



# **FORM 10-Q**

**NORTHROP GRUMMAN CORP /DE/ - NOC**

**Filed: July 27, 2006 (period: June 30, 2006)**

Quarterly report which provides a continuing view of a company's financial position

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

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**FORM 10-Q**

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

For the Quarterly Period Ended June 30, 2006

or

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

Commission File Number  
1-16411

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

**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

**95-4840775**  
(I.R.S. Employer  
Identification Number)

**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 ☒ No ☐

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 ☒ Accelerated filer ☐ Non-accelerated filer ☐

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

Yes ☐ No ☒

**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 July 25, 2006, 344,514,817 shares of common stock were outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## CONSOLIDATED CONDENSED STATEMENTS OF FINANCIAL POSITION

(Unaudited)

<i>\$ in millions</i>	June 30, 2006	December 31, 2005
<b>Assets:</b>		
Cash and cash equivalents	\$ 751	\$ 1,605
Accounts receivable, net of progress payments of \$34,246 in 2006 and \$31,889 in 2005	3,907	3,553
Inventoried costs, net of progress payments of \$1,159 in 2006 and \$1,162 in 2005	1,296	1,164
Deferred income taxes	774	783
Prepaid expenses and other current assets	317	446
Total current assets	7,045	7,551
Property, plant, and equipment, net of accumulated depreciation of \$2,829 in 2006 and \$2,595 in 2005	4,403	4,403
Goodwill	17,380	17,383
Other purchased intangibles, net of accumulated amortization of \$1,494 in 2006 and \$1,421 in 2005	1,200	1,273
Prepaid retiree benefits cost and intangible pension asset	2,888	2,925
Other assets	760	679
<b>Total assets</b>	<b>\$ 33,676</b>	<b>\$ 34,214</b>

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## NORTHROP GRUMMAN CORPORATION

<i>\$ in millions</i>	June 30, 2006	December 31, 2005
<b><i>Liabilities and Shareholders' Equity:</i></b>		
Notes payable to banks	\$ 79	\$ 50
Current portion of long-term debt	735	1,214
Trade accounts payable	1,452	1,589
Accrued employees' compensation	1,093	1,105
Advances on contracts	1,665	1,626
Income taxes payable	589	668
Other current liabilities	1,525	1,722
Total current liabilities	7,138	7,974
Long-term debt	3,821	3,881
Mandatorily redeemable preferred stock	350	350
Accrued retiree benefits	3,779	3,701
Deferred income taxes	626	595
Other long-term liabilities	916	885
Total liabilities	16,630	17,386
Common stock, 800,000,000 shares authorized; issued and outstanding: 2006 — 344,410,947; 2005 — 347,357,291	344	347
Paid-in capital	11,185	11,571
Retained earnings	5,642	5,055
Accumulated other comprehensive loss	(125)	(145)
Total shareholders' equity	17,046	16,828
<b>Total liabilities and shareholders' equity</b>	<b>\$ 33,676</b>	<b>\$ 34,214</b>

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

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**NORTHROP GRUMMAN CORPORATION**
**CONSOLIDATED CONDENSED STATEMENTS OF INCOME**  
**(Unaudited)**

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions, except per share</i>	<b>2006</b>	2005	<b>2006</b>	2005
<b>Sales and Service Revenues</b>				
Product sales	\$ 4,772	\$ 5,177	\$ 9,169	\$ 9,980
Service revenues	2,829	2,630	5,525	5,129
<b>Total sales and service revenues</b>	<b>7,601</b>	7,807	<b>14,694</b>	15,109
<b>Cost of Sales and Service Revenues</b>				
Cost of product sales	3,691	4,146	7,137	7,979
Cost of service revenues	2,464	2,351	4,830	4,579
General and administrative expenses	764	689	1,441	1,335
<b>Operating margin</b>	<b>682</b>	621	<b>1,286</b>	1,216
<b>Other Income (Expense)</b>				
Interest income	3	25	16	39
Interest expense	(87)	(94)	(177)	(189)
Other, net	(9)	7	(10)	89
<b>Income from continuing operations before income taxes</b>	<b>589</b>	559	<b>1,115</b>	1,155
<b>Federal and foreign income taxes</b>	<b>147</b>	190	<b>311</b>	388
<b>Income from continuing operations</b>	<b>442</b>	369	<b>804</b>	767
<b>(Loss) gain from discontinued operations, net of tax</b>	<b>(12)</b>	(2)	<b>(17)</b>	9
<b>Net income</b>	<b>\$ 430</b>	\$ 367	<b>\$ 787</b>	\$ 776
<b>Basic Earnings (Loss) Per Share</b>				
Continuing operations	\$ 1.28	\$ 1.03	\$ 2.33	\$ 2.13
Discontinued operations	(.03)	(.01)	(.05)	.03
<b>Basic earnings per share</b>	<b>\$ 1.25</b>	\$ 1.02	<b>\$ 2.28</b>	\$ 2.16
<b>Weighted average common shares outstanding, in millions</b>	<b>344.0</b>	358.5	<b>345.6</b>	359.5
<b>Diluted Earnings (Loss) Per Share</b>				
Continuing operations	\$ 1.26	\$ 1.01	\$ 2.29	\$ 2.10
Discontinued operations	(.03)	(.01)	(.05)	.02
<b>Diluted earnings per share</b>	<b>\$ 1.23</b>	\$ 1.00	<b>\$ 2.24</b>	\$ 2.12
<b>Weighted average diluted shares outstanding, in millions</b>	<b>350.1</b>	365.2	<b>351.8</b>	365.7

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 June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
Net income	\$ 430	\$ 367	\$ 787	\$ 776
Other Comprehensive Income (Loss)				
Change in cumulative translation adjustment	14	(5)	17	(4)
Unrealized loss on marketable securities, net of tax of \$1 and \$3 for the three and six months ended June 30, 2006, respectively, and \$0 for 2005	(4)	(2)	(5)	(2)
Reclassification adjustment on write-down of marketable securities, net of tax of \$5 for the three and six months ended June 30, 2006	8		8	
Reclassification adjustment on sale of marketable securities, net of tax of \$15				(29)
Other comprehensive income (loss), net of tax	18	(7)	20	(35)
Comprehensive income	\$ 448	\$ 360	\$ 807	\$ 741

*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)**

	Six months ended June 30	
<i>\$ in millions</i>	2006	2005
<b>Operating Activities</b>		
Sources of Cash		
Cash received from customers		
Progress payments	\$ 3,451	\$ 3,571
Collections on billings	10,961	11,586
Income tax refunds received	11	29
Interest received	18	71
Other cash receipts	58	16
Total sources of cash-continuing operations	14,499	15,273
Uses of Cash		
Cash paid to suppliers and employees	13,223	13,521
Interest paid	192	195
Income taxes paid	397	349
Excess tax benefits from stock-based compensation	47	
Payments for litigation settlement		99
Other cash payments	16	14
Total uses of cash-continuing operations	13,875	14,178
Cash provided by continuing operations	624	1,095
Cash used in discontinued operations	(101)	(19)
Net cash provided by operating activities	523	1,076
<b>Investing Activities</b>		
Proceeds from sale of businesses, net of cash divested	43	56
Payment for businesses purchased, net of cash acquired		(313)
Proceeds from sale of property, plant, and equipment	10	5
Additions to property, plant, and equipment	(324)	(346)
Proceeds from insurance carrier	71	
Proceeds from sale of investment		143
Payments for purchase of investment	(35)	
Other investing activities, net	(16)	(17)
Net cash used in investing activities	(251)	(472)
<b>Financing Activities</b>		
Borrowings under lines of credit	29	55
Repayment of borrowings under lines of credit		(11)
Principal payments of long-term debt	(521)	(32)
Proceeds from stock option exercises	338	52
Dividends paid	(194)	(176)
Excess tax benefits from stock-based compensation	47	
Common stock repurchases	(825)	(507)
Net cash used in financing activities	(1,126)	(619)
Decrease in cash and cash equivalents	(854)	(15)
Cash and cash equivalents, beginning of period	1,605	1,230
Cash and cash equivalents, end of period	\$ 751	\$ 1,215

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	Six months ended June 30	
<i>\$ in millions</i>	2006	2005
<b>Reconciliation of Income from Continuing Operations to Net Cash Provided by Operating Activities</b>		
Income from continuing operations	\$ 804	\$ 767
Adjustments to reconcile to net cash provided by operating activities		
Depreciation	278	257
Amortization of intangible assets	73	108
Stock-based compensation	107	63
Excess tax benefits from stock-based compensation	(47)	
Loss on disposals of property, plant, and equipment	5	6
Amortization of long-term debt premium	(8)	(10)
Loss (gain) on investments	13	(70)
Decrease (increase) in		
Accounts receivable	(2,711)	(3,085)
Inventoried costs	(124)	(96)
Prepaid expenses and other current assets	(32)	(23)
Increase (decrease) in		
Progress payments	2,354	2,986
Accounts payable and accruals	(164)	(23)
Deferred income taxes	31	95
Income taxes payable	(96)	13
Retiree benefits	114	136
Other non-cash transactions, net	27	(29)
Cash provided by continuing operations	624	1,095
Cash used in discontinued operations	(101)	(19)
Net cash provided by operating activities	\$ 523	\$ 1,076
<b>Non-Cash Investing and Financing Activities</b>		
Sale of businesses		
Liabilities assumed by purchaser	\$ 18	\$ 41
Purchase of business		
Fair value of assets acquired, including goodwill		\$ 356
Consideration given for businesses purchased		(313)
Liabilities assumed		\$ 43

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

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**NORTHROP GRUMMAN CORPORATION**
**CONSOLIDATED CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**(Unaudited)**

	Six months ended June 30	
	2006	2005
<i>\$ in millions, except per share</i>		
<b>Common Stock</b>		
At beginning of period	\$ 347	\$ 364
Common stock repurchased	(12)	(9)
Employee stock awards and options	9	3
At end of period	344	358
<b>Paid-in Capital</b>		
At beginning of period	11,571	12,426
Common stock repurchased	(813)	(480)
Employee stock awards and options	427	78
At end of period	11,185	12,024
<b>Retained Earnings</b>		
At beginning of period	5,055	4,014
Net income	787	776
Dividends	(200)	(176)
At end of period	5,642	4,614
<b>Unearned Compensation</b>		
At beginning of period		(3)
Amortization of unearned compensation		1
At end of period		(2)
<b>Accumulated Other Comprehensive Loss</b>		
At beginning of period	(145)	(101)
Change in cumulative translation adjustment	17	(4)
Unrealized loss on marketable securities, net of tax	(5)	(2)
Reclassification adjustment on write-down of marketable securities, net of tax	8	
Reclassification adjustment on sale of marketable securities, net of tax		(29)
At end of period	(125)	(136)
Total shareholders' equity	\$17,046	\$ 16,858
Cash dividends per share	\$ .56	\$ .49

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

**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 material 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 consolidated financial position, results of operations, and cash flows. The results reported in these 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 2005 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 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 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 year financial statements and related notes have been reclassified to conform to the 2006 presentation.

Effective January 1, 2006, the company established a new reportable segment, Northrop Grumman Technical Services (Technical Services), to leverage existing business strengths and synergies in the rapidly expanding areas of logistics support, sustainment and technical services. Technical Services consolidates multiple programs in logistics operations from the Electronics (formerly Electronic Systems), Integrated Systems, Mission Systems, and Information Technology segments.

During the second quarter of 2006, the company completed the shut down of the Enterprise Information Technology business formerly reported as part of the Information Technology segment. As such, the assets, liabilities, and results of operations of this business have been reclassified from continuing operations to discontinued operations for all periods presented (See Note 5).

**2. NEW ACCOUNTING STANDARDS**

There was no material effect on the company's consolidated financial position or results of operations due to new accounting pronouncements that became effective during the periods presented. The expanded disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123R – *Share-Based Payment* are presented in Note 14.

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### **NORTHROP GRUMMAN CORPORATION**

Other new pronouncements issued by the Financial Accounting Standards Board (FASB) and not effective until after June 30, 2006, are not expected to have a significant effect on the company's consolidated financial position or results of operations, with the possible exception of the following, which is currently being evaluated by management:

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48 – *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on accounting for derecognition, interest, penalties, accounting in interim periods, disclosure and classification of matters related to uncertainty in income taxes, and transitional requirements upon adoption of FIN 48. FIN 48 is effective for fiscal years beginning after December 15, 2006. Management is currently evaluating the effect that adoption of this interpretation will have on the company's consolidated financial position and results of operations.

### **3. COMMON STOCK DIVIDEND**

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

### **4. BUSINESS ACQUIRED**

*Integic* – On March 21, 2005, the company acquired privately held Integic Corporation (Integic) for \$319 million, which included transaction costs of \$6 million. Integic specializes in enterprise health and business process management solutions and is reported in the Information Technology segment. The assets, liabilities, and results of operations of Integic were not material and thus pro-forma information is not presented.

### **5. BUSINESSES SOLD AND DISCONTINUED OPERATIONS**

*Winchester* – On June 23, 2006, the company sold Winchester Electronics (Winchester) for net cash proceeds of \$17 million and recognized an after-tax gain of \$2 million in discontinued operations. 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.

*Interconnect* – On February 24, 2006, the company sold the assembly business of Interconnect Technologies (Interconnect) for net cash proceeds of \$26 million and recognized an after-tax gain of \$5 million in discontinued operations. The results of operations of the assembly business of Interconnect, reported in the Electronics segment, were not material to any of the periods presented and have therefore not been reclassified as discontinued operations.

*Enterprise Information Technology* – In January 2006, management announced its strategic decision to exit the value-added reseller business reported within the Information Technology segment as the Enterprise Information Technology (EIT) business area. The shut down of this business was completed during the second quarter of 2006 and costs associated with the shut down 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, for all periods presented.

*Teldix* – On March 31, 2005, the company sold Teldix GmbH (Teldix) for \$56 million in cash and recognized an after-tax gain of \$11 million in discontinued operations. Subsequent purchase price adjustment pursuant to the sale agreement increased the after-tax gain to \$14 million for the year ended December 31, 2005. The results of operations of Teldix, reported in the Electronics segment, were not material to any of the periods presented and have therefore not been reclassified as discontinued operations.

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Sales and operating results of the EIT business and the gains from divestitures of other businesses classified within discontinued operations for the three and six months ended June 30, 2006, and 2005, respectively, were as follows:

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
Sales	\$ 52	\$ 155	\$143	\$ 306
Loss from discontinued operations	\$ (8)	\$ (5)	\$ (17)	\$ (5)
Income tax benefit	3	2	6	2
Loss from discontinued operations, net of tax	(5)	(3)	(11)	(3)
Gains from other divestitures	4	1	12	17
Income tax expense	(11)		(18)	(5)
(Loss) gain from discontinued operations, net of tax	\$(12)	\$ (2)	\$(17)	\$ 9

The assets and liabilities of the EIT business, as shown in the table below, are not material and have been collapsed into "Prepaid expenses and other current assets" and "Other current liabilities," respectively, in the accompanying Consolidated Condensed Statements of Financial Position.

<i>\$ in millions</i>	June 30, 2006	December 31, 2005
Current assets	\$ 50	\$ 140
Property, plant, and equipment, net		1
Other assets	2	1
Total assets	\$ 52	\$ 142
Accounts payable and other current liabilities	\$ 26	\$ 206
Total liabilities	\$ 26	\$ 206

**6. SEGMENT INFORMATION**

Effective January 1, 2006, the company established a new reportable segment, Technical Services, to leverage existing business strengths and synergies in the rapidly expanding areas of logistics support, sustainment and technical services. Technical Services consolidates multiple programs in logistics operations from the Electronics, Integrated Systems, Mission Systems and Information Technology segments.

Effective January 1, 2006, in order to provide a more relevant depiction of the management and performance of the company's businesses, sales and segment operating margin in the following tables were revised to include margin on intersegment sales for all periods presented. Intersegment amounts are then eliminated upon consolidation of the segments.

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

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The following table presents segment sales and service revenues for the three and six months ended June 30, 2006, and 2005.

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
<b>Sales and Service Revenues</b>				
<b>Information &amp; Services</b>				
Mission Systems	\$ 1,338	\$ 1,271	\$ 2,602	\$ 2,525
Information Technology	993	968	1,941	1,847
Technical Services	300	286	575	560
<b>Total Information &amp; Services</b>	<b>2,631</b>	<b>2,525</b>	<b>5,118</b>	<b>4,932</b>
<b>Aerospace</b>				
Integrated Systems	1,397	1,391	2,834	2,678
Space Technology	865	875	1,720	1,738
<b>Total Aerospace</b>	<b>2,262</b>	<b>2,266</b>	<b>4,554</b>	<b>4,416</b>
<b>Electronics</b>	<b>1,635</b>	<b>1,769</b>	<b>3,144</b>	<b>3,316</b>
<b>Ships</b>	<b>1,437</b>	<b>1,587</b>	<b>2,570</b>	<b>3,101</b>
<b>Other</b>		11		22
<b>Intersegment eliminations</b>	<b>(364)</b>	<b>(351)</b>	<b>(692)</b>	<b>(678)</b>
Total sales and service revenues	\$ 7,601	\$ 7,807	\$14,694	\$ 15,109

The following table presents segment operating margin reconciled to total operating margin for the three and six months ended June 30, 2006, and 2005.

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
<b>Operating Margin</b>				
<b>Information &amp; Services</b>				
Mission Systems	\$ 132	\$ 99	\$ 249	\$ 192
Information Technology	86	82	170	158
Technical Services	16	14	29	26
<b>Total Information &amp; Services</b>	<b>234</b>	<b>195</b>	<b>448</b>	<b>376</b>
<b>Aerospace</b>				
Integrated Systems	142	117	291	259
Space Technology	81	74	152	141
<b>Total Aerospace</b>	<b>223</b>	<b>191</b>	<b>443</b>	<b>400</b>
<b>Electronics</b>	<b>181</b>	<b>199</b>	<b>358</b>	<b>361</b>
<b>Ships</b>	<b>129</b>	<b>102</b>	<b>197</b>	<b>209</b>
<b>Other</b>		(5)		(6)
<b>Intersegment eliminations</b>	<b>(25)</b>	<b>(18)</b>	<b>(51)</b>	<b>(38)</b>
Total segment operating margin	742	664	1,395	1,302
Non-segment factors affecting operating margin				
Unallocated expenses	(46)	(42)	(81)	(69)
Net pension (expense) income	(12)	2	(22)	(9)
Reversal of royalty income included above	(2)	(3)	(6)	(8)
Total operating margin	\$ 682	\$ 621	\$ 1,286	\$ 1,216

*Unallocated Expenses* – This reconciling item 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 U.S. Government Cost Accounting Standards (CAS) regulations and the Federal Acquisition Regulation, and therefore not allocated to the segments.

*Net Pension (Expense) Income* – Net pension (expense) income reflects pension expense determined in accordance with GAAP less the pension expense included in segment cost of sales to the extent that these costs are currently recognized under CAS. For the three months ended June 30, 2006, and 2005, pension expense determined in accordance with GAAP was \$113 million and \$103 million, respectively, offset by pension expense under CAS of \$101 million and \$105 million, respectively. For the six months ended June 30, 2006 and 2005, pension expense determined in accordance with GAAP was \$225 million and \$206 million, respectively, offset by pension expense under CAS of \$203 million and \$197 million, respectively.

## 7. EARNINGS PER SHARE

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

*Diluted Earnings Per Share* – The dilutive effect of stock options and other stock awards granted to employees under stock-based compensation plans totaled 6.1 million shares and 6.7 million shares for the three months ended June 31, 2006, and 2005, respectively, and 6.2 million shares and 6.2 million shares for the six months ended June 30, 2006, and 2005, respectively. Shares issuable pursuant to the mandatorily redeemable preferred stock are not included in the diluted earnings per share calculations because their effect was not dilutive for the periods presented. The weighted-average diluted shares outstanding exclude shares issuable under stock options that have an exercise price in excess of the average market price of the company's common stock during the period. The number of shares excluded was approximately 20 thousand for the six months ended June 30, 2006, and approximately 4 million for the six months ended June 30, 2005.

*Share Repurchases* – On October 24, 2005, the company's board of directors authorized a share repurchase program of up to \$1.5 billion of its outstanding common stock, which commenced in November 2005 and is expected to be completed by the end of 2006.

Under this program, the company entered into an initial agreement with Credit Suisse, New York Branch (Credit Suisse) on November 4, 2005, to repurchase approximately 9.1 million shares of common stock at an initial price of \$55.15 per share for a total of \$500 million. Credit Suisse immediately borrowed shares that were sold to and canceled by the company. Subsequently, Credit Suisse purchased shares in the open market to settle its share borrowings. On March 1, 2006, Credit Suisse completed its purchases under this agreement, and the company paid \$37 million for the final price adjustment under the terms of the agreement. The final average purchase price was \$59.05 per share.

