NORTHROP GRUMMAN CORP /DE/
Form 10-Q
July 25, 2012

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2012
or

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

Commission File Number 1-16411
NORTHROP GRUMMAN CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE	80-0640649
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2980 Fairview Park Drive, Falls Church, Virginia 22042
www.northropgrumman.com
(Address of principal executive offices and internet site)
(703) 280-2900
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No *
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No *
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):
Large accelerated filer x Accelerated filer * Non-accelerated filer * Smaller reporting company *
(Do not check if a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes * No x
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 20, 2012, 247,210,252 shares of common stock were outstanding.

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CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
$ in millions, except per share amounts	2012	2011	2012	2011
Sales				
Product	$3,399	$3,709	$ 6,740	$ 7,572
Service	2,875	2,851	5,732	5,722
Total sales	6,274	6,560	12,472	13,294
Operating costs and expenses				
Product	2,604	2,860	5,131	5,863
Service	2,316	2,303	4,630	4,655
General and administrative expenses	580	556	1,141	1,124
Operating income	774	841	1,570	1,652
Other (expense) income				
Interest expense	(52)	(53)	(105)	(111)
Other, net	5	—	18	5
Earnings from continuing operations before income taxes	727	788	1,483	1,546
Federal and foreign income tax expense	247	268	497	530
Earnings from continuing operations	480	520	986	1,016
Earnings from discontinued operations, net of tax	—	—	—	34
Net earnings	$ 480	$ 520	$ 986	$ 1,050
Basic earnings per share				
Continuing operations	$ 1.91	$ 1.84	$ 3.91	$ 3.54
Discontinued operations	—	—	—	0.12
Basic earnings per share	$ 1.91	$ 1.84	$ 3.91	$ 3.66
Weighted-average common shares outstanding, in millions	250.8	282.6	252.0	287.2
Diluted earnings per share				
Continuing operations	$ 1.88	$ 1.81	$ 3.84	$ 3.48
Discontinued operations	—	—	—	0.11
Diluted earnings per share	$ 1.88	$ 1.81	$ 3.84	$ 3.59
Weighted-average diluted shares outstanding, in millions	254.7	287.2	256.5	292.2
Net earnings (from above)	$ 480	$ 520	$ 986	$ 1,050
Other comprehensive income				
Change in cumulative translation adjustment	(15)	—	(9)	27
Change in unrealized gain on marketable securities and cash flow hedges, net of tax	—	—	—	(2)
Change in unamortized benefit plan costs, net of tax	54	14	104	35
Other comprehensive income, net of tax	39	14	95	60
Comprehensive income	$ 519	$ 534	$ 1,081	$ 1,110

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

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CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited)

$ in millions	June 30, 2012	December 31, 2011
Assets		
Cash and cash equivalents	$ 3,148	$ 3,002
Accounts receivable, net of progress payments	3,119	2,964
Inventoried costs, net of progress payments	704	873
Deferred tax assets	504	496
Prepaid expenses and other current assets	225	411
Total current assets	7,700	7,746
Property, plant and equipment, net of accumulated depreciation of $4,094 in 2012 and $3,933 in 2011	2,935	3,047
Goodwill	12,344	12,374
Non-current deferred tax assets	838	900
Other non-current assets	1,409	1,344
Total assets	$25,226	$25,411
Liabilities		
Trade accounts payable	$ 1,191	$ 1,481
Accrued employees compensation	1,020	1,196
Advance payments and billings in excess of costs incurred	1,826	1,777
Other current liabilities	1,571	1,681
Total current liabilities	5,608	6,135
Long-term debt, net of current portion	3,932	3,935
Pension and post-retirement plan liabilities	4,067	4,079
Other non-current liabilities	904	926
Total liabilities	14,511	15,075
Commitments and contingencies (Note 8)		
Shareholders’ equity		
Preferred stock, $1 par value; 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $1 par value; 800,000,000 shares authorized; issued and outstanding: 2012—248,039,410; 2011—253,889,622	248	254
Paid-in capital	3,443	3,873
Retained earnings	10,419	9,699
Accumulated other comprehensive loss	(3,395)	(3,490)
Total shareholders’ equity	10,715	10,336
Total liabilities and shareholders’ equity	$25,226	$25,411

