATING RESULTS

Selected financial highlights are presented in the table below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
$ in millions, except per share	**2007**	2006	**2007**	2006
Sales and service revenues	**$ 7,928**	$ 7,429	**$ 23,194**	$ 22,100
Cost of sales and service revenues	**7,121**	6,880	**20,948**	20,259
Operating margin	**807**	549	**2,246**	1,841
Interest expense, net	**(78)**	(73)	**(237)**	(234)
Other, net	**2**	1	**(22)**	(9)
Federal and foreign income taxes	**241**	169	**641**	482
Diluted earnings per share from continuing operations	**1.41**	.88	**3.84**	3.17
Net cash provided by operating activities	**1,015**	962	**2,156**	1,485

Sales and Service Revenues
Sales and service revenues consist of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
$ in millions	**2007**	2006	**2007**	2006
Product sales	**$ 4,310**	$ 4,404	**$ 13,015**	$ 13,550
Service revenues	**3,618**	3,025	**10,179**	8,550
Sales and service revenues	**$ 7,928**	$ 7,429	**$ 23,194**	$ 22,100

Sales and service revenues for the three and nine months ended September 30, 2007, increased $499 million and approximately $1.1 billion, respectively, as compared with the same periods in 2006, reflecting higher sales in all operating segments except Integrated Systems. The increase is primarily due to higher sales volume across a wide spectrum of programs. The decrease in Integrated Systems sales is due primarily to the transition of certain development programs to their early production phases. See the Segment Operating Results section below for further information.

Cost of Sales and Service Revenues
Cost of sales and service revenues is comprised of the following:

	Three Months Ended	Nine Months Ended

	September 30,		September 30,	
$ in millions	**2007**	2006	**2007**	2006
Cost of product sales	**$ 3,236**	$ 3,518	**$ 9,987**	$ 10,631
% of product sales	***75.1%***	*79.9%*	***76.7%***	*78.5%*
Cost of service revenues	**3,094**	2,576	**8,635**	7,406
% of service revenues	***85.5%***	*85.2%*	***84.8%***	*86.6%*
General and administrative expenses	**791**	786	**2,326**	2,222
% of total sales and service revenues	***10.0%***	*10.6%*	***10.0%***	*10.1%*
Cost of sales and service revenues	**$ 7,121**	$ 6,880	**$ 20,948**	$ 20,259

Cost of Product Sales and Service Revenues Cost of product sales as a percentage of product sales for the three and nine months ended September 30, 2007, as compared to the same period in 2006 improved primarily at Mission

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Systems, Ships, and Integrated Systems. Cost of service revenues as a percentage of service revenues for the three months ended September 30, 2007, as compared to the same period in 2006, remained essentially unchanged while improving for the comparable nine-month period primarily at Technical Services. See the Segment Operating Results section below for further information.

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, general and administrative expenses are allocated to contracts in progress on a systematic basis and contract performance factors include this cost component as an element of cost.

Operating Margin

The company considers operating margin to be an important measure for evaluating its operating performance and, as is typical in the industry, defines operating margin as revenues less the related cost of producing the revenues and general and administrative expenses. Operating margin for the company is further evaluated for each of the business segments in which the company operates, and segment operating margin is one of the key metrics used by management of the company to internally manage its operations.

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

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Segment operating margin	**$ 817**	$ 699	**$ 2,293**	$ 2,100
Unallocated expenses	**(41)**	(148)	**(139)**	(235)
Net pension adjustment	**31**	(2)	**92**	(24)
Total operating margin	**$ 807**	$ 549	**$ 2,246**	$ 1,841

Segment Operating Margin Segment operating margin for the three months ended September 30, 2007, increased $118 million, or 17 percent, as compared to the same period in 2006. Total segment operating margin was 10.3 percent and 9.4 percent of total sales and service revenues for the three months ended September 30, 2007, and 2006, respectively. See the Segment Operating Results section below for further information.

Segment operating margin for the nine months ended September 30, 2007, increased $193 million, or 9 percent, as compared to the same period in 2006. Total segment operating margin was 9.9 percent and 9.5 percent of total sales and service revenues for the nine months ended September 30, 2007, and 2006, respectively. See the Segment Operating Results section below for further information.

Unallocated Expenses Unallocated expenses for the three months ended September 30, 2007, decreased $107 million, or 72 percent, as compared with the same period in 2006, primarily due to $112.5 million in lower legal and investigative provisions, and $29 million in lower post-retirement benefit costs determined under GAAP as a result of a plan design change in 2006, offset by an increase in other costs including $17 million in higher litigation expenses.

Unallocated expenses for the nine months ended September 30, 2007, decreased $96 million, or 41 percent, as compared with the same period in 2006, primarily due to $86 million in lower post-retirement benefit costs determined under GAAP as a result of a plan design change in 2006 and $63 million lower legal and investigative provisions, offset by an increase in other costs including $18 million in higher litigation expenses.

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 U.S. Government Cost Accounting Standards (CAS). For the three months ended September 30, 2007, and 2006, pension expense (income) determined in accordance with GAAP was $89 million and $112 million,

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respectively, and pension expense determined in accordance with CAS amounted to $120 million and $110 million, respectively. For the nine months ended September 30, 2007, and 2006, pension expense determined in accordance with GAAP was $263 million and $337 million, respectively, and pension expense determined in accordance with CAS amounted to $355 million and $313 million, respectively. The reduction in GAAP pension cost primarily results from higher returns on plan assets and a voluntary pre-funding in the fourth quarter of 2006.

Interest Expense, Net
Interest expense, net for the three and nine months ended September 30, 2007, increased $5 million and $3 million, respectively, as compared with the same periods in 2006 primarily due to a lower amount of interest-bearing cash deposits, partially offset by lower average debt outstanding.

Other, Net
Other, net expense for the nine months ended September 30, 2007, increased $13 million, as compared with the same period in 2006 primarily due to $8 million related to a loss on asset disposal.

Federal and Foreign Income Taxes
The company s effective tax rate on income from continuing operations for the three months ended September 30, 2007, was 33.0 percent compared with 35.4 percent for the same period in 2006.

The company s effective tax rate on income from continuing operations for the nine months ended September 30, 2007, was 32.3 percent compared with 30.2 percent for the same period in 2006. During the nine months ended September 30, 2006, the company received final approval from the U.S. Congress Joint Committee on Taxation for the agreement previously reached with the IRS regarding its audit of the company s B-2 program for the years ended December 31, 1997 through December 31, 2000. As a result, the company recognized a net tax benefit of $48 million due to the reversal of previously established expense provisions. The company recognized a net tax benefit of $18 million in 2006 related to tax credits associated with qualified wages paid to employees affected by Hurricane Katrina.

Discontinued Operations
Discontinued operations for the three and nine months ended September 30, 2007, is primarily comprised of a $1 million and $10 million after-tax loss, respectively, on the shutdown of the remaining Interconnect Technologies (ITD) business, formerly reported in the Electronics segment. See Note 5 to the consolidated condensed financial statements in Part I, Item I.

Discontinued operations for the three months ended September 30, 2006, is primarily comprised of a $4 million after-tax loss on the sale of the assembly business unit of ITD and a $3 million after-tax loss on the shutdown of the Enterprise Information Technology (EIT), formerly reported in the Information Technology segment. Discontinued operations for the nine months ended September 30, 2006, is primarily comprised of a $12 million after-tax loss on the shutdown of the remaining ITD business and a $14 million after-tax loss on the shutdown of EIT, partially offset by a $4 million after-tax gain on the sale of the assembly business of ITD, and a $2 million after-tax gain on the divestiture of Winchester Electronics. See Note 5 to the consolidated condensed financial statements in Part I, Item I.

Diluted Earnings Per Share
Diluted earnings per share from continuing operations for the three months ended September 30, 2007, were $1.41, as compared with $.88 per share in the same period in 2006. Earnings per share are based on weighted average diluted shares outstanding of 352.6 million for the three months ended September 30, 2007, and 351.0 million for the same period in 2006. Diluted earnings per share from continuing operations and the weighted average diluted shares

outstanding in 2007 include the dilutive effects of the mandatorily redeemable convertible series B preferred stock. See Note 7 to the consolidated condensed financial statements in Part I, Item 1.