The company entered into a second agreement with Credit Suisse on March 6, 2006, to repurchase approximately 11.6 million shares of common stock at an initial price of \$64.78 per share for a total of \$750 million. Under this agreement, Credit Suisse immediately borrowed shares that were sold to and canceled by the company. Subsequently, Credit Suisse purchased shares in the open market to settle its share borrowings. On May 26, 2006, Credit Suisse completed its purchases under this agreement, and the company paid \$37 million for the final price adjustment under the terms of the agreement. The final average purchase price was \$68.01 per share.

Share repurchases take place at management's discretion and 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.

**8. INVESTMENT IN TRW AUTO**

On March 11, 2005, the company sold 7.3 million of its TRW Automotive Holdings Corp. (TRW Auto) common shares for \$143 million, and recorded an after-tax gain of \$45 million. The sale reduced the company's ownership of TRW Auto to 9.7 million common shares. The remaining investment is carried at cost of \$97 million and included in "Other assets" as of June 30, 2006, and December 31, 2005. The company does not consider this investment to be critical to its ongoing business operations. Any future sale would be limited by restrictions described in the Second Amended and Restated Stockholders Agreement dated January 28, 2004, between the company and TRW Auto.

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

Effective January 1, 2006, the company realigned businesses among four of its operating segments to form a new segment. As a result of this realignment, goodwill of approximately \$731 million was reallocated among these five segments.

The changes in the carrying amounts of goodwill for the six months ended June 30, 2006, were as follows:

<i>\$ in millions</i>	Balance as of December 31, 2005	Goodwill Transferred in Segment Realignment	Fair Value Adjustments to Net Assets Acquired	Balance as of June 30, 2006
Mission Systems	\$ 4,256	\$ (313)		\$ 3,943
Information Technology	2,649	(403)		2,246
Technical Services		731		731
Integrated Systems	992	(4)	\$ (3)	985
Space Technology	3,295			3,295
Electronics	2,575	(11)		2,564
Ships	3,616			3,616
Total	\$ 17,383	\$ —	\$ (3)	\$ 17,380

**Purchased Intangible Assets**

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

<i>\$ in millions</i>	June 30, 2006			December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Contract and program intangibles	\$2,594	\$ (1,428)	\$ 1,166	\$2,594	\$ (1,357)	\$ 1,237
Other purchased intangibles	100	(66)	34	100	(64)	36
Total	\$2,694	\$ (1,494)	\$ 1,200	\$2,694	\$ (1,421)	\$ 1,273

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 22 years. Aggregate amortization expense for the three and six months ended June 30, 2006, was \$31 million and \$73 million, respectively.

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The table below shows expected amortization for purchased intangibles for the remainder of 2006 and for the next five years:

*\$ in millions*

Year Ended December 31	
2006 (July 1 - December 31)	\$ 62
2007	121
2008	111
2009	101
2010	81
2011	42

**10. IMPACT FROM HURRICANE KATRINA**

During the third quarter of 2005, the company's operations in the Gulf Coast area of the U. S. were significantly impacted by Hurricane Katrina. As a result of the hurricane, the Ships segment suffered property damage, contract cost growth, and work delays.

As of June 30, 2006, management estimates that the total cost to repair or replace assets damaged by the storm and the costs to clean up and restore its operations will total approximately \$850 million, substantially all of which is expected to be recovered through the company's comprehensive property damage insurance. Following the storm, the company has incurred \$311 million through June 30, 2006, to clean-up and restore its facilities, including capital expenditures. The company is continuing to assess its damage estimates as the process of repairing its operations is performed.

Through June 30, 2006, the company has received \$233 million in insurance proceeds, the majority of which represent the reimbursement of clean-up and recovery costs and funds to replace facilities destroyed by the storm. As of June 30, 2006, the company has written off \$61 million in assets that were completely destroyed by the storm. The company is in the process of managing a substantial repair and restoration activity to identify, estimate and secure the repairs needed to restore its affected operations. This includes developing the company's extensive claim submissions to its insurers, and overseeing the repair and restoration process. To date, the company has submitted estimated expenditures for recovery that are substantially in excess of the insurance proceeds received, and is awaiting resolution of its submissions.

The company's comprehensive property insurance includes coverage for business interruption effects caused by the storm, however, the company is unable to currently estimate the amount of any recovery or the period in which its claims related to business interruption will be resolved. Accordingly, no such amounts have been recognized by the company in the accompanying consolidated condensed financial statements.

In accordance with cost accounting regulations relating to U. S. Government contractors, recovery of property damages in excess of the net book value of the damaged assets as well as losses on property damage that are not recovered through insurance are required to be included in the company's overhead pools and allocated to current contracts under a systematic process. The company is currently in discussions with its government customers regarding the allocation methodology to be used to account for these differences. Depending upon the outcome of these discussions, and the ultimate resolution of the company's damage claims with its insurance providers, the company may be required to recognize additional cost growth on its contracts and cumulative downward adjustment to its contract profit rates at a future date.

The insurance provider for coverage of damages over \$500 million advised management of a disagreement regarding coverage of losses in excess of \$500 million, and this matter is currently being litigated by the

company as described in Note 11. The company believes that its insurance policies are enforceable and intends to pursue all of its available rights and remedies. However, based on the current status of the litigation between the company and its insurance provider, no assurances can be made as to the ultimate outcome of this matter. To the extent that its insurance recoveries are inadequate to fund the repair and restoration costs that the company deems necessary, the company will pursue other means for funding the shortfall, including funding from its current operations.

## 11. LITIGATION

*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, and apart from the specific matters discussed elsewhere herein, the company does not believe that the resolution of any of these various claims and legal proceedings will have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

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. During discovery in the second quarter of 2006, Cogent asserted entitlement to in excess of \$50 million for lost profits, in excess of \$100 million for loss of goodwill and business opportunities, in excess of \$6 million in royalties, doubling of actual damages and other amounts, including, without limitation, attorneys' fees. Decision is pending on the request by all parties for a continuance of the September 12, 2006, scheduled trial date. The company does not believe, but can give no assurance, that the outcome of this matter would have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

*U.S. Government Investigations and Claims* – Departments and agencies of the U.S. Government have the authority to investigate various transactions and operations of the company, and the results of such investigations may lead to administrative, civil, or criminal proceedings, the ultimate outcome of which could be fines, penalties, repayments, 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.

At a briefing 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. It is unclear whether the potential claims relate to a civil False Claims Act case that remains under seal in the U.S. District Court for the Central District of California. The company responded to the allegations, and the parties continue to meet to better understand the factual basis of the claims before the government decides whether to institute formal legal proceedings or to pursue some other form of resolution. Because of the highly technical nature of the issues involved and their classified status, final resolution of this matter could take a considerable amount of time, particularly if litigation should ensue. If the U.S. Department of Justice were to pursue litigation and were to be ultimately successful on its theories of liability and compensatory damages, the effect upon the company's consolidated financial position, results of operations, and cash flows would be material. Based upon its review to date, the company believes that it acted appropriately in this matter but can give no assurance that its view will prevail. The company is not able to estimate the amount of damages, if any, at this time.

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

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*Insurance Recovery* – Damage from Hurricane Katrina is covered by the company's comprehensive property insurance program. The insurance provider for coverage in excess of \$500 million has advised the company of a disagreement regarding coverage for certain losses experienced by the company. Management believes its losses are covered by insurance and has filed a declaratory relief action in the U. S. District Court in Los Angeles, California, seeking a judicial determination that its property insurance program covers all Katrina-related losses in excess of the applicable deductible. Trial on the issue of coverage is set to begin in April 2007. The amount and timing of insurance recoveries remain uncertain due to the difficulty in estimating total damage and the pending legal action with the insurance provider.

## **12. 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 June 30, 2006, the amounts are not material individually or in the aggregate.

*Income Tax Matters* – During the second quarter of 2006, the company received final approval from the U.S. Congress Joint Committee on Taxation for the agreement previously reached with the Internal Revenue Service regarding its audits of the company's B-2 program for the years ended December 31, 1997 through December 31, 2000. As a result, the company recognized tax benefits of \$48 million during the second quarter of 2006, due to the reversal of previously established expense provisions.

*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 at June 30, 2006, the range of reasonably possible future costs for environmental remediation sites is \$240 million to \$351 million, of which \$269 million is accrued. Factors that could result in changes to the company's estimates include: modification of planned remedial actions, increase or decrease 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.

*Co-Operative Agreements* – In 2003, Ships executed agreements with the states of Mississippi and Louisiana, respectively, whereby Ships will lease 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. Under the Mississippi agreement, Ships is required to match the state's funding with Modernization and Sustaining & Maintenance expenditures of up to \$313 million and create up to 2,000 new full-time jobs in

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Mississippi by December 2009. As of June 30, 2006, a total of \$100 million had been appropriated in 2002, 2003 and 2004 by Mississippi requiring, through a Memorandum of Understanding (MOU) with the Mississippi Development Authority, an increase of 1,334 jobs and matching expenditures of \$201 million. Ships has fully complied with both requirements. On March 27, 2006, the final appropriation of \$56 million was approved by the legislature and will require the creation of the final 666 new full-time jobs in Mississippi and matching expenditures of \$112 million. Under the Louisiana agreement, Ships is required to match the state's funding for expenditures up to \$56 million through 2007, and employ a minimum of 5,200 full-time employees in 16 of the 32 fiscal quarters beginning January 1, 2003, and ending December 31, 2010. As of June 30, 2006, \$56 million has been appropriated by Louisiana and employment commitments for 12 of the 16 quarters have been fulfilled and the matching funds requirement has been met.

Failure by Ships to meet these commitments would result in reimbursement by Ships to Mississippi and Louisiana in accordance with the respective agreements. As of June 30, 2006, management believes that Ships is in compliance with its commitments to date under these agreements, and expects that all future commitments under these agreements will be met based on the most recent Ships 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 June 30, 2006, there were \$480 million of unused stand-by letters of credit, \$94 million of bank guarantees, and \$562 million of surety bonds outstanding.

*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 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 Inc. (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 the merits of the claims as well as to assess the amounts being claimed. If the parties are unable to reach a negotiated resolution of the claims, the company expects that Goodrich will 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. The company does not have sufficient information to assess the probable outcome of the 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, and cash flows could be material.

*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 does not believe, but can give no assurance, that the outcome of any such matters would have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

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

### 13. RETIREMENT BENEFITS

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

	Three months ended June 30				Six months ended June 30			
	Pension Benefits		Medical and Life Benefits		Pension Benefits		Medical and Life Benefits	
	2006	2005	2006	2005	2006	2005	2006	2005
<i>\$ in millions</i>								
<b>Components of Net Periodic Benefit Cost</b>								
Service cost	\$ 185	\$ 169	\$ 17	\$ 16	\$ 370	\$ 338	\$ 35	\$ 34
Interest cost	292	273	47	46	583	546	94	91
Expected return on plan assets	(393)	(367)	(13)	(13)	(786)	(734)	(26)	(25)
Amortization of:								
Prior service costs	9	13	(1)		18	26	(3)	
Net loss from previous years	20	15	8	7	40	30	16	13
Other								
<b>Net periodic benefit cost</b>	<b>\$ 113</b>	<b>\$ 103</b>	<b>\$ 58</b>	<b>\$ 56</b>	<b>\$ 225</b>	<b>\$ 206</b>	<b>\$ 116</b>	<b>\$ 113</b>
<b>Defined contribution plans cost</b>	<b>\$ 67</b>	<b>\$ 64</b>			<b>\$ 134</b>	<b>\$ 127</b>		

*Employer Contributions* – The company expects to contribute approximately \$441 million to its pension plans and approximately \$192 million to its medical and life benefits plans in 2006. As of June 30, 2006, contributions of \$157 million and \$74 million have been made to the company's pension plans and its medical and life benefits plans, respectively.

### 14. STOCK-BASED COMPENSATION

At June 30, 2006, the company had stock-based awards outstanding under three stock-based compensation plans: the 2001 Long-Term Incentive Stock Plan, the 1993 Long-Term Incentive Stock Plan, both applicable to employees, and the 1995 Stock Option Plan for Non-Employee Directors. 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). A detailed description of these plans can be found in the company's 2005 Annual Report on Form 10-K.

Prior to January 1, 2006, the company applied Accounting Principles Board Opinion No. 25 – *Accounting for Stock Issued to Employees* and related interpretations in accounting for awards made under the company's stock-based compensation plans. Stock Options granted under the plans had an exercise price equal to or greater than the market value of the common stock on the date of the grant, and accordingly, no compensation expense was recognized. Stock Awards were valued at their fair market value measured at the date of grant, updated periodically using the mark-to-market method, and compensation expense was recognized over the vesting period of the award.

*Accelerated Vesting* – On May 16, 2005, in connection with an evaluation of the company's overall incentive compensation strategy, the Compensation and Management Development Committee of the company's board of directors approved accelerating the vesting for all outstanding unvested employee Stock Options (excluding options held by elected officers), effective September 30, 2005. As part of its evaluation, management considered the amount of compensation expense that would otherwise have been recognized in the company's results of operations upon the adoption of SFAS No. 123R. The accelerated options had a weighted average exercise price of \$51 with original vesting dates through April 2009. The charge associated with the acceleration of vesting was not material.

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*Adoption of New Standard* – Effective January 1, 2006, the company adopted the provisions of SFAS No. 123R using the modified-prospective transition method and the disclosures that follow are based on applying SFAS No. 123R. Under this transition method, compensation expense recognized during the six months ended June 30, 2006, included: (a) compensation expense for all share-based awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 – *Accounting for Stock-Based Compensation*, and (b) compensation expense for all share-based awards granted on or after January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. In accordance with the modified-prospective transition method, results for prior periods have not been restated. All of the company's stock award plans are considered equity plans under SFAS No. 123R, and compensation expense recognized as previously described is net of estimated forfeitures of share based awards over the vesting period. The effect of adopting SFAS No. 123R was not material to the company's income from continuing operations and net income for the three and six month periods ended June 30, 2006, and the cumulative effect of adoption using the modified-prospective transition method was similarly not material.

*Compensation Expense* – Total stock-based compensation for the six months ended June 30, 2006, and 2005, was \$107 million and \$63 million, respectively, of which \$6 million and \$1 million related to Stock Options and \$101 million and \$62 million related to Stock Awards, respectively. Tax benefits recognized in the consolidated condensed statements of income for stock-based compensation during the six months ended June 30, 2006, and 2005, were \$38 million and \$22 million, respectively. In addition, the company realized excess tax benefits of \$42 million from the exercise of Stock Options and \$5 million from the vesting of Stock Awards in the six months ended June 30, 2006. SFAS 123R requires that cash flows resulting from excess tax benefits be classified as financing cash flows in the accompanying consolidated condensed statements of cash flows.

*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 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 six months ended June 30, 2006, and 2005, were as follows:

	2006	2005
Dividend yield	1.6%	1.9%
Volatility rate	25%	30%
Risk-free interest rate	4.6%	3.6%
Expected option life (years)	6.0	6.0

The weighted average grant date fair value of Stock Options granted during the six months ended June 30, 2006, and 2005, was \$18 and \$16 per share, respectively.

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Stock Option activity for the six months ended June 30, 2006, was as follows:

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (\$ in millions)
<b>Outstanding at January 1, 2006</b>	<b>27,817,816</b>	<b>\$ 48</b>	<b>5.5 years</b>	<b>\$ 329</b>
Granted	806,690	65		
Exercised	(7,165,196)	48		
Cancelled	(5,164)	39		
<b>Outstanding at June 30, 2006</b>	<b>21,454,146</b>	<b>\$ 49</b>	<b>5.4 years</b>	<b>\$ 321</b>
Vested and expected to vest in the future at June 30, 2006	21,367,417	\$ 49	5.4 years	\$ 320
Exercisable at June 30, 2006	19,841,644	\$ 48	5.1 years	\$ 311
Available for grant at June 30, 2006	12,626,684			

The total intrinsic value of options exercised during the six months ended June 30, 2006, and 2005, was \$120 million and \$18 million, respectively. Intrinsic value is measured using the fair market value at the date of exercise (for shares exercised) or at June 30, 2006 (for outstanding options), less the applicable exercise price.

*Stock Awards* – The fair value of Stock Awards is determined based on the closing market price of the company's common stock on the grant date. Compensation expense for Stock Awards is measured at the grant date and recognized over the vesting period. 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. There were 1.9 million Stock Awards that vested and were issued in the six months ended June 30, 2005, with a total fair value of \$104 million. There were 2.2 million Stock Awards granted in the six months ended June 30, 2005, with a weighted average grant date fair value of \$54 per share.

Stock Award activity for the six months ended June 30, 2006, was as follows:

	Stock Awards	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term
<b>Outstanding at January 1, 2006</b>	<b>5,785,918</b>	<b>\$ 53</b>	<b>0.9 years</b>
Granted (including performance adjustment on shares vested)	4,230,791	63	
Vested	(2,380,267)	56	
Forfeited	(133,984)	53	
<b>Outstanding at June 30, 2006</b>	<b>7,502,458</b>	<b>\$ 57</b>	<b>1.8 years</b>
Available for grant at June 30, 2006	6,947,676		

*Unrecognized Compensation Expense* – At June 30, 2006, there was \$343 million of unrecognized compensation expense related to unvested awards granted under the company's stock-based compensation plans, of which \$21 million relates to Stock Options and \$322 million relates to Stock Awards. These amounts are expected to be charged to expense over a weighted-average period of 2 years.

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*Pro-forma Compensation Expense* – Had compensation expense for the three and six months ended June 30, 2005, been determined based on the fair value at the grant dates for Stock Awards and Stock Options, consistent with SFAS No. 123 – *Accounting for Stock-Based Compensation*, net income, basic earnings per share, and diluted earnings per share would have been as shown in the table below:

<i>\$ in millions, except per share</i>	<b>Three months ended June 30, 2005</b>	<b>Six months ended June 30, 2005</b>
Net income as reported	\$ 367	\$ 776
Stock-based compensation, net of tax, included in net income as reported	25	41
Stock-based compensation, net of tax, that would have been included in net income, if the fair value method had been applied to all awards	(57)	(84)
Pro-forma net income using the fair value method	\$ 335	\$ 733
<b>Basic Earnings Per Share</b>		
As reported	\$ 1.02	\$ 2.16
Pro-forma	\$ .93	\$ 2.04
<b>Diluted Earnings Per Share</b>		
As reported	\$ 1.00	\$ 2.12
Pro-forma	\$ .92	\$ 2.00

**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 as of June 30, 2006, and the related consolidated condensed statements of income and comprehensive income for the three-month and six-month periods ended June 30, 2006 and 2005, and the related consolidated condensed statements of cash flows and changes in shareholders' equity for the six-month periods ended June 30, 2006 and 2005. 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, 2005, 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 16, 2006, 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, 2005 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  
July 26, 2006

## 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 condensed consolidated financial statements included in this Form 10-Q, as well as the company's 2005 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 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, Northrop Grumman participates in many high-priority defense and commercial technology programs in the United States (U.S.) and abroad. Northrop Grumman conducts most of its business with the U.S. Government, principally the Department of Defense. The company also conducts business with foreign governments and makes domestic and international commercial sales.

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

Effective January 1, 2006, in order to provide a more relevant depiction of the management and performance of the company's businesses, sales and segment operating margin in the following tables were revised to include margin on intersegment sales for all periods presented. Intersegment amounts are then eliminated upon consolidation of the segments.

## CRITICAL ACCOUNTING POLICIES, ESTIMATES, AND JUDGMENTS

The company's 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 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. Actual results could differ materially from those estimates.

There have been no changes in the company's critical accounting policies during the three and six months ended June 30, 2006.

## CONSOLIDATED OPERATING RESULTS

Selected financial highlights are presented in the table below.

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions, except per share</i>	2006	2005	2006	2005
Sales and service revenues	\$ 7,601	\$ 7,807	\$14,694	\$15,109
Operating margin	682	621	1,286	1,216
Interest income	3	25	16	39
Interest expense	(87)	(94)	(177)	(189)
Other, net	(9)	7	(10)	89
Federal and foreign income taxes	147	190	311	388
Diluted earnings per share from continuing operations	1.26	1.01	2.29	2.10
Cash provided by continuing operations	657	823	624	1,095

**Sales and Service Revenues**

Sales and service revenues for the three months ended June 30, 2006, decreased \$206 million, or 3 percent, while sales and service revenues for the six months ended June 30, 2006, decreased \$415 million, or 3 percent, as compared with the same periods in 2005. The decreases in the three and six-month periods were primarily due to decreased sales in the Ships and Electronics segments. The decrease in the Ships segment was due to lower volume on the DDG 1000 program (formerly known as the DD(X) program), as well as hurricane-related work delays on the LPD, LHD, and DDG programs. The decrease in the Electronics segment was primarily due to lower volume in the Aerospace Systems and Defensive Systems business areas.

