NORTHROP GRUMMAN CORP /DE/
Form 10-K
February 20, 2008

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

FORM 10-K

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

For the fiscal year ended December 31, 2007

Commission file number 1-16411

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

DELAWARE	**95-4840775**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1840 Century Park East, Los Angeles, California 90067 (310) 553-6262
www.northropgrumman.com
(Address and telephone number of principal executive offices and internet site)

Securities registered pursuant to section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $1 par value	New York Stock Exchange
Series B Convertible Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.
Yes o No x

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes o No x

As of June 30, 2007, the aggregate market value of the common stock (based upon the closing price of the stock on the New York Stock Exchange) of the registrant held by non-affiliates was approximately $26,763 million.

As of February 19, 2008, 337,919,384 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Northrop Grumman Corporation s Proxy Statement for the 2008 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

NORTHROP GRUMMAN CORPORATION

Table of Contents

Table of Contents

NORTHROP GRUMMAN CORPORATION

PART I

Item 1. Business

HISTORY AND ORGANIZATION

History

Northrop Grumman Corporation (Northrop Grumman or the company) is an integrated enterprise consisting of many formerly separate businesses that cover the entire defense spectrum, from undersea to outer space and into cyberspace. The companies that have become part of today s Northrop Grumman achieved historic accomplishments, from transporting Charles Lindbergh across the Atlantic to carrying astronauts to the moon s surface and back.

The company was originally formed in California in 1939 and was reincorporated in Delaware in 1985. From 1994 through 2002, the company entered a period of significant expansion through acquisitions of other businesses, most notably:

- In 1994, Northrop Corporation acquired Grumman Corporation (Grumman) and was renamed Northrop Grumman. Grumman was a premier military aircraft systems integrator and builder of the Lunar Module that first delivered men to the surface of the moon.

- In 1996, the company acquired the defense and electronics businesses of Westinghouse Electric Corporation, a world leader in the development and production of sophisticated radar and other electronic systems for the nation s defense, civil aviation, and other international and domestic applications.

- In 1997, the company acquired Logicon, a provider of military and commercial information systems and services that met the needs of its national defense, civil and industrial customers.

- In 1999, the company acquired Teledyne Ryan (Ryan), a business unit of Allegheny-Teledyne, a world leader in the design, development and manufacture of unmanned airborne reconnaissance, surveillance, deception and target systems. In 1927, Ryan produced the *Spirit of St. Louis*, which Charles Lindbergh flew across the Atlantic. Ryan was also a pioneer in the development of Unmanned Aerial Vehicles (UAVs).

- In 2001, the company acquired Litton Industries (Litton), a global electronics and information technology enterprise, and one of the nation s leading full-service design, engineering, construction, and life cycle supporters of major surface ships for the United States (U.S.) Navy, U.S. Coast Guard, and international navies.

- Also in 2001, Newport News Shipbuilding (Newport News) was added to the company. Newport News is the nation s sole designer, builder and refueler of nuclear-powered aircraft carriers and one of only two companies capable of designing and building nuclear-powered submarines.

- In 2002, Northrop Grumman acquired the space and mission systems businesses of TRW, a leading developer of military and civil space systems and satellite payloads, as well as a leading global integrator of complex, mission-enabling systems and services.

The acquisition of these and other businesses have shaped the company into its present position as a premier provider of technologically advanced, innovative products, services and solutions in information and services, aerospace, electronics and shipbuilding. As prime contractor, principal subcontractor, partner, or preferred supplier, Northrop

Grumman participates in many high-priority defense and commercial technology programs in the U.S. and abroad. The company conducts most of its business with the U.S. Government, principally the Department of Defense (DoD). The company also conducts business with local, state, and foreign governments and domestic and international commercial customers. For a description of the company s foreign operations, see Risk Factors in Part I, Item 1A.

NORTHROP GRUMMAN CORPORATION

Organization

The company is aligned into seven reportable segments 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 each presented as separate businesses. Newport News and Ship Systems are aggregated and reported as the Ships business in accordance with the provisions of Statement of Financial Accounting Standards No. 131 *Disclosures about Segments of an Enterprise and Related Information.*

The company, from time to time, acquires or disposes of businesses, and realigns contracts, programs or business areas among and within its operating segments that possess similar customers, expertise, and capabilities. These realignments are designed to more fully leverage existing capabilities and enhance development and delivery of products and services. For a description of material business dispositions that occurred during 2007, see Note 5 to the consolidated financial statements in Part II, Item 8. In January 2007, certain programs and business areas were transferred among Information Technology, Mission Systems, Space Technology, and Technical Services. The business descriptions below and operating results for all periods presented have been revised to reflect these changes made through December 31, 2007.

Subsequent Realignments In January 2008, the Newport News and Ship Systems sectors were realigned into a single segment called Northrop Grumman Shipbuilding to enable the company to more effectively utilize its shipbuilding assets and deploy its talented shipbuilders, processes, technologies, production facilities and planned capital investment to meet customer needs. This realignment had no impact on the company s consolidated financial position, results of operations, cash flows, or segment reporting.

Also in January 2008, the company announced the transfer of certain programs and assets from the Mission Systems segment to the Space Technology segment, effective July 1, 2008. This transfer will allow Mission Systems to focus on the rapidly growing command, control, communications, computers, intelligence, surveillance, and reconnaissance (C4ISR) business, and the missiles business will be an integrated element of the company s Aerospace business growth strategy. In addition, certain Electronics businesses were transferred to Mission Systems effective January 2008. The transfer of these businesses is not expected to have a material effect on the company s consolidated financial position, results of operations, or cash flows.

These subsequent realignments have not been reflected in any of the accompanying financial information.

INFORMATION & SERVICES

Mission Systems

The Mission Systems segment, headquartered in Reston, Virginia, is a leading global systems integrator of complex, mission-enabling systems for government, military, and commercial customers. The segment consists of three areas of business: Command, Control and Communications (C3); Intelligence, Surveillance, and Reconnaissance (ISR); and Missile Systems.

Command, Control and Communications C3 supports the DoD, aerospace prime contractors, and other customers. Offerings include operational and tactical command and control systems; communications solutions and network management; tactical data link communications products and integration; network services; software defined radios; decision support and management information systems; system engineering and integration; land forces and global combat support; intelligence support to operations, mission planning and management applications; critical infrastructure security and force protection; logistics automation; robotic systems; homeland security solutions; naval systems engineering support and integration; and command centers integration.

Intelligence, Surveillance and Reconnaissance ISR supports the Intelligence Community, the DoD, and other federal agencies. Offerings include large systems integration; net-centric signals intelligence; airborne reconnaissance; payload control; tasking and collection; satellite ground stations; data collection and storage; information analysis and knowledge integration; computer network operations; information operations and information assurance; analysis and visualization tools; environmental and weather systems; special intelligence; and sustainment services.

NORTHROP GRUMMAN CORPORATION

Missile Systems Missile Systems supports the Air Force Intercontinental Ballistic Missile (ICBM) Program, the U.S. Ballistic Missile Defense System, the Missile Defense Integration Operations Center, and the Kinetic Energy Interceptors (KEI) program in support of the U.S. Air Force, the U.S. Army, the Missile Defense Agency, and other aerospace prime contractors. Offerings include battle management, command, control, communications (BMC3) and fire control systems; air and missile system engineering and integration; modeling and simulation; program management; system test and integration; development and deployment; missile system sustainment and modernization services; warfighter operations; and development and test activities for boost phase and midcourse intercept for the global layered missile defense system.

Information Technology

The Information Technology segment, headquartered in McLean, Virginia, consists of four areas of business: Intelligence; Civilian Agencies; Commercial, State & Local; and Defense.

Intelligence Intelligence provides information technology (IT) systems, services and solutions primarily to the U.S. Intelligence Community, which includes customers in national agencies, defense, homeland security, and other agencies at the federal, state and local level. This business area also collaborates with other Information Technology business areas by providing specialized technology solutions in areas such as information security, secure wireless communications, secure cross agency information-sharing and geospatial information systems. Services and solutions span the entire mission life cycle from requirements and technology development through processing and data analysis to information delivery.

Civilian Agencies Civilian Agencies provides IT systems, services and solutions primarily for federal civilian agencies, as well as government and commercial healthcare customers. Civilian Agencies customers include the departments of Homeland Security, Treasury, Justice, Transportation, State, Interior, and the U.S. Postal Service. Homeland Security offerings include secure networking, criminal justice systems, and identity management. Healthcare customers include the Department of Health and Human Services, DoD Health Affairs, the Centers for Disease Control and Prevention, the Food and Drug Administration, the Department of Veterans Affairs, and a number of pharmaceutical manufacturers. Healthcare offerings include enterprise architecture, systems integration, infrastructure management, document management, human capital management, case management, and specialized health IT solutions in electronic medical records pertaining to public health, life sciences, disease surveillance, benefits, and clinical trials research.