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Diluted earnings per share from continuing operations for the nine months ended September 30, 2007, were $3.84, as compared with $3.17 per share in the same period in 2006. Earnings per share are based on weighted average diluted shares outstanding of 355.4 million for the nine months ended September 30, 2007, and 352.1 million for the same period in 2006. Diluted earnings per share from continuing operations and the weighted average diluted shares outstanding in 2007 include the dilutive effects of the mandatorily redeemable convertible series B preferred stock. See Note 7 to the consolidated condensed financial statements in Part I, Item 1.

Net Cash Provided by Operating Activities

For the three months ended September 30, 2007, net cash provided from operating activities was $1,015 million compared to $962 million for the same period in 2006. The increase of $53 million, or 6 percent, was due to $375 million in higher sources of cash primarily from $365 million in increased collections net of progress payments, partially offset by $295 million in higher uses of cash primarily due to a $252 million increase in cash paid to suppliers and employees and $60 million in additional income taxes paid.

Net cash provided by operating activities for the nine months ended September 30, 2007, was $2,156 million compared to $1,485 million for the same period in 2006. The increase of $671 million, or 45 percent, was due to $1.5 billion in higher sources of cash primarily from $1.4 billion in increased collections net of progress payments, $79 million in higher insurance proceeds, and $66 million in less cash used in discontinued operations, offset by $888 million in higher uses of cash primarily due to a $768 million increase in cash paid to suppliers and employees and $129 million in additional income taxes paid.

SEGMENT OPERATING RESULTS

Effective January 1, 2007, the company realigned businesses among its operating segments that possess similar customers, expertise, and capabilities. The realignment more fully leverages existing capabilities and enhances development and delivery of highly integrated services. The realignment primarily involved the transfer of the Radio Systems business from the Space Technology segment to the Mission Systems segment and the transfer of the UK Airborne Warning and Controls System (AWACS) program from the Information Technology segment to the Technical Services segment. On July 1, 2006, certain logistics, services and technical support programs were transferred from Electronics, Integrated Systems, Mission Systems, and Space Technology to Technical Services. The sales and segment operating margin in the following tables have been revised, where applicable, to reflect these realignments for all periods presented.

For presentation purposes, the company s seven reportable segments are categorized into four primary businesses. The Mission Systems, Information Technology and Technical Services reportable segments are presented as Information & Services. The Integrated Systems and Space Technology reportable segments are presented as Aerospace. The Electronics and Ships reportable segments are presented as separate businesses. The Ships reportable segment includes the aggregated results of the Newport News and Ship Systems operating segments.

Funded contract acquisitions, sales and service revenues, and segment operating margin in the tables within this section include intercompany amounts that are eliminated in the consolidated condensed financial statements in Part I, Item 1.

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	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Sales and Service Revenues				
Information & Services				
Mission Systems	**$ 1,459**	$ 1,340	**$ 4,363**	$ 4,087
Information Technology	**1,107**	1,023	**3,288**	2,928
Technical Services	**573**	526	**1,644**	1,340
Total Information & Services	**3,139**	2,889	**9,295**	8,355
Aerospace				
Integrated Systems	**1,255**	1,317	**3,761**	4,116
Space Technology	**750**	699	**2,273**	2,170
Total Aerospace	**2,005**	2,016	**6,034**	6,286
Electronics	**1,673**	1,665	**4,980**	4,756
Ships	**1,469**	1,238	**3,984**	3,808
Intersegment eliminations	**(358)**	(379)	**(1,099)**	(1,105)
Sales and service revenues	**$ 7,928**	$ 7,429	**$ 23,194**	$ 22,100
Segment Operating Margin				
Information & Services				
Mission Systems	**$ 144**	$ 131	**$ 423**	$ 400
Information Technology	**72**	92	**248**	256
Technical Services	**28**	34	**88**	96
Total Information & Services	**244**	257	**759**	752
Aerospace				
Integrated Systems	**145**	137	**454**	426
Space Technology	**59**	66	**187**	184
Total Aerospace	**204**	203	**641**	610
Electronics	**211**	198	**579**	552
Ships	**183**	76	**396**	273
Intersegment eliminations	**(25)**	(35)	**(82)**	(87)
Segment operating margin	**$ 817**	$ 699	**$ 2,293**	$ 2,100

KEY SEGMENT FINANCIAL MEASURES

Operating Performance Assessment and Reporting

The company manages and assesses the performance of its businesses based on its 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 on page I-25. Based on this approach and the nature of the company s operations, the discussion of results of operations generally focuses around the company s seven reportable segments versus distinguishing between products and services. Product sales are predominantly generated in the Electronics, Integrated Systems, Space Technology and Ships segments, while the majority of the company s service revenues are generated by the Information Technology, Mission Systems and Technical Services segments.

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Funded Contract Acquisitions
Funded contract acquisitions represent amounts funded during the period on customer contractually obligated orders. Funded contract acquisitions tend to fluctuate from period to period and are determined by the size and timing of new and follow-on orders and by obligations of funding on previously awarded unfunded orders. In the period that a business is purchased, its existing funded order backlog as of the date of purchase is reported as funded contract acquisitions. In the period that a business is sold, its existing funded order backlog as of the divestiture date is deducted from funded contract acquisitions.

Sales and Service Revenues
Period-to-period sales generally vary less than funded contract acquisitions and 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 revenues incurred due to varying production activity levels, delivery rates, or service levels on individual contracts. Volume changes will typically carry a corresponding margin change based on the margin rate for a particular contract.

Segment Operating Margin
Segment operating margin reflects the performance of segment contracts and programs. 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 and other retiree benefits, and other expenses not considered allowable or allocable under applicable CAS regulations and the Federal Acquisition Regulation, and therefore not allocated to the segments. Changes in segment operating margin are typically expressed in terms of volume, as discussed above, or performance. Performance refers to changes in contract margin rates. 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 margin changes are accounted for on a cumulative to date basis at the time an EAC change is recorded.

Operating margin may also be affected by, among other things, the effects of workforce stoppages, the effects of natural disasters (such as hurricanes and 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 are included in the Glossary of Programs beginning on page I-42.

INFORMATION & SERVICES

Mission Systems
Mission Systems is a leading global system integrator of complex, mission-enabling systems for government, military, and commercial customers. Products and services are grouped into the following business areas: Command, Control and Communications (C3); Intelligence, Surveillance and Reconnaissance (ISR); and Missile Systems.

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006

Funded Contract Acquisitions	**$ 1,360**	$ 1,136	**$ 4,261**	$ 4,178
Sales and Service Revenues	**1,459**	1,340	**4,363**	4,087
Segment Operating Margin	**144**	131	**423**	400
As a percentage of segment sales	**9.9%**	9.8%	**9.7%**	9.8%

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Funded Contract Acquisitions
Mission Systems contract acquisitions for the three months ended September 30, 2007, increased $224 million, or 20 percent, as compared with the same period in 2006, primarily due to higher funding received from the Force XXI Battle Brigade and Below (FBCB2) Installation Kits (I-Kits) program, Guardrail Modernization program and the Kinetic Energy Interceptors (KEI) program. Significant acquisitions during the three months ended September 30, 2007 included $66 million for the FBCB2 I-Kits program, $41 million for the Intercontinental Ballistic Missile (ICBM) program, $50 million for a restricted program, $39 million for KEI program and $38 million for the F-22 program.

Mission Systems contract acquisitions for the nine months ended September 30, 2007, increased $83 million, or 2 percent, as compared with the same period in 2006, primarily due to higher acquisitions in ISR related to the acquisition of Essex and a restricted program win, partially offset by the receipt of delayed funding upon approval of the federal defense budget during the first quarter of 2006. Significant acquisitions during the nine months ended September 30, 2007, included $385 million for the ICBM program, $158 million for the Joint National Integration Center Research & Development (JRDC) program, $149 million for the F-22 program, $106 million for the FBCB2 I-Kits program, $98 million for the Ground-Based Midcourse Defense Fire Control and Communications (GFC/C) program and $81 million for the F-35 program.

Sales and Service Revenues
Mission Systems revenues for the three months ended September 30, 2007, increased $119 million, or 9 percent, as compared with the same period in 2006. The increase was primarily due to $90 million in higher sales in ISR, $20 million in higher sales in Missile Systems and $16 million in higher sales in C3. The increase in ISR is primarily due to the acquisition of Essex. The increase in Missile Systems is primarily due to increased scope and funding levels in the KEI and JRDC programs. The increase in C3 is due to higher volume in several programs, including the FBCB2 I-Kits program, partially offset by lower volume in the F-35 program as hardware development winds down in 2007 and reduced scope and deliveries in the F-22 program accelerated into 2006.