**Operating Margin**

The operating margin rate for the three months ended June 30, 2006, was 9.0 percent, as compared to 8.0 percent for the same period in 2005. The operating margin rate for the six months ended June 30, 2006, was 8.8 percent, as compared to 8.0 percent in the same period in 2005. The increases for both periods included double-digit operating margin increases in the Mission Systems and Integrated Systems segments.

Operating margin consists of the following:

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
Segment operating margin	\$ 742	\$ 664	\$ 1,395	\$ 1,302
Unallocated expenses	(46)	(42)	(81)	(69)
Net pension (expense) income	(12)	2	(22)	(9)
Reversal of royalty income	(2)	(3)	(6)	(8)
Total operating margin	\$ 682	\$ 621	\$ 1,286	\$ 1,216

*Unallocated Expenses* – Unallocated expenses for the three and six months ended June 30, 2006, increased \$4 million and \$12 million, respectively, as compared with the same periods in 2005. The increases were primarily due to higher corporate costs not allocated to the operating segments.

*Net Pension (Expense) Income* – Net pension (expense) income reflects pension expense determined in accordance with GAAP less the pension expense included in segment cost of sales to the extent that these costs are currently recognized under U.S. Government Cost Accounting Standards (CAS). Net pension expense for the three months ended June 30, 2006, increased \$14 million, while net pension expense for the six months ended June 30, 2006, increased \$13 million, as compared with the same periods in 2005.

*Reversal of Royalty Income* – Royalty income is included in segment operating margin for internal reporting purposes. For external reporting purposes, royalty income is reclassified to the “Other, net” line item discussed below.

**Interest Income**

Interest income for the three and six months ended June 30, 2006, decreased \$22 million and \$23 million, respectively, as compared with the same periods in 2005. The decreases were primarily due to interest received in relation to a state tax refund for research and development credits during the second quarter of 2005 and lower average cash balances during the 2006 periods.

**Interest Expense**

Interest expense for the three months ended June 30, 2006, decreased \$7 million, or 7 percent, while the interest expense for the six months ended June 30, 2006, decreased \$12 million, or 6 percent, as compared with the same periods in 2005. The decreases were primarily due to lower average debt outstanding in 2006 as compared with 2005.

**Other, Net**

Other, net for the three months ended June 30, 2006, decreased \$16 million, as compared with the same period in 2005. The decreases were primarily due to a \$13 million write down of marketable securities in the 2006 period.

Other, net for the six months ended June 30, 2006, decreased \$99 million, as compared with the same period in 2005. The decrease was primarily due to the pre-tax gain of \$70 million recognized from the sale of TRW Auto shares in the first quarter of 2005.

**Federal and Foreign Income Taxes**

The company's effective tax rate on income from continuing operations for the three months ended June 30, 2006, was 25.0 percent as compared with 34.0 percent for the same period in 2005. During the second quarter of 2006, the company received final approval from the U.S. Congress Joint Committee on Taxation for the agreement previously reached with the Internal Revenue Service regarding its audits of the company's B-2 program for the years ended December 31, 1997 through December 31, 2000. As a result of the agreement the company recognized tax benefits of \$48 million during the second quarter of 2006, due to the reversal of previously established expense provisions.

The company's effective tax rate on income from continuing operations for the six months ended June 30, 2006, was 27.9 percent as compared with 33.6 percent for the same period in 2005. The decrease was primarily due to the recognition of the tax benefit discussed above.

**Discontinued Operations**

Discontinued operations for the three months ended June 30, 2006, is primarily comprised of a \$5 million after-tax loss on the shutdown of the Enterprise Information Technology (EIT) business (formerly reported in the Information Technology segment), partially offset by a \$2 million after-tax gain on the divestiture of Winchester Electronics (Winchester). Discontinued operations for the three months ended June 30, 2005, is primarily comprised of a \$3 million after-tax operating loss from the shutdown of EIT. See Note 5 to the Consolidated Condensed Financial Statements in Part I, Item 1.

Discontinued operations for the six months ended June 30, 2006, is primarily comprised of an \$11 million after-tax loss on the shutdown of EIT, partially offset by a \$5 million after-tax gain on the divestiture of Interconnect, and a \$2 million after-tax gain on the divestiture of Winchester. Discontinued operations for the six months ended June 30, 2005, is primarily comprised of an \$11 million after-tax gain on the divestiture of Teldix GmbH (Teldix), partially offset by \$3 million in after-tax operating losses from EIT. See Note 5 to the Consolidated Condensed Financial Statements in Part I, Item 1.

**Diluted Earnings Per Share from Continuing Operations**

Diluted earnings per share from continuing operations for the three months ended June 30, 2006, was \$1.26 per share, as compared with \$1.01 per share in the same period in 2005. Earnings per share are based on weighted average diluted shares outstanding of 350.1 million for the three months ended June 30, 2006, and 365.2 million for the same period in 2005. The decrease in weighted average shares outstanding is primarily due to the impact of the share repurchase program. See Note 7 to the Consolidated Condensed Financial Statements in Part I, Item 1.

Diluted earnings per share from continuing operations for the six months ended June 30, 2006, was \$2.29 per share, as compared with \$2.10 per share in the same period in 2005. Earnings per share are based on weighted average diluted shares outstanding of 351.8 million for the six months ended June 30, 2006, and 365.7 million for the same period in 2005. The decrease in weighted average shares outstanding is primarily due to the impact of the share repurchase program. See Note 7 to the Consolidated Condensed Financial Statements in Part I, Item 1.

**Cash Provided by Continuing Operations**

For the three months ended June 30, 2006, the company provided cash from continuing operations of \$657 million compared to \$823 million for the three months ended June 30, 2005. The decrease was primarily due to timing of cash payments and receipts during the quarter.

For the six months ended June 30, 2006, the company provided cash from continuing operations of \$624 million compared with \$1.1 billion for the six months ended June 30, 2005. The decrease was primarily due to a decline in progress payments received during the 2006 period.

**SEGMENT OPERATING RESULTS**

Effective January 1, 2006, the company established a new reportable segment, Technical Services, to leverage existing business strengths and synergies in the rapidly expanding areas of logistics support, sustainment and technical services. Technical Services consolidates multiple programs in logistics operations from the Electronics, Integrated Systems, Mission Systems and Information Technology segments.

Effective January 1, 2006, certain business areas within the Electronics and Information Technology segments were realigned and some business areas have been renamed. Where applicable, all comparisons to prior period information reflect these realignments and references to business areas in the discussion below reflect the new names.

Effective January 1, 2006, in order to provide a more relevant depiction of the management and performance of the company's businesses, sales and segment operating margin in the following tables were revised to include margin on intersegment sales for all periods presented. Intersegment amounts are then eliminated upon consolidation of the segments.

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

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
<b>Sales and Service Revenues</b>				
<b>Information &amp; Services</b>				
Mission Systems	\$ 1,338	\$ 1,271	\$ 2,602	\$ 2,525
Information Technology	993	968	1,941	1,847
Technical Services	300	286	575	560
<b>Total Information &amp; Services</b>	<b>2,631</b>	<b>2,525</b>	<b>5,118</b>	<b>4,932</b>
<b>Aerospace</b>				
Integrated Systems	1,397	1,391	2,834	2,678
Space Technology	865	875	1,720	1,738
<b>Total Aerospace</b>	<b>2,262</b>	<b>2,266</b>	<b>4,554</b>	<b>4,416</b>
<b>Electronics</b>	<b>1,635</b>	<b>1,769</b>	<b>3,144</b>	<b>3,316</b>
<b>Ships</b>	<b>1,437</b>	<b>1,587</b>	<b>2,570</b>	<b>3,101</b>
<b>Other</b>		11		22
<b>Intersegment eliminations</b>	<b>(364)</b>	<b>(351)</b>	<b>(692)</b>	<b>(678)</b>
Total sales and service revenues	\$ 7,601	\$ 7,807	\$ 14,694	\$ 15,109
<b>Segment Operating Margin</b>				
<b>Information &amp; Services</b>				
Mission Systems	\$ 132	\$ 99	\$ 249	\$ 192
Information Technology	86	82	170	158
Technical Services	16	14	29	26
<b>Total Information &amp; Services</b>	<b>234</b>	<b>195</b>	<b>448</b>	<b>376</b>
<b>Aerospace</b>				
Integrated Systems	142	117	291	259
Space Technology	81	74	152	141
<b>Total Aerospace</b>	<b>223</b>	<b>191</b>	<b>443</b>	<b>400</b>
<b>Electronics</b>	<b>181</b>	<b>199</b>	<b>358</b>	<b>361</b>
<b>Ships</b>	<b>129</b>	<b>102</b>	<b>197</b>	<b>209</b>
<b>Other</b>		(5)		(6)
<b>Intersegment eliminations</b>	<b>(25)</b>	<b>(18)</b>	<b>(51)</b>	<b>(38)</b>
Total segment operating margin	\$ 742	\$ 664	\$ 1,395	\$ 1,302

Segment operating results are discussed below with respect to the following financial measures:

**Contract Acquisitions** – Contract acquisitions represent orders received during the period for which funding has been contractually obligated by the customer. Contract acquisitions tend to fluctuate from year to year and are determined by the size and timing of new and follow-on orders. In the year that a business is purchased or divested, its existing funded order backlog as of the date of purchase or disposition is reported as an increase or decrease, respectively, to contract acquisitions.

**Sales and Service Revenues** – Year-to-year sales generally vary less than contract acquisitions and reflect performance under new and ongoing contracts. Changes in sales and service revenues are typically expressed in terms of volume. Volume generally refers to increases (or decreases) in revenues incurred due to varying activity levels or delivery rates on individual contracts. Volume changes will typically carry a corresponding margin change based on the margin rate for a particular contract.

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*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 pension expense/income that is not currently recognized under CAS, as well as the portion of corporate, legal, environmental, state income tax, other retiree benefits, and other expenses not considered allowable costs under CAS 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 basis at the time an EAC change is recorded.

Contract Acquisitions, Sales and Service Revenues, and Segment Operating Margin in the tables within this section include intercompany amounts that are eliminated in the accompanying Consolidated Condensed Financial Statements.

**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 focused in the following business areas: Command, Control & Intelligence Systems; Missile Systems; and Technical & Management Services.

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
Contract Acquisitions	<b>\$1,179</b>	\$1,133	<b>\$2,907</b>	\$2,363
Sales and Service Revenues	<b>1,338</b>	1,271	<b>2,602</b>	2,525
Segment Operating Margin	<b>132</b>	99	<b>249</b>	192
<i>As a percentage of segment sales</i>	<b>9.9%</b>	7.8%	<b>9.6%</b>	7.6%

**Contract Acquisitions**

Mission Systems contract acquisitions for the three months ended June 30, 2006, increased \$46 million, or 4 percent, as compared with the same period in 2005. Significant acquisitions during the three months ended June 30, 2006, included \$86 million for the Intercontinental Ballistic Missile (ICBM) program, \$70 million for the Kinetic Energy Interceptor (KEI) program, and \$59 million for the Ground-Based Midcourse Fire Control Communications program.

Mission Systems contract acquisitions for the six months ended June 30, 2006, increased \$544 million, or 23 percent, as compared with the same period in 2005, partially due to the receipt of delayed funding upon approval of the federal defense budget. Significant acquisitions during the six months ended June 30, 2006, included \$499 million for the ICBM program, \$134 million for the Joint National Integration Center Research & Development Contract, \$121 million for the KEI program, \$67 million for the Command Post Program, and \$64 million for the Space Based Space Surveillance program.

**Sales and Service Revenues**

Mission Systems revenues for the three months ended June 30, 2006, increased \$67 million, or 5 percent, as compared with the same period in 2005. The increase was due to higher volume across all three business areas. Command, Control & Intelligence Systems revenue increased \$31 million, primarily due to increased volume on the Command Post Program and the Air and Missile Defense Command and Control System Tactical Support

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program. Technical & Management Services revenue increased \$16 million due to higher volume on the Air Force Civil Engineering Support Agency (AFCESA) and various other programs. Missile Systems revenue increased \$9 million, primarily due to higher volume on the KEI program and the Joint National Integration Center Research & Development Contract.

Mission Systems revenues for the six months ended June 30, 2006, increased \$77 million, or 3 percent, as compared with the same period in 2005. The increase was due to higher sales in Command, Control & Intelligence Systems and Technical & Management Services, partially offset by lower volume in Missile Systems. Command, Control & Intelligence Systems revenue increased \$64 million, due to increased volume on several programs. Technical & Management Services revenue increased \$16 million, due to increased volume on the AFCESA and Joint Warfighting Center programs. Missile Systems revenue decreased \$7 million, due to lower volume on the ICBM program, partially offset by increased volume on the KEI program and the Joint National Integration Center Research & Development Contract.

*Segment Operating Margin*

Mission Systems operating margin for the three and six months ended June 30, 2006, increased \$33 million, or 33 percent, and \$57 million, or 30 percent, as compared with the same periods in 2005. The increases were primarily due to higher volume and improved performance on several programs in Command, Control & Intelligence Systems and Technical & Management Services, and lower amortization expense for purchased intangibles.

**Information Technology**

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

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
Contract Acquisitions	<b>\$926</b>	\$1,198	<b>\$2,133</b>	\$2,159
Sales and Service Revenues	<b>993</b>	968	<b>1,941</b>	1,847
Segment Operating Margin	<b>86</b>	82	<b>170</b>	158
<i>As a percentage of segment sales</i>	<b>8.7%</b>	8.5%	<b>8.8%</b>	8.6%

*Contract Acquisitions*

Information Technology contract acquisitions for the three months ended June 30, 2006, decreased \$272 million, or 23 percent, as compared with the same period in 2005. Significant acquisitions during the three months ended June 30, 2006, included \$93 million for the Virginia Information Technology Outsourcing program, \$37 million for the National Geospatial-Intelligence Agency Enterprise Engineering program, \$23 million for the Defense Threat Reduction Agency program, and \$20 million for the Systems and Software Engineering Services program.

Information Technology contract acquisitions for the six months ended June 30, 2006, decreased \$26 million, or 1 percent, as compared with the same period in 2005. Significant acquisitions during the six months ended June 30, 2006, included \$114 million for the National Geospatial-Intelligence Agency Enterprise Engineering program, \$93 million for the Virginia Information Technology Outsourcing program, \$71 million for the Identification 1 program, and \$47 million for the San Diego Information Technology Outsourcing program.

*Sales and Service Revenues*

Information Technology revenues for the three months ended June 30, 2006, increased \$25 million, or 3 percent, as compared with the same period in 2005. The increase was primarily due to higher volume in Defense and

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Intelligence, partially offset by lower volume in Civilian Agencies. Defense revenues increased \$21 million, primarily due to new programs, most notably the United Kingdom Whole Life Support Programme. Intelligence revenues increased \$11 million, due to increased volume on various programs. Civilian Agencies revenues decreased \$10 million due to lower volume on various programs.

Information Technology revenues for the six months ended June 30, 2006, increased \$94 million, or 5 percent, as compared with the same period in 2005. The increase was primarily due to increased volume in Defense, Intelligence, and Civilian Agencies. Defense revenues increased \$57 million due to new programs, most notably the United Kingdom Whole Life Support Programme. Intelligence revenues increased \$29 million, due to increased volume on various programs. Civilian Agencies revenues increased \$17 million, primarily due to the acquisition of Integic Corporation (Integic) in March 2005.

*Segment Operating Margin*

Information Technology operating margin for the three months ended June 30, 2006, increased \$4 million, or 5 percent, as compared with the same period in 2005. The increase was primarily due to higher volume and performance improvements in Defense and lower amortization expense for purchased intangibles, partially offset by lower volume in Civilian Agencies.

Information Technology operating margin for the six months ended June 30, 2006, increased \$12 million, or 8 percent, as compared to the same period in 2005. The increase was primarily due to higher volume and improved program performance in Defense and Intelligence, and lower amortization expense for purchased intangibles, partially offset by lower volume in Civilian Agencies and Commercial, State & Local.

**Technical Services**

Technical Services is a leading provider of logistics, infrastructure, and sustainment support, while also providing a wide-array of technical services including training and simulation.

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	<b>2006</b>	2005	<b>2006</b>	2005
Contract Acquisitions	<b>\$511</b>	\$175	<b>\$962</b>	\$444
Sales and Service Revenues	<b>300</b>	286	<b>575</b>	560
Segment Operating Margin	<b>16</b>	14	<b>29</b>	26
<i>As a percentage of segment sales</i>	<b>5.3%</b>	4.9%	<b>5.0%</b>	4.6%

*Contract Acquisitions*

Technical Services contract acquisitions for the three months ended June 30, 2006, increased \$336 million, or 192 percent, as compared with the same period in 2005. Significant acquisitions during the three months ended June 30, 2006, included \$274 million for a three-year extension on the Saudi Arabia National Guard (SANG) program, \$63 million for the Space Gateway Support (SGS) program, and \$22 million for the Citizenship and Immigration Services (CIS) program.

Technical Services contract acquisitions for the six months ended June 30, 2006, increased \$518 million, or 117 percent, as compared with the same period in 2005. Significant acquisitions during the six months ended June 30, 2006, included \$297 million for the SANG program, \$234 million for the SGS program, \$43 million for the CIS program, \$43 million for the B-2 Repairs program, \$44 million for the Ft. Irwin program, and \$38 million for the Battle Command Training Program.

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Technical Services revenues for the three months ended June 30, 2006, increased \$14 million, or 5 percent, as compared with the same period in 2005. The increase was primarily due to higher volume in the Combined Tactical Training Range (CTTR), CIS, and Ft. Irwin programs, partially offset by lower volume on the SGS program.

Technical Services revenues for the six months ended June 30, 2006, increased \$15 million, or 3 percent, as compared with the same period in 2005. Increased scope on the CTTR program and higher volume on the CIS and Ft. Irwin programs were partially offset by lower volume on the SGS and SANG programs.

*Segment Operating Margin*

Technical Services operating margin for the three months ended June 30, 2006, increased \$2 million or 14 percent as compared to the same period in 2005. The increase was primarily due to improved performance on the SANG program.

Technical Services segment operating margin for the six months ended June 30, 2006, increased \$3 million or 12 percent, as compared to the same period in 2005. The increase was primarily due to improved performance on the SANG program, partially offset by lower performance on the SGS program.

**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 focused in the following business areas: Integrated Systems Western Region, Airborne Early Warning & Electronic Warfare Systems, and Airborne Ground Surveillance & Battle Management Systems.

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	<b>2006</b>	2005	<b>2006</b>	2005
Contract Acquisitions	<b>\$ 869</b>	\$ 662	<b>\$3,604</b>	\$2,587
Sales and Service Revenues	<b>1,397</b>	1,391	<b>2,834</b>	2,678
Segment Operating Margin	<b>142</b>	117	<b>291</b>	259
<i>As a percentage of segment sales</i>	<b>10.2%</b>	8.4%	<b>10.3%</b>	9.7%

*Contract Acquisitions*

Integrated Systems contract acquisitions for the three months ended June 30, 2006, increased \$207 million, or 31 percent, as compared with the same period in 2005. Significant acquisitions during the three months ended June 30, 2006, included \$319 million for the High Altitude Long Endurance (HALE) Systems (Global Hawk) program and \$124 million for the F-35 program.

Integrated Systems contract acquisitions for the six months ended June 30, 2006, increased \$1 billion, or 39 percent, as compared with the same period in 2005. Significant acquisitions during the six months ended June 30, 2006, included \$731 million for the F/A-18 program, \$657 million for the E-2D Advanced Hawkeye program, \$435 million for the F-35 program, and \$375 million for the HALE Systems program.

*Sales and Service Revenues*

Integrated Systems revenues for the three months ended June 30, 2006, increased \$6 million as compared with the same period in 2005. The increase was due to higher volume in Integrated Systems Western Region, partially

## NORTHROP GRUMMAN CORPORATION

offset by lower volume in Airborne Early Warning & Electronic Warfare Systems and Airborne Ground Surveillance & Battle Management Systems. Integrated Systems Western Region revenue increased \$93 million, primarily due to higher volume in the F/A-18 and F-35 programs. Airborne Early Warning & Electronic Warfare Systems revenue decreased \$73 million, primarily due to lower volume in the E-2D Advanced Hawkeye and E-2C Multi-year programs. Airborne Ground Surveillance & Battle Management Systems revenue decreased \$14 million, primarily due to lower volume in the Joint Surveillance Target Attack System (Joint STARS) program.

Integrated Systems revenues for the six months ended June 30, 2006, increased \$156 million, or 6 percent, as compared with the same period in 2005. The increase was primarily due to higher volume in Integrated Systems Western Region, partially offset by lower volume in Airborne Ground Surveillance & Battle Management Systems. Integrated Systems Western Region revenue increased \$166 million, due to higher volume in the F/A-18 and F-35 programs. Airborne Ground Surveillance & Battle Management Systems revenue decreased \$12 million, primarily due to lower volume in the Joint STARS program.