Commercial, State & Local Commercial, State & Local provides IT systems, services and solutions primarily for state and local agencies and commercial customers. The commercial business centers on managed IT services both as a prime contractor and partner in addition to specialized solutions that address specific business needs. The state and local focus includes public safety, secure wireless solutions, human services, and managed IT services. This business area provides IT outsourcing services on a service level agreement basis, where contractual terms are based on infrastructure volume and service levels. Services include management of data centers, networks, desktops, storage, security, help desk, and applications. Specialized state and local offerings include systems for police/fire/medical emergency dispatch, public safety command centers, biometric identification, and human services.

Defense Defense provides IT systems, services and solutions to all elements of the DoD including the Air Force, Navy, Army, Marines, the Office of the Secretary of Defense, and the Unified Combatant Commands. Offerings include business applications and systems integration related to human capital and business management, logistics, transportation, supply chain, and combat systems support. Other offerings consist of information technology and network infrastructures, including modernization, architecture, design and capacity modeling. Defense also provides solutions and services for defense technology laboratories and research and development centers, system program offices, operational commands, education and training commands, test centers, and other defense agencies.

Table of Contents

NORTHROP GRUMMAN CORPORATION

Technical Services

The Technical Services segment, headquartered in Herndon, Virginia, provides infrastructure management and maintenance, training and preparedness, and logistics and life cycle management in a wide array of operating environments. The segment consists of three areas of business: Systems Support; Training and Simulation; and Life Cycle Optimization and Engineering.

Systems Support Systems Support provides infrastructure and base operations management, including base support and civil engineering work, military aerial and ground range operations, support functions which include space launch services, construction, combat vehicle maintenance, protective and emergency services, and range-sensor-instrumentation operations. Primary customers include the Department of Energy, the DoD, the National Aeronautics and Space Administration (NASA), the Department of Homeland Security, and the U.S. Intelligence community, in both domestic and international locations.

Training and Simulation Training and Simulation provides realistic and comprehensive training to senior military leaders and peacekeeping forces, designs and develops future conflict training scenarios, and provides U.S. warfighters and international allies with live, virtual, and constructive training programs. This business area also offers diverse training applications ranging from battle command to professional military education. Primary customers include the DoD, Department of State and Department of Homeland Security.

Life Cycle Optimization and Engineering Life Cycle Optimization and Engineering provides complete life cycle product support and weapons system sustainment. This business area is focused on providing Performance Based Logistical support to the warfighter including supply chain management services, warehousing and inventory transportation, field services and mobilization, sustaining engineering, maintenance, repair and overhaul supplies, and on-going weapon maintenance and technical assistance. The group specializes in rebuilding essential parts and assemblies. Primary customers include the DoD as well as international military and commercial customers.

AEROSPACE

Integrated Systems

The Integrated Systems segment, headquartered in El Segundo, California, designs, develops, produces, and supports fully missionized integrated systems and subsystems in the areas of battlespace awareness, command and control systems, integrated combat systems, and airborne ground surveillance. The segment is organized into the following areas of business: Integrated Systems Western Region (ISWR) and Integrated Systems Eastern Region (ISER).

Integrated Systems Western Region The principal manned vehicle programs in ISWR are subcontractor work on the F/A-18 and F-35 programs and prime contract work on the B-2 program and the Multi-Platform Radar Technology Insertion Program (MP-RTIP). For the F/A-18, ISWR is responsible for the full integration of the center and aft fuselage and vertical tail sections and associated subsystems. For the F-35, ISWR is responsible for the detailed design and integration and production of the center fuselage and weapons bay, systems engineering, mission system software, autonomic logistics and global sustainment, ground and flight test support, signature/low observables development, and support of modeling and simulation activities. ISWR is the prime systems integration contractor for the MP-RTIP, which will provide advanced radar capabilities for the Global Hawk UAV and potential future Wide Area Surveillance (WAS) platform. ISWR is working on a radar and avionics upgrade program for the B-2 bomber and is a prime integrator for all logistics support activities including program depot maintenance.

The principal unmanned vehicle programs at ISWR are the Global Hawk, the Naval Unmanned Combat Air System (N-UCAS), Aerial Targets, and the Fire Scout. ISWR is the prime contractor for these product lines with the exception of the Army version of Fire Scout for Future Combat Systems (FCS). The Global Hawk is a high altitude long endurance unmanned aerial reconnaissance system. N-UCAS is a development/demonstration program that will design, build and test two demonstration vehicles that will conduct a carrier demonstration. The technology demonstrations are to show carrier control area operations, catapult launch, and an arrested

NORTHROP GRUMMAN CORPORATION

landing of a low observable unmanned aerial combat vehicle. Aerial Targets has two primary models, the BQM-74 and the BQM-34 and is the prime contractor on multiple domestic and international contracts. Fire Scout is a vertical takeoff and landing tactical UAV system in development and consists of two versions the Vertical Takeoff and Landing Unmanned Air Vehicle (VTUAV) for the U.S. Navy and the FCS Class IV UAV for the U.S. Army.

Integrated Systems Eastern Region
Airborne Early Warning and Battle Management Command & Control-Navy (AEW & BMC2) AEW & BMC2 s principal products include the E-2C Hawkeye and E-2D Advanced Hawkeye aircraft (currently in the system development and demonstration (SDD) phase of development and Pilot Production). The Hawkeye is the U.S. Navy s airborne battle management command and control mission system platform providing airborne early warning detection, identification, tracking, targeting, and communication capabilities. The company is currently performing on a follow-on multi-year contract for eight E-2C aircraft to be delivered to the U.S. Navy through 2009 (two aircraft delivered in 2006 and two aircraft delivered in 2007). The company is developing the next generation capability including radar, mission computer, vehicle, and other system enhancements called the E-2D Advanced Hawkeye under an SDD contract with the U.S. Navy. Pilot Production of three aircraft was authorized in 2007 and long lead funding for the first lot of Low Rate Initial Production (three aircraft) was received in December 2007.

Intelligence, Surveillance, Reconnaissance & Battle Management Command & Control Air Force (ISR & BMC2-AF) ISR & BMC2-AF is the prime contractor on the Joint Surveillance Target Attack Radar System (Joint STARS) program. Joint STARS detects, locates, classifies, tracks, and targets potentially hostile ground movement in all weather conditions. It is designed to operate around the clock in constant communication through secure data links with U.S. Air Force command posts, U.S. Army mobile ground stations, or centers for military analysis far from the point of conflict. The Joint STARS program is currently developing performance upgrades and retrofits under an ongoing Systems Improvement Program. Fleet sustainment is performed through the Total Systems Support contract currently in its eighth fiscal year. In February 2007, an initial non-recurring contract was awarded to re-engine the fleet of nineteen aircraft with modern, more reliable, powerful and fuel efficient engines. Follow-on nonrecurring efforts and recurring contract awards are expected in 2008. Following the customer s decision in 2007 not to fund the E-10A Technology Demonstration Development Program, a one-year Mission Execution Program study contract was awarded that will leverage the E-10A analysis and design concepts for the Joint STARS platform.

Electronic Support & Attack Solutions (ES & AS) ES & AS principal products include the EA-6B (Prowler) and the electronic attack system for the EA-18G aircraft. The Prowler is currently the armed services only offensive tactical radar jamming aircraft. ES & AS has developed the next generation mission system for this aircraft under the Increased Capacity (ICAP) III contract and has completed the final test and evaluation phase. The company completed the low-rate initial production for ICAP III Kits during 2006, and was awarded a follow-on contract for ICAP III Kits & Spares, with deliveries commencing in 2007. In addition, the company is performing on a contract to incorporate the ICAP III mission system into an F/A-18 platform, designated the EA-18G. Integrated Systems is the principal subcontractor to Boeing for this program, which is currently in the SDD phase. Northrop Grumman has been authorized to begin production of Low Rate Initial Production units.

Maritime & Tactical Systems The principal programs include the Littoral Combat Ship Mission Package Integration contract and Mine Counter Measures contracts with multiple customers that focus on detecting and neutralizing in-land, coastal and water surface/subsurface mines.

Space Technology

The Space Technology segment, headquartered in Redondo Beach, California, develops a broad range of systems at the leading edge of space, defense, and electronics technology. The segment provides products primarily to the U.S. Government that are critical to the nation s security and leadership in science and technology. In October 2007, Space Technology realigned its organizational structure to better position itself with its customer base for

NORTHROP GRUMMAN CORPORATION

future growth. Products and services are grouped into the following business areas: Civil Systems; Military Systems; National Systems; and Technology & Emerging Systems.

Civil Systems The Civil Systems business area produces and integrates space-based systems, instruments, and services primarily for NASA, the National Oceanic and Atmospheric Administration, and other governmental agencies. These systems are primarily used for space science, earth observation and environmental monitoring, and exploration missions. A variety of systems and services are provided, including mission and system engineering services, satellite and instrument systems, mission operations, and propulsion systems. Major programs include National Polar-orbiting Operational Environmental Satellite System (NPOESS), the James Webb Space Telescope (JWST), and the legacy Chandra space telescope and Earth Observing System programs.