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30	
$ in millions	2012	2011
Operating activities		
Sources of cash—continuing operations		
Cash received from customers		
Collections on billings	$ 9,911	$ 11,028
Progress payments	2,553	1,975
Other cash receipts	38	80
Total sources of cash—continuing operations	12,502	13,083
Uses of cash—continuing operations		
Cash paid to suppliers and employees	(10,969)	(11,692)
Pension contributions	(33)	(550)
Interest paid, net of interest received	(102)	(119)
Income taxes paid, net of refunds received	(584)	(613)
Excess tax benefits from stock-based compensation	(29)	(21)
Other cash payments	(14)	(10)
Total uses of cash—continuing operations	(11,731)	(13,005)
Cash provided by continuing operations	771	78
Cash used in discontinued operations	—	(232)
Net cash provided by (used in) operating activities	771	(154)
Investing activities		
Continuing operations		
Maturities of short-term investments	250	—
Capital expenditures	(132)	(217)
Contribution received from the spin-off of shipbuilding business	—	1,429
Proceeds from sale of business, net of cash divested	43	—
Other investing activities, net	1	41
Cash provided by investing activities from continuing operations	162	1,253
Cash used in investing activities from discontinued operations	—	(63)
Net cash provided by investing activities	162	1,190
Financing activities		
Common stock repurchases	(555)	(1,013)
Cash dividends paid	(265)	(277)
Proceeds from exercises of stock options	67	86
Excess tax benefits from stock-based compensation	29	21
Payments of long-term debt	—	(750)
Other financing activities, net	(63)	6
Net cash used in financing activities	(787)	(1,927)
Increase (decrease) in cash and cash equivalents	146	(891)
Cash and cash equivalents, beginning of year	3,002	3,701
Cash and cash equivalents, end of period	$ 3,148	$ 2,810

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

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	Six Months Ended June 30	
$ in millions	2012	2011
Reconciliation of net earnings to net cash provided by (used in) operating activities		
Net earnings	$986	$1,050
Net earnings from discontinued operations	—	(34)
Adjustments to reconcile to net cash provided by (used in) operating activities:		
Depreciation	212	218
Amortization	31	37
Stock-based compensation	76	66
Excess tax benefits from stock-based compensation	(29)	(21)
(Increase) decrease in assets:		
Accounts receivable, net	(175)	(164)
Inventoried costs, net	143	6
Prepaid expenses and other assets	(95)	5
Increase (decrease) in liabilities:		
Accounts payable and accruals	(453)	(757)
Deferred income taxes	(21)	79
Income taxes payable	(22)	9
Retiree benefits	137	(440)
Other, net	(19)	24
Cash provided by continuing operations	771	78
Cash used in discontinued operations	—	(232)
Net cash provided by (used in) operating activities	$771	($ 154)

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

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CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

	Six Months Ended June 30	
$ in millions, except per share amounts	2012	2011
Common stock		
Beginning of year	$ 254	$ 291
Common stock repurchased	(9)	(16)
Stock awards and options	3	3
End of period	248	278
Paid-in capital		
Beginning of year	3,873	7,778
Common stock repurchased	(548)	(991)
Stock awards and options	118	131
Spin-off of shipbuilding business	—	(1,892)
End of period	3,443	5,026
Retained earnings		
Beginning of year	9,699	8,124
Net earnings	986	1,050
Dividends declared	(266)	(277)
End of period	10,419	8,897
Accumulated other comprehensive loss		
Beginning of year	(3,490)	(2,757)
Other comprehensive income, net of tax	95	60
Spin-off of shipbuilding business	—	524
End of period	(3,395)	(2,173)
Total shareholders' equity	$10,715	$12,028
Cash dividends declared per share	$ 1.05	$ 0.97