### Segment Operating Margin

Integrated Systems operating margin for the three months ended June 30, 2006, increased \$25 million, or 21 percent, as compared with the same period in 2005. The increase was primarily due to performance improvements in Integrated Systems Western Region.

Integrated Systems operating margin for the six months ended June 30, 2006, increased \$32 million, or 12 percent, as compared to the same period in 2005. The increase in operating margin was primarily due to higher volume and improved performance in Integrated Systems Western Region and Airborne Early Warning & Electronic Warfare Systems.

### Space Technology

Space Technology develops and integrates a broad range of systems at the leading edge of space, defense, and electronics technology, including the design, development, manufacture, and integration of spacecraft systems and subsystems, electronic and communications payloads, advanced avionics systems, and high energy laser systems and subsystems. Products and services are focused in the following business areas: Intelligence, Surveillance & Reconnaissance; Civil Space; Satellite Communications; Software Defined Radios; Missile & Space Defense; and Technology.

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
Contract Acquisitions	\$ 730	\$ 737	\$ 2,371	\$ 1,610
Sales and Service Revenues	865	875	1,720	1,738
Segment Operating Margin	81	74	152	141
<i>As a percentage of segment sales</i>	9.4%	8.5%	8.8%	8.1%

### Contract Acquisitions

Space Technology contract acquisitions for the three months ended June 30, 2006, decreased \$7 million, or 1 percent, as compared with the same period in 2005. Significant acquisitions during the three months ended June 30, 2006, included \$151 million for restricted programs, \$79 million for the Advanced Extremely High Frequency (AEHF) program, and additional funding of \$76 million for the National Polar-orbiting Operational Environmental Satellite System (NPOESS) program.

Space Technology contract acquisitions for the six months ended June 30, 2006, increased \$761 million, or 47 percent, as compared with the same period in 2005. Significant acquisitions during the six months ended June 30, 2006, included \$632 million for restricted programs, \$421 million for the AEHF program, and additional funding of \$380 million for the NPOESS program.

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### NORTHROP GRUMMAN CORPORATION

#### *Sales and Service Revenues*

Space Technology revenues for the three months ended June 30, 2006, decreased \$10 million, or 1 percent, as compared with the same period in 2005. The decrease was primarily due to lower volume in Intelligence, Surveillance & Reconnaissance, partially offset by higher volume in Satellite Communications. Intelligence, Surveillance & Reconnaissance revenue decreased \$31 million, primarily due to lower volume in restricted programs. Satellite Communications sales increased \$22 million, primarily due to increased volume in the AEHF program.

Space Technology revenues for the six months ended June 30, 2006, decreased \$18 million, or 1 percent, as compared with the same period in 2005. The decrease was primarily due to lower volume in Intelligence, Surveillance & Reconnaissance, Software Defined Radios, Missile & Space Defense, and Civil Space, partially offset by higher volume in Satellite Communications. Intelligence, Surveillance & Reconnaissance revenue decreased \$23 million, primarily due to lower sales in restricted programs. Software Defined Radios revenues decreased \$22 million, primarily due to lower volume in the NextGen program and the Avionics Engineering Centers. Missile & Space Defense revenues decreased \$19 million, primarily due to the completion of the Mobile Tactical High Energy Laser program in 2005, and Civil Space revenues decreased \$18 million, primarily due to lower volume in the NPOESS program. Satellite Communications revenues increased \$52 million, primarily due to increased volume in the AEHF program.

#### *Segment Operating Margin*

Space Technology operating margin for the three months ended June 30, 2006, increased \$7 million, or 9 percent, as compared with the same period in 2005. The increase was primarily due to performance improvements in Software Defined Radios.

Space Technology operating margin for the six months ended June 30, 2006, increased \$11 million, or 8 percent, as compared to the same period in 2005. The increase is primarily due to improved performance in Software Defined Radios, Satellite Communications, and Missile & Space Defense.

### 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. Products and services are focused in the following business areas: Aerospace Systems, Defensive Systems, Navigation Systems, Government Systems, Naval & Marine Systems, and Defense Other.

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
Contract Acquisitions	\$ 1,612	\$ 1,389	\$3,458	\$ 3,059
Sales and Service Revenues	1,635	1,769	3,144	3,316
Segment Operating Margin	181	199	358	361
<i>As a percentage of segment sales</i>	11.1%	11.2%	11.4%	10.9%

#### *Contract Acquisitions*

Electronics contract acquisitions for the three months ended June 30, 2006, increased \$223 million, or 16 percent, as compared with the same period in 2005. Significant acquisitions during the three months ended June 30, 2006, included \$125 million for the Automated Flat Sorting Machine Automatic Induct (AFSM-ai) Follow On program and \$124 million for the Mark VII program.

Electronics contract acquisitions for the six months ended June 30, 2006, increased \$399 million, or 13 percent, as compared with the same period in 2005. Significant acquisitions during the six months ended June 30, 2006,

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included \$162 million for the Multi-Platform Radar Technology Insertion Program, \$148 million for the Mark VII program, \$127 million for the Space Based Infrared System program, and \$125 million for the AFSM-ai Follow On program.

#### *Sales and Service Revenues*

Electronics revenues for the three months ended June 30, 2006, decreased \$134 million, or 8 percent, as compared with the same period in 2005. The decrease was primarily due to lower volume in Aerospace Systems and Defensive Systems. Aerospace Systems decreased \$73 million, primarily due to lower volume on the F-16 Block 60 and the Multi-role Electronically Scanned Array programs. Defensive Systems decreased \$59 million, primarily due to lower volume on the Longbow missile program. These decreases were partially offset by higher volume in Naval & Marine Systems.

Electronics revenues for the six months ended June 30, 2006, decreased \$172 million, or 5 percent, as compared with the same period in 2005. The decrease was primarily due to lower volume in Aerospace Systems, Defensive Systems and Navigation Systems, partially offset by increased volume in Government Systems. Aerospace Systems decreased \$105 million, primarily due to lower volume on the F-16 Block 60 and Peace Eagle programs. Defensive Systems decreased \$57 million, primarily due to lower volume in the Longbow missile program. Navigation Systems decreased \$30 million, primarily due to the divestiture of Teldix in 2005. Government Systems increased \$16 million, primarily due to higher volume on Tactical Communications and Postal Automation programs, partially offset by lower volume in Homeland Defense programs.

#### *Segment Operating Margin*

Electronics operating margin for the three months ended June 30, 2006, decreased \$18 million, or 9 percent, as compared with the same period in 2005. The decrease was primarily due to forward loss provisions recorded on the Airborne Self Protection Integrated Suite II (ASPIS II) and Peace Eagle fixed-price development programs in Aerospace Systems, partially offset by lower amortization expense for purchased intangibles and performance improvements on several programs.

Electronics operating margin for the six months ended June 30, 2006, decreased \$3 million, or 1 percent, as compared to the same period in 2005. The decrease was primarily due to forward loss provisions recorded on the ASPIS II and Peace Eagle fixed-price development programs in Aerospace Systems, partially offset by lower amortization expense for purchased intangibles.

### SHIPS

Ships is one of the nation's leading full service 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 commercial vessels. Ships is also 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. Products and services are focused in the following business areas: Aircraft Carriers, Expeditionary Warfare, Submarines, Surface Combatants, Coast Guard & Coastal Defense, Services, and Commercial & Other.

	Three months ended June 30		Six months ended June 30	
<i>\$ in millions</i>	2006	2005	2006	2005
Contract Acquisitions	\$ 2,740	\$ 321	\$ 5,794	\$ 1,487
Sales and Service Revenues	1,437	1,587	2,570	3,101
Segment Operating Margin	129	102	197	209
<i>As a percentage of segment sales</i>	9.0%	6.4%	7.7%	6.7%

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### **NORTHROP GRUMMAN CORPORATION**

#### *Contract Acquisitions*

Ships contract acquisitions for the three months ended June 30, 2006, increased \$2.4 billion as compared with the same period in 2005. Significant acquisitions during the three months ended June 30, 2006, included \$2.3 billion for the LPD program and \$175 million for the Coast Guard's Maritime Security Large National Security Cutter program.

Ships contract acquisitions for the six months ended June 30, 2006, increased \$4.3 billion as compared with the same period in 2005. Significant acquisitions during the six months ended June 30, 2006, included \$2.4 billion for the LPD program, \$1.1 billion for the *USS Carl Vinson* program, \$758 million for the Virginia-class Block II program, \$374 million for the CVN21 program, and \$101 million for the LHD program.

#### *Sales and Service Revenues*

Ships revenues for the three months ended June 30, 2006, decreased \$150 million, or 9 percent, as compared with the same period in 2005. The decrease was primarily due to lower volume in Surface Combatants and Expeditionary Warfare, partially offset by increased volume in Aircraft Carriers and Submarines. Surface Combatants revenue decreased \$194 million, primarily due to lower volume in the DDG 1000 program (formerly the DD(X) program) as well as hurricane-related work delays in the DDG program. Expeditionary Warfare revenue decreased \$25 million, primarily due to hurricane-related work delays in the LPD and LHD programs. Aircraft Carriers increased \$48 million, primarily due to refueling of the *USS Carl Vinson*. Submarines increased \$30 million, primarily due to the Virginia-class Block II program.

Ships revenues for the six months ended June 30, 2006, decreased \$531 million, or 17 percent, as compared with the same period in 2005. The decrease was primarily due to decreased volume in Surface Combatants and Expeditionary Warfare, partially offset by increased volume in Aircraft Carriers and Submarines. Surface Combatants decreased \$470 million, primarily due to lower volume in DDG 1000 program and hurricane-related work delays in the DDG program. Expeditionary Warfare decreased \$134 million, primarily due to hurricane-related work delays in the LPD and LHD programs. Aircraft Carriers increased \$63 million and Submarines increased \$26 million.

#### *Segment Operating Margin*

Ships operating margin for the three months ended June 30, 2006, increased \$27 million, or 26 percent, as compared with the same period in 2005. The increase was primarily due to performance improvements in Submarines and Coast Guard & Coastal Defense, partially offset by decreased volume in Surface Combatants and Commercial & Other. Submarines increased primarily due to material incentives and improved performance in the Virginia-class Block II program. Coast Guard & Coastal Defense increased primarily due to improved performance in the Coast Guard's Maritime Security Large National Security Cutter program. Surface Combatants decreased due to lower volume in the DDG and DDG 1000 programs. Commercial & Other decreased due to additional closeout costs related to the delivery of the final Polar Tanker. The increase in segment operating margin as a percentage of segment sales was primarily due to the performance improvements in Submarines and Coast Guard & Coastal Defense.

Ships operating margin for the six months ended June 30, 2006, decreased \$12 million, or 6 percent, as compared to the same period in 2005. The decrease is primarily due to lower volume and reduced margin rates in Surface Combatants, Expeditionary Warfare, and Commercial & Other, offset by improved performance in Submarines. Surface Combatants and Expeditionary Warfare decreased primarily due to hurricane-related work delays and cost growth. Commercial & Other decreased due to the additional closeout costs related to the delivery of the final Polar Tanker. Submarines increased primarily due to material incentives and improved performance in the Virginia-class Block II program.

**BACKLOG**

Total backlog at June 30, 2006, was approximately \$58 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 Indefinite Delivery/Indefinite Quantity orders. Backlog is converted into sales as work is performed or deliveries are made.

The following table presents funded, unfunded, and total backlog by segment.

<i>\$ in millions</i>	June 30, 2006		
	Funded	Unfunded	Total Backlog
<b>Information &amp; Services</b>			
Mission Systems	\$ 2,781	\$ 7,505	\$10,286
Information Technology	2,435	2,357	4,792
Technical Services	763	525	1,288
<b>Total Information &amp; Services</b>	<b>5,979</b>	<b>10,387</b>	<b>16,366</b>
<b>Aerospace</b>			
Integrated Systems	4,515	6,255	10,770
Space Technology	1,650	8,602	10,252
<b>Total Aerospace</b>	<b>6,165</b>	<b>14,857</b>	<b>21,022</b>
<b>Electronics</b>	<b>6,671</b>	<b>1,737</b>	<b>8,408</b>
<b>Ships</b>	<b>9,353</b>	<b>3,604</b>	<b>12,957</b>
<b>Intersegment eliminations</b>	<b>(619)</b>		<b>(619)</b>
<b>Total</b>	<b>\$27,549</b>	<b>\$ 30,585</b>	<b>\$58,134</b>

Major components in unfunded backlog as of June 30, 2006, included various restricted programs across all operating segments, the Kinetic Energy Interceptor program in the Mission Systems segment; the F-35 and F/A-18 programs in the Integrated Systems segment; the NPOESS program 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 six months ended June 30, 2006, was \$523 million compared to net cash provided of \$1.1 billion for the same period of 2005. The decrease was primarily due to the timing of cash collections from customers during 2006 as compared with the same period in 2005. Net cash from operating activities for the six months ended June 30, 2005, included a payment of \$99 million for a litigation settlement.

For 2006, cash generated from operations supplemented by borrowings under credit facilities is expected to be sufficient to service debt and contract obligations, finance capital expenditures, complete the share repurchase program, and continue paying dividends to the company's shareholders.

*Investing Activities* – Net cash used in investing activities for the six months ended June 30, 2006, was \$251 million compared to \$472 million in the same period of 2005. During the six months ended June 30, 2006, the company made capital expenditures of \$324 million, and received \$71 million of insurance proceeds related to

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### **NORTHROP GRUMMAN CORPORATION**

Hurricane Katrina, \$26 million in net proceeds from the sale of Interconnect, and \$17 million in net proceeds from the sale of Winchester. During the six months ended June 30, 2005, the company made capital expenditures of \$346 million, acquired Integic for \$313 million, sold 7.3 million common shares of TRW Auto for \$143 million, and sold Teldix for \$56 million.

*Financing Activities* – Net cash used in financing activities for the six months ended June 30, 2006, was \$1.1 billion compared to \$619 million in the same period of 2005. Net cash used in financing activities for the six months ended June 30, 2006, included payments of \$521 million related to maturities of long-term debt. During the six months ended June 30, 2006 and 2005, the company paid approximately \$825 million and \$507 million under common stock repurchase programs, respectively. See Note 7 to the Consolidated Condensed Financial Statements in Part I, Item 1. During the six months ended June 30, 2006, and 2005, the company received cash of \$338 million and \$52 million, respectively, from the exercise of stock options.

### **NEW ACCOUNTING STANDARDS**

There was no material effect on the company's consolidated financial position or results of operations due to new accounting pronouncements that became effective during the periods presented. The expanded disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123R – *Share-Based Payment* are presented in Note 14.

Other new pronouncements issued by the Financial Accounting Standards Board (FASB) and not effective until after June 30, 2006, are not expected to have a significant effect on the company's consolidated financial position or results of operations, with the possible exception of the following, which is currently being evaluated by management:

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48 – *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on accounting for derecognition, interest, penalties, accounting in interim periods, disclosure and classification of matters related to uncertainty in income taxes, and transitional requirements upon adoption of FIN 48. FIN 48 is effective for fiscal years beginning after December 15, 2006. Management is currently evaluating the effect that adoption of this interpretation will have on the company's consolidated financial position and results of operations.

### **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,” “assume,” “intend,” “anticipate,” and variations thereof and 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 2005 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 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 and appeals;

- hurricane-related insurance recoveries;
- environmental remediation;
- 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;
- effective tax rates and timing and amounts of tax payments;
- the results of any audit or appeal process with the Internal Revenue Service; 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.

### **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, and short-term investments. At June 30, 2006, substantially all borrowings were fixed-rate long-term debt obligations, none of which are callable until maturity (other than make-whole calls). 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 June 30, 2006.

The company may enter into interest rate swap agreements to manage its exposure to interest rate fluctuations. The company does not hold or issue derivative financial instruments for trading purposes. At June 30, 2006, two interest rate swap agreements were in effect but were not material.

*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 June 30, 2006, the amount of foreign currency forward contracts outstanding was not material. The market risk exposure relating to foreign currency exchange is not 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 (President and Chief Financial Officer) have evaluated the company's disclosure controls and procedures as of June 30, 2006, 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

**NORTHROP GRUMMAN CORPORATION**

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 June 30, 2006, 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.

**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

*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, and apart from the specific matters discussed elsewhere herein, the company does not believe that the resolution of any of these various claims and legal proceedings will have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

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. During discovery in the second quarter of 2006, Cogent asserted entitlement to in excess of \$50 million for lost profits, in excess of \$100 million for loss of goodwill and business opportunities, in excess of \$6 million in royalties, doubling of actual damages and other amounts, including, without limitation, attorneys' fees. Decision is pending on the request by all parties for a continuance of the September 12, 2006, scheduled trial date. The company does not believe, but can give no assurance, that the outcome of this matter would have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

*U.S. Government Investigations and Claims* – Departments and agencies of the U.S. Government have the authority to investigate various transactions and operations of the company, and the results of such investigations may lead to administrative, civil, or criminal proceedings, the ultimate outcome of which could be fines, penalties, repayments 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.

At a briefing 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. It is unclear whether the potential claims relate to a civil False Claims Act case that remains under seal in the U.S. District Court for the Central District of California. The company responded to the allegations, and the parties continue to meet to better understand the factual basis of the claims before the government decides whether to institute formal legal proceedings or to pursue some other form of resolution. Because of the highly technical nature of the issues involved and their classified status, final resolution of this matter could take a considerable amount of time, particularly if litigation should ensue. If the U.S. Department of Justice were to pursue litigation and were to be ultimately successful on its theories of liability and compensatory damages, the effect upon the company's consolidated financial position, results of operations, and cash flows would be material. Based upon its review to date, the company believes that it acted appropriately in this matter but can give no assurance that its view will prevail. The company is not able to estimate the amount of damages, if any, at this time.

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

**Item 1A. Risk Factors**

The following are new or modified risk factors that should be read in conjunction with the risk factors disclosed in the company's 2005 Annual Report on Form 10-K:

***The Company's Insurance Coverage May Be Inadequate to Cover All of Its Significant Risks or Its Insurers May Deny Coverage of Material Losses Incurred by the Company, Which Could Adversely Affect the Company's Profitability and Overall Consolidated Financial Position.***

Primarily as a result of the major hurricanes in 2004 and 2005 (including Hurricanes Katrina and Rita), market conditions have substantially changed, resulting in an overall reduced amount of total available coverage. The company endeavors to identify and obtain in established markets insurance agreements to cover significant risks and liabilities (including, among others, natural disasters, products liability and business interruption). Not every risk or liability can be protected against by insurance, and, for insurable risks, the limits of coverage reasonably obtainable in the market may not be sufficient to cover all actual losses or liabilities incurred. Because of the reduction in overall available coverage referred to above, the company may have to bear substantial costs for uninsured losses that could have an adverse effect upon its consolidated results of operations and its overall consolidated financial position. Additionally, disputes with insurance carriers over coverage may affect the timing of cash flows and, where litigation with the carrier becomes necessary, an outcome unfavorable to the company may adversely affect the company's consolidated results of operations. See Note 11 to the Consolidated Condensed Financial Statements in Part I, Item 1.

***Pension and Medical Expense Associated with the Company's Retirement Benefit Plans May Change Significantly Depending Upon Changes in Actuarial Assumptions, Future Market Performance of Plan Assets, and Changes in Regulations, and Such Changes Could Adversely Affect the Company's Consolidated Financial Position, Results of Operations, and Cash Flows.***

A substantial portion of the company's current and retired employee population is covered by pension and post-retirement benefit plans, the costs of which are dependent upon the company's estimates of rates of return on benefit related assets, discount rates for future payment obligations, rates of future cost growth and trends for future costs. Variances from these estimates could adversely affect the company's consolidated financial position and results of operations.

Certain of the company's pension plans are under-funded. The U.S. Congress is currently considering proposed legislation designed to increase the amount by which companies fund their pension plans among other provisions. It is not possible to predict whether Congress will adopt pension reform legislation, or what form any final legislation might take. Should the proposed legislation become law, the company may be required to increase its pension funding obligations.

***Current Trends in U.S. Government Procurement May Adversely Affect Cash Flows or Program Profitability.***

The company, like others in the defense industry, is aware of a potential problem presented by strict compliance with the Defense Federal Acquisition Regulation Supplement preference for enumerated specialty metals sourced domestically or from certain foreign countries. Subcontractors and lower-tier suppliers have made disclosures indicating inability to comply with the rule as written, particularly for low-value parts such as washers, screws, nuts, bolts, resistors and capacitors. Inability to certify that all enumerated specialty metals in a product comply with sourcing requirements can lead to U.S. Government customers withholding a portion of a payment on delivery or may prevent delivery altogether of materiel and products critical to national defense.