Military Systems Military Systems produces and integrates spiral development programs and operational programs associated with the U.S. Air Force, Missile Defense Agency, and other military customers. Responsibilities include study design, build integration, launch, and operations of major U.S. military space systems. Programs include the Advanced Extremely High Frequency (AEHF) payload, Transformational Satellite (TSAT) communications system, Space Tracking and Surveillance System (STSS), and the communication payload for the legacy Milstar program, currently in operation. The Defense Support Program (DSP) is also part of this business area, and has been monitoring ballistic missile launches for the U.S. Air Force for decades.

National Systems The National Systems business area gives the nation s monitoring systems a global reach and enhanced national security. Addressing requirements in space-based intelligence, surveillance, and reconnaissance systems, National Systems provides mission and system engineering, satellite systems, and mission operations. Customers are predominantly restricted, as are the major programs.

Technology & Emerging Systems Technology & Emerging Systems consists of government funded research and development contracts in support of the three business areas above. In addition, it includes the Airborne Laser (ABL), other directed energy programs and advanced concepts programs.

ELECTRONICS

The Electronics segment, headquartered in Linthicum, Maryland, designs, develops, produces, integrates, and supports high performance sensors, intelligence processing, and navigation systems operating in all environments from undersea to outer space and cyberspace. It also develops, produces, integrates, and supports power, power control, and ship control systems for commercial and naval ships in domestic and international markets. In select markets it performs as a prime contractor, integrating multiple subsystems to provide complete systems to meet customers solution requirements. The segment is composed of five areas of business: Aerospace Systems; Defensive Systems; Government Systems; Naval & Marine Systems; and Navigation Systems.

Aerospace Systems Aerospace Systems provides sensors, sensor processing, integrated sensor suites, and radar countermeasure systems for military surveillance and precision-strike; missile tracking and warning; space satellite applications; and radio frequency electronic warfare. Fire control radars include systems for the F-16, F-22, F-35 and B-1B. Navigation radars include commercial and military systems for transport and cargo aircraft. Surveillance products include the Airborne Warning and Control System (AWACS) radar, the 737 Multi-Role Electronically Scanned Array (MESA) radar, the Multi-Platform Radar Technology Insertion Program (MP-RTIP, the ship-board Cobra Judy Replacement (CJR) radar, and multiple payloads on the P-8A. Space satellite products include the Space-Based Infrared Surveillance (SBIRS) program, payloads for restricted programs, the Defense Meteorological

Satellite Program (DMSP), NPOESS, and the DSP. Radio frequency electronic warfare products include radar warning receivers, self-protection jammers, and integrated electronic warfare systems for aircraft such as the EA-6B, EA-18, F-16 and F-15.

Defensive Systems Defensive Systems provides systems that support combat aviation by protecting aircraft and helicopters from attack, by providing capabilities for precise targeting and tactical surveillance, by improving mission availability through automated test systems and by improving mission skills through advanced simulation systems. It also provides systems that support land forces. Aircraft and helicopter protection systems include

NORTHROP GRUMMAN CORPORATION

infrared detection and countermeasures systems to defeat shoulder-launched and infrared-guided missiles. Targeting systems include lasers for target designation and image processing and sensor applications, and the LITENING pod system to detect and designate targets for engagement by precision weapons in aircraft such as the F-16 and F/A-18. Test systems include systems to test electronic components of combat aircraft on the flight line and in repair facilities. Land force systems include precision guided munitions for artillery and UAV delivery, night vision goggles, laser designators, weapon sights, tactical radars for warning of missile and artillery attack, and fire control radars for helicopters. Defensive Systems also provides standard simulators for use on test ranges and training facilities to emulate threats of potential adversaries.

Government Systems Government Systems provides products and services to meet the needs of governments for improvements in the effectiveness of their civil and military infrastructure and of their combat and counter-terrorism operations. This includes systems and systems integration of products and services for postal automation, for the detection and alert of Chemical, Biological, Radiological, Nuclear and Explosive (CBRNE) material, for homeland defense, communications, and air traffic management, and for multi-sensor processing and analysis for combat units and national agencies of data from ISR systems. Key programs include: Advanced Flat Sorting Machines; International Sorting Centers; U.S. Postal Service bio-detection systems; national level communications, information processing and air defense systems for international customers; unattended ground sensors; the ISR Distributed Common Ground System for the U.S. military services and national agencies; and deployed ISR and persistent surveillance processing systems.

Naval & Marine Systems Naval and Marine Systems provides major subsystems and subsystem integration for sensors, sensor processing, missile launching, ship controls and power generation. It provides systems to military surface and subsurface platforms, and bridge and machinery control systems for commercial maritime applications. Principal programs include: radars for navigation; radars for gun fire control and cruise missile defense; bridge management and control systems; power generation systems for aircraft carriers; power and propulsion systems for the Virginia Class submarine; launch systems for Trident submarines and the KEI program; the Advanced SEAL Delivery System mini-submarine; and unmanned semi-autonomous naval systems.

Navigation Systems Navigation Systems provides advanced navigation, identification of friend or foe and avionics systems for military and commercial applications. Its products are used in commercial space and aircraft; in military air, land, sea, and space systems; and in both U.S. and international markets. Its subsidiaries, LITEF Germany and Northrop Grumman Italia, are leading European inertial sensors and systems suppliers. Key programs and applications include: integrated avionics for the U.S. Marine Corps attack and utility helicopters and U.S. Navy E-2 aircraft; military navigation and positioning systems for the F-16 fighter, F-22A fighter/attack aircraft, Eurofighter, and U.S. Navy MH-60 helicopter; navigation systems for commercial aircraft; navigation systems for military and civil space satellites and deep space exploration; identification of friend-or-foe transponders and interrogators; and systems for the C-17 aircraft, Eurofighter and MH-60 helicopter. Navigation Systems also develops and produces fiber-optic acoustic systems for underwater surveillance for Virginia Class submarines and the AN/TYQ-23 multi-service mobile tactical command centers for the U.S. Marine Corps and U.S. Air Force.

SHIPS

The Ships segment includes the following areas of business: Aircraft Carriers; Expeditionary Warfare; Surface Combatants; Submarines; Coast Guard & Coastal Defense; Fleet Support; and Services, Commercial & Other.

Aircraft Carriers Ships is the nation s sole industrial designer, builder, and refueler of nuclear-powered aircraft carriers. The U.S. Navy s newest carrier, the *USS Ronald Reagan*, was delivered to the fleet in May 2004. Construction on the last carrier in the Nimitz class, the *George H. W. Bush*, continues. The *Bush* christening occurred in the fall of 2006 and delivery to the U.S. Navy is expected in late 2008. Advanced design and preparation continues for the new generation carrier, Ford class, which will incorporate transformational technologies that will result in manning reductions, improved war fighting capability, and a new nuclear propulsion plant design. The construction award for the first ship of the Ford class, the *Gerald R. Ford*, is

Table of Contents

NORTHROP GRUMMAN CORPORATION

expected in mid 2008. The company also provides ongoing maintenance for the U.S. Navy aircraft carrier fleet through overhaul, refueling, and repair work. Ships is currently performing the refueling and complex overhaul of the *USS Carl Vinson* with redelivery to the U.S. Navy anticipated in early 2009. Planning for the *USS Theodore Roosevelt* refueling and complex overhaul began in the fall of 2006 and the ship is expected to arrive at Newport News, Virginia in the fall of 2009.

Expeditionary Warfare Expeditionary Warfare programs include the design and construction of amphibious assault ships for the U.S. Navy, including the WASP LHD 1 class and the San Antonio LPD 17 class. Ships is the sole provider for the LHD class of large-deck, 40,500-ton multipurpose amphibious assault ships, which serve as the centerpiece of an Amphibious Ready Group. Currently, the LHD 8 is under construction and is a significant upgrade from the preceding seven ships of its class. The design and production of the LHD 8 is a $1.9 billion program with delivery scheduled for late 2008. In 2007, the construction contract for LHA 6, the first in a new class of enhanced amphibious assault ships, was awarded. The ship is scheduled for delivery in 2012. Ships is also the sole provider of the LPD 17 class of ships, which function as amphibious transports. The initial three ships were delivered in 2005, 2006, and 2007, and five LPD 17 ships are currently under construction. In December 2007, the construction award for the ninth ship was received.

Surface Combatants Surface Combatants includes the design and construction of the Arleigh Burke DDG 51 class Aegis guided missile destroyers, and the design of DDG 1000 (previously DD(X)), the Navy s future transformational surface combatant class. Ships is one of two prime contractors designing and building DDG 51 class destroyers, which provide primary anti-aircraft and anti-missile ship protection for the U.S. Navy fleet. Four Arleigh Burke class destroyers are currently under construction. In 2006, Ships was awarded Phase IV detail design & long lead construction funding for the initial DDG 1000. The contract calls for an equal split of ship detail design efforts between the company and Bath Iron Works, a wholly owned subsidiary of General Dynamics Corporation. The construction award for the initial ship is anticipated in the first half of 2008. The advanced technologies developed on DD(X) Phase III are being incorporated into DDG 1000 and are anticipated to be incorporated into the next generation guided missile cruiser CG(X).