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. BASIS OF PRESENTATION

Principles of Consolidation and Reporting

These unaudited condensed consolidated financial statements include the accounts of Northrop Grumman Corporation and subsidiaries (herein referred to as "Northrop Grumman," the "company," "we," "us," or "our"). All intercompany accounts, transactions, and profits are eliminated in consolidation. Investments in equity securities and joint ventures where the company has significant influence, but not control, are accounted for using the equity method.

The accompanying unaudited condensed consolidated financial statements of the company have been prepared by management in accordance with the rules of the Securities and Exchange Commission (SEC) for interim reporting purposes. These statements include all adjustments of a normal recurring nature considered necessary by management for a fair presentation of the condensed consolidated financial position, results of operations, and cash flows.

The results reported in these financial statements are not necessarily indicative of results that may be expected for the entire year. These financial statements should be read in conjunction with the information contained in the company’s Annual Report on Form 10-K for the year ended December 31, 2011 (2011 Annual Report on Form 10-K).

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

Accounting Estimates

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

The majority of our contracts are accounted for under the percentage-of-completion method. For such contracts, changes in estimates of contract sales, costs and profits are recognized using the cumulative catch-up method of accounting. This method recognizes, in the current period, the cumulative effect of the changes in contract performance as if the revised estimate had been used since contract inception. Changes in contract estimates occur for a variety of reasons, including changes in contract scope, changes in estimated contract revenue, changes in contract cost estimates due to unanticipated cost growth or the resolution of contract risks at lower cost than anticipated, as well as changes in contract overhead costs or general and administrative expenses over the performance period. The company has an extensive contract management process involving several functional organizations and numerous personnel who are skilled at managing contract activities. As the company's business involves performing on a broad portfolio of long-term contracts, generally involving complex customized products and services, changes in estimates occur routinely over the contract performance period.

Significant changes in estimates on a single contract could have a material effect on the company's consolidated financial position or results of operations, and where such changes occur, separate disclosure is made of the nature, underlying conditions and financial impact of the change. During the three and six months ended June 30, 2012, aggregate net changes in contract estimates recognized using the cumulative catch-up method of accounting increased operating income by $222 million ($0.57 per diluted share) and $487 million ($1.24 per diluted share), respectively. During the three and six months ended June 30, 2011, such changes in contract estimates increased operating income by $201 million ($0.46 per diluted share) and $345 million ($0.77 per diluted share), respectively. No discrete event or adjustment to an individual contract was material to the condensed consolidated statements of earnings and comprehensive income for any of these periods.

Related Party Transactions

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

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Accounting Standards Updates

Accounting standards updates effective after June 30, 2012, are not expected to have a material effect on the company’s consolidated financial position or results of operations.

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

$ in millions	June 30, 2012	December 31, 2011
Unamortized benefit plan costs, net of tax benefit of $2,217 as of June 30, 2012, and $2,289 as of December 31, 2011	($3,383)	($3,487)
Cumulative translation adjustment	(13)	(4)
Net unrealized gain on marketable securities and cash flow hedges, net of tax expense	1	1
Total accumulated other comprehensive loss	($3,395)	($3,490)

Unamortized benefit plan costs consist primarily of net after-tax actuarial losses totaling $3.8 billion and $3.9 billion as of June 30, 2012, and December 31, 2011, respectively. Net actuarial gains or losses principally arise from gains or losses on plan assets due to variations in the fair market value of the underlying assets and changes in the benefit obligation due to changes in actuarial assumptions, primarily changes in the discount rate.