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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 June 30, 2006.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
April 1, 2006, through April 30, 2006				\$ 213 million
May 1, 2006, through May 31, 2006				\$ 176 million
June 1, 2006, through June 30, 2006				\$ 176 million
<b>Total</b>	<b>—</b>	<b>\$ —</b>	<b>—</b>	<b>\$ 176 million</b>

- (1) On October 24, 2005, the company's board of directors authorized a share repurchase program of up to \$1.5 billion of its outstanding common stock, which commenced in November 2005 and is expected to be completed by the end of 2006.

Under this program, the company entered into an initial agreement with Credit Suisse, New York Branch (Credit Suisse) on November 4, 2005, to repurchase approximately 9.1 million shares of common stock at an initial price of \$55.15 per share for a total of \$500 million. Credit Suisse immediately borrowed shares that were sold to and canceled by the company. Subsequently, Credit Suisse purchased shares in the open market to settle its share borrowings. On March 1, 2006, Credit Suisse completed its purchases under this agreement, and the company paid \$37 million for the final price adjustment under the terms of the agreement. The final average purchase price was \$59.05 per share.

The company entered into a second agreement with Credit Suisse on March 6, 2006, to repurchase approximately 11.6 million shares of common stock at an initial price of \$64.78 per share for a total of \$750 million. Under this agreement, Credit Suisse immediately borrowed shares that were sold to and canceled by the company. Subsequently, Credit Suisse purchased shares in the open market to settle its share borrowings. On May 26, 2006, Credit Suisse completed its purchases under this agreement and the company paid \$37 million for the final price adjustment under the terms of the agreement (which is deducted from the dollar value remaining under the program in the table above). The final average purchase price was \$68.01 per share.

Share repurchases take place at management's discretion and 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.

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No information is required in response to this item.

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

a) Annual Meeting –

The annual meeting of stockholders of Northrop Grumman Corporation was held May 17, 2006.

b) Election of Directors –

The following Director nominees were elected at the annual meeting:

John T. Chain, Jr.  
Vic Fazio  
Stephen E. Frank  
Charles R. Larson  
Richard B. Myers  
Ronald D. Sugar

The Directors whose terms of office continue are:

Lewis W. Coleman  
Phillip Frost  
Philip A. Odeen  
Aulana L. Peters  
Kevin W. Sharer

c) The matters voted upon at the meeting and the results of each vote are as follows:

Directors:	Votes For	Votes Withheld		
John T. Chain, Jr.	291,487,549	16,418,799		
Vic Fazio	302,884,087	5,022,261		
Stephen E. Frank	302,929,754	4,976,594		
Charles R. Larson	206,173,584	101,732,764		
Richard B. Myers	303,354,137	4,522,211		
Ronald D. Sugar	299,274,873	8,631,475		

  

	Votes For	Votes Against	Votes Abstaining	Broker Non-Votes
Ratification of the appointment of Deloitte & Touche LLP as the company's independent auditors	301,519,431	4,080,671	2,306,246	0
Proposal amending the company's Restated Certificate of Incorporation to eliminate the super majority vote requirement	266,370,560	14,141,270	3,118,138	24,276,380
Stockholder proposal regarding an independent board chairman	99,622,738	180,358,732	3,648,498	24,276,380

**Item 5. Other Information**

No information is required in response to this item.

**Item 6. Exhibits**

*10.1	Second Amendment dated and effective as of April 27, 2006 to the Northrop Grumman Savings Excess Plan, as amended and restated effective October 1, 2004, and as amended by First Amendment effective as of April 29, 2005
*10.2	Northrop Grumman Corporation Non-Employee Directors Equity Participation Plan As Amended May 17, 2006
*10.3	Northrop Grumman 2006 Annual Incentive Plan and Incentive Compensation Plan (for Non-Section 162(m) Officers)
*10.4	2006 CPC Incentive Restricted Stock Rights Agreement of Wesley G. Bush dated May 16, 2006 granted under the 2001 Long-Term Incentive Stock Plan
*10.5	2006 CPC Incentive Restricted Stock Rights Agreement of Scott J. Seymour dated May 16, 2006 granted under the 2001 Long-Term Incentive Stock Plan
*10.6	Northrop Grumman Executive Health Plan Matrix effective July 1, 2006
*15	Letter from independent registered public accounting firm regarding unaudited interim financial information
*31.1	Rule 13a-14(a)/15d-14(a) Certification of Ronald D. Sugar (Section 302 of the Sarbanes-Oxley Act of 2002)
*31.2	Rule 13a-14(a)/15d-14(a) Certification of Wesley G. Bush (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 Wesley G. Bush pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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\* Filed with this Report

\*\* Furnished with this Report

**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: July 26, 2006

By: /s/ KENNETH N. HEINTZ  
Kenneth N. Heintz  
Corporate Vice President, Controller and  
Chief Accounting Officer  
(Principal Accounting Officer)

**SECOND AMENDMENT TO THE  
NORTHROP GRUMMAN  
SAVINGS EXCESS PLAN  
(AMENDED AND RESTATED EFFECTIVE AS OF OCTOBER 1, 2004)**

This Amendment to the October 1, 2004 restatement of the Northrop Grumman Savings Excess Plan ("Plan") provides that the membership of the Plan's Administrative Committee and the Administrative Committee for the Northrop Grumman Deferred Compensation Plan shall be the same.

This Amendment is effective as of April 27, 2006.

**1. Section 7.1(a) is amended in its entirety to read as follows:**

(a) The Administrative Committee shall be comprised of the individuals (in their corporate capacity) who are members of the Administrative Committee for the Northrop Grumman Deferred Compensation Plan. If no such Administrative Committee exists, the members of the Administrative Committee for the Plan shall be the individuals holding the following positions within the Company (as such titles may be modified from time to time), or their successors in office: the Corporate Vice President and Chief Human Resources and Administration Officer; the Corporate Vice President, Controller and Chief Accounting Officer; the Vice President, Taxation; the Vice President, Trust Administration and Investments; the Vice President Compensation, Benefits and HRIS; and the Corporate Director, Benefits Administration and Services. A member of the Administrative Committee may resign by delivering a written notice of resignation to the Corporate Vice President and Chief Human Resources and Administration Officer.

\* \* \* \*

IN WITNESS WHEREOF, this Amendment is hereby executed by a duly authorized officer on this 27<sup>th</sup> day of April, 2006.

**NORTHROP GRUMMAN CORPORATION**

By:           /s/ DEBORA L. CATSAVAS            
          **Debora L. Catsavas**  
          **Vice President, Compensation, Benefits and HRIS**

**NORTHROP GRUMMAN CORPORATION**  
**NON-EMPLOYEE DIRECTORS EQUITY PARTICIPATION PLAN**

**As Amended May 17, 2006**

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## ARTICLE 1

### *Introduction*

*Section 1.01. Purpose.* The purposes of the Plan are to enable the Company to attract and retain outstanding individuals to serve as non-employee directors of the Company, and to further align the interests of non-employee directors with the interests of the other shareholders of the Company by making the amount of the compensation of non-employee directors dependent in part on the value and appreciation over time of the Common Stock of the Company.

*Section 1.02. Effective Date.* This restatement of the Plan is effective as of December 18, 2002. The Plan was originally effective March 19, 1997.

## ARTICLE 2

### *Definitions*

The following terms when used and capitalized in the Plan will have the following meanings:

*Section 2.01. Accrual.* Any dollar amounts credited to the Equity Participation Account, including any Special Accrual, Annual Accruals, Additional Accruals and Dividend Equivalents.

*Section 2.02. Annual Accrual.* This is defined in Section 6.02.

*Section 2.03. Annual Retainer Fee.* That fixed amount paid to Directors exclusive of travel expenses, meeting fees, committee fees, or any other similar remuneration.

*Section 2.04. Board.* The Board of Directors of the Company.

*Section 2.05. Change in Control.* This is defined in Sections A.02-A.04.

*Section 2.06. Common Stock.* The Common Stock of the Company.

*Section 2.07. Company.* Northrop Grumman Corporation.

*Section 2.08. Conversion Date.* The date the Outside Director's service as a member of the Board terminates for any reason, including death.

*Section 2.09. Debilitating Illness.* Any physical or mental condition which renders an individual unable to carry on the normal duties of his or her active business career.

*Section 2.10. Director.* A member of the Board.

*Section 2.11. Dividend Equivalent.* An amount equal to the cash dividend per share which is payable on any dividend payment date for the Common Stock.

*Section 2.12. Electing Outside Director.* An Outside Director participating in the Retirement Plan who, at the inception of this Plan, elected to terminate participation in the Retirement Plan and to participate in this Plan instead.

*Section 2.13. Equity Participation Account.* An unfunded bookkeeping account maintained by the Company for a Participant to which amounts are credited under the Plan.

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*Section 2.14. Fair Market Value Of The Common Stock.* This is determined as follows:

(a) for relevant Accruals and Conversion Dates that occur on or before February 18, 1998, the closing price of a share of Common Stock as reported on the composite tape for securities listed on the New York Stock Exchange (the "Exchange") for the date in question. If no sales of Common Stock were made on the Exchange on that date, the closing price of a share of Common Stock as reported on said composite tape for the preceding day on which sales of Common Stock were made on the Exchange shall be substituted; and

(b) for relevant Accruals and Conversion Dates that occur after February 18, 1998, the average of the daily closing prices of a share of Common Stock as reported on the composite tape for securities listed on the Exchange for the 20 trading days (counting as trading days only days on which sales of Common Stock are reported) ending with the date in question.

*Section 2.15. Outside Director.* A Director who is not a common law employee of the Company.

*Section 2.16. Participant.* Each current or former Outside Director eligible for benefits under the Plan who has not yet received a complete distribution of his or her benefits under the Plan, other than a former Outside Director who terminated service with the Board without any entitlement to benefits under Sections 4.01-4.03.

*Section 2.17. Plan.* The Northrop Grumman Corporation Non-Employee Directors Equity Participation Plan.

*Section 2.18. Retired Outside Director.* An Outside Director whose service as a member of the Board for any reason has terminated and who is entitled to receive a distribution.

*Section 2.19. Retirement Plan.* The Northrop Grumman Corporation Board of Directors Retirement Plan.

*Section 2.20. Special Accrual.* This is defined in Section 6.03.

*Section 2.21. Surviving Spouse.* A person who:

(a) was legally married to the Participant for at least one year prior to the date the Participant ceases to serve on the Board (including death while serving on the Board), and

(b) outlives the deceased Participant by at least 30 calendar days, to the extent he or she is not prevented from receiving benefits under the Plan by a court order or property settlement at the time payments would otherwise be due.

*Section 2.22. Total Disability.* Total disability as defined in the Northrop Grumman Long-Term Disability Insurance Plan.

*Section 2.23. Unit.* An equivalent to a share of Common Stock, which is the denomination into which all dollar Accruals to any Equity Participation Account are to be converted.

*Section 2.24. Year Of Service.* A 12-consecutive-month period of service as an Outside Director.

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## ARTICLE 3

### *Participation*

*Section 3.01. In General.* A Director is eligible to participate in the Plan if he or she:

- (a) becomes an Outside Director after March 19, 1997, or
- (b) is an Electing Outside Director.

## ARTICLE 4

### *Entitlement To Benefits*

*Section 4.01. Normal Benefit.* Each Participant who terminates service on the Board will be entitled to receive a benefit under Section 5.01 if he or she satisfies (a) or (b):

- (a) He or she completes at least three consecutive Years of Service.
- (b) He or she retires from the Board as a result of Total Disability or a Debilitating Illness.

Notwithstanding any provision of the Plan to the contrary, a Participant that terminates service on the Board without satisfying either (a) or (b) above will be entitled to receive a benefit under Section 5.01 if:

- (i) He or she terminated service on the Board for the sole purpose of pursuing or accepting a position (whether appointed, elected, or otherwise) with a federal, state, or local governmental entity or for some other purpose that is determined by the Company to constitute public service; and
- (ii) He or she recommences service on the Board as an Outside Director within a reasonably practicable period following the termination of, or termination of the pursuit of, the governmental or public service position and the Participant's total service before and after the termination and commencement of service on the Board, when aggregated, equals at least three Years of Service.

*Section 4.02. Partial Benefit.* A Participant will be entitled to receive a partial benefit under Section 5.02 if:

- (a) he or she terminates service on the Board prior to completing three consecutive Years of Service, and
- (b) his or her termination occurs because he or she will have attained age 70 prior to the Annual Meeting of Shareholders.

*Section 4.03. Change in Control Benefit.* A Participant who is not entitled to benefits under Section 4.01 will be entitled to receive a Change in Control benefit under Section 5.03 if the conditions described in Appendix A are met.

*Section 4.04. Better-Of Benefit.* A Participant entitled to a benefit under Sections 4.01-4.03 will be entitled to "better-of" benefits under Section 5.04 if he or she:

- (a) was a Participant in the Plan and a current Outside Director as of March 1, 1998, and
- (b) terminates service on account of death, Debilitating Illness or Total Disability.

*Section 4.05. Surviving Spouse Benefit.* Upon a Participant's death, his or her Surviving Spouse, if any, will be eligible to receive the remainder of the payments due the Participant. If there is no Surviving Spouse, all payments will cease.

*Section 4.06. Other Participants.* No benefits will be paid with respect to a Participant who terminates service with the Board unless the eligibility conditions of Section 4.01, 4.02 or 4.03 are satisfied.

## ARTICLE 5

### *Amount Of Benefit*

*Section 5.01. Normal Benefit Amount.* The normal benefit amount is the full balance of the Participant's Equity Participation Account.

*Section 5.02. Partial Benefit Amount.* The partial benefit amount is the Participant's Equity Participation Account multiplied by a fraction.

(a) The numerator of the fraction is the number of the Participant's completed consecutive Years of Service and the denominator is three.

(b) For purposes of (a), completed Years of Service include completed months of service (rounded up to the nearest month) expressed as a fraction of a year to the nearest quarter.

*Section 5.03. Change in Control Benefit Amount.* The Change in Control benefit is equal to the full balance of the Participant's Equity Participation Account.

*Section 5.04. Better-Of Benefit Amount.* A Participant entitled to "better-of" benefits will have his or her benefits determined under this Section if that would result in greater benefits than those provided under Sections 5.01-5.03, as applicable.

(a) The benefit under this Section equals the benefit the Participant would receive (if any) if he or she were a participant under the Retirement Plan.

(b) If a Participant would not be entitled to any benefit under the Retirement Plan (e.g., because he or she failed to meet the five years of service requirement), this Section will not provide any alternative benefits.

(c) The Retirement Plan benefit will be considered greater for purposes of this Section if the present value of the projected Retirement Plan benefit is greater than the Participant's balance in his or her Equity Participation Account at the Conversion Date.

(d) For purposes of determining the present value of the Retirement Plan benefit, the following assumptions will be used:

(1) An interest rate assumption of 6.5% will be used.

(2) No mortality factor will be applied. The Participant will be assumed to get all payments before dying.

(3) The Annual Retainer Fee used by the Retirement Plan will be assumed to remain constant for all future years.

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## ARTICLE 6

### *Accounts*

*Section 6.01. Equity Participation Accounts.* An Equity Participation Account will be maintained for each Participant having an amount to his or her credit under the Plan. The account will keep track of Accruals and payments for a Participant's benefit.

*Section 6.02. Annual Accruals.* On each March 19, the Company will credit an amount equal to 50% of the Annual Retainer Fee in effect on that date (an "Annual Accrual") to the Equity Participation Account of each Participant who provided a full Year of Service in the immediately preceding 12-month period.

(a) No accrual will be made for any Outside Director who has provided at least ten consecutive Years of Service.

(b) Participants who have provided less than a full Year of Service for the immediately preceding 12-month period will receive a pro rated portion of the normal Annual Accrual based on their months of service for the period (rounded up to the nearest month) divided by 12.

*Section 6.03. Special Accruals.* As of March 19, 1997, the Company credited to the Equity Participation Account of each Electing Outside Director a special, one-time credit (a "Special Accrual"). The dollar amount of the Special Accrual was equal to the present value (calculated at a 6.5% discount rate) of the accrued benefits of an Electing Outside Director under the Retirement Plan.

*Section 6.04. Conversion Of Accruals Into Units.* Each Accrual will be converted into Units by dividing the dollar amount of the Accrual by the Fair Market Value of the Common Stock on the day the Accrual is made. Units will be calculated and recorded in Equity Participation Accounts rounded to the third decimal place.

*Section 6.05. Dividend Equivalents.* On each date on which cash dividends are paid on shares of the Common Stock, Equity Participation Accounts will be credited with one Dividend Equivalent for each Unit credited to such Account.

(a) Each fraction of a Unit will be credited with a like fraction of a Dividend Equivalent on such date.

(b) Dividend Equivalents credited to each Equity Participation Account will be converted into Units by dividing the dollar amount of the Dividend Equivalent by the Fair Market Value of the Common Stock on the date the Dividend Equivalent is accrued.

*Section 6.06. Change in the Common Stock.* In the event of any stock dividend, stock split, recapitalization, distribution of property, merger, split-up, spin-off, or other change affecting or distribution with respect to the Common Stock of the Company (other than cash dividends), the Units in each Account will be adjusted in the same manner and proportion as the change to the Common Stock.

*Section 6.07. Benefit Accrual Freeze Effective June 1, 2005.* Notwithstanding any other provision of this Plan, no further Accruals shall be credited to any Participant's Equity Participation Account under this Plan at any time after May 31, 2005; provided, however, that Dividend Equivalents will continue to be credited to a Participant's Equity Participation Account after such date in accordance with Section 6.05. Accordingly, each Participant shall be entitled to the benefit he or she earned under this Plan through and including May 31, 2005, but, except with respect to Dividend Equivalents, shall not be credited with any additional Accruals or other benefits following May 31, 2005. No person shall become a Participant under this Plan at any time after May 31, 2005. Notwithstanding the foregoing provisions, a Participant shall continue to be credited with Years of Service for periods of service as an Outside Director after May 31, 2005."

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ARTICLE 7

*Distributions*

*Section 7.01. In General.*

- (a) All distributions of Equity Participation Accounts to Participants will be made in cash.
- (b) The Equity Participation Account of each Retired Outside Director will be paid in a number of annual installments equal to the number of full Years of Service for which benefits have been accrued (not to exceed ten), subject to (d).
- (c) Payments will commence on the 20th business day following the Conversion Date for such Equity Participation Account, and then on each anniversary of the Conversion Date.
- (d) All payments will cease no later than:
  - (1) upon the death of the Surviving Spouse, or
  - (2) if there is no Surviving Spouse, upon the death of the Participant.

*Section 7.02. Amount of Installments.* Each installment will be in an amount equal to the total dollar value of the Equity Participation Account as of the Conversion Date or the applicable anniversary date of the Conversion Date to which the payment relates divided by the number of installments remaining to be paid.

*Section 7.03. Conversion of Units into Dollars.* The total dollar value of the Equity Participation Account will be determined by multiplying the number of Units then in the account by the Fair Market Value of the Common Stock on the Conversion Date or any applicable anniversary. The number of Units in the account will be reduced by the Unit equivalent of each payment.

*Section 7.04. T-Bond Election:* If a Participant makes an election under this section, the amount of each payment will be determined under this section rather than under Section 7.03. The timing and number of payments will still be determined under Section 7.01.

(a) *Account Balance:* If a Participant makes an election under this section, his or her Equity Participation Account will be converted to a deemed principal amount at the Conversion Date which will earn deemed interest on the remaining balance. The Account will be increased for deemed interest and reduced for payments made. The Account will no longer be based on the value of the Common Stock.

(b) *Initial Principal Amount:* The initial principal amount for any Participant will be determined on the Conversion Date by multiplying the number of Units in the Participant's Equity Participation Account by the Fair Market Value of the Common Stock on the Conversion Date.

(c) *Initial Payment:* The initial payment will be equal to the Initial Principal Amount divided by the total number of installments to be paid.

(d) *Later Payments:* Each annual installment after the Initial Payment will be equal to the remaining Account balance at the applicable anniversary of the Conversion Date divided by the number of remaining installments.

(e) *Interest Credits:* Interest will be credited on the amount remaining after the Initial Payment and future account balances at the rate specified in (f), compounded daily.

(f) *T-Bond Rate*: The interest rate will be equal to the average interest rate on 10-year U.S. Treasury bonds for the 52 weeks ending immediately prior to the applicable anniversary of the Conversion Date.

(g) *Elections*: An election under this subsection may be made only by delivering a written election of this T-Bond option to the Secretary of Northrop Grumman Corporation (or its successor), on a form specified by the Secretary:

(1) no later than March 1, 1998, in the case of Participants who were Outside Directors as of February 18, 1998, or

(2) no later than 30 days after becoming an Outside Director with respect to Participants who become Outside Directors after March 1, 1998.

After the relevant date in (1) or (2), an election (or failure to make an election) under this Section will become irrevocable.

*Section 7.05. Payment to a Trust*. The Participant may elect that payments under this Article be made to a trust. Any payments due will be made to the trust as long as the election by the Participant remains in effect.