Submarines Northrop Grumman is one of only two U.S. companies capable of designing and building nuclear-powered submarines. In February 1997, the company and Electric Boat, a wholly owned subsidiary of General Dynamics Corporation, reached an agreement to cooperatively build *Virginia* Class nuclear attack submarines. The lead ship, *USS Virginia*, was delivered by Electric Boat to the U.S. Navy and commissioned into the fleet in October 2004. The *USS Texas* was delivered by Ships in the spring of 2006. The *USS Hawaii* was delivered by Electric Boat in December 2006, and *North Carolina*, the final block one ship, is expected to be delivered by Ships in early 2008. Electric Boat and Ships were awarded a construction contract in August 2003, which was subsequently modified in January 2004, for the second block of six *Virginia* Class submarines. Planning and long lead material procurement is underway on all six boats of the second block; construction has begun on the first four. The construction award for the third block is expected in late 2008.

Coast Guard & Coastal Defense Ships is a joint venture partner along with Lockheed Martin for the Coast Guard s Deepwater Modernization Program. Ships has design and production responsibility for surface ships. In 2006, the Ships/Lockheed Martin joint venture was awarded a 43 month contract extension for the Deepwater program. Currently, the first three National Security Cutters (NSC) are in construction. The initial NSC will be delivered in early 2008.

Fleet Support Ships provides after-market services, including on-going maintenance and repair work, for a wide array of naval and commercial vessels. The company has ship repair facilities in the U.S. Navy s largest homeports of Norfolk, Virginia, and San Diego, California.

Services, Commercial & Other Under the Polar Tanker program, Ships was under contract to produce five double-hulled tankers. These tankers each transport one million barrels of crude oil from Alaska to west coast refineries and are fully compliant with the Oil Pollution Act of 1990. The last ship under this program was delivered in mid-2006.

Table of Contents

NORTHROP GRUMMAN CORPORATION

Corporate

The company s principal executive offices are located at 1840 Century Park East, Los Angeles, California 90067. The company s telephone number is (310) 553-6262. The company s home page on the Internet is www.northropgrumman.com. The company makes web site content available for informational purposes, and such content is not incorporated by reference into this Form 10-K, unless so specified herein.

SUMMARY SEGMENT FINANCIAL DATA

For a more complete understanding of the company s segment financial information, see Segment Operating Results in Part II, Item 7, and Note 6 to the consolidated financial statements in Part II, Item 8.

CUSTOMERS AND REVENUE CONCENTRATION

The company s primary customer is the U.S. Government. Revenue from the U.S. Government accounted for approximately 90 percent of total revenues in 2007, 2006, and 2005. No other customer accounted for more than 10 percent of total revenue during any period presented. No single product or service accounted for more than 10 percent of total revenue during any period presented. See Risk Factors in Part I, Item 1A.

PATENTS

The following table summarizes the number of patents the company owns or has pending as of December 31, 2007:

	Owned	Pending	**Total**
U.S. patents	3,572	708	**4,280**
Foreign patents	2,464	1,767	**4,231**
Total	6,036	2,475	**8,511**

Patents developed while under contract with the U.S. Government may be subject to use by the U.S. Government. In addition the company licenses intellectual property to, and from, third parties. Management believes the company s ability to conduct its operations would not be materially affected by the loss of any particular intellectual property right.

SEASONALITY

No material portion of the company s business is considered to be seasonal. The timing of revenue recognition is based on several factors including the timing of contract awards, the incurrence of contract costs, cost estimation, and unit deliveries. See Revenue Recognition in Part II, Item 7.

RAW MATERIALS

The most significant raw material required by the company is steel, used primarily for shipbuilding. The company has mitigated supply risk by negotiating long-term agreements with a number of steel suppliers. In addition, the company has mitigated price risk related to its steel purchases through certain contractual arrangements with the

U.S. Government. While the company has generally been able to obtain key raw materials required in its production processes in a timely manner, a significant delay in receipt of these supplies by the company could have a material effect on the company s consolidated results of operations. See Risk Factors in Part I, Item 1A.

GOVERNMENT REGULATION

The company s business is affected by numerous laws and regulations relating to the award, administration and performance of U.S. Government contracts. See Risk Factors in Part I, Item 1A.

Certain programs with the U.S. Government that are prohibited by the customer from being publicly discussed in detail are referred to as restricted in this Form 10-K. The consolidated financial statements and financial

NORTHROP GRUMMAN CORPORATION

information contained within this Form 10-K reflect the operating results of restricted programs under accounting principles generally accepted in the United States of America (GAAP). See Risk Factors in Part I, Item 1A.

RESEARCH AND DEVELOPMENT

Company-sponsored research and development activities primarily include independent research and development (IR&D) efforts related to government programs. IR&D expenses are included in general and administrative expenses and are allocated to U.S. Government contracts. Company-sponsored research and development expenses totaled $537 million, $572 million, and $536 million in 2007, 2006, and 2005, respectively. Expenses for research and development sponsored by the customer are charged directly to the related contracts.

EMPLOYEE RELATIONS

The company believes that it maintains good relations with its 122,600 employees, of which approximately 17 percent are covered by 32 collective bargaining agreements. The company expects to re-negotiate nine of its collective bargaining agreements in 2008. It is not expected that the results of these negotiations will, either individually or in the aggregate, have a material adverse effect on the company s results of operations. See Risk Factors in Part I, Item 1A.

ENVIRONMENTAL MATTERS

Federal, state, and local laws relating to the protection of the environment affect the company s manufacturing operations. The company has provided for the estimated cost to complete environmental remediation where the company has determined 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. These estimates may change given the inherent difficulty in estimating environmental cleanup costs to be incurred in the future due to the uncertainties regarding the extent of the required cleanup, determination of legally responsible parties, and the status of laws, regulations, and their interpretations.

In order to assess the potential impact on the company s financial statements, management estimates the possible remediation costs that reasonably could be incurred by the company on a site-by-site basis. Such estimates take into consideration the professional judgment of the company s environmental engineers and, when necessary, consultation with outside environmental specialists. In most instances, only a range of reasonably possible costs can be estimated. However, in the determination of accruals, the most probable amount is used when determinable, and the minimum is used when no single amount is more probable. The company records accruals for environmental cleanup costs in the accounting period in which the company s responsibility is established and the costs can be reasonably estimated. The company does not anticipate and record insurance recoveries before it has determined that collection is probable.

Management estimates that at December 31, 2007, the range of reasonably possible future costs for environmental remediation sites is $186 million to $285 million, of which $223 million is accrued in other current liabilities in the consolidated statements of financial position. Environmental accruals are recorded on an undiscounted basis. At sites involving multiple parties, the company provides environmental accruals based upon its expected share of liability, taking into account the financial viability of other jointly liable parties. Environmental expenditures are expensed or capitalized as appropriate. Capitalized expenditures relate to long-lived improvements in currently operating facilities. In addition, 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, which could have a material effect on the company s consolidated financial position, results of operations, or cash flows. The company has made the investments it believes necessary in order to comply with environmental laws.

Table of Contents

NORTHROP GRUMMAN CORPORATION

COMPETITIVE CONDITIONS

Northrop Grumman, along with Lockheed Martin Corporation, The Boeing Company, Raytheon Company, and General Dynamics Corporation are among the largest companies in the U.S. defense industry at this time. Northrop Grumman competes against these and other companies for a number of programs, both large and small. Intense competition and long operating cycles are both key characteristics of Northrop Grumman s business and the defense industry. It is common in this industry for work on major programs to be shared among a number of companies. A company competing to be a prime contractor may, upon ultimate award of the contract to another party, turn out to be a subcontractor for the ultimate prime contracting party. It is not uncommon to compete for a contract award with a peer company and, simultaneously, perform as a supplier to or a customer of such competitor on other contracts. The nature of major defense programs, conducted under binding contracts, allows companies that perform well to benefit from a level of program continuity not common in many industries.

The company s success in the competitive defense industry depends upon its ability to develop and market its products and services, as well as its ability to provide the people, technologies, facilities, equipment, and financial capacity needed to deliver those products and services with maximum efficiency. It is necessary to maintain, as the company has, sources for raw materials, fabricated parts, electronic components, and major subassemblies. In this manufacturing and systems integration environment, effective oversight of subcontractors and suppliers is as vital to success as managing internal operations.

Similarly, there is intense competition among many companies in the information and services markets which is generally more labor intensive with competitive margin rates over contract periods of shorter duration. Competitors in the information and services markets include the defense industry participants mentioned above as well as many other large and small entities with expertise in various specialized areas. The company s ability to successfully compete in the information and services markets depends on a number of factors; most important is the capability to deploy skilled professionals, many requiring security clearances, at competitive prices across the diverse spectrum of these markets. Accordingly, various workforce initiatives are in place to ensure the company is successful in attracting, developing and retaining sufficient resources to maintain or improve its competitive position within these markets. See Risk Factors in Part I, Item 1A.

EXECUTIVE OFFICERS

See Part III, Item 10, for information about executive officers of the company.