Mission Systems revenues for the nine months ended September 30, 2007, increased $276 million, or 7 percent, as compared with the same period in 2006. The increase was primarily due to $190 million in higher sales volume in ISR and $108 million in higher sales in Missile Systems. The increase in ISR is due to the acquisition of Essex and higher volume in several programs awarded in 2006, partially offset by several programs completed or nearing completion in 2007. The increase in Missile Systems is due to higher volume in the KEI, ICBM, JRDC, and GFC/C programs.

Segment Operating Margin
Mission Systems operating margin for the three months ended September 30, 2007, increased $13 million, or 10 percent, as compared with the same period in 2006, primarily due to the effect of net sales volume increases across various programs, partially offset by an increase in amortization of purchased intangibles.

Mission Systems operating margin for the nine months ended September 30, 2007, increased $23 million, or 6 percent, as compared with the same period in 2006, primarily due to the effect of net sales volume increases across various programs, partially offset by an increase in amortization of purchased intangibles.

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Information Technology

Information Technology is a premier provider of advanced information technology (IT) solutions, engineering, and business services for government and commercial customers. Products and services are grouped into the following business areas: Intelligence; Civilian Agencies; Commercial, State & Local (CS&L); and Defense.

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Funded Contract Acquisitions	**$ 1,360**	$ 1,384	**$ 3,319**	$ 3,516
Sales and Service Revenues	**1,107**	1,023	**3,288**	2,928
Segment Operating Margin	**72**	92	**248**	256
As a percentage of segment sales	**6.5%**	9.0%	**7.5%**	8.7%

Funded Contract Acquisitions

Information Technology contract acquisitions for the three months ended September 30, 2007, decreased $24 million, or 2 percent, as compared with the same period in 2006, primarily reflecting decreases of $107 million in CS&L and $36 million in Civilian Agencies, partially offset by increases of $74 million in Intelligence and $62 million in Defense. Significant non-restricted acquisitions during the three months ended September 30, 2007 included $152 million for the Virginia IT outsourcing program and $111 million for the National Geospatial-Intelligence Agency Enterprise Engineering program.

Information Technology contract acquisitions for the nine months ended September 30, 2007, decreased $197 million, or 6 percent, as compared with the same period in 2006, primarily reflecting decreases of $172 million in CS&L and $46 million in Civilian Agencies, partially offset by an increase of $58 million in Defense. Significant non-restricted acquisitions during the nine months ended September 30, 2007, included $201 million for the Virginia IT outsourcing program, $126 million for the National Geospatial-Intelligence Agency Enterprise Engineering program, $113 million for the Systems and Software Engineering Services program, and additional funding of $110 million for the Network Centric Solutions program.

Sales and Service Revenues

Information Technology revenues for the three months ended September 30, 2007, increased $84 million, or 8 percent, as compared with the same period in 2006. The increase was primarily due to $69 million in higher sales volume in CS&L and $63 million in higher sales in Intelligence, partially offset by $41 million in lower sales in Civilian Agencies. The increase in CS&L is due to higher volume associated with the New York City Wireless, San Diego County IT outsourcing, and Virginia IT outsourcing programs. The increase in Intelligence is primarily due to higher volume associated with new restricted program wins. The decrease in Civilian Agencies is primarily due to program budget reductions and program completion.

Information Technology revenues for the nine months ended September 30, 2007, increased $360 million, or 12 percent, as compared with the same period in 2006. The increase was primarily due to $226 million in higher sales volume in CS&L and $179 million in higher sales in Intelligence, partially offset by $71 million in lower sales in Civilian Agencies. The increase in CS&L is due to higher volume associated with new programs awarded in 2006, including the Virginia IT outsourcing, New York City Wireless, and San Diego County IT outsourcing programs. The increase in Intelligence is due to new restricted program wins and higher volume on various existing programs. The decrease in Civilian Agencies is primarily due to program budget reductions and program completion.

Segment Operating Margin

Information Technology operating margin for the three months ended September 30, 2007 decreased $20 million or 22 percent, as compared with the same period in 2006. The decrease in operating margin was driven by reduced margins related to large IT outsourcing programs, offset by the effects of increased volume and improved

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performance on other CS&L and Intelligence programs. The lower IT outsourcing margins were due to increased transition cost, including $22 million in increased amortization of deferred and other outsourcing costs. The operating margin decrease also reflects discretionary spending for internal information systems infrastructure expected to yield future cost improvements.

Information Technology operating margin for the nine months ended September 30, 2007 decreased $8 million, or 3 percent, as compared with the same period in 2006. The decrease in operating margin was driven by $27 million in increased amortization of deferred and other outsourcing costs on large IT outsourcing programs compared to the prior period, offset by the effects of increased volume on several Intelligence, CS&L, and Defense programs. The operating margin decrease also reflects discretionary spending for internal information systems infrastructure expected to yield future cost improvements..

Technical Services

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. Services are grouped into the following business areas: Systems Support, Life Cycle Optimization and Engineering (LCOE), and Training and Simulation Group (TSG).

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Funded Contract Acquisitions	**$ 441**	$ 712	**$ 1,478**	$ 1,888
Sales and Service Revenues	**573**	526	**1,644**	1,340
Segment Operating Margin	**28**	34	**88**	96
As a percentage of segment sales	**4.9%**	6.5%	**5.4%**	7.2%

Funded Contract Acquisitions

Technical Services funded contract acquisitions for the three months ended September 30, 2007, decreased $271 million, or 38 percent, as compared with the same period in 2006, primarily representing a decrease of $357 million in Systems Support Group (SSG), partially offset by an increase of $80 million in LCOE and an increase of $22 million in TSG. Significant acquisitions for the three months ended September 30, 2007, included $64 million for the Hunter CLS program, $48 million for the Nevada Test Site (NTS) program, $44 million for the Joint Base Operations Services Contract (JBOSC), $35 million for F-15 Repairs program at Warner Robins Regional Service Center, $21 million for the Warner Robins Fleet Sustainment Engineering programs, and additional funding of $21 million for the UK AWACS program.

Technical Services funded contract acquisitions for the nine months ended September 30, 2007, decreased $410 million, or 22 percent, as compared with the same period in 2006, primarily representing a decrease of $289 million in TSG, a decrease of $212 million in SSG, partially offset by a $93 million increase in LCOE. Significant acquisitions during the nine months ended September 30, 2007, included $333 million for the NTS program, $205 million for the JBOSC program, $131 million for the Hunter CLS program, $70 million for F-15 repairs, $63 million for the Field Support Services program, $58 million for the Ft. Irwin program, $54 million for the Post Production Spares program, $45 million for the Battle Command Training Program, and $43 million for the Tyndall Operations programs.

Sales and Service Revenues

Technical Services revenues for the three months ended September 30, 2007, increased $47 million, or 9 percent, as compared with the same period in 2006. The increase was primarily driven by $32 million in sales volume on the NTS program and $12 million in higher sales across various TSG programs.

Technical Services revenues for the nine months ended September 30, 2007, increased $304 million, or 23 percent, as compared with the same period in 2006. The increase was primarily driven by $254 million from

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the effects of higher sales volume on the NTS program and $49 million from the effects of higher sales across various LCOE and TSG programs.

Segment Operating Margin
Technical Services operating margin for the three months ended September 30, 2007, decreased $6 million, or 18 percent, as compared with the same period in 2006, primarily due to favorable 2006 margin adjustments to reflect risk eliminated on contracts for spares production on fixed-price contracts.

Technical Services operating margin for the nine months ended September 30, 2007, decreased $8 million, or 8 percent, as compared with the same period in 2006, primarily due to the reason noted above.

AEROSPACE

Integrated Systems
Integrated Systems is a leader in the design, development, and production of airborne early warning, electronic warfare and surveillance, and battlefield management systems, as well as manned and unmanned tactical and strike systems. Products and services are grouped into the following business areas: Integrated Systems Western Region (ISWR); Integrated Systems Eastern Region (ISER); and International Programs.

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Funded Contract Acquisitions	**$ 990**	$ 705	**$ 3,437**	$ 4,259
Sales and Service Revenues	**1,255**	1,317	**3,761**	4,116
Segment Operating Margin	**145**	137	**454**	426
As a percentage of segment sales	**11.6%**	10.4%	**12.1%**	10.3%

Funded Contract Acquisitions
Integrated Systems funded contract acquisitions for the three months ended September 30, 2007, increased $285 million, or 40 percent, as compared with the same period in 2006, primarily due to $70 million on the Joint STARS program and $71 million on the EA-18G program. Significant acquisitions during the three months ended September 30, 2007, included $128 million for the F-35 program, $115 million for the HALE Systems (Global Hawk) program, and $112 million for the EA-18G program.