## ARTICLE 8

### *Miscellaneous Provisions*

*Section 8.01. Amendment And Termination*. The Board may at any time, or from time to time, amend or terminate the Plan.

(a) No such amendment or termination may reduce Plan benefits which accrued prior to the amendment or termination without the prior written consent of each person entitled to receive benefits under the Plan who is adversely affected by such action.

(b) The amendment and termination power of this Section is also subject to the provisions of Section A.06.

*Section 8.02. Plan Unfunded*. The Plan is unfunded. Benefits under the Plan represent only a general contractual conditional obligation of the Company to pay in accordance with the provisions of the Plan.

*Section 8.03. No Assignments*. All payments under the Plan will be made only to the Participant, to his or her Surviving Spouse, or to any trust designated by the Participant under Section 7.05. The right to receive payments under the Plan may not otherwise be assigned or transferred by, and is not subject to the claims of creditors of, any Participant or his or her Surviving Spouse.

*Section 8.04. No Double Payment*. This Section applies if, despite the prior Section, with respect to any Participant (or his or her Surviving Spouse), the Company is required to make payments under this Plan to a person or entity other than the proper payees described in the Plan. In such a case, any amounts due the Participant (or his or her Surviving Spouse) under this Plan will be reduced by the actuarial value of the payments required to be made to such other person or entity.

(a) Actuarial value will be determined using the following actuarial assumptions specified by Treas. Reg. § 1.417(e)-1(d)(2)-(4) (or any successor regulation). The stability period will be one calendar month and the lookback month will be the second calendar month preceding the stability period.

(b) In dividing a Participant's benefit between the Participant and another person or entity, consistent actuarial assumptions and methodologies will be used so that there is no increased cost to the Company on an actuarial basis.

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*Section 8.05. No Other Rights.* Neither the establishment of the Plan, nor any action taken under it, will in any way obligate the Company to nominate an Outside Director for re-election or continue to retain an Outside Director on the Board or confer upon any Outside Director any other rights with respect to the Company.

*Section 8.06. Successors of the Company.* The Plan will be binding upon any successor to the Company, whether by merger, acquisition, consolidation or otherwise.

*Section 8.07. Law Governing.* The Plan will be governed by the laws of the State of California.

*Section 8.08. Actions By Company.* Any powers exercisable by the Company under the Plan will be utilized by written resolution adopted by the Board or its delegate. The Board may by written resolution delegate any of the Company's powers under the Plan and any such delegations may provide for subdelegations, also by written resolution.

*Section 8.09. Plan Representatives.* Those authorized to act as Plan representatives will be designated in writing by the Board or its delegate.

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APPENDIX A

*Change In Control Benefits*

*Section A.01. In General.* This Appendix provides for accelerated vesting of benefits in the event of a Change of Control.

*Section A.02. Change In Control.* Except as provided in Sections A.03 and A.04, a Change in Control occurs under any of the following circumstances:

(a) Any “person” as such term is used in Sections 13(d)(3) and 14(d)(2) of the Securities Exchange Act of 1934, as amended (“Exchange Act”) or any successor provisions, other than a trustee or other fiduciary holding securities under any other employee benefit plan of the Company or an Affiliate, becomes the “beneficial owner” (as defined in Rule 13d-3 under the Exchange Act or any successor provisions), directly or indirectly, of securities of the Company representing fifteen percent (15%) or more of the combined voting power of the Company’s then outstanding securities (unless the event causing the fifteen percent (15%) threshold to be crossed is an acquisition of securities directly from the Company).

(b) During any period of two consecutive years, “Continuing Directors”, as described in (2), cease for any reason to constitute at least a majority of the Board.

(1) The period of two consecutive years does not include any period prior to the adoption of this Plan on March 19, 1997.

(2) The term “Continuing Directors”, for purposes of this Appendix, means:

(A) individuals who at the beginning of the two-consecutive-year period constitute the Board, and

(B) any new director whose nomination by the Board or election by the Company’s shareholders was approved by a vote of at least two-thirds of the directors then still in office who either were directors at the beginning of the two-consecutive-year period or whose election or nomination for election was previously so approved. This clause (B) does not include a director designated by a person who has entered into an agreement with the Company to effect a transaction described in (a) or (c) of this Section.

(c) The shareholders of the Company approve a merger or consolidation of the Company with any other corporation, but only if the transaction closes or is otherwise effectuated. This subsection (c) does not cover a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least 80% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation.

(d) The shareholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition of the Company or all or substantially all of the Company’s assets, but only if the transaction closes or is otherwise effectuated.

*Section A.03. Override by Board.* Transactions described in the previous Section do not constitute Changes in Control if, immediately prior to the change in ownership, merger, consolidation, sale or other disposition, liquidation or change in the Board, the Board shall pass a resolution approved by a vote of the majority of the Continuing Directors to the effect that it has determined that such transaction does not constitute a Change in Control within the intention of this definition. In addition, if a Change in Control has occurred, no subsequent event shall result in another Change in Control.

---

*Section A.04. February, 1998 Vote.* No Change in Control will be deemed to have occurred by virtue of the vote of shareholders on February 26, 1998 to merge with Lockheed Martin Corporation unless and until that merger closes.

*Section A.05. Vesting at Change in Control.* Any Participant serving as an Outside Director at the time of a Change in Control will immediately become entitled to Change in Control benefits under Section 5.03. Actual payment of benefits will not commence until termination of his or her service in accordance with Section 7.01.

*Section A.06. Limitation on Amendment Authority.* The Plan may not be amended, terminated, or otherwise modified or interpreted to eliminate, reduce or defer Change in Control benefits with respect to the circumstances described in Section A.02(c) or (d), between the date of the shareholder vote and the closing or other effectuation of the transaction. This Section is not intended to reduce the Board's authority under Section A.03.

**NORTHROP GRUMMAN 2006 ANNUAL INCENTIVE PLAN  
AND  
INCENTIVE COMPENSATION PLAN (for NON-SECTION 162(m) OFFICERS)**

SECTION I

PURPOSE

Northrop Grumman has an annual incentive program to promote the success of the Company and render its operations profitable to the maximum extent by providing incentives to key employees. Participating employees have varying degrees of impact on the overall success and performance of the Company. To facilitate the appropriate incentive level for each Participant, Northrop Grumman utilizes two incentive plans that use common financial and business performance criteria:

- The Incentive Compensation Plan (ICP)
- The Annual Incentive Plan (AIP)

SECTION II

DEFINITIONS

1. Company—Northrop Grumman Corporation and such of its subsidiaries as are consolidated in its consolidated financial statements.
2. Code—The Internal Revenue Code of 1986, as amended from time to time.
3. Committee—The Compensation and Management Development Committee of the Board of Directors of the Company.
4. Incentive Compensation—Awards payable under these plans.
5. Participant—An employee of the Company granted or eligible to receive Incentive Compensation award under one of these Plans.
6. Performance Criteria—The performance criteria is a weighted combination of various financial and non-financial factors approved by the Committee for the Performance Year.
7. Performance Year—The year with respect to which an award of Incentive Compensation is calculated and paid.
8. Plans—Collectively, the Incentive Compensation Plan (ICP); and/or the Annual Incentive Plan (AIP).
9. Plan Year—The fiscal year of Northrop Grumman Corporation.
10. Section 162(m) Officer—An employee who is a “covered employee” as defined in Section 162(m) of the Code with respect to an award of Incentive Compensation under the 2002 Incentive Compensation Plan for any Performance Year.

SECTION III

PARTICIPATION

Employees may be eligible for incentive compensation under one of the Northrop Grumman incentive plans as described below.

1. Incentive Compensation Plan (ICP):
  - a. Employees eligible to receive incentive compensation under the ICP are elected corporate officers of the rank of vice president and above and the presidents of those consolidated subsidiaries that the

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committee determines to be significant in the overall corporate operations that are not section 162(m) officers for the performance year. If an executive receives or is eligible to receive an incentive compensation award under the 2002 Incentive Compensation Plan for 162(m) officers, then the executive will not be eligible and shall not receive an incentive compensation award under the ICP.

- b. Directors, as such, shall not participate in the ICP, but the fact that an elected corporate officer or subsidiary president is also a director of the Company shall not prevent participation.

2. Annual Incentive Plan (AIP):

- a. Employees eligible to receive incentive compensation awards under the AIP are appointed vice presidents, senior management, middle management and individual key contributors (employees normally in a position that customarily perform quasi-management or team leadership duties). In addition, employees may be eligible to participate in the AIP if they have specific individual goals that directly contribute to the attainment of their respective business unit's operating goals or if employees are considered "high performing" and are in a position to make measurable and significant contributions to the success of the Company.
- b. At the beginning of, or prior to, a performance year, the Company's CEO approves the number of participants eligible for participation in the AIP. Participants are then selected by their management based on an assessment of their position relative to other candidates, their performance, and their potential impact on achievement of business unit and the Company goals.
- c. Participation in the AIP during any performance year does not imply nor guarantee participation in the AIP in future years.

3. Non-Duplication of Awards

- a. A participant may not receive an incentive compensation award under more than one of the above plans for the performance year. The only exception to this is in the event that an individual is a participant in a particular plan for a portion of the performance year and then is selected to participate in one of the other plans for the remainder of that performance year. In this event, an individual may receive pro-rated awards based on the time that he/she participated in each plan.
- b. A participant will not be eligible to receive any incentive compensation award from either of these plans if the employee is a participant in the Company's 2002 Incentive Compensation Plan for 162(m) Officers.

4. Death, Disability, or Retirement

A participant may be eligible to receive a pro-rated incentive compensation award in the event of the employee's death, disability, or retirement. In the case of a deceased participant, such incentive compensation award will be paid to the participant's estate.

5. Employment Status

Except as provided in Section III 4 (see above), in order to be eligible to receive a payment from these plans, a participant must be an active employee of the Company as of December 31 of the plan year, unless an exception is approved in writing by the Company's chief human resources and administrative officer.

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SECTION IV  
GOAL SETTING AND PERFORMANCE CRITERIA

Goal setting and performance planning are essential elements of plan administration. This requires establishing performance criteria, such as annual goals, goal weights, and performance measures. Except as provided in the plan, the Committee approves annual business and financial goals for the Company no later than the end of the first quarter of the annual performance period.

1. Corporation Goals

For each performance year, until otherwise determined by the Committee, financial and non-financial objectives will be established by the Committee in its sole discretion.

2. Financial Measures

- a. The CEO's recommended goals are reviewed and amended as appropriate, and established by the Committee at its sole discretion. Measures may include, but are not limited to: cash management, cash flow, return on investment, debt reduction, revenue growth, net earnings, and return on equity.
- b. The Committee approves a performance threshold, a target level and a maximum performance level for each of the financial measures for the performance year.

3. Supplemental Goals

Supplemental goals may be either qualitative or quantitative such as, but not limited to: customer satisfaction, contract acquisition, delivery schedule, cycle-time improvement, productivity, quality, workforce diversity, and environmental management. The CEO recommends the supplemental goals based on sector goals contained in Annual Operating Plans and corporate office goals established prior to the beginning of each year. Supplemental goals have stated milestones and weights. The CEO's recommended supplemental goals are reviewed and amended as appropriate, and established by the Committee at its sole discretion.

4. Individual Goals

Each year participants develop individual goals that support achievement of the Company's business plan and the specific goals established by the Committee in the three aforementioned corporation goals. Individual goals are prepared, approved and documented. The employee's manager reviews these goals with each participant to ensure they are aggressive, coordinated and focused on attainment of Company business objectives.

SECTION V  
PERFORMANCE DETERMINATION

At the end of the performance year the CEO evaluates the performance of each of the operating units and that of the overall Company against the financial and business goals established at the beginning of the performance year and submits his assessment to the Committee.

The CEO's final evaluation of performance (the "unit performance factor" or "UPF") is stated numerically and is a performance multiplier for individual incentive targets. The UPF will vary from 0.0 to a maximum as approved by the Committee.

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The Committee, in its sole discretion, after taking into account its appraisal of the overall performance of the Company in the attainment of such predetermined financial and non-financial objectives, may either increase or decrease the company UPF for these plans.

SECTION VI  
INCENTIVE COMPENSATION APPROPRIATIONS

1. The amount appropriated for the plans for a performance year is based on the CEO's determination of the UPF (as approved or modified by the Committee) and applied to the individual incentive targets of participants. These performance-adjusted targets are aggregated into the "Appropriated Incentive Compensation" for the performance year.
2. In no event shall incentive compensation payable to participants for a performance year exceed the appropriated incentive compensation for the plans as approved by the Committee.
3. Any appropriated incentive compensation for a performance year, which is not actually distributed to the participants as awards for such year, cannot be transferred to the following performance year.

SECTION VII  
INCENTIVE COMPENSATION AWARDS

1. Individual Award Factors
  - a. Target award percentage—is established annually and is a percentage of annual aggregate salary that reflects the varying impact of participant's positions on business results. Generally vice presidents will have higher target award percentages than senior middle managers and so forth.
  - b. Individual performance—prior to the submission of recommended incentive compensation awards, each participant will be evaluated by his management in relation to the participant's achievement of predetermined individual goals and his/her relative contribution during the performance year compared to other participants to the success or profit of the Company. This assessment of performance (the "individual performance factor" or "IPF") is stated numerically and is a performance multiplier for individual incentive targets. The IPF may range from 0 to 1.5.
  - c. Both the IPF and the UPF are multipliers for the individual participant's target award percentage to determine that participant's incentive compensation award.
2. ICP Awards:
  - a. The Committee shall review the CEO's recommendations and make the final determination of each individual ICP participant's incentive compensation award for the performance year.
3. AIP Awards:
  - a. Prior to the payment of any incentive compensation awards for a performance year, the CEO, or his delegate, may in his sole discretion, adjust or reduce to zero recommended amounts of incentive compensation awards to all or any of the participants.
  - b. The CEO or his delegate shall determine the amount of any adjustment in a participant's incentive compensation award on the basis of such factors as he deems relevant, and shall not be required to establish any allocation or weighting component with respect to the factors he considers.

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SECTION VIII  
ADMINISTRATION OF THE PLANS

1. ICP: The Committee shall be responsible for the administration of the Plan. The Committee shall:
  - a. Interpret the ICP, make any rules and regulations relating to that plan, determine which consolidated subsidiaries are significant for the purpose of the first paragraph of SECTION III, and determine factual questions arising in connection with the ICP, after such investigation or hearing as the Committee may deem appropriate.
  - b. As soon as feasible after the close of each performance year and prior to the payment of any incentive compensation for such performance year, review the performance of each participant and determine the amount of each participant's individual incentive compensation award, if any, with respect to that performance year.
  - c. Have sole discretion in determining incentive compensation awards under the ICP, except that in making awards the Committee may, in its discretion, request and consider the recommendations of the CEO and others whom it may designate.
  - d. Any decisions made by the Committee under the provisions of this SECTION VIII, as well as any interpretations of the ICP by the Committee, shall be conclusive and binding on all parties concerned.
2. AIP: The CEO shall be responsible for the administration of this plan. The CEO shall:
  - a. Interpret the AIP, make any rules and regulations relating to the plan, and determine factual questions arising in connection with the AIP.
  - b. As soon as feasible after the close of each performance year and prior to the payment of any incentive compensation for such performance year, review the recommended awards of selected participants, as determined by the CEO, to determine if the award is appropriate with respect to that performance year, making any adjustments as he deems necessary and approving each such award.
  - c. Review and approve the total incentive compensation award expenditure of each sector and the Company overall.
  - d. Any decisions made by the CEO under the provisions of this Section VIII, as well as any interpretation of the AIP by the CEO, shall be conclusive and binding on all parties concerned.

SECTION IX  
METHOD OF PAYMENT OF INCENTIVE  
COMPENSATION TO INDIVIDUALS

1. ICP Payments
  - a. The amount of incentive compensation award determined for each participant with respect to a given performance year shall be paid in cash or in common stock of the Company ("Northrop Grumman common stock") or partly in cash and partly in Northrop Grumman common stock, as the Committee may determine. Except as provided below in this Section IX and subject to any applicable deferred compensation election to the contrary, payment of the incentive compensation award with respect to a given performance year shall be made by March 15 of the year following such performance year.
  - b. Payments in cash may be made in a lump sum with respect to an incentive compensation award for a performance year, or in installments, as the Committee may determine and (in the case of installments) to the extent consistent with Section 409A of the code. In either event, the Committee may impose such conditions, including forfeitures and restrictions, as the Committee believes will best serve the interests of the Company and the purposes of the ICP.

- c. Payments in Northrop Grumman common stock may be made in full with respect to an incentive compensation award for a performance year, or in installments, as the Committee may determine and (in the case of installments) to the extent consistent with Section 409A of the code. In either event, the Committee may impose such conditions, including forfeitures and restrictions, as the Committee believes will best serve the interests of the Company and the purposes of the ICP.
- d. In making awards of Northrop Grumman common stock, the Committee shall first determine all incentive compensation awards in terms of dollars. The total dollar amount of all incentive compensation awards for a particular year shall not exceed the appropriated incentive compensation for that performance year under the ICP. After fixing the total amount of each Participant's incentive compensation award in terms of dollars, then if some or all of the award is to be paid in Northrop Grumman common stock, the dollar amount of the incentive compensation award so to be paid shall be converted into shares of Northrop Grumman common stock by using the fair market value of such stock on the date of the award. "Fair market value" shall be the closing price of such stock on the New York Stock Exchange on the date of the award, or, if no sales of such stock occurred on that date, then on the last preceding date on which such sales occurred. No fractional share shall be issued.
- e. If an incentive compensation award is paid in Northrop Grumman common stock, the number of shares shall be appropriately adjusted for any stock splits, stock dividends, re-capitalization or other relevant changes in capitalization effective after the date of award and prior to the date as of which the participant becomes the record owner of the shares received in payment of the award. All such adjustments thereafter shall accrue to the participant as the record owner of the shares.
- f. Northrop Grumman common stock issued in payment of incentive compensation awards may, at the option of the Board of Directors, be either originally issued shares or treasury shares.
- g. Distribution of awards shall be governed by the terms and conditions applicable to such awards, as determined by the Committee or its delegate. An award, the payment of which is to be deferred pursuant to the terms of an employment agreement, shall be paid as provided by the terms of such agreement. Awards or portions thereof deferred pursuant to any other deferred compensation plan or deferral arrangement shall be paid as provided in such plan or arrangement. Any other awards the payment of which has been deferred, in whole or in part, shall be paid as determined by the Committee.
- h. The Company shall have the right to deduct from all payments under the ICP any federal, state, or local taxes required by law to be withheld with respect to such payments.
- i. No participant or any other party claiming an interest in amounts earned under the ICP shall have any interests whatsoever in any specific asset of the Company. To the extent that any party acquires a right to receive payments under the ICP, such right shall be equivalent to that of an unsecured general creditor of the Company. Awards payable under the plan shall be payable in shares or from the general assets of Northrop Grumman, and no special or separate reserve, fund or deposit shall be made to assure payment of such awards.

## 2. AIP Payments

- a. The amount of incentive compensation award determined for each participant with respect to a given performance year shall be paid in cash no later than March 15 of the year following that performance year.
- b. The Company shall have the right to deduct from all payments under this plan any federal, state, or local taxes required by law to be withheld with respect to such payments.
- c. No participant or any other party claiming an interest in amounts earned under the AIP shall have any interest whatsoever in any specific asset of the Company. To the extent that any party acquires a right to receive payments under the plan, such right shall be equivalent to that of an unsecured general creditor of the Company. Awards payable under the AIP shall be payable in shares or from the general assets of Northrop Grumman, and no special or separate reserve, fund or deposit shall be made to assure payment of such awards.

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SECTION X  
AMENDMENT OR TERMINATION OF PLANS

The Committee shall have the right to terminate or amend these plans at any time and to discontinue further appropriations to the plans.

Without limiting the generality of the preceding paragraph, the Committee reserves the right to adjust performance measures, the applicable performance goals and performance results with respect to either or both of the plans to the extent the Committee determines such adjustment is reasonably necessary or advisable to preserve the intended incentives and benefits under the plans to reflect (1) any change in capitalization, any corporate transaction (such as a reorganization, combination, separation, merger, acquisition, or any combination of the foregoing), or any complete or partial liquidation, (2) any change in accounting policies or practices, or (3) the effects of any special charges to earnings, or (4) any other similar special circumstances.

SECTION XI  
EFFECTIVE DATE

These plans shall be effective for performance years commencing with and following 2006 and shall stay in effect until amended, modified or terminated by the Committee. The provisions of these plans, together with those of the 2002 Incentive Compensation Plan for Section 162(m) Officers, shall supersede and replace those of prior plan documents.