AVAILABLE INFORMATION

Throughout this Form 10-K, the company incorporates by reference information from parts of other documents filed with the Securities and Exchange Commission (SEC). The SEC allows the company to disclose important information by referring to it in this manner, and you should review this information in addition to the information contained herein.

The company s annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and proxy statement for the annual shareholders meeting, as well as any amendments to those reports, are available free of charge through the company s web site as soon as reasonably practicable after electronic filing of such material with the SEC. You can learn more about the company by reviewing the company s SEC filings on the company s web site. The company s SEC reports can be accessed through the investor relations page of the company s web site at www.northropgrumman.com.

The SEC also maintains a web site at www.sec.gov that contains reports, proxy statements and other information regarding SEC registrants, including Northrop Grumman. The public may read and copy any materials filed by the company with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

NORTHROP GRUMMAN CORPORATION

Item 1A. Risk Factors

The company s consolidated financial position, results of operations and cash flows are subject to various risks, many of which are not exclusively within the company s control, that may cause actual performance to differ materially from historical or projected future performance. Information contained within this Form 10-K should be carefully considered by investors in light of the risk factors described below.

n ***The Company Depends Heavily on a Single Customer, the U.S. Government, for a Substantial Portion of the Company s Business, Including Programs Subject to Security Classification Restrictions on Information. Changes Affecting this Customer s Capacity to Do Business with the Company or the Effects of Competition in the Defense Industry Could Have a Material Adverse Effect On the Company or Its Prospects.***

Approximately 90 percent of the company s revenues during 2007 were derived from products and services ultimately sold to the U.S. Government and are therefore affected by, among other things, the federal budget process. The company is a supplier, either directly or as a subcontractor or team member, to the U.S. Government and its agencies as well as foreign governments and agencies. These contracts are subject to the respective customers political and budgetary constraints and processes, changes in customers short-range and long-range strategic plans, the timing of contract awards, and in the case of contracts with the U.S. Government, the congressional budget authorization and appropriation processes, the U.S. Government s ability to terminate contracts for convenience or for default, as well as other risks such as contractor suspension or debarment in the event of certain violations of legal and regulatory requirements. The termination or failure to fund one or more significant contracts by the U.S. Government could have a material adverse effect on the company s results of operations or prospects.

In the event of termination for the government s convenience, contractors are normally protected by provisions covering reimbursement for costs incurred. The company is involved as a plaintiff in a lawsuit concerning a contract terminated for convenience. See Other Matters in Part I, Item 3. Termination resulting from the company s default could expose the company to liability and have a material adverse effect on its ability to compete for contracts.

In addition, a material amount of the company s revenues and profits is derived from programs that are subject to security classification restrictions (restricted business), which could limit the company s ability to discuss details about these programs, their risks or any disputes or claims relating to such programs. As a result, investors might have less insight into the company s restricted business than other businesses of the company or could experience less ability to evaluate fully the risks, disputes or claims associated with restricted business.

The company s success in the competitive defense industry depends upon its ability to develop and market its products and services, as well as its ability to provide the people, technologies, facilities, equipment, and financial capacity needed to deliver those products and services with maximum efficiency. A loss of business to the company s competitors could have a material adverse affect on the company s ability to generate favorable financial results and maintain market share.

n ***Many of the Company s Contracts Contain Performance Obligations That Require Innovative Design Capabilities, Are Technologically Complex, Require State-Of-The-Art Manufacturing Expertise or Are Dependent Upon Factors Not Wholly Within the Company s Control. Failure to Meet These Obligations Could Adversely Affect the Company s Profitability and Future Prospects.***

The company designs, develops and manufactures technologically advanced and innovative products and services applied by its customers in a variety of environments. Problems and delays in development or delivery as a result of issues with respect to design, technology, licensing and patent rights, labor, learning curve assumptions, or materials and components could prevent the company from achieving contractual requirements.

NORTHROP GRUMMAN CORPORATION

In addition, the company s products cannot be tested and proven in all situations and are otherwise subject to unforeseen problems. Examples of unforeseen problems which could negatively affect revenue and profitability include loss on launch of spacecraft, premature failure, problems with quality, country of origin, delivery of subcontractor components or services, and unplanned degradation of product performance. These failures could result, either directly or indirectly, in loss of life or property. Among the factors that may affect revenue and profits could be unforeseen costs and expenses not covered by insurance or indemnification from the customer, diversion of management focus in responding to unforeseen problems, loss of follow-on work, and, in the case of certain contracts, repayment to the government customer of contract cost and fee payments previously received by the company.

Certain contracts, primarily involving space satellite systems, contain provisions that entitle the customer to recover fees in the event of partial or complete failure of the system upon launch or subsequent deployment for less than a specified period of time. Under such terms, the company could be required to forfeit fees previously recognized and/or collected. The company has not experienced any material losses in the last decade in connection with such contract performance incentive provisions. However, if the company were to experience launch failures or complete satellite system failures in the future, such events could have a material adverse impact on the company s consolidated financial position or results of operations.

n ***Contract Cost Growth on Fixed-Price and Other Contracts That Cannot Be Justified as an Increase In Contract Value Due From Customers Exposes The Company to Reduced Profitability and the Potential Loss of Future Business.***

Operating margin is adversely affected when contract costs that cannot be billed to customers are incurred. This cost growth can occur if estimates to complete increase due to technical challenges or if initial estimates used for calculating the contract price were incorrect. The cost estimation process requires significant judgment and expertise. Reasons for cost growth may include unavailability and productivity of labor, the nature and complexity of the work to be performed, the effect of change orders, the availability of materials, the effect of any delays in performance, availability and timing of funding from the customer, natural disasters, and the inability to recover any claims included in the estimates to complete. A significant change in cost estimates on one or more programs could have a material effect on the company s consolidated financial position or results of operations.

Due to their nature, fixed-price contracts inherently have more risk than flexibly priced contracts and therefore generally carry higher profit margins. Approximately 30 percent of the company s annual revenues are derived from fixed-price contracts see Contracts in Part II, Item 7. Flexibly priced contracts may carry risk to the extent of their specific contract terms and conditions relating to performance award fees, including cost sharing agreements, and negative performance incentives. The company typically enters into fixed-price contracts where costs can be reasonably estimated based on experience. In addition, certain contracts other than fixed-price contracts have provisions relating to cost controls and audit rights. Should the terms specified in those contracts not be met, then profitability may be reduced. Fixed-price development work comprises a small portion of the company s fixed-price contracts and inherently has more uncertainty as to future events than production contracts and therefore more variability in estimates of the costs to complete the development stage. As work progresses through the development stage into production, the risks associated with estimating the total costs of the contract are generally reduced. In addition, successful performance of fixed-price development contracts which include production units is subject to the company s ability to control cost growth in meeting production specifications and delivery rates. While management uses its best judgment to estimate costs associated with fixed-price development contracts, future events could result in either upward or downward adjustments to those estimates. Examples of the company s significant fixed-price development contracts include the F-16 Block 60 combat avionics program and the MESA radar system program for the Wedgetail and Peace Eagle contracts, both of which are performed by the Electronics segment. It is also not unusual in the Ships business for the company to negotiate fixed-price

NORTHROP GRUMMAN CORPORATION

production follow-on contracts before the development effort has been completed and learning curves fully realized on existing flexibly priced development contracts.

- ***The Company Uses Estimates When Accounting for Contracts. Changes In Estimates Could Affect The Company s Profitability and Its Overall Financial Position.***

Contract accounting requires judgment relative to assessing risks, estimating contract revenues and costs, and making assumptions for schedule and technical issues. Due to the size and nature of many of the company s contracts, the estimation of total revenues and costs at completion is complicated and subject to many variables. For example, assumptions have to be made regarding the length of time to complete the contract because costs also include expected increases in wages and prices for materials. Similarly, assumptions have to be made regarding the future impact of efficiency initiatives and cost reduction efforts. Incentives, awards, or penalties related to performance on contracts are considered in estimating revenue and profit rates, and are recorded when there is sufficient information to assess anticipated performance.

Because of the significance of the judgments and estimation processes described above, it is possible that materially different amounts could be obtained if different assumptions were used or if the underlying circumstances were to change. Changes in underlying assumptions, circumstances or estimates may have a material adverse effect upon future period financial reporting and performance. See Critical Accounting Policies, Estimates, and Judgments in Part II, Item 7.

- ***The Company s Operations Are Subject to Numerous Domestic and International Laws, Regulations and Restrictions, and Noncompliance With These Laws, Regulations and Restrictions Could Expose the Company to Fines, Penalties, Suspension or Debarment, Which Could Have a Material Adverse Effect on the Company s Profitability and Its Overall Financial Position.***

The company has thousands of contracts and operations in many parts of the world subject to U.S. and foreign laws and regulations. Prime contracts with various agencies of the U.S. Government and subcontracts with other prime contractors are subject to numerous procurement regulations, including the False Claims Act and the International Traffic in Arms Regulation promulgated under the Arms Export Control Act, with noncompliance found by any one agency possibly resulting in fines, penalties, debarment, or suspension from receiving additional contracts with all U.S. Government agencies. Given the company s dependence on U.S. Government business, suspension or debarment could have a material adverse effect on the company.