Integrated Systems funded contract acquisitions for the nine months ended September 30, 2007, decreased $822 million, or 19 percent, as compared with the same period in 2006, resulting from decreases of $530 million and $458 million at ISER and ISWR, respectively, partially offset by an increase of $158 million on International Programs. The decrease is primarily due to higher 2006 funded contract acquisitions as a result of delayed funding upon approval of the fiscal year 2006 defense budget. Significant acquisitions during the nine months ended September 30, 2007, included $800 million for the F/A-18 program, $442 million for the B-2 program, and $381 million for the HALE Systems (Global Hawk) program.

Sales and Service Revenues
Integrated Systems revenues for the three months ended September 30, 2007, decreased $62 million, or 5 percent, as compared with the same period in 2006. The decrease reflects $75 million in lower sales due to the transition of the

E-2D Advanced Hawkeye, F-35 and EA-18G development programs to their early production phases, and $48 million associated with the effects of significant customer-directed scope reductions associated with the E-10A platform and related Multi-Platform Radar Technology Insertion Program (MP-RTIP) efforts, partially offset by $40 million in higher volume on the F/A-18 Multi-Year Procurement (MYP) program and $33 million in higher volume on the HALE Systems (Global Hawk) program.

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Integrated Systems revenues for the nine months ended September 30, 2007, decreased $355 million, or 9 percent, as compared with the same period in 2006. Approximately $300 million of the decrease was a result of the transition of the E-2D Advanced Hawkeye, F-35 and EA-18G development programs to their early production phases. Also contributing to the reduction in revenues was $88 million from the effects of significant customer-directed scope reductions associated with the E-10A platform and related MP-RTIP efforts as well as $52 million of lower volume on the Navy Unmanned Combat Air System (N-UCAS) Operational Assessment (OA) program as it nears completion. These reductions were partially offset by $59 million in higher volume on the F/A-18 MYP program and $51 million in higher volume on the Global Hawk program.

Segment Operating Margin
Integrated Systems operating margin for the three months ended September 30, 2007, increased $8 million, or 6 percent, as compared with the same period in 2006. The increase in operating margin includes net performance improvements primarily attributable to the E-2C Post Multi-Year and E-2D Advanced Hawkeye programs, partially offset by the effects of the lower sales volume described above. The increase in operating margin as a percentage of segment sales is primarily due to risk reduction on the E-2 program and improved performance on B-2 support programs.

Integrated Systems operating margin for the nine months ended September 30, 2007, increased $28 million, or 7 percent, as compared with the same period in 2006. The increase in operating margin includes net margin improvements totaling $54 million primarily due to favorable settlement of prior years overhead costs and risk reduction achieved on various B-2 programs, partially offset by the margin effects of lower sales volume described above. The increase in operating margin as a percentage of segment sales is primarily due to risk reduction on the E-2 program, improved performance on B-2 support programs, and the favorable settlement of prior years overhead costs described above.

Space Technology
Space Technology develops and integrates a broad range of systems at the leading edge of space, defense, and electronics technology. The segment supplies products primarily to the U.S. Government that are critical to maintaining the nation s security and leadership in science and technology. Space Technology s business areas focus on the design, development, manufacture, and integration of satellite systems and subsystems, electronic and communications payloads, and high energy laser systems and subsystems. Products and services are grouped into the following business areas: Intelligence, Surveillance and Reconnaissance (ISR); Civil Space; Satellite Communications (SatCom); Missile & Space Defense; and Technology.

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Funded Contract Acquisitions	**$ 475**	$ 409	**$ 1,665**	$ 2,534
Sales and Service Revenues	**750**	699	**2,273**	2,170
Segment Operating Margin	**59**	66	**187**	184
As a percentage of segment sales	**7.9%**	9.4%	**8.2%**	8.5%

Funded Contract Acquisitions

Space Technology funded contract acquisitions for the three months ended September 30, 2007, increased $66 million, or 16 percent, as compared with the same period in 2006, primarily representing a $176 million increase for Civil Space, partially offset by a $70 million decrease in ISR and a $30 million decrease for SatCom. Significant acquisitions during the three months ended September 30, 2007 included $168 million for the National Polar-orbiting Operational Environmental Satellite System (NPOESS) program, $139 million for restricted contracts, and $52 million for the James Webb Space Telescope (JWST) program.

Space Technology funded contract acquisitions for the nine months ended September 30, 2007, decreased $869 million, or 34 percent, as compared with the same period in 2006, primarily representing a $398 million

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decrease in SatCom, a $271 million decrease in ISR, a $141 million decrease in Civil Space, and an $80 million decrease in Technology. The decrease is primarily due to the receipt of delayed funding upon approval of the federal defense budget during the first quarter of 2006. Significant acquisitions during the nine months ended September 30, 2007, included $626 million in restricted contracts, $221 million for the NPOESS program, funding of $164 million in the JWST program, and additional funding of $163 million in the Space Tracking and Surveillance System (STSS) program.

Sales and Service Revenues
Space Technology revenues for the three and nine months ended September 30, 2007, increased $51 million and $103 million, or 7 percent and 5 percent, respectively, as compared with the same period in 2006. The increase was primarily due to higher sales in ISR due to higher volume on restricted programs and the Space Radar program.

Segment Operating Margin
Space Technology operating margin for the three months ended September 30, 2007, decreased $7 million, or 11 percent, as compared with the same period in 2006. Operating margin was lower in 2007 due primarily to positive performance impacts in 2006, partially offset by the effects of net sales volume increases in 2007.

Space Technology operating margin for the nine months ended September 30, 2007, increased $3 million, or 2 percent, as compared with the same period in 2006. The increase in operating margin includes the effects of increased volume and net performance improvements in 2007, partially offset by positive performance impacts in 2006.

ELECTRONICS

Electronics is a leading designer, developer, manufacturer and integrator of a variety of advanced electronic and maritime systems for national security and select non-defense applications. Electronics provides systems to U.S. and international customers for such applications as airborne surveillance, aircraft fire control, precision targeting, electronic warfare, automatic test equipment, inertial navigation, integrated avionics, space sensing, intelligence processing, air traffic control, air and missile defense, homeland defense, communications, mail processing, biochemical detection, ship bridge control, and shipboard components. Products and services are grouped into the following business areas: Aerospace Systems; Government Systems; Naval & Marine Systems (NMS); Defensive Systems; Navigation Systems; and Defense Other.

	Three Months Ended September 30		Nine Months Ended September 30	
$ in millions	**2007**	2006	**2007**	2006
Funded Contract Acquisitions	**$ 2,320**	$ 1,632	**$ 6,891**	$ 4,925
Sales and Service Revenues	**1,673**	1,665	**4,980**	4,756
Segment Operating Margin	**211**	198	**579**	552
As a percentage of segment sales	**12.6%**	11.9%	**11.6%**	11.6%

Funded Contract Acquisitions
Electronics funded contract acquisitions for the three months ended September 30, 2007, increased $688 million, or 42 percent, as compared with the same period in 2006 primarily representing increases of $510 million and

$187 million for Aerospace Systems and Defensive Systems, respectively. Significant acquisitions during the three months ended September 30, 2007 included $242 million for the MESA Korea program, a $222 million task order for the LAIRCM Indefinite Delivery Indefinite Quantity (IDIQ) program, $158 million for the F-16 (V)9 Upgrade Kits 120-Lot, $92 million for the BDS Flats Production program, and $82 million for the Vehicular Intercommunications Systems (VIS).

Electronics funded contract acquisitions for the nine months ended September 30, 2007, increased $2 billion, or 40 percent, as compared with the same period in 2006 primarily representing increases of $931 million,

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$462 million and $462 million for Government Systems, Defensive Systems, and Aerospace Systems, respectively. Significant acquisitions during the nine months ended September 30, 2007, included $875 million for the Flats Sequencing System (FSS) program, $399 million for the LAIRCM IDIQ program, $242 million for the MESA Korea program, $230 million for the VIS program, and $34 million for the Ground/Air Task Oriented Radar (G/ATOR) program.