SECTION XII  
MISCELLANEOUS

1. Participation in any plan shall not constitute an agreement of the participant to remain in the employ of and to render his/her services to the Company, or of the Company to continue to employ such participant, and the Company may terminate the employment of a participant at any time with or without cause.
2. In the event any provision of the plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the plans, and the plans shall be construed and enforced as if the illegal or invalid provision had not been included.
3. All costs of implementing and administering the plans shall be borne by the Company.
4. All obligations of the Company under the plans shall be binding upon and inure to the benefit of any successor to the Company, whether the existence of such successor is the result of a direct or indirect purchase, merger, consolidation, or otherwise, of all or substantially all of the business and/or assets of the Company.
5. The plans and any agreements hereunder, shall be governed by and construed in accordance with the laws of the state of Delaware.
6. The rights of a participant or any other person to any payment or other benefits under either of the plans may not be assigned, transferred, pledged, or encumbered except by will or the laws of decent or distribution.

Neither of the plans constitutes a contract. Neither of the plans confers upon any person any right to receive a bonus or any other payment or benefit. There is no commitment or obligation on the part of Northrop Grumman (or any affiliate) to continue any bonus plan (similar to the plans or otherwise) in any particular year.

**NORTHROP GRUMMAN CORPORATION**  
**TERMS AND CONDITIONS APPLICABLE TO 2006 CPC INCENTIVE**  
**RESTRICTED STOCK RIGHTS**  
**GRANTED UNDER THE 2001 LONG-TERM INCENTIVE STOCK PLAN**

These Terms and Conditions (“Terms”) apply to certain “Restricted Stock Rights” (“RSRs”) granted by Northrop Grumman Corporation (the “Company”) to **Wesley G. Bush** in 2006. The date of grant of the RSR award is May 16, 2006 (the “Grant Date”). The number of RSRs applicable to the award is 40,000. The date of grant and number of RSRs are also reflected in the electronic stock plan award recordkeeping system (“Stock Plan System”) maintained by the Company or its designee. These Terms apply only with respect to Mr. Bush’s 2006 RSR award. You (Mr. Bush) are referred to as the “Grantee” with respect to your award. Capitalized terms are generally defined in Section 9 below if not otherwise defined herein.

Each RSR represents a right to receive one share of the Company’s Common Stock, or cash of equivalent value as provided herein, subject to vesting as provided herein. The number of RSRs subject to your award is subject to adjustment as provided herein. The RSR award is subject to all of the terms and conditions set forth in these Terms, and is further subject to all of the terms and conditions of the Plan, as it may be amended from time to time, and any rules adopted by the Committee, as such rules are in effect from time to time.

**1. Vesting; Issuance of Shares.**

Subject to Sections 2 and 5 below, one hundred percent (100%) of the number of RSRs subject to your award (subject to adjustment as provided in Section 5.1) shall vest upon the fourth anniversary of the Grant Date.

The Company shall pay a vested RSR as soon as practicable following the vesting of the RSR and no later than March 15<sup>th</sup> of the year following the year of vesting. The Company shall pay such vested RSRs in either an equivalent number of shares of Common Stock, or, in the discretion of the Committee, in cash or in a combination of shares of Common Stock and cash. In the event of a cash payment, the amount of the payment for vested RSR to be paid in cash (subject to tax withholding as provided in Section 6 below) will equal the Fair Market Value (as defined below) of a share of Common Stock as of the date that such RSR became vested. No fractional shares will be issued.

**2. Early Termination of Award; Termination of Employment.**

**2.1 General.** The RSRs subject to the award, to the extent not previously vested, shall terminate and become null and void if and when (a) the award terminates in connection with a Change in Control pursuant to Section 5 below, or (b) except as provided in Section 2.6 and in Section 5, the Grantee ceases for any reason to be an employee of the Company or one of its subsidiaries.

**2.2 Leave of Absence.** Unless the Committee otherwise provides (at the time of the leave or otherwise), if the Grantee is granted a leave of absence by the Company, the Grantee (a) shall not be deemed to have incurred a termination of employment at the time such leave commences for purposes of the award, and (b) shall be deemed to be employed by the Company for the duration of such approved leave of absence for purposes of the award. A termination of employment shall be deemed to have occurred if the Grantee does not timely return to active employment upon the expiration of such approved leave or if the Grantee commences a leave that is not approved by the Company.

**2.3 Salary Continuation.** Subject to Section 2.2 above, the term “employment” as used herein means active employment by the Company and salary continuation without active employment (other than a leave of absence approved by the Company that is covered by Section 2.2) will not, in and of itself, constitute “employment” for purposes hereof (in the case of salary continuation without active employment, the Grantee’s cessation of active employee status shall, subject to Section 2.2, be deemed to be a termination of “employment” for purposes hereof). Furthermore, salary continuation

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will not, in and of itself, constitute a leave of absence approved by the Company for purposes of the award.

**2.4 Sale or Spinoff of Subsidiary or Business Unit.** For purposes of the RSRs subject to the award, a termination of employment of the Grantee shall be deemed to have occurred if the Grantee is employed by a subsidiary or business unit and that subsidiary or business unit is sold, spun off, or otherwise divested and the Grantee does not otherwise continue to be employed by the Company after such event.

**2.5 Continuance of Employment Required.** Except as expressly provided in Section 2.6 and in Section 5, the vesting of the RSRs subject to the award requires continued employment through the fourth anniversary of the Grant Date as a condition to the vesting of any portion of the award. Employment for only a portion of the vesting period, even if a substantial portion, will not entitle the Grantee to any proportionate vesting or avoid or mitigate a termination of rights and benefits upon or following a termination of employment. Nothing contained in these Terms, the Stock Plan System, or the Plan constitutes an employment commitment by the Company or any subsidiary, affects the Grantee's status (if the Grantee is otherwise an at-will employee) as an employee at will who is subject to termination without cause, confers upon the Grantee any right to continue in the employ of the Company or any subsidiary, or interferes in any way with the right of the Company or of any subsidiary to terminate such employment at any time.

**2.6 Death or Disability.** If the Grantee dies while employed by the Company or a subsidiary, or if the Grantee's employment by the Company and its subsidiaries terminates due to the Grantee's Disability, the outstanding and previously unvested RSRs subject to the award shall vest as of the date of the Grantee's death or Disability, as applicable. In the event of the Grantee's death prior to the delivery of shares or other payment with respect to any vested RSRs, the Grantee's Successor shall be entitled to any payments to which the Grantee would have been entitled under this Agreement with respect to such vested and unpaid RSRs.

### **3. Non-Transferability and Other Restrictions.**

The award, as well as the RSRs subject to the award, are non-transferable and shall not be subject in any manner to sale, transfer, anticipation, alienation, assignment, pledge, encumbrance or charge. The foregoing transfer restrictions shall not apply to: (a) transfers to the Company; or (b) transfers pursuant to a qualified domestic relations order (as defined in the Code). Notwithstanding the foregoing, the Company may honor any transfer required pursuant to the terms of a court order in a divorce or similar domestic relations matter to the extent that such transfer does not adversely affect the Company's ability to register the offer and sale of the underlying shares on a Form S-8 Registration Statement and such transfer is otherwise in compliance with all applicable legal, regulatory and listing requirements.

### **4. Compliance with Laws; No Stockholder Rights Prior to Issuance.**

The Company's obligation to make any payments or issue any shares with respect to the award is subject to full compliance with all then applicable requirements of law, the Securities and Exchange Commission, the Commissioner of Corporations of the State of California, or other regulatory agencies having jurisdiction over the Company and its shares, and of any exchange upon which stock of the Company may be listed. The Grantee shall not have the rights and privileges of a stockholder with respect to any shares which may be issued in respect of the RSRs until the date appearing on the certificate(s) for such shares (or, in the case of shares entered in book entry form, the date that the shares are actually recorded in such form for the benefit of the Grantee), if such shares become deliverable.

### **5. Adjustments; Change in Control.**

**5.1 Adjustments.** The RSRs and the shares subject to the award are subject to adjustment upon the occurrence of events such as stock splits, stock dividends and other changes in capitalization in accordance with Section 6(a) of the Plan. In the event of any adjustment, the Company will give the Grantee written notice thereof which will set forth the nature of the adjustment.

**5.2 Possible Acceleration on Change in Control.** Notwithstanding the Company's ability to terminate the award as provided in Section 5.3 below,



the outstanding and previously unvested RSRs subject to the award shall become fully vested as of the date of the Grantee's termination of employment in the following circumstances:

- (a) if the Grantee is covered by a Change in Control Severance Arrangement at the time of the termination, if the termination of employment constitutes a "Qualifying Termination" (as such term, or any similar successor term, is defined in such Change in Control Severance Arrangement) that triggers the Grantee's right to severance benefits under such Change in Control Severance Arrangement.
- (b) if the Grantee is not covered by a Change in Control Severance Arrangement at the time of the termination and if the termination occurs either within the Protected Period corresponding to a Change in Control of the Company or within twenty-four (24) calendar months following the date of a Change in Control of the Company, the Grantee's employment by the Company and its subsidiaries is involuntarily terminated by the Company and its subsidiaries for reasons other than Cause or by the Grantee for Good Reason.

Notwithstanding anything else contained herein to the contrary, the termination of the Grantee's employment (or other events giving rise to Good Reason) shall not entitle the Grantee to any accelerated vesting pursuant to clause (b) above if there is objective evidence that, as of the commencement of the Protected Period, the Grantee had specifically been identified by the Company as an employee whose employment would be terminated as part of a corporate restructuring or downsizing program that commenced prior to the Protected Period and such termination of employment was expected at that time to occur within six (6) months. The applicable Change in Control Severance Arrangement shall govern the matters addressed in this paragraph as to clause (a) above.

**5.3 Automatic Acceleration; Early Termination.** If the Company undergoes a Change in Control triggered by clause (iii) or (iv) of the definition thereof and the Company is not the surviving entity and the successor to the Company (if any) (or a Parent thereof) does not agree in writing prior to the occurrence of the Change in Control to continue and assume the award following the Change in Control, or if for any other reason the award would not continue after the Change in Control, then upon the Change in Control the outstanding and previously unvested RSRs subject to the award shall vest fully and completely. Unless the Committee expressly provides otherwise in the circumstances, no acceleration of vesting of the award shall occur pursuant to this Section 5.3 in connection with a Change in Control if either (a) the Company is the surviving entity, or (b) the successor to the Company (if any) (or a Parent thereof) agrees in writing prior to the Change in Control to assume the award. The award shall terminate, subject to such acceleration provisions, upon a Change in Control triggered by clause (iii) or (iv) of the definition thereof in which the Company is not the surviving entity and the successor to the Company (if any) (or a Parent thereof) does not agree in writing prior to the occurrence of the Change in Control to continue and assume the award following the Change in Control. The Committee may make adjustments pursuant to Section 6(a) of the Plan and/or deem an acceleration of vesting of the award pursuant to this Section 5.3 to occur sufficiently prior to an event if necessary or deemed appropriate to permit the Grantee to realize the benefits intended to be conveyed with respect to the shares underlying the RSRs; provided, however, that, the Committee may reinstate the original terms of the award if the related event does not actually occur.

## **6. Tax Matters.**

**6.1 Tax Withholding.** The Company or the subsidiary which employs the Grantee shall be entitled to require, as a condition of making any payments or issuing any shares upon vesting of the RSRs, that the Grantee or other person entitled to such shares or other payment pay any sums required to be withheld by federal, state or local tax law with respect to such vesting or payment. Alternatively, the Company or such subsidiary, in its discretion, may make such provisions for the withholding of taxes as it deems appropriate (including, without limitation, withholding the taxes due from compensation otherwise payable to the Grantee or reducing the number of shares otherwise deliverable with respect to the award (valued at their then Fair Market Value) by the amount necessary to satisfy such withholding



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obligations at the flat percentage rates applicable to supplemental wages).

**6.2 Transfer Taxes.** The Company will pay all federal and state transfer taxes, if any, and other fees and expenses in connection with the issuance of shares in connection with the vesting of the RSRs.

## **7. Committee Authority.**

The Committee has the discretionary authority to determine any questions as to the date when the Grantee's employment terminated and the cause of such termination and to interpret any provision of these Terms, the Stock Plan System, the Plan, and any other applicable rules. Any action taken by, or inaction of, the Committee relating to or pursuant to these Terms, the Stock Plan System, the Plan, or any other applicable rules shall be within the absolute discretion of the Committee and shall be conclusive and binding on all persons.

## **8. Plan; Amendment.**

The RSRs are governed by, and the Grantee's rights are subject to, all of the terms and conditions of the Plan and any other rules adopted by the Committee, as the foregoing may be amended from time to time. The Grantee shall have no rights with respect to any amendment of these Terms, the Certificate or the Plan unless such amendment is in writing and signed by a duly authorized officer of the Company. In the event of a conflict between the provisions of the Stock Plan System and the provisions of these Terms and/or the Plan, the provisions of these Terms and/or the Plan, as applicable, shall govern.

## **9. Definitions.**

Whenever used in these Terms, the following terms shall have the meanings set forth below and, when the meaning is intended, the initial letter of the word is capitalized:

**"Board"** means the Board of Directors of the Company.

**"Cause"** means the occurrence of either or both of the following:

- (i) The Grantee's conviction for committing an act of fraud, embezzlement, theft, or

other act constituting a felony (other than traffic related offenses or as a result of vicarious liability); or

- (ii) The willful engaging by the Grantee in misconduct that is significantly injurious to the Company. However, no act, or failure to act, on the Grantee's part shall be considered "willful" unless done, or omitted to be done, by the Grantee not in good faith and without reasonable belief that his action or omission was in the best interest of the Company.

**"Change in Control"** is used as defined in the Plan.

**"Change in Control Severance Arrangement"** means a "Special Agreement" entered into by and between the Grantee and the Company that provides severance protections in the event of certain changes in control of the Company or the Company's Change-in-Control Severance Plan, as each may be in effect from time to time, or any similar successor agreement or plan that provides severance protections in the event of a change in control of the Company.

**"Code"** means the United States Internal Revenue Code of 1986, as amended.

**"Committee"** means the Company's Compensation and Management Development Committee or any successor committee appointed by the Board to administer the Plan.

**"Disability"** means disabled pursuant to the provisions of the Company's (or one of its subsidiary's) Long Term Disability Plan applicable to the Grantee; or, if the Grantee is not covered by such a Long Term Disability Plan, the incapacity of the Grantee, due to injury, illness, disease, or bodily or mental infirmity, to engage in the performance of substantially all of the usual duties of employment with the Company or the subsidiary which

employs the Grantee, such disability to be determined by the Committee upon receipt and in reliance on competent medical advice from one or more individuals, selected by the Committee, who are qualified to give such professional medical advice.

“**Exchange Act**” means the United States Securities Exchange Act of 1934, as amended.

“**Fair Market Value**” is used as defined in the Plan; provided, however, the Committee in determining such Fair Market Value for purposes of the award may utilize such other exchange, market, or listing as it deems appropriate. For purposes of a cashless exercise, the Fair Market Value of the shares shall be the price at which the shares in payment of the exercise price are sold.

“**Good Reason**” means, without the Grantee’s express written consent, the occurrence of any one or more of the following:

(i) A material and substantial reduction in the nature or status of the Grantee’s authorities or responsibilities (when such authorities and/or responsibilities are viewed in the aggregate) from their level in effect on the day immediately prior to the start of the Protected Period, other than (A) an inadvertent act that is remedied by the Company promptly after receipt of notice thereof given by the Grantee, and/or (B) changes in the nature or status of the Grantee’s authorities or responsibilities that, in the aggregate, would generally be viewed by a nationally-recognized executive placement firm as resulting in the Grantee having not materially and substantially fewer authorities and responsibilities (taking into consideration the Company’s industry) when compared to the authorities and responsibilities applicable to the position held by the Grantee immediately prior to the start of the Protected Period. The Company may retain a nationally-recognized executive placement firm for purposes of making the determination required by the preceding sentence and the written opinion of the firm thus selected shall be conclusive as to this issue.

(ii) A reduction by the Company in the Grantee’s annualized rate of base salary as in effect on the date of grant of the award or as the same shall be increased from time to time.

(iii) A significant reduction by the Company of the Grantee’s aggregate incentive opportunities under the Company’s short

and/or long-term incentive programs, as such opportunities exist on the date of grant of the award, or as such opportunities may be increased after the date of grant of the award. For this purpose, a significant reduction in the Grantee’s incentive opportunities shall be deemed to have occurred in the event the Grantee’s targeted annualized award opportunities and/or the degree of probability of attainment of such annualized award opportunities are diminished by the Company from the levels and probability of attainment that existed as of the date of grant of the award.

(iv) The failure of the Company to maintain (x) the Grantee’s relative level of coverage and accruals under the Company’s employee benefit and/or retirement plans, policies, practices, or arrangements in which the Grantee participates as of the date of grant of the award, both in terms of the amount of benefits provided, and amounts accrued and (y) the relative level of the Grantee’s participation in such plans, policies, practices, or arrangements on a basis at least as beneficial as, or substantially equivalent to, that on which the Grantee participated in such plans immediately prior to the date of grant of the award. For this purpose, the Company may eliminate and/or modify existing programs and coverage levels; provided, however, that the Grantee’s level of coverage under all such programs must be at least as great as is provided to executives who have the same or lesser levels of reporting responsibilities within the Company’s organization.

(v) The Grantee is informed by the Company that his or her principal place of employment for the Company will be relocated to a location that is greater than fifty (50) miles away from the Grantee’s principal place of employment for the Company at the start of the corresponding Protected Period; provided that, if the Company communicates an intended effective date for such relocation, in no event shall Good Reason exist pursuant to this clause (v) more than ninety (90) days before such intended effective date.

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The Grantee's right to terminate employment for Good Reason shall not be affected by the Grantee's incapacity due to physical or mental illness. The Grantee's continued employment shall not constitute a consent to, or a waiver of rights with respect to, any circumstances constituting Good Reason herein.

"**Plan**" means the Northrop Grumman 2001 Long-Term Incentive Stock Plan, as it may be amended from time to time.

The "**Protected Period**" corresponding to a Change in Control of the Company shall be a period of time determined in accordance with the following:

- (i) If the Change in Control is triggered by a tender offer for shares of the Company's stock or by the offeror's acquisition of shares pursuant to such a tender offer, the Protected Period shall commence on the date of the initial tender offer and shall continue through and including the date of the Change in Control; provided that in no case will the Protected Period commence earlier than the date that is six (6) months prior to the Change in Control.
- (ii) If the Change in Control is triggered by a merger, consolidation, or reorganization of the Company with or involving any other corporation, the Protected Period shall commence on the date that serious and substantial discussions first take place to effect the merger, consolidation, or reorganization and shall continue through and including the date of the Change in Control; provided that in no case will the Protected Period commence earlier than the date that is six (6) months prior to the Change in Control.
- (iii) In the case of any Change in Control not described in clause (i) or (ii) above, the Protected Period shall commence on the date that is six (6) months prior to the Change in Control and shall continue through and including the date of the Change in Control.

"**Successor**" means the person acquiring a Grantee's rights to a grant under the Plan by will or by the laws of descent or distribution.

**NORTHROP GRUMMAN CORPORATION**  
**TERMS AND CONDITIONS APPLICABLE TO 2006 CPC INCENTIVE**  
**RESTRICTED STOCK RIGHTS**  
**GRANTED UNDER THE 2001 LONG-TERM INCENTIVE STOCK PLAN**

These Terms and Conditions (“Terms”) apply to certain “Restricted Stock Rights” (“RSRs”) granted by Northrop Grumman Corporation (the “Company”) to **Scott J. Seymour** in 2006. The date of grant of the RSR award is May 16, 2006 (the “Grant Date”). The number of RSRs applicable to the award is 15,000. The date of grant and number of RSRs are also reflected in the electronic stock plan award recordkeeping system (“Stock Plan System”) maintained by the Company or its designee. These Terms apply only with respect to Mr. Seymour’s 2006 RSR award. You (Mr. Seymour) are referred to as the “Grantee” with respect to your award. Capitalized terms are generally defined in Section 9 below if not otherwise defined herein.

Each RSR represents a right to receive one share of the Company’s Common Stock, or cash of equivalent value as provided herein, subject to vesting as provided herein. The number of RSRs subject to your award is subject to adjustment as provided herein. The RSR award is subject to all of the terms and conditions set forth in these Terms, and is further subject to all of the terms and conditions of the Plan, as it may be amended from time to time, and any rules adopted by the Committee, as such rules are in effect from time to time.

**1. Vesting; Issuance of Shares.**

Subject to Sections 2 and 5 below, one hundred percent (100%) of the number of RSRs subject to your award (subject to adjustment as provided in Section 5.1) shall vest upon the third anniversary of the Grant Date.

The Company shall pay a vested RSR as soon as practicable following the vesting of the RSR and no later than March 15<sup>th</sup> of the year following the year of vesting. The Company shall pay such vested RSRs in either an equivalent number of shares of Common Stock, or, in the discretion of the Committee, in cash or in a combination of shares of Common Stock and cash. In the event of a cash payment, the amount of the payment for vested RSR to be paid in cash (subject to tax withholding as provided in Section 6 below) will equal the Fair Market Value (as defined below) of a share of Common Stock as of the date that such RSR became vested. No fractional shares will be issued.