In addition, international business subjects the company to numerous U.S. and foreign laws and regulations, including, without limitation, regulations relating to import-export control, technology transfer restrictions, repatriation of earnings, exchange controls, the Foreign Corrupt Practices Act, and the anti-boycott provisions of the U.S. Export Administration Act. Failure by the company or its sales representatives or consultants to comply with these laws and regulations could result in administrative, civil, or criminal liabilities and could, in the extreme case, result in suspension or debarment from government contracts or suspension of the company s export privileges, which could have a material adverse effect on the company. Changes in regulation or political environment may affect the company s ability to conduct business in foreign markets including investment, procurement, and repatriation of earnings.

The company operates in a highly regulated environment and is routinely audited by the U.S. Government and others. On a regular basis, the company monitors its policies and procedures with respect to its contracts to ensure consistent application under similar terms and conditions and to assess compliance with all applicable government regulations. Negative audit findings could result in termination of a contract, forfeiture of profits, or suspension of payments. From time to time the company is subject to U.S. Government investigations relating to its operations. Government contractors that are found to have violated the law such as the False Claims Act or the Arms Export Control Act, or are indicted or convicted for violations of other federal laws, or are found not to have acted responsibly as defined by the law, may be subject to significant fines. Such convictions could also result in suspension or debarment from government

NORTHROP GRUMMAN CORPORATION

contracting for some period of time. Given the company s dependence on government contracting, suspension or debarment could have a material adverse effect on the company.

n ***The Company s Business Is Subject to Disruption Caused By Issues With Its Suppliers, Subcontractors, Workforce, Natural Disasters and Other Factors That Could Adversely Affect the Company s Profitability and Its Overall Financial Position.***

The company may be affected by delivery or performance issues with key suppliers and subcontractors, as well as other factors that may cause operating results to be adversely affected. Changes in inventory requirements or other production cost increases may also have a negative effect on the company s consolidated financial position or results of operations.

Performance failures by a subcontractor of the company or difficulty in maintaining complete alignment of the subcontractor s obligations with the company s prime contract obligations may adversely affect the company s ability to perform its obligations on the prime contract, which could reduce the company s profitability due to damages or other costs that may not be fully recoverable from the subcontractor or from the customer and could result in a termination of the prime contract and have an adverse effect on the company s ability to compete for future contracts.

Operating results are heavily dependent upon the company s ability to attract and retain sufficient personnel with requisite skill sets and/or security clearances. The successful negotiation of collective bargaining agreements and avoidance of organized work stoppages are also critical to the ongoing operations of the company.

The company has significant operations located in regions of the U.S. that may be exposed to damaging storms and other natural disasters. While preventative measures typically help to minimize harm to the company, the damage and disruption resulting from certain storms or other natural disasters may be significant. Although no assurances can be made, the company believes it can recover costs associated with natural disasters through insurance or its contracts.

Natural disasters such as storms and earthquakes can disrupt electrical and other power distribution networks and cause adverse effects on profitability and performance, including computer and internet operation and accessibility. Computer viruses and similar harmful software programs, as well as network outages, disruptions and attacks also may have a material adverse effect on the company s profitability and performance unless quarantined or otherwise prevented.

n ***Changes In Future Business Conditions Could Cause Business Investments and/or Recorded Goodwill to Become Impaired, Resulting In Substantial Losses and Write-Downs That Would Reduce the Company s Operating Income.***

As part of its overall strategy, the company will, from time to time, acquire a minority or majority interest in a business. These investments are made upon careful target analysis and due diligence procedures designed to achieve a desired return or strategic objective. These procedures often involve certain assumptions and judgment in determining acquisition price. After acquisition, unforeseen issues could arise which adversely affect the anticipated returns or which are otherwise not recoverable as an adjustment to the purchase price. Even after careful integration efforts, actual operating results may vary significantly from initial estimates. Goodwill accounts for approximately half of the company s recorded total assets. The company evaluates goodwill amounts for impairment annually, or when evidence of potential impairment exists. The annual impairment test is based on several factors requiring judgment. Principally, a significant decrease in expected reporting unit cash flows or changes in market conditions may indicate potential impairment of recorded goodwill. See Critical Accounting Policies, Estimates, and Judgments in Part II, Item 7.

NORTHROP GRUMMAN CORPORATION

n ***The Company Is Subject to Various Claims and Litigation That Could Ultimately Be Resolved Against The Company Requiring Material Future Cash Payments and/or Future Material Charges Against the Company s Operating Income and Materially Impairing the Company s Financial Position.***

The size and complexity of the company s business make it highly susceptible to claims and litigation. The company is subject to environmental claims, income tax matters and other litigation, which, if not resolved within established accruals, could have a material adverse effect on the company s consolidated financial position, results of operations, or cash flows. See Legal Proceedings in Part I, Item 3, and Critical Accounting Policies, Estimates, and Judgments in Part II, Item 7.

n ***Pension and Medical Expense Associated with the Company s Retirement Benefit Plans May Fluctuate Significantly Depending Upon Changes in Actuarial Assumptions and Future Market Performance of Plan Assets.***

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 various assumptions, including 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 have a material adverse effect on the company s consolidated financial position, results of operations, and cash flows.

n ***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 Financial Position.***

The company endeavors to identify and obtain in established markets insurance agreements to cover significant risks and liabilities (including, among others, natural disasters, product 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. In some, but not all, circumstances the company may receive indemnification from the U.S. Government. Because of the limitations 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 have a material adverse effect on the company s consolidated results of operations. See Note 15 to the consolidated financial statements in Part II, Item 8.

n ***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. Subject to limitations, 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.

Item 1B. Unresolved Staff Comments

Not applicable.

NORTHROP GRUMMAN CORPORATION

FORWARD-LOOKING STATEMENTS AND PROJECTIONS

Statements in this Form 10-K that are in the future tense, and all statements accompanied by terms such as believe, project, expect, estimate, forecast, assume, intend, plan, anticipate, outlook, and variations thereof ar 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 Part I, Item 1A, 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, claims, appeals and investigations;
- hurricane-related insurance recoveries;
- environmental remediation;
- acquisitions and divestitures of businesses;
- joint ventures and other business arrangements;
- access to capital;
- performance issues with key suppliers and subcontractors;
- product performance and the successful execution of internal plans;
- successful negotiation of contracts with labor unions;
- allowability and allocability of costs under U.S. Government contracts;
- effective tax rates and timing and amounts of tax payments;
- the results of any audit or appeal process with the 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-K as well as other risk factors subsequently identified, including, among others, those identified in the company s filings with the SEC on Form 10-Q and Form 8-K.

Item 2. Properties

At December 31, 2007, the company had approximately 57 million square feet of floor space at approximately 515 separate locations, primarily in the U.S., for manufacturing, warehousing, research and testing, administration and various other uses. At December 31, 2007, the company leased to third parties approximately 948,000 square feet of its owned and leased facilities, and had vacant floor space of approximately 965,000 square feet.

At December 31, 2007, the Company s business operating segments had major operations at the following locations:

Mission Systems Huntsville, AL; Carson, Huntington Beach, McClellan, Oxnard, Rancho Carmel, Redondo Beach, San Bernardino, San Diego, San Jose, San Pedro, Van Nuys and Sacramento, CA; Aurora and Colorado Springs, CO; East Hartford, CT; Washington, DC; Orlando, FL; Cambridge, MA; Annapolis, Annapolis Junction, Columbia, Elkridge and Lanham, MD; Bellevue, NE; Fairborn and Kettering, OH; Middletown, RI;

NORTHROP GRUMMAN CORPORATION

Clearfield, UT; and Arlington, Chantilly, Chester, Dahlgren, Fairfax, Falls Church, Herndon, Newport News, Reston, Stafford, Vienna and Virginia Beach, VA.

Information Technology El Segundo, Hawthorne, and San Diego, CA; Colorado Springs and Lafayette, CO; Washington, DC; Atlanta, GA; Andover, MA; Annapolis Junction and Rockville, MD; Bethpage, Bohemia, and Queens, NY; Fairborn, OH; Irving, TX; and Chantilly, Fairfax, Falls Church, Herndon, Lorton, McLean, Reston, and Richmond, VA.

Technical Services Sierra Vista, AZ; Warner Robins, GA; Lake Charles, LA; Albuquerque, NM; Oklahoma City, OK; and Herndon, VA.

Integrated Systems Camarillo, Carson, El Segundo, Fort Tejon, Goleta, Hawthorne, Mojave, Palmdale, and San Diego, CA; Jacksonville, Melbourne and St. Augustine, FL; Hollywood, MD; Moss Point, MS; New Town, ND; Bethpage, NY; and Lexington, SC.

Space Technology El Segundo, Manhattan Beach, and Redondo Beach, CA; Devens, MA; St. Charles, MO; and Charlotte, NC.