2. EARNINGS PER SHARE, SHARE REPURCHASES AND DIVIDENDS ON COMMON STOCK

Basic Earnings Per Share

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

Diluted Earnings Per Share

Diluted earnings per share includes the dilutive effect of awards granted to employees under stock-based compensation plans. The dilutive effect of these securities totaled 3.9 million shares and 4.5 million shares for the three and six months ended June 30, 2012, respectively. The dilutive effect of these securities totaled 4.6 million shares and 5.0 million shares for the three and six months ended June 30, 2011, respectively. The weighted-average diluted shares outstanding for the three and six months ended June 30, 2012, excludes anti-dilutive stock options to purchase approximately 2.8 million shares in both periods, because such options have exercise prices in excess of the average market price of the company’s common stock during the period. The weighted-average diluted shares outstanding for the three and six months ended June 30, 2011, excludes anti-dilutive stock options to purchase approximately 2.0 million shares and 2.8 million shares, respectively.

Share Repurchases

The table below summarizes the company’s share repurchases:

Repurchase Program Authorization Date	Amount Authorized (in millions)	Total Shares Retired (in millions)	Average Price Per Share[2]	Shares Repurchased (in millions) Six Months Ended June 30 2012	2011
June 16, 2010[1]	$4,245	53.5	$57.86	9.3	15.7

(1) On June 16, 2010, the company’s board of directors authorized a share repurchase program of up to $2.0 billion of the company’s common stock. On April 25, 2011, after the company had repurchased $245 million of shares, the company’s board of directors authorized an increase to the remaining share repurchase authorization to $4.0 billion. As of June 30, 2012, the company had $1.1 billion remaining under this authorization for share repurchases.

(2) Calculated as the average price paid per share under the respective repurchase program, including commissions paid.

Share repurchases take place at management's discretion under pre-established, non-discretionary programs, depending on market conditions, in the open market, or 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 program authorizations. In connection with the spin-off of the former shipbuilding business (see Note 3), the company obtained a Private Letter Ruling from the Internal Revenue Service that generally limits our share repurchases to approximately 88 million shares within two years of the spin-off. The limitation expires on March 31, 2013. Due to share repurchases subsequent to the spin-off, the remaining number of shares that we can repurchase under this share repurchase limitation as of June 30, 2012, was approximately 38 million shares. Cash available from unusual transactions, such as the disposition of significant assets, should they arise, can be used to repurchase additional shares.

Dividends on Common Stock

In May 2012, the company increased the quarterly common stock dividend to $0.55 per share; an increase from the previous amount of $0.50 per share.

In May 2011, the company increased the quarterly common stock dividend to $0.50 per share from the previous amount of $0.47 per share.

3. BUSINESS DISPOSITIONS AND DISCONTINUED OPERATIONS

Spin-off of Shipbuilding Business

Effective March 31, 2011, the company completed the spin-off to its shareholders of Huntington Ingalls Industries, Inc. (HII). HII was formed to operate the company's former shipbuilding business. The company made a pro rata distribution to its shareholders of one share of HII common stock for every six shares of the company’s common stock held on the record date of March 30, 2011, or 48.8 million shares of HII common stock. HII paid a $1.4 billion cash contribution to the company. There was no gain or loss recognized as a result of the spin-off transaction.

Prior to the completion of the spin-off, the company and HII entered into a Separation and Distribution Agreement dated March 29, 2011, and several other agreements that govern the post-separation relationship. These agreements generally provide that each party is responsible for its respective assets, liabilities and obligations following the spin-off, including employee benefits, intellectual property, information technology, insurance, and tax-related assets and liabilities. The agreements also describe the company’s commitments to provide HII with certain transition services for up to one year. During the first quarter of 2012, the company and HII agreed to extend certain information technology transition services for a limited time beyond the initial one-year term. Costs incurred for transition services are reimbursed by HII.

In connection with the spin-off, the company incurred $27 million of non-deductible transaction costs in the six months ended June 30, 2011, which were included in discontinued operations.

Discontinued Operations

Earnings for the former shipbuilding business and an adjustment to the gain from a previous divestiture reco