**2. Early Termination of Award; Termination of Employment.**

**2.1 General.** The RSRs subject to the award, to the extent not previously vested, shall terminate and become null and void if and when (a) the award terminates in connection with a Change in Control pursuant to Section 5 below, or (b) except as provided in Section 2.6 and in Section 5, the Grantee ceases for any reason to be an employee of the Company or one of its subsidiaries.

**2.2 Leave of Absence.** Unless the Committee otherwise provides (at the time of the leave or otherwise), if the Grantee is granted a leave of absence by the Company, the Grantee (a) shall not be deemed to have incurred a termination of employment at the time such leave commences for purposes of the award, and (b) shall be deemed to be employed by the Company for the duration of such approved leave of absence for purposes of the award. A termination of employment shall be deemed to have occurred if the Grantee does not timely return to active employment upon the expiration of such approved leave or if the Grantee commences a leave that is not approved by the Company.

**2.3 Salary Continuation.** Subject to Section 2.2 above, the term “employment” as used herein means active employment by the Company and salary continuation without active employment (other than a leave of absence approved by the Company that is covered by Section 2.2) will not, in and of itself, constitute “employment” for purposes hereof (in the case of salary continuation without active employment, the Grantee’s cessation of active employee status shall, subject to Section 2.2, be deemed to be a termination of “employment” for purposes hereof). Furthermore, salary continuation

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will not, in and of itself, constitute a leave of absence approved by the Company for purposes of the award.

**2.4 Sale or Spinoff of Subsidiary or Business Unit.** For purposes of the RSRs subject to the award, a termination of employment of the Grantee shall be deemed to have occurred if the Grantee is employed by a subsidiary or business unit and that subsidiary or business unit is sold, spun off, or otherwise divested and the Grantee does not otherwise continue to be employed by the Company after such event.

**2.5 Continuance of Employment Required.** Except as expressly provided in Section 2.6 and in Section 5, the vesting of the RSRs subject to the award requires continued employment through the third anniversary of the Grant Date as a condition to the vesting of any portion of the award. Employment for only a portion of the vesting period, even if a substantial portion, will not entitle the Grantee to any proportionate vesting or avoid or mitigate a termination of rights and benefits upon or following a termination of employment. Nothing contained in these Terms, the Stock Plan System, or the Plan constitutes an employment commitment by the Company or any subsidiary, affects the Grantee's status (if the Grantee is otherwise an at-will employee) as an employee at will who is subject to termination without cause, confers upon the Grantee any right to continue in the employ of the Company or any subsidiary, or interferes in any way with the right of the Company or of any subsidiary to terminate such employment at any time.

**2.6 Death or Disability.** If the Grantee dies while employed by the Company or a subsidiary, or if the Grantee's employment by the Company and its subsidiaries terminates due to the Grantee's Disability, the outstanding and previously unvested RSRs subject to the award shall vest as of the date of the Grantee's death or Disability, as applicable. In the event of the Grantee's death prior to the delivery of shares or other payment with respect to any vested RSRs, the Grantee's Successor shall be entitled to any payments to which the Grantee would have been entitled under this Agreement with respect to such vested and unpaid RSRs.

### **3. Non-Transferability and Other Restrictions.**

The award, as well as the RSRs subject to the award, are non-transferable and shall not be subject in any manner to sale, transfer, anticipation, alienation, assignment, pledge, encumbrance or charge. The foregoing transfer restrictions shall not apply to: (a) transfers to the Company; or (b) transfers pursuant to a qualified domestic relations order (as defined in the Code). Notwithstanding the foregoing, the Company may honor any transfer required pursuant to the terms of a court order in a divorce or similar domestic relations matter to the extent that such transfer does not adversely affect the Company's ability to register the offer and sale of the underlying shares on a Form S-8 Registration Statement and such transfer is otherwise in compliance with all applicable legal, regulatory and listing requirements.

### **4. Compliance with Laws; No Stockholder Rights Prior to Issuance.**

The Company's obligation to make any payments or issue any shares with respect to the award is subject to full compliance with all then applicable requirements of law, the Securities and Exchange Commission, the Commissioner of Corporations of the State of California, or other regulatory agencies having jurisdiction over the Company and its shares, and of any exchange upon which stock of the Company may be listed. The Grantee shall not have the rights and privileges of a stockholder with respect to any shares which may be issued in respect of the RSRs until the date appearing on the certificate(s) for such shares (or, in the case of shares entered in book entry form, the date that the shares are actually recorded in such form for the benefit of the Grantee), if such shares become deliverable.

### **5. Adjustments; Change in Control.**

**5.1 Adjustments.** The RSRs and the shares subject to the award are subject to adjustment upon the occurrence of events such as stock splits, stock dividends and other changes in capitalization in accordance with Section 6(a) of the Plan. In the event of any adjustment, the Company will give the Grantee written notice thereof which will set forth the nature of the adjustment.

**5.2 Possible Acceleration on Change in Control.** Notwithstanding the Company's ability to terminate the award as provided in Section 5.3 below,



the outstanding and previously unvested RSRs subject to the award shall become fully vested as of the date of the Grantee's termination of employment in the following circumstances:

- (a) if the Grantee is covered by a Change in Control Severance Arrangement at the time of the termination, if the termination of employment constitutes a "Qualifying Termination" (as such term, or any similar successor term, is defined in such Change in Control Severance Arrangement) that triggers the Grantee's right to severance benefits under such Change in Control Severance Arrangement.
- (b) if the Grantee is not covered by a Change in Control Severance Arrangement at the time of the termination and if the termination occurs either within the Protected Period corresponding to a Change in Control of the Company or within twenty-four (24) calendar months following the date of a Change in Control of the Company, the Grantee's employment by the Company and its subsidiaries is involuntarily terminated by the Company and its subsidiaries for reasons other than Cause or by the Grantee for Good Reason.

Notwithstanding anything else contained herein to the contrary, the termination of the Grantee's employment (or other events giving rise to Good Reason) shall not entitle the Grantee to any accelerated vesting pursuant to clause (b) above if there is objective evidence that, as of the commencement of the Protected Period, the Grantee had specifically been identified by the Company as an employee whose employment would be terminated as part of a corporate restructuring or downsizing program that commenced prior to the Protected Period and such termination of employment was expected at that time to occur within six (6) months. The applicable Change in Control Severance Arrangement shall govern the matters addressed in this paragraph as to clause (a) above.

**5.3 Automatic Acceleration; Early Termination.** If the Company undergoes a Change in Control triggered by clause (iii) or (iv) of the definition thereof and the Company is not the surviving entity and the successor to the Company (if any) (or a Parent thereof) does not agree in writing prior to the occurrence of the Change in Control to continue and assume the award following the Change in Control, or if for any other reason the award would not continue after the Change in Control, then upon the Change in Control the outstanding and previously unvested RSRs subject to the award shall vest fully and completely. Unless the Committee expressly provides otherwise in the circumstances, no acceleration of vesting of the award shall occur pursuant to this Section 5.3 in connection with a Change in Control if either (a) the Company is the surviving entity, or (b) the successor to the Company (if any) (or a Parent thereof) agrees in writing prior to the Change in Control to assume the award. The award shall terminate, subject to such acceleration provisions, upon a Change in Control triggered by clause (iii) or (iv) of the definition thereof in which the Company is not the surviving entity and the successor to the Company (if any) (or a Parent thereof) does not agree in writing prior to the occurrence of the Change in Control to continue and assume the award following the Change in Control. The Committee may make adjustments pursuant to Section 6(a) of the Plan and/or deem an acceleration of vesting of the award pursuant to this Section 5.3 to occur sufficiently prior to an event if necessary or deemed appropriate to permit the Grantee to realize the benefits intended to be conveyed with respect to the shares underlying the RSRs; provided, however, that, the Committee may reinstate the original terms of the award if the related event does not actually occur.

## **6. Tax Matters.**

**6.1 Tax Withholding.** The Company or the subsidiary which employs the Grantee shall be entitled to require, as a condition of making any payments or issuing any shares upon vesting of the RSRs, that the Grantee or other person entitled to such shares or other payment pay any sums required to be withheld by federal, state or local tax law with respect to such vesting or payment. Alternatively, the Company or such subsidiary, in its discretion, may make such provisions for the withholding of taxes as it deems appropriate (including, without limitation, withholding the taxes due from compensation otherwise payable to the Grantee or reducing the number of shares otherwise deliverable with respect to the award (valued at their then Fair Market Value) by the amount necessary to satisfy such withholding



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obligations at the flat percentage rates applicable to supplemental wages).

**6.2 Transfer Taxes.** The Company will pay all federal and state transfer taxes, if any, and other fees and expenses in connection with the issuance of shares in connection with the vesting of the RSRs.

## **7. Committee Authority.**

The Committee has the discretionary authority to determine any questions as to the date when the Grantee's employment terminated and the cause of such termination and to interpret any provision of these Terms, the Stock Plan System, the Plan, and any other applicable rules. Any action taken by, or inaction of, the Committee relating to or pursuant to these Terms, the Stock Plan System, the Plan, or any other applicable rules shall be within the absolute discretion of the Committee and shall be conclusive and binding on all persons.

## **8. Plan; Amendment.**

The RSRs are governed by, and the Grantee's rights are subject to, all of the terms and conditions of the Plan and any other rules adopted by the Committee, as the foregoing may be amended from time to time. The Grantee shall have no rights with respect to any amendment of these Terms, the Certificate or the Plan unless such amendment is in writing and signed by a duly authorized officer of the Company. In the event of a conflict between the provisions of the Stock Plan System and the provisions of these Terms and/or the Plan, the provisions of these Terms and/or the Plan, as applicable, shall govern.

## **9. Definitions.**

Whenever used in these Terms, the following terms shall have the meanings set forth below and, when the meaning is intended, the initial letter of the word is capitalized:

**"Board"** means the Board of Directors of the Company.

**"Cause"** means the occurrence of either or both of the following:

- (i) The Grantee's conviction for committing an act of fraud, embezzlement, theft, or

other act constituting a felony (other than traffic related offenses or as a result of vicarious liability); or

- (ii) The willful engaging by the Grantee in misconduct that is significantly injurious to the Company. However, no act, or failure to act, on the Grantee's part shall be considered "willful" unless done, or omitted to be done, by the Grantee not in good faith and without reasonable belief that his action or omission was in the best interest of the Company.

**"Change in Control"** is used as defined in the Plan.

**"Change in Control Severance Arrangement"** means a "Special Agreement" entered into by and between the Grantee and the Company that provides severance protections in the event of certain changes in control of the Company or the Company's Change-in-Control Severance Plan, as each may be in effect from time to time, or any similar successor agreement or plan that provides severance protections in the event of a change in control of the Company.

**"Code"** means the United States Internal Revenue Code of 1986, as amended.

**"Committee"** means the Company's Compensation and Management Development Committee or any successor committee appointed by the Board to administer the Plan.

**"Disability"** means disabled pursuant to the provisions of the Company's (or one of its subsidiary's) Long Term Disability Plan applicable to the Grantee; or, if the Grantee is not covered by such a Long Term Disability Plan, the incapacity of the Grantee, due to injury, illness, disease, or bodily or mental infirmity, to engage in the performance of substantially all of the usual duties of employment with the Company or the subsidiary which

employs the Grantee, such disability to be determined by the Committee upon receipt and in reliance on competent medical advice from one or more individuals, selected by the Committee, who are qualified to give such professional medical advice.

“**Exchange Act**” means the United States Securities Exchange Act of 1934, as amended.

“**Fair Market Value**” is used as defined in the Plan; provided, however, the Committee in determining such Fair Market Value for purposes of the award may utilize such other exchange, market, or listing as it deems appropriate. For purposes of a cashless exercise, the Fair Market Value of the shares shall be the price at which the shares in payment of the exercise price are sold.

“**Good Reason**” means, without the Grantee’s express written consent, the occurrence of any one or more of the following:

(i) A material and substantial reduction in the nature or status of the Grantee’s authorities or responsibilities (when such authorities and/or responsibilities are viewed in the aggregate) from their level in effect on the day immediately prior to the start of the Protected Period, other than (A) an inadvertent act that is remedied by the Company promptly after receipt of notice thereof given by the Grantee, and/or (B) changes in the nature or status of the Grantee’s authorities or responsibilities that, in the aggregate, would generally be viewed by a nationally-recognized executive placement firm as resulting in the Grantee having not materially and substantially fewer authorities and responsibilities (taking into consideration the Company’s industry) when compared to the authorities and responsibilities applicable to the position held by the Grantee immediately prior to the start of the Protected Period. The Company may retain a nationally-recognized executive placement firm for purposes of making the determination required by the preceding sentence and the written opinion of the firm thus selected shall be conclusive as to this issue.

(ii) A reduction by the Company in the Grantee’s annualized rate of base salary as in effect on the date of grant of the award or as the same shall be increased from time to time.

(iii) A significant reduction by the Company of the Grantee’s aggregate incentive opportunities under the Company’s short

and/or long-term incentive programs, as such opportunities exist on the date of grant of the award, or as such opportunities may be increased after the date of grant of the award. For this purpose, a significant reduction in the Grantee’s incentive opportunities shall be deemed to have occurred in the event the Grantee’s targeted annualized award opportunities and/or the degree of probability of attainment of such annualized award opportunities are diminished by the Company from the levels and probability of attainment that existed as of the date of grant of the award.

(iv) The failure of the Company to maintain (x) the Grantee’s relative level of coverage and accruals under the Company’s employee benefit and/or retirement plans, policies, practices, or arrangements in which the Grantee participates as of the date of grant of the award, both in terms of the amount of benefits provided, and amounts accrued and (y) the relative level of the Grantee’s participation in such plans, policies, practices, or arrangements on a basis at least as beneficial as, or substantially equivalent to, that on which the Grantee participated in such plans immediately prior to the date of grant of the award. For this purpose, the Company may eliminate and/or modify existing programs and coverage levels; provided, however, that the Grantee’s level of coverage under all such programs must be at least as great as is provided to executives who have the same or lesser levels of reporting responsibilities within the Company’s organization.

(v) The Grantee is informed by the Company that his or her principal place of employment for the Company will be relocated to a location that is greater than fifty (50) miles away from the Grantee’s principal place of employment for the Company at the start of the corresponding Protected Period; provided that, if the Company communicates an intended effective date for such relocation, in no event shall Good Reason exist pursuant to this clause (v) more than ninety (90) days before such intended effective date.

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The Grantee's right to terminate employment for Good Reason shall not be affected by the Grantee's incapacity due to physical or mental illness. The Grantee's continued employment shall not constitute a consent to, or a waiver of rights with respect to, any circumstances constituting Good Reason herein.

"**Plan**" means the Northrop Grumman 2001 Long-Term Incentive Stock Plan, as it may be amended from time to time.

The "**Protected Period**" corresponding to a Change in Control of the Company shall be a period of time determined in accordance with the following:

- (i) If the Change in Control is triggered by a tender offer for shares of the Company's stock or by the offeror's acquisition of shares pursuant to such a tender offer, the Protected Period shall commence on the date of the initial tender offer and shall continue through and including the date of the Change in Control; provided that in no case will the Protected Period commence earlier than the date that is six (6) months prior to the Change in Control.
- (ii) If the Change in Control is triggered by a merger, consolidation, or reorganization of the Company with or involving any other corporation, the Protected Period shall commence on the date that serious and substantial discussions first take place to effect the merger, consolidation, or reorganization and shall continue through and including the date of the Change in Control; provided that in no case will the Protected Period commence earlier than the date that is six (6) months prior to the Change in Control.
- (iii) In the case of any Change in Control not described in clause (i) or (ii) above, the Protected Period shall commence on the date that is six (6) months prior to the Change in Control and shall continue through and including the date of the Change in Control.

"**Successor**" means the person acquiring a Grantee's rights to a grant under the Plan by will or by the laws of descent or distribution.

## Northrop Grumman Executive Health Plan Matrix

Plan Feature	Benefit
<b>Eligibility</b>	Employee + Spouse & Dependents
<b>Medical Plan</b>	Premium PPO Plan administered by Blue Cross Blue Shield of Illinois
Coverage	100% coverage, for all eligible plan expenses
Annual Deductible	No annual deductible
Co-payment/Co-insurance	No co-payment/No co-insurance
Preventive Care Coverage	\$500 annual maximum per covered individual
<b>Prescription Drug Coverage</b>	Covered under Medical Plan
Annual Deductible	No annual deductible
Coverage – retail 30-day supply	100% coverage, when network pharmacy is utilized
Coverage – mail order 90-day supply	100% coverage, when network pharmacy is utilized
<b>Vision and Hearing Coverage</b>	\$500 vision/ \$500 per year per plan year per covered individual
<b>Acupuncture and Acupressure</b>	20 visits [combined] – per person, per plan year
<b>Chiropractic Care</b>	40 visits per benefit plan year
<b>Physical Therapy</b>	50 visits per benefit plan year (in and out-of-network combined)
<b>Speech Therapy</b>	50 visits per benefit plan year (in and out-of-network combined)
<b>Occupational Therapy</b>	50 visits per benefit plan year (in and out-of-network combined)
<b>Mental Health Coverage</b>	Mental health is 100% covered (in and out-of-network combined)
Inpatient treatment must be pre-authorized by Value Options	Unlimited office visits (in and out-of-network)
Mental Health Maximums	Combined Lifetime Limits - included in \$2 million per person Medical lifetime maximum
<b>Health Plan Lifetime Maximums</b>	\$2,000,000.00 per covered individual, including mental health benefits
<b>Dental Plan</b>	Premium PPO Plan administered by Delta Dental
Annual maximum	\$4,000 per person – per benefit plan year
Coverage	100% coverage, for all eligible plan expenses up to annual maximum
Annual Deductible	No annual deductible
Co-payment/Co-insurance	No co-payment/No co-insurance
Plan Feature	Benefit
<b>Eligibility</b>	Employee
<b>Life Insurance Coverage</b>	Company-paid life insurance 3x Annual base salary up to a maximum of \$2 million
<b>Accidental Death &amp; Dismemberment (AD&amp;D) Coverage</b>	Company-paid accidental death & dismemberment insurance – 6 x Annual base salary up to a maximum of \$1 million
<b>Long-Term Disability (LTD)</b>	Company-paid basic LTD benefit of 75% of monthly base salary, up to a maximum monthly benefit of \$25,000
<b>Executive Physicals</b>	\$2,000/year allowance for executive physical
Effective July 1, 2006	

**LETTER FROM INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

July 26, 2006

Northrop Grumman Corporation  
1840 Century Park East  
Los Angeles, California

We have made a review, in accordance with the standards of the Public Company Accounting Oversight Board (United States), of the unaudited interim financial information of Northrop Grumman Corporation and subsidiaries for the periods ended June 30, 2006 and 2005, as indicated in our report dated July 26, 2006; because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended June 30, 2006, is incorporated by reference in Registration Statement Nos. 033-59815, 033-59853, 333-03959, 333-68003, 333-67266, 333-61936, 333-100179, 333-107734, 333-121104, 333-125120 and 333-127317 on Form S-8; Registration Statement Nos. 333-78251, 333-85633, 333-71290, and 333-77056 on Form S-3; and Registration Statement Nos. 333-40862, 333-54800, and 333-83672 on Form S-4.

We also are aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

/s/ DELOITTE & TOUCHE LLP  
Los Angeles, California

**CERTIFICATION PURSUANT TO  
RULE 13a-14(a)/15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ronald D. Sugar, certify that:

1. I have reviewed this report on Form 10-Q of Northrop Grumman Corporation ("company");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the company's most recent fiscal quarter (the company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: July 26, 2006

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/s/ RONALD D. SUGAR  
Ronald D. Sugar  
Chairman and Chief Executive Officer

**CERTIFICATION PURSUANT TO  
RULE 13a-14(a)/15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Wesley G. Bush, certify that:

1. I have reviewed this report on Form 10-Q of Northrop Grumman Corporation ("company");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the company's most recent fiscal quarter (the company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: July 26, 2006

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/s/ WESLEY G. BUSH  
Wesley G. Bush  
President and Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Northrop Grumman Corporation (the “company”) on Form 10-Q for the period ending June 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Ronald D. Sugar, Chairman and Chief Executive Officer of the company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the company.

Date: July 26, 2006

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/s/ RONALD D. SUGAR  
Ronald D. Sugar  
Chairman and Chief Executive Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Northrop Grumman Corporation (the “company”) on Form 10-Q for the period ending June 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Wesley G. Bush, President and Chief Financial Officer of the company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the company.

Date: July 26, 2006

/s/ WESLEY G. BUSH  
\_\_\_\_\_  
Wesley G. Bush  
President and Chief Financial Officer

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