Electronics Huntsville, AL; Tempe, AZ; Azusa, Sunnyvale and Woodland Hills, CA; Boulder, CO; Norwalk, CT; Apopka, FL; Rolling Meadows, IL; Annapolis, Annapolis Junction, Baltimore, Belcamp, Elkridge, Gaithersburg, Hagerstown, Linthicum and Sykesville, MD; Springfield, MO; Ocean Springs, MS; Melville and Williamsville, NY; Cincinnati, OH; Garland, TX; Salt Lake City, UT; and Charlottesville, VA. Locations outside the U.S. include France, Germany, Italy, and the United Kingdom.

Ships National City and San Diego, CA; Avondale, Harahan, Harvey, Tallulah and Waggaman, LA; Gautier, Gulfport, Moss Point and Pascagoula, MS; Chesapeake, Hampton, Newport News, Suffolk, and Virginia Beach, VA; and Bremerton, WA.

Corporate and other locations Brea and Los Angeles, CA; Des Plaines, IL; Olathe, KS; Hanover Township, NJ; York, PA; Irving and Marshall, TX; and Arlington, VA. Locations outside the U.S. include Canada and the United Kingdom.

The following is a summary of the company s floor space at December 31, 2007:

Square feet (in thousands)	Owned	Leased	U.S. Government Owned/Leased	Total
Information & Services				
Mission Systems	652	5,768		6,420
Information Technology	33	4,239		4,272
Technical Services	156	1,365	62	1,583
Aerospace				
Integrated Systems	3,974	3,021	2,023	9,018
Space Technology	2,912	2,108		5,020
Electronics	8,472	3,557		12,029

Ships	13,177	3,907	80	17,164
Corporate	809	622		1,431
Total	30,185	24,587	2,165	56,937

The company believes its properties are well maintained and in good operating condition and that the productive capacity of the company s properties is adequate to meet current contractual requirements and those for the foreseeable future.

NORTHROP GRUMMAN CORPORATION

Item 3. Legal Proceedings

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

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

As previously disclosed, on May 17, 2007, the U.S. Coast Guard issued a revocation of acceptance under the Deepwater Program for eight converted 123-foot patrol boats (the vessels) based on alleged hull buckling and shaft alignment problems . By letter dated June 5, 2007, the Coast Guard stated that the revocation of acceptance also was based on alleged nonconforming topside equipment on the vessels. On August 13, 2007, the company submitted a response to the Coast Guard, maintaining that the revocation of acceptance was improper. In late December 2007, the Coast Guard responded to the company s August submittal and advised Integrated Coast Guard Systems (the contractors joint venture for performing the Deepwater Program) that the Coast Guard is seeking $96.1 million from the Joint Venture as a result of the revocation of acceptance of the eight vessels delivered under the 123-foot conversion program. The majority of the costs associated with the 123-foot conversion effort are associated with the alleged structural deficiencies of the vessels which were converted under contracts with the company and with a subcontractor to the company. The letter is not a contracting officer s final decision and the company and its joint venture partner and subcontractor are preparing a response. Based upon the information available to the company to date, the company believes that it has substantive defenses but can give no assurance that its views will prevail.

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

NORTHROP GRUMMAN CORPORATION

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

As previously disclosed, the company was a defendant in litigation brought by Cogent Systems, Inc. (Cogent) in Los Angeles Superior Court in California on April 20, 2005, for unspecified damages for alleged unauthorized use of Cogent technology relating to fingerprint recognition. On September 10, 2007, the company and Cogent announced that they had reached an agreement to settle the litigation and the settlement documents were executed in the fourth quarter of 2007. Under the terms of the agreement, the company agreed to pay Cogent $25 million to settle the litigation and $15 million for a non-exclusive license to use specified Cogent state-of- the-art automated fingerprint identification software in certain existing programs. Substantially all these amounts were charged to expense in 2007. The company and Cogent also agreed to enter into a five-year research and development, service and products agreement, under which the company must purchase from Cogent $20 million in new products and services over the term of the agreement.

As previously disclosed, the U.S. District Court for the Central District of California consolidated two separately filed Employee Retirement Income Security Act (ERISA) lawsuits, which the plaintiffs seek to have certified as class actions, into the In Re Northrop Grumman Corporation ERISA Litigation. On August 7, 2007, the Court denied plaintiffs motion for class certification, and the plaintiffs appealed the Court s decision on class certification to the U.S. Court of Appeals for the Ninth Circuit. On October 11, 2007, the Ninth Circuit granted appellate review, which delayed the commencement of trial previously scheduled to begin January 22, 2008. The company believes, but can give no assurance, that the outcome of these matters would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Other Matters

In the event of contract termination for the government s convenience, contractors are normally protected by provisions covering reimbursement for costs incurred under the contract. As previously disclosed, the company received a termination for convenience notice on the Tri-Service Standoff Attack Missile (TSSAM) program in 1995. In December 1996, the company filed a lawsuit against the U.S. Government in the U.S. Court of Federal Claims seeking the recovery of approximately $750 million for uncompensated performance costs, investments and a reasonable profit on the program. Prior to 1996, the company had charged to operations in excess of $600 million related to this program. The company is unable to predict whether it will realize some or all of its claims, none of which are recorded on its consolidated statement of financial position, from the U.S. Government related to the TSSAM program.

As previously disclosed, the company is pursuing legal action against an insurance provider arising out of a disagreement concerning the coverage of certain losses related to Hurricane Katrina (see Notes 15 and 17 to the consolidated financial statements in Part II, Item 8). The company commenced the action against Factory Mutual Insurance Company (FM Global) on November 4, 2005, which is now pending in the U.S. District Court for the Central District of California, Western Division. In August 2007, the district court issued an order finding that the excess insurance policy provided coverage for the company s Katrina-related loss. In November 2007, FM Global filed a notice of appeal of the district court s order. Based on the current status of the assessment and claim process, no assurances can be made as to the ultimate outcome of this matter.

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

No items were submitted to a vote of security holders during the fourth quarter of 2007.

Table of Contents

NORTHROP GRUMMAN CORPORATION

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) *Market Information.*

The company s common stock is listed on the New York Stock Exchange.

The following table sets forth, for the periods indicated, the high and low closing sale prices of the company s common stock as reported in the consolidated reporting system for the New York Stock Exchange Composite Transactions:

	2007			2006		
January to March	**$ 75.72**	**to**	**$ 66.95**	$ 69.83	to	$ 59.63
April to June	**$ 77.87**	**to**	**$ 72.68**	$ 71.23	to	$ 62.17
July to September	**$ 79.86**	**to**	**$ 74.67**	$ 68.88	to	$ 63.05
October to December	**$ 84.48**	**to**	**$ 77.09**	$ 69.71	to	$ 64.59

(b) *Holders.*

The approximate number of common shareholders was 40,223 as of February 19, 2008.

(c) *Dividends.*

Quarterly dividends per common share for the most recent two years are as follows:

	2007	2006
January to March	**$ 0.37**	$ 0.26
April to June	**0.37**	0.30
July to September	**0.37**	0.30
October to December	**0.37**	0.30
	$ 1.48	$ 1.16

The quarterly dividend for the mandatorily redeemable preferred shares was $1.75 per share for each quarter in 2007 and 2006.

Common Stock

The company has 800,000,000 shares authorized at a $1 par value per share, of which 337,834,561 and 345,921,809 shares were outstanding as of December 31, 2007 and 2006, respectively.

Preferred Stock

The company has 10,000,000 shares authorized with a liquidation value of $100 per share, of which 3,500,000 shares were designated as Series B and were issued and outstanding as of December 31, 2007 and 2006.

Subsequent Event On February 20, 2008, the company s Board of Directors approved the redemption of the Series B convertible preferred stock on April 4, 2008.

(d) *Annual Meeting of Stockholders.*

The Annual Meeting of Stockholders of Northrop Grumman Corporation will be held on May 21, 2008, at the Space Technology Presentation Center, One Space Park, Redondo Beach, California 90278.

Table of Contents

NORTHROP GRUMMAN CORPORATION

(e) *Stock Performance Graph.*

**COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN
AMONG NORTHROP GRUMMAN CORPORATION, S & P 500 INDEX
AND S & P AEROSPACE/DEFENSE INDEX**

(1) Assumes $100 invested at the close of business on December 31, 2002, in Northrop Grumman Corporation common stock, Standard & Poor s (S&P) 500 Index, and the S&P Aerospace/Defense Index.

(2) The cumulative total return assumes reinvestment of dividends.

(3) The S&P Aerospace/Defense Index is comprised of The Boeing Company, General Dynamics Corporation, Goodrich Corporation, Honeywell International Inc., L-3 Communications, Lockheed Martin Corporation, Northrop Grumman Corporation, Precision Castparts Corp., Raytheon Company, Rockwell Collins, Inc., and United Technologies Corporation.

(4) The total return is weighted according to market capitalization of each company at the beginning of each year.

(5) The Stock Performance Graph is not incorporated by reference and shall not be deemed to be filed.