Sales and Service Revenues
Electronics revenues for the three months ended September 30, 2007, increased $8 million, or less than 1 percent, as compared with the same period in 2006. The increase was primarily due to $54 million higher sales in the Defensive Systems, and $23 million in NMS, partially offset by $73 million lower sales in Aerospace Systems. The increase in Defensive Systems sales is primarily due to higher deliveries on land forces and EO & IR countermeasure programs. The increase in NMS sales is due to higher volume on commercial products and a restricted program. The lower Aerospace Systems sales are primarily due to the effect of declining volume on fixed price development programs.

Electronics revenues for the nine months ended September 30, 2007, increased $224 million, or 5 percent, as compared with the same period in 2006. The increase was primarily due to $124 million higher sales in NMS, $108 million higher sales in the Government Systems, and $86 million in Defensive Systems, partially offset by $113 million lower sales in Aerospace Systems. The increase in NMS sales is primarily due to higher volume on a restricted program. The increase in Government Systems sales is primarily attributable to increases in communications and postal automation programs. The increase in Defensive Systems is primarily due to higher deliveries on land forces and EO & IR countermeasure programs. The lower Aerospace Systems sales are primarily due to the effect of declining volume on fixed price development programs.

Segment Operating Margin
Electronics operating margin for the three months ended September 30, 2007, increased $13 million, or 7 percent, as compared with the same period in 2006. The increase in operating margin includes $11 million from the effects of higher net sales volume primarily in Defensive Systems and Government Systems and $6 million in net performance improvements, primarily due to elimination of risk on the Virginia Class program at NMS.

Electronics operating margin for the nine months ended September 30, 2007, increased $27 million, or 5 percent, as compared with the same period in 2006. The increase in operating margin is primarily attributable to $21 million from the effects of higher net sales volume in Government Systems and Defensive Systems.

SHIPS

Ships is the nation s sole industrial designer, builder, and refueler of nuclear-powered aircraft carriers and one of only two companies capable of designing and building nuclear-powered submarines for the U.S. Navy. Ships is also one of the nation s leading full service systems providers for the design, engineering, construction, and life cycle support of major surface ships for the U.S. Navy, U.S. Coast Guard, international navies, and for commercial vessels. Products and services are grouped into the following business areas: Aircraft Carriers; Expeditionary Warfare; Surface Combatants; Submarines; Coast Guard & Coastal Defense; Fleet Support, Services; and Commercial & Other.

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$ in millions	Three Months Ended September 30 **2007**	2006	Nine Months Ended September 30 **2007**	2006
Funded Contract Acquisitions	**$ 895**	$ 578	**$ 3,161**	$ 6,372
Sales and Service Revenues	**1,469**	1,238	**3,984**	3,808
Segment Operating Margin	**183**	76	**396**	273
As a percentage of segment sales	**12.5%**	6.1%	**9.9%**	7.2%

Funded Contract Acquisitions
Ships contract acquisitions for the three months ended September 30, 2007, increased $317 million, or 55 percent, as compared with the same period in 2006, primarily in Coast Guard and Coastal Defense. Significant acquisitions during the three months ended September 30, 2007, included $492 million for the WMSL National Security (WMSL) program, $119 million for the LPD program, $117 million of funded contract acquisitions from the reorganization of AMSEC, LLC (AMSEC), $32 million for the *Virginia*-class submarine program, and additional funding of $31 million for the DDG program.

Ships contract acquisitions for the nine months ended September 30, 2007, decreased $3.2 billion, or 50 percent, as compared with the same period in 2006, primarily representing decreases of $1.7 billion in both Aircraft Carriers and Expeditionary Warfare. The decrease is partially due to higher 2006 funded contract acquisitions as a result of delayed funding approval of the fiscal year 2006 defense budget. Significant acquisitions during the nine months ended September 30, 2007 included $796 million for the LHA program, $509 million for the WMSL program, $507 million for the DDG 1000 program, $464 million for the *Virginia*-class submarine program, $293 million for the LPD program, $117 million for AMSEC, and additional funding of $91 million for the DDG program.

Sales and Service Revenues
Ships revenues for the three months ended September 30, 2007, increased $231 million, or 19 percent, as compared with the same period in 2006. The increase was primarily due to $104 million in higher sales in Expeditionary Warfare, $39 million in higher sales in Coast Guard and Coastal Defense, $36 million in higher sales in Fleet Support, $25 million in higher sales in Submarines, and $17 million in higher sales in Surface Combatants. The increase in Expeditionary Warfare was primarily due to higher sales volume in the LPD and LHA programs, partially offset by lower sales in the LHD program. The increase in Coast Guard and Coastal Defense was primarily due to higher sales volume in the WMSL program. The increase in Fleet Support was due to the reorganization of AMSEC. The increase in Submarines was due to $24 million in higher sales volume on the USS *Toledo*. The increase in Surface Combatants was due to higher sales volume in the DDG program.

Ships revenues for the nine months ended September 30, 2007, increased $176 million, or 5 percent, as compared with the same period in 2006. The increase was primarily due to $141 million in higher sales in Expeditionary Warfare, $76 million in higher sales in Coast Guard and Coastal Defense, $36 million in higher sales for Fleet Support, $22 million in higher sales in Aircraft Carriers, $19 million in higher sales in Submarines, partially offset by $90 million in lower sales in Surface Combatants, $33 million in lower sales in Services, Commercial and Other. The increase in Expeditionary Warfare was primarily due to higher sales volume in the LPD and LHA programs due to production ramp-ups, partially offset by lower sales volume in the LHD program as a result of a now-concluded labor strike at the Pascagoula, Mississippi shipyard. The increase in Coast Guard and Coastal Defense was primarily due to higher sales volume in the WMSL program. The increase in Fleet Support was due to the reorganization of AMSEC.

The decrease in Surface Combatants was due to lower sales in the DDG 1000 program and the impacts of the labor strike.

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Segment Operating Margin

Ships operating margin for the three months ended September 30, 2007, increased $107 million, or 141 percent, as compared with the same period in 2006 consisting of $45 million resulting from risk reduction on certain contracts due to the resolution of contract discussions with the customer, a $22 million gain resulting from the reorganization of AMSEC (see Note 4 to the consolidated condensed financial statements in Part I, Item 1), and volume increases and improved performance across various programs, including work performed at the Gulf Coast shipyards on contracts awarded post-Katina.

Ships operating margin for the nine months ended September 30, 2007, increased $123 million, or 45 percent, as compared with the same period in 2006, primarily consisting of net performance improvements of $15 million, increased volume of $20 million across multiple programs, $62 million for recovery of lost profits due to having reached an agreement on the insurance claim on the first layer of coverage related to Hurricane Katrina and a $22 million gain resulting from the reorganization of AMSEC (see Note 4 to the consolidated condensed financial statements in Part I, Item 1). The performance improvements include the quarterly effects described above, offset by $55 million resulting from a contract earnings rate adjustment on LHD 8 primarily due to a schedule extension resulting from manpower constraints in critical crafts (electrical and pipefitting) following the strike at the Pascagoula shipyard in 2007.

BACKLOG

Total backlog at September 30, 2007, was approximately $64.1 billion. Total backlog includes both funded backlog (unfilled 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.

The estimated value of contracts awarded to the company during the three and nine months ended September 30, 2007, is approximately $11.5 billon and $25.9 billion, respectively.

	September 30, 2007			December 31, 2006		
$ in millions	**Funded**	**Unfunded**	**Total Backlog**	Funded	Unfunded	Total Backlog
Information & Services						
Mission Systems	**$ 3,017**	**$ 8,938**	**$ 11,955**	$ 3,119	$ 8,488	$ 11,607
Information Technology	**2,698**	**2,143**	**4,841**	2,667	1,840	4,507
Technical Services	**1,209**	**3,251**	**4,460**	1,375	3,973	5,348
Total Information & Services	**6,924**	**14,332**	**21,256**	7,161	14,301	21,462
Aerospace						
Integrated Systems	**3,961**	**5,151**	**9,112**	4,285	4,934	9,219
Space Technology	**1,015**	**8,735**	**9,750**	1,623	7,138	8,761
Total Aerospace	**4,976**	**13,886**	**18,862**	5,908	12,072	17,980

Electronics	**8,487**	**1,981**	**10,468**	6,576	1,583	8,159
Ships	**10,031**	**3,466**	**13,497**	10,854	2,566	13,420
Total	**$ 30,418**	**$ 33,665**	**$ 64,083**	$ 30,499	$ 30,522	$ 61,021

Major components in unfunded backlog as of September 30, 2007, include the KEI program in the Mission Systems segment; the NTS program in the Technical Services segment; the F-35 and F/A-18 programs in the

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Integrated Systems segment; the NPOESS and restricted programs in the Space Technology segment; and Block II of the *Virginia*-class submarines program in the Ships segment.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities Net cash provided by operating activities for the nine months ended September 30, 2007, was $2,156 million compared to $1,485 million for the same period in 2006. The increase of $671 million, or 45 percent, was due to $1.5 billion in higher sources of cash primarily due to $1.4 billion in increased collections net of progress payments, $79 million in higher insurance proceeds, and $66 million in less cash used in discontinued operations, offset by $888 million in higher uses of cash primarily due to a $768 million increase in cash paid to suppliers and employees and $129 million in additional income taxes paid.

For 2007, cash generated from operations, supplemented by borrowings under credit facilities, is expected to be sufficient to service debt and contract obligations, finance capital expenditures and share repurchases, and continue paying dividends to the company s shareholders.

Investing Activities Net cash used in investing activities for the nine months ended September 30, 2007, was $1.1 billion compared to $442 million in the same period of 2006. The increase is primarily due to the acquisition of Essex for $584 million. In addition, during the nine months ended September 30, 2007, the company made capital expenditures of $431 million and paid $89 million for deferred costs related to outsourcing contracts and related software costs. During the nine months ended September 30, 2006, the company made capital expenditures of $493 million and received $90 million of insurance proceeds related to the recovery of capital expenditures associated with Hurricane Katrina.

Financing Activities Net cash used in financing activities for the nine months ended September 30, 2007, was $1.3 billion compared to $1.2 billion in the same period of 2006. The increase primarily results from $269 million in additional stock repurchases, $126 million in less proceeds from stock option exercises, $99 million less in net borrowings under lines of credit, $80 million in additional dividends paid, partially offset by $426 million in lower principal payments of long-term debt. Net cash used in financing activities for the nine months ended September 30, 2007, included payments of $1.1 billion for common stock repurchases and $378 million for the payment of dividends, offset by $246 million in proceeds from stock option exercises. See Note 7 to the consolidated condensed financial statements in Part I, Item 1 for a discussion concerning the company s common stock repurchases.

Contractual Obligations Upon adoption of FIN 48 *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109,* on January 1, 2007, the estimated value of the company s uncertain tax positions was a liability of $514 million resulting from unrecognized net tax benefits. The estimated timing of future settlement upon adoption was as follows: 2007 - $66.7 million; 2008-2009 $147 million; 2010-2011 $287.6 million; 2012 and beyond $12.7 million.

Other than the matter discussed above, there have been no material changes to contractual obligations outside the company s ordinary course of business since December 31, 2006.

NEW ACCOUNTING STANDARDS

The disclosure requirements and cumulative effect of adoption of the FIN 48 *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* are presented in Note 14 to the consolidated condensed financial statements in Part 1, Item 1.

Other new pronouncements issued but not effective until after September 30, 2007 are not expected to have a significant effect on the company s consolidated financial position or results of operations.

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FORWARD-LOOKING INFORMATION

Statements in this Form 10-Q that are in the future tense, and all statements accompanied by terms such as believe, project, expect, estimate, forecast, assume, intend, plan, guidance, anticipate, outlook, and variati similar terms are intended to be forward-looking statements as defined by federal securities law. Forward-looking statements are based upon assumptions, expectations, plans and projections that are believed valid when made, but that are subject to the risks and uncertainties identified under Risk Factors in the company s 2006 Annual Report on Form 10-K as amended or supplemented by the information in Part II, Item 1A below, that may cause actual results to differ materially from those expressed or implied in the forward-looking statements.

The company intends that all forward-looking statements made will be subject to the safe harbor protection of the federal securities laws pursuant to Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based upon, among other things, the company s assumptions with respect to:

- future revenues;
- expected program performance and cash flows;
- returns on pension plan assets and variability of pension actuarial and related assumptions;
- the outcome of litigation, claims, appeals and investigations;
- hurricane-related insurance recoveries;
- environmental remediation;
- acquisitions and divestitures of businesses;
- successful reduction of debt;
- performance issues with key suppliers and subcontractors;
- product performance and the successful execution of internal plans;
- successful negotiation of contracts with labor unions;
- allowability and allocability of costs under U.S. Government contracts;
- effective tax rates and timing and amounts of tax payments;
- the results of any audit or appeal process with the IRS; and
- anticipated costs of capital investments.

You should 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. As noted above, these forward-looking statements speak only as of the date when they are made. The company does not undertake any obligation to update forward-looking statements to reflect events, circumstances, changes in expectations, or the occurrence of unanticipated events after the date of those statements. Moreover, in the future, the company, through senior management, may make forward-looking statements that involve the risk factors and other matters described in this Form 10-Q as well as other risk factors subsequently identified, including, among others, those identified in the company s filings with the Securities and Exchange Commission on Form 10-K, Form 10-Q and Form 8-K.

GLOSSARY OF PROGRAMS

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

Program Name	Program Description

ABL	Airborne Laser	Design and develop the system s Chemical Oxygen Iodine Laser (COIL) and the Beacon Illuminator Laser (BILL) for Missile Defense Agency s Airborne Laser, providing a capability to destroy boost-phase missiles at very long range.

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Program Name	Program Description
AEHF Advanced Extremely High Frequency	Provide the communication payload for the nation s next generation military strategic and tactical relay systems that will deliver survivable, protected communications to U.S. forces and selected allies worldwide.
APG-66	Provide engineering services, technical support, spares and repairs for the AN/APG-66 fire control radar that is utilized for the F-16 and other military aircraft.
B-2 Stealth Bomber	Maintain 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.
Battle Command Training Program	Operates the Corporate-based models and automated tools used for the collection and analysis of information used by U.S. Army Battle Command Training Program.
BDS Flats Production	Provide enhanced Biohazard Detection System (BDS) flat mail screening to rapidly analyze and detect potential biological threats at postal service mail-sorting facilities.
Coast Guard s Deepwater Program	Design, develop, construct and deploy surface assets to recapitalize the Coast Guard.
DDG 51	Build Aegis guided missile destroyer, equipped for conducting anti-air, anti-submarine, anti-surface and strike operations.
DDG 1000 Zumwalt-class destroyer	Design the first in a class of the U.S. Navy s multi-mission surface combatants tailored for land attack and littoral dominance.
E-2D Advanced Hawkeye	The E-2D builds upon the Hawkeye 2000 configuration with significant radar improvement performance. The E-2D provides over the horizon airborne early warning (AEW), surveillance, tracking, and command and control capability to the U.S. Naval Battle Groups and Joint Forces.
E-10A	Mission Execution Program (MEP) to continue to mature the technologies of the E-10A Battle Management/Command and Control capabilities.
E/A -18G	Provide the AEA suite to Boeing which includes the ALQ-218 (V2) receiving system, the ALQ-227 communications countermeasures system and the Electronic Attack Unit, that interfaces with the legacy F/A-18 air vehicle.

EO & IR countermeasures	Provides protection against the ground launched man portable (MANPAD) infrared missile threat by automatically detecting missile launch and jamming the missile s guidance system with a laser beam, causing a miss. The AAQ-24 is a stand-alone electronic warfare system installed on over 380 USAF and international transport aircraft and helicopters, is fully operational with the USAF and Royal Air Force (RAF), and is the only laser DIRCM system available in the world.
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.
F/A-18 Multi-Year Procurement (MYP)	Build the center/aft sections of 210 F/A-18 E/F aircraft through 2009 as a principal subcontractor to Boeing.

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Program Name	Program Description
F-16 Block 60	Direct commercial firm fixed-price program with LM Aero to develop and produce 80 Lot systems for aircraft delivery to the United Arab Emirates Air Force as well as test equipment and spares to be used to support in-country repairs of sensors.
F-16(V)9 Upgrade Kits 120-Lot	Production and delivery of 120 radar line replacement units and kits including spares.
F-35 Development (Joint Strike Fighter)	Design, integration, and/or development of the center fuselage and weapons bay, communications, navigations, identification subsystem, systems engineering, and mission systems software as well as provide ground and flight test support, modeling, simulation activities, and training courseware.
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.
Force XXI Battle Brigade and Below (FBCB2)	Install in Army vehicles a system of computer hardware and software that forms a wireless, tactical Internet for near-real-time situational awareness and command and control on the battlefield.
Flats Sequencing System / Postal Automation	Build systems for the U.S. Postal Service designed to further automate the flats mail stream, which includes large envelopes, catalogs and magazines.
Ft. Irwin Logistics Support Services (LSS)	Operate and manage a large-scale maintenance and repair program involving tracked and wheeled vehicles, basic issue items, communications equipment, and weapons needed for desert training.
G/ATOR Ground / Air Task Oriented Radar	A development program to provide the next generation ground based multi-mission radar for the USMC. Provides Short Range Air Defense, Air Defense Surveillance, Ground Weapon Location and Air Traffic Control. Replaces five existing USMC single-mission radars.
Ground-Based Midcourse Defense Fire Control and Communications (GFCIC)	Develop software to coordinate sensor and interceptor operations during missile flight.
Hunter CLS	Operate, maintain, train and sustain the multi-mission Hunter Unmanned Aerial System in addition to deploying Hunter support teams.

Global Hawk HALE (High-Altitude, Long-Endurance) Systems	Provide the Global Hawk HALE unmanned aerial system for use in the global war on terror and has a central role in Intelligence, Reconnaissance, and Surveillance supporting operations in Afghanistan and Iraq.
ICBM - Intercontinental Ballistic Missile	Maintain readiness of the nation s ICBM weapon systems by ensuring the system s total performance.
JBOSC Joint Base Operations Support	Provides all infrastructure support needed for launch and base operations at the NASA Spaceport.
JRDC Joint National Integration Center Research & Development	Support the development and application of modeling and simulation, wargaming, test and analytic tools for air and missile defense.

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Program Name	Program Description
Joint STARS	Joint Surveillance Target Attack Radar System (Joint STARS) detects, locates, classifies, tracks and targets hostile ground movements, communicating real-time information through secure data links with U.S. Air Force and Army command posts.
JWST James Webb Space Telescope	Design, develop, integrate and test a space-based infrared telescope satellite to observe the formation of the first stars and galaxies in the universe.
Kinetic Energy Interceptor	Develop mobile missile-defense system with the unique capability to destroy a hostile missile during its boost, ascent or midcourse phase of flight.
LAIRCM IDIQ Large Aircraft Infrared Counter-measures Indefinite Delivery and Indefinite Quantity	Infrared countermeasures systems for C-17 and C-130 aircraft. The IDIQ contract will further allow for the purchase of LAIRCM hardware for foreign military sales and other government agencies.
LHA	Detail design and construct amphibious assault ships for use as an integral part of joint, interagency, and multinational maritime forces.
LHD	Build multipurpose amphibious assault ships.
LPD	Build amphibious transport dock ships.
MESA Korea	Consists of a 4 lot MESA radar/IFF subsystem delivery with limited NRE. The program also includes associated spares, support equipment and installation & check out activities, with direct and indirect offset projects. Northrop Grumman s customer is the Boeing Company, with ultimate product delivery to the ROKAF.
MP-RTIP Multi-Platform Radar Technology Insertion Program	Design, develop, fabricate and test modular, scalable 2-dimensional active electronically scanned array (2D-AESA) radars for integration on the E-10A and Global Hawk (GH) Airborne platforms. Also provides enhanced Wide Area Surveillance system capabilities on the E-10A Multi sensor Command and Control Aircraft and better reconnaissance and surveillance capabilities on the GH
New York City Wireless	Provide New York City s broadband public-safety wireless network.
N-UCAS Navy Unmanned Combat Air System (OA) Operational Assessment	A contract from the Defense Advanced Research Projects Agency (DARPA) to demonstrate the technical feasibility, military utility and operational value of networked, unmanned air-combat systems to suppress enemy air defenses, perform electronic attack, conduct

	intelligence, surveillance and reconnaissance missions, and perform precision strike attacks.
NGA EE National Geospatial Intelligence Agency Enterprise Engineering	Deliver engineering services necessary to direct the planning, development and implementation of all NGA s activities and systems comprising the National System for Geospatial Intelligence.
Network Centric Solution	Provide Network-Centric Information Technology, Networking, Telephony and Security (NCITNTS), Voice, Video and Data Communications Commercial-off-the-Shelf (COTS) products, system solutions, hardware and software.

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Program Name	Program Description
NPOESS National Polar-orbiting Operational Environmental Satellite System	Design, develop, integrate, test, and operate an integrated system comprised of two satellites with mission sensors and associated ground elements for providing global and regional weather and environmental data.
NTS Nevada Test Site	Manage and operate the Nevada Test Site facility and provide infrastructure support, including management of the nuclear explosives safety team, support of hazardous chemical spill testing, emergency response training and conventional weapons testing.
Post Production Spares	Provide post production repairs and replacement of various Northrop Grumman radar systems, and provide spares and repairs for the F-S/T-38, F/A-18, E-2C, and C-2 vehicles.
San Diego County 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.
Space Radar	Develop system concepts and architectures as part of the first phase of this program to provide intelligence, surveillance and reconnaissance capabilities for warfighters and the intelligence community.
STSS Space Tracking and Surveillance System	Develop a critical system for the nation s missile defense architecture employing low-earth orbit satellites with on board infrared sensors to detect, track and discriminate ballistic missiles. The program includes two flight demonstration satellites with subsequent development and production blocks of satellites.
Tyndall Operations	Provides engineering and management support services to the U.S. Air Force Civil Engineer Support Agency (AFCESA).
USS Toledo	Depot Modernization Period (DMP) being performed at Newport News for this 688-class submarine. A DMP is a midlife availability for extensive modernization to improve war fighting capabilities and maintenance to ensure the ship remains certified for unrestricted operations to design test depth.
UK AWACS program	Provide aircraft-maintenance and design-engineering support services.
Virginia IT outsourcing	Provide high-level IT consulting and services to Virginia state and local agencies including data center, help desk, desktop, network, applications and cross-functional services.

VIS Vehicular Intercommunications Systems	Provide clear and noise-free communications between crew members inside combat vehicles and externally over as many as six combat net radios for the U.S. Army. The active noise-reduction features of VIS provide significant improvement in speech intelligibility, hearing protection, and vehicle crew performance.
Virginia-class Submarines	Construct the newest attack submarine in conjunction with Electric Boat.
Wedgetail	Joint program with Boeing to supply Multirole Electronically Scanned Array (MESA) radar antenna for AEW&C aircraft.

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Program Name	Program Description
Warner Robbins Fleet Sustainment Engineering	Sustains legacy weapons systems through the application of engineering capabilities, including systems engineering, hardware design, software development and maintenance, logistics, electronic warfare, automated test equipment, and avionics engineering.
WMSL National Security Cutter (NSC)	Detail design and construct the U.S. Coast Guard s National Security Cutters equipped to carry out the core missions of maritime security, maritime safety, protection of natural resources, maritime mobility, and national defense.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rates The company is exposed to market risk, primarily related to interest rates and foreign currency exchange rates. Financial instruments subject to interest rate risk include fixed-rate long-term debt obligations, variable-rate short-term debt outstanding under the credit agreement, short-term investments, and long-term notes receivable. At September 30, 2007, substantially all borrowings were fixed-rate long-term debt obligations, of which a significant portion are not callable until maturity. The company s sensitivity to a 1 percent change in interest rates is tied primarily to its $2 billion credit agreement, which had no balance outstanding at September 30, 2007.

Foreign Currency The company enters 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, 2007, the amount of foreign currency forward contracts outstanding was not material. The company does not consider the market risk exposure relating to foreign currency exchange to be material to the consolidated financial statements.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The company s principal executive officer (Chairman and Chief Executive Officer) and principal financial officer (Corporate Vice President and Chief Financial Officer) have evaluated the company s disclosure controls and procedures as of September 30, 2007, and have concluded that these controls and procedures are effective to ensure that information required to be disclosed by the company in the reports that it files or submits under the Securities Exchange Act of 1934 (15 USC § 78a et seq) 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 by the company in the reports that it files or submits 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 Control Over Financial Reporting

During the three months ended September 30, 2007, no change occurred in the company s internal control over financial reporting that materially affected, or is likely to materially affect, the company s internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

As previously disclosed, in October 2005, the U.S. Department of Justice and a classified U.S. Government customer apprised the company of potential substantial claims relating to certain microelectronic parts produced by the Space and Electronics Sector of former TRW Inc., now a component of the company. The relationship, if any, between the potential claims and a civil False Claims Act case that remains under seal in the U.S. District Court for the Central District of California remains unclear to the company. In the third quarter of 2006, the parties commenced settlement discussions. While the company continues to believe that it did not breach the contracts in question and that it acted appropriately in this matter, the company proposed to settle the claims and any associated matters and recognized a pre-tax charge of $112.5 million in the third quarter of 2006 to cover the cost of the settlement proposal and associated investigative costs. The company extended the offer in an effort to avoid litigation and in recognition of the value of the relationship with this customer. The U.S. Government has advised the company that if settlement is not reached it will pursue its claims through litigation. Because of the highly technical nature of the issues involved and their classified status and because of the significant disagreement between the company and the U.S. Government as to the U.S. Government s theories of liability and damages (including a material difference between the U.S. Government s damage theories and the company s offer), final resolution of this matter could take a considerable amount of time, particularly if litigation should ensue. If the U.S. Government were to pursue litigation and were to be ultimately successful on its theories of liability and damages, which could be trebled under the Federal False Claims Act, the effect upon the company s consolidated financial position, results of operations, and cash flows would materially exceed the amount provided by the company. Based upon the information available to the company to date, the company believes that it has substantive defenses but can give no assurance that its views will prevail. Accordingly, the ultimate disposition of this matter cannot presently be determined.

As previously disclosed, on May 17, 2007, the U.S. Coast Guard issued a revocation of acceptance under the Deepwater Program for eight converted 123-foot patrol boats (the vessels) based on alleged hull buckling and shaft alignment problems . By letter dated June 5, 2007, the Coast Guard stated that the revocation of acceptance also was based on alleged nonconforming topside equipment on the vessels. On August 13, 2007, the company submitted a response to the Coast Guard, maintaining that the revocation of acceptance was improper. The contract value associated with the eight converted vessels is approximately $85 million. The Coast Guard has not specified the amount of damages sought in connection with the eight vessels. Based upon the information available to the company to date, the company believes that it has substantive defenses but can give no assurance that its views will prevail. However, the company believes, but can give no assurance, that the outcome of this matter would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Based upon the available information regarding matters that are subject to U.S. Government investigations, other than as set out above, the company believes, but can give no assurance, that the outcome of any such matters would not

have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Litigation Various claims and legal proceedings arise in the ordinary course of business and are pending against the company and its properties. Based upon the information available, the company believes that the resolution

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of any of these various claims and legal proceedings would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

As previously disclosed, the company is a defendant in litigation brought by Cogent Systems, Inc. (Cogent) in Los Angeles Superior Court in California on April 20, 2005, for unspecified damages for alleged unauthorized use of Cogent technology relating to fingerprint recognition. On September 10, 2007, the company and Cogent announced that they had reached an agreement to settle the litigation. The agreement is subject to completion of definitive documents. Under the terms of the agreement, the company has agreed to pay Cogent $25 million to settle the litigation. The company also has agreed to pay Cogent $15 million for a non-exclusive license to use specified Cogent state-of-the-art automated fingerprint identification software in certain existing programs. The company and Cogent also have agreed to enter into a five-year research and development, service and products agreement, under which the company will pay Cogent $20 million for products and services over the term of the agreement. This settlement will end the litigation and allow the companies to work together on a strategic alliance to provide customers with state-of-the-art fingerprint identification technology and other biometric solutions. A substantial portion of the costs to settle this matter had been provided for in previous periods and, accordingly, the resolution of this matter did not have a material effect on the financial statements for the quarter ended September 30, 2007.

As previously disclosed, the U.S. District Court for the Central District of California consolidated two separately filed ERISA lawsuits, which the plaintiffs seek to have certified as class actions, into the In Re Northrop Grumman Corporation ERISA Litigation. On August 7, 2007, the Court denied plaintiffs motion for class certification. The plaintiffs sought leave to file an appeal with the U.S. Court of Appeals for the Ninth Circuit on the issue of class certification. On September 28, 2007, the Ninth Circuit ordered that the trial court proceedings be stayed pending its decision on whether to grant appellate review, and on October 11, 2007, the Ninth Circuit granted such review. The decision to grant appellate review will delay the commencement of trial previously scheduled to begin January 22, 2008. The company believes, but can give no assurance, that the outcome of these matters would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Other Matters As previously disclosed, the company is pursuing legal action against an insurance provider arising out of a disagreement concerning the coverage of certain losses related to Hurricane Katrina (see Notes 9 and 11 to the consolidated condensed financial statements). The company commenced the action against Factory Mutual Insurance Company (FM Global) on November 4, 2005, which is now pending in the U.S. District Court for the Central District of California, Western Division. In August 2007, the district court issued an order finding that the excess insurance policy provided coverage for the company s Katrina related loss. FM Global has advised the company that it intends to appeal the order. Based on the current status of the assessment and claim process, no assurances can be made as to the ultimate outcome of this matter.

Item 1A. Risk Factors

There are no material changes to the risk factors previously disclosed in the company s 2006 Annual Report on Form 10-K.

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

Purchases of Equity Securities The table below summarizes the company s repurchases of common stock during the three months ended September 30, 2007.

Period	Total Number of Shares Purchased[1]	Average Price Paid per Share[1]	Total Numbers of Shares Purchased as of Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 1, 2007, through July 31, 2007	6,483,402	$ 77.27	6,483,402	$ 82 million
August 1, 2007, through August 31, 2007				$ 82 million
September 1, 2007, through September 30, 2007				$ 82 million
Total	**6,483,402**	**$ 77.27**	**6,483,402**	$ 82 million

(1) On December 14, 2006, the company s board of directors authorized a share repurchase program of up to $1 billion of its outstanding common stock. This new authorization was in addition to $176 million remaining on the company s previous share repurchase authorization which commenced in November 2005. As of September 30, 2007, the company has $82 million authorized for share repurchases.

Under this program, the company entered into an accelerated share repurchase agreement with JP Morgan Chase Bank, London Branch (JPMC) on July 30, 2007, to repurchase approximately 6.5 million shares of common stock at an initial price of $77.12 per share for a total of $500 million. Under this agreement, JPMC immediately borrowed shares that were sold to and canceled by the company. Subsequently, JPMC began purchasing shares in the open market to settle its share borrowings. The accelerated repurchase agreement was completed on September 17, 2007, and the company paid $2 million to JPMC for the final purchase price adjustment under the terms of the agreement.

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

Item 3. Defaults Upon Senior Securities

No information is required in response to this item.

Item 4. Submission of Matters to a Vote of Security Holders

No information is required in response to this item.

Item 5. Other Information

No information is required in response to this item.

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Item 6. Exhibits

*10.1	Non-Employee Director Compensation Term Sheet, effective October 1, 2007
10.2	Form of Amended and Restated Credit Agreement dated as of August 10, 2007, among Northrop Grumman Corporation, as Borrower; Northrop Grumman Systems Corporation and Northrop Grumman Space & Mission Systems Corp., as Guarantors; the Lenders party thereto; JPMorgan Chase Bank, N.A., as Payment Agent, an Issuing Bank, Swingline Lender and Administrative Agent; Credit Suisse, as Administrative Agent; Citicorp USA, Inc., as Syndication Agent; Deutsche Bank Securities Inc. and The Royal Bank of Scotland PLC, as Documentation Agents; and BNP Paribas as Co-Documentation Agent (incorporated by reference to Exhibit 10.1 to Form 8-K dated and filed August 13, 2007)
10.3	Accelerated Share Repurchase Agreement, dated July 30, 2007 between Northrop Grumman Corporation and JPMorgan Chase Bank, National Association, London Branch (incorporated by reference to Exhibit 10.1 to Form 8-K dated and filed August 1, 2007)
10.4	Retirement Transition Agreement dated October 2, 2007 between Northrop Grumman Corporation and Scott J. Seymour (incorporated by reference to Exhibit 10.1 to Form 8-K dated and filed October 5, 2007)
10.5	Consultant Contract dated October 5, 2007 between Northrop Grumman Corporation and Scott J. Seymour (incorporated by reference to Exhibit 10.2 to Form 8-K dated and filed October 5, 2007)
*15	Letter from Independent Registered Public Accounting Firm
*31.1	Rule 13a-15(e)/15d-15(e) Certification of Ronald D. Sugar (Section 302 of the Sarbanes-Oxley Act of 2002)
*31.2	Rule 13a-15(e)/15d-15(e) Certification of James F. Palmer (Section 302 of the Sarbanes-Oxley Act of 2002)
**32.1	Certification of Ronald D. Sugar 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

* Filed with this Report

** Furnished with this Report

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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)

Date: October 24, 2007

By: **/s/ Kenneth N. Heintz**

Kenneth N. Heintz
Corporate Vice President, Controller and
Chief Accounting Officer
(Principal Accounting Officer)