Table of Contents

NORTHROP GRUMMAN CORPORATION

(f) *Purchases of Equity Securities by the Issuer and Affiliated Purchasers.*

The table below summarizes the company s repurchases of common stock during the three months ended December 31, 2007.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Numbers of Shares Purchased as of Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 through October 31, 2007				$ 82 million
November 1 through November 30, 2007	1,022,600	$ 79.11	1,022,600	$
December 1 through December 31, 2007				$ 2.5 billion(1)
Total	1,022,600	$ 79.11	1,022,600	$ 2.5 billion

(1) On December 19, 2007, the company s Board of Directors authorized a share repurchase program of up to $2.5 billion of its outstanding common stock. As of December 31, 2007, the company has $2.5 billion authorized for share repurchases.

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

(g) *Securities Authorized for Issuance Under Equity Compensation Plans.*

For a description of securities authorized under the company s equity compensation plans, see Note 19 of the consolidated financial statements in Part II, Item 8.

Table of Contents

NORTHROP GRUMMAN CORPORATION

Item 6. Selected Financial Data

The data presented in the following table are derived from the audited financial statements and other company information adjusted to reflect the current application of discontinued operations as well as the two-for one stock split of the company s common stock in 2004. See also Business Acquisitions and Business Dispositions in Part II, Item 7.

Selected Financial Data

	Year Ended December 31				
$ in millions except per share	**2007**	2006	2005	2004	2003
Sales and Service Revenues					
United States Government	**$ 28,700**	$ 27,019	$ 27,021	$ 25,491	$ 22,063
Other customers	**3,318**	3,094	2,957	3,386	3,398
Total revenues	**$ 32,018**	$ 30,113	$ 29,978	$ 28,877	$ 25,461
Operating margin	**$ 3,006**	$ 2,464	$ 2,200	$ 1,985	$ 1,474
Income from continuing operations	**1,803**	1,573	1,396	1,079	771
Basic earnings per share, from continuing operations	**$ 5.28**	$ 4.55	$ 3.92	$ 3.00	$ 2.11
Diluted earnings per share, from continuing operations	**5.16**	4.46	3.84	2.96	2.09
Cash dividends declared per common share	**1.48**	1.16	1.01	.89	.80
Year-End Financial Position					
Total assets	**$ 33,373**	$ 32,009	$ 34,214	$ 33,303	$ 33,022
Notes payable to banks and long-term debt	**4,055**	4,162	5,145	5,158	5,891
Total long-term obligations and preferred stock	**9,254**	8,641	9,412	10,438	10,876
Financial Metrics					
Free cash flow from operations	**$ 2,068**	$ 942	$ 1,804	$ 1,264	$ 161
Net working capital (deficit)	**$ 340**	$ (28)	$ (418)	$ 692	$ (595)
Current ratio	**1.05 to 1**	1.00 to 1	.95 to 1	1.11 to 1	.91 to 1
Notes payable to banks and long-term debt as a percentage of shareholders equity	**22.9%**	25.0%	30.6%	30.9%	37.3%
Other Information					
Company-sponsored research and development expenses	**$ 537**	$ 572	$ 536	$ 502	$ 429
Maintenance and repairs	**337**	360	430	396	242

Payroll and employee benefits	**12,947**	12,510	12,191	12,445	10,936
Number of employees at year-end	**122,600**	122,200	123,600	125,400	123,400

-24-

NORTHROP GRUMMAN CORPORATION

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

Business

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

Notable Events

Certain notable events or activity affecting the company s 2007 consolidated financial results included the following:

- Sales increases 6 percent to record $32 billion.
- Operating margin increase of 22 percent over 2006.
- Cash from operations increases to record $2.9 billion after $200 million pension pre-funding.
- Diluted earnings per share from continuing operations of $5.16 per share.
- Total backlog of $64.1 billion.
- Share repurchases totaling $1.2 billion.
- Business acquisitions totaling approximately $690 million.
- Partial insurance settlement with all but one of the primary insurers and recognition of $62 million in business interruption recovery related to Hurricane Katrina. See Notes 15 and 17 to the consolidated financial statements in Part II, Item 8.
- Contract earnings rate charge on LHD 8 of approximately $55 million following the strike at the Pascagoula shipyard.
- Adoption of a new tax accounting standard on accounting for uncertain tax positions see Note 12 to the consolidated financial statements in Part II, Item 8.

Outlook

U.S. defense contractors have benefited from the upward trend in overall defense spending over recent years. Certain programs in which the company participates may be subject to potential reductions due to a slower rate of growth in the U.S. Defense Budget forecasts and funds being utilized to support the on-going Global War on Terrorism. Despite the trend of slower growth rates in the U.S. defense budget, the company believes that its portfolio of technologically advanced, innovative products, services, and integrated solutions will generate revenue growth in 2008 and beyond. Based on total backlog (funded and unfunded) of approximately $64 billion as of December 31, 2007, the company expects sales in 2008 of approximately $33 billion and forecasts improvement in net income over 2007. The major industry and economic factors that may affect the company s future performance are described in the following paragraphs.

Industry Factors

Northrop Grumman is subject to the unique characteristics of the U.S. defense industry as a monopsony, and by certain elements peculiar to its own business mix. Northrop Grumman, along with Lockheed Martin Corporation, The Boeing Company, Raytheon Company, and General Dynamics Corporation are among the largest companies in the U.S. defense industry at this time. Northrop Grumman competes against these and other companies for a number of programs, both large and small. Intense competition and long operating cycles are both key characteristics of Northrop Grumman s business and the defense industry. It is common in this industry for work on major programs to be shared among a number of companies. A company competing to be a prime contractor may, upon ultimate award of the contract to another party, turn out to be a subcontractor for the ultimate prime contracting party. It is not uncommon to compete for a contract award with a peer company and simultaneously perform as a supplier to or a customer of such competitor on other contracts. The nature of

NORTHROP GRUMMAN CORPORATION

major defense programs, conducted under binding contracts, allows companies that perform well to benefit from a level of program continuity not common in many industries.

The company s success in the competitive defense industry depends upon its ability to develop and market its products and services, as well as its ability to provide the people, technologies, facilities, equipment, and financial capacity needed to deliver those products and services with maximum efficiency. It is necessary to maintain, as the company has, sources for raw materials, fabricated parts, electronic components, and major subassemblies. In this manufacturing and systems integration environment, effective oversight of subcontractors and suppliers is as vital to success as managing internal operations.

Similarly, there is intense competition among many companies in the information and services markets which is generally more labor intensive with competitive margin rates over contract periods of shorter duration. Competitors in the information and services markets include the defense industry participants mentioned above as well as many other large and small entities with expertise in various specialized areas. The company s ability to successfully compete in the information and services markets depends on a number of factors; most important is the capability to deploy skilled professionals, many requiring security clearances, at competitive prices across the diverse spectrum of these markets. Accordingly, various workforce initiatives are in place to ensure the company is successful in attracting, developing and retaining sufficient resources to maintain or improve its competitive position within these markets.

Economic Opportunities, Challenges, and Risks

The defense of the U.S. and its allies requires the ability to respond to one or more regional conflicts, terrorist acts, or threats to homeland security and is increasingly dependent upon early threat identification. National responses to those threats may require unilateral or cooperative initiatives ranging from dissuasion, deterrence, active defense, security and stability operations, or peacekeeping. The U.S. Government continues to place a high priority on the protection of its engaged forces and citizenry and in minimizing collateral damage when force must be applied in pursuit of national objectives. As a result, the U.S. and its military coalitions increasingly rely on sophisticated systems providing long-range surveillance and intelligence, battle management, and precision strike capabilities combined with the ability to rapidly deploy effective force to any region. Accordingly, defense procurement spending is expected to be weighted toward the development and procurement of military platforms and systems demonstrating the stealth, long-range, survivability, persistence and standoff capabilities that can overcome such obstacles to access. Additionally, advanced electronics and software that enhance the capabilities of individual systems and provide for the real-time integration of individual surveillance, information management, strike, and battle management platforms will also be required.

While the upward trend in overall defense spending may slow, defense requirements are not expected to change significantly in the foreseeable future. Many allied countries are focusing their development and procurement efforts on advanced electronics and information systems capabilities to enhance their interoperability with U.S. forces. The size of future U.S. and international defense budgets is expected to remain responsive to the international security environment. The proposed 2009 budget provides $515.4 billion in discretionary authority for the DoD base budget, representing a $35.9 billion or 7.5 percent increase over the enacted level for fiscal 2008. This proposed budget includes reductions in certain programs in which the company participates or for which the company expects to compete, however the company believes that spending on recapitalization and modernization of homeland security and defense assets will continue to be a national priority, with particular emphasis on areas involving intelligence, persistent surveillance, cyber space and non-conventional warfare capabilities.

U.S. Government programs in which the company either participates, or strives to participate, must compete with other programs for consideration during the U.S. budget formulation and appropriation processes. Budget decisions made in this environment will have long-term consequences for the size and structure of the company and the entire defense industry.

NORTHROP GRUMMAN CORPORATION

Substantial new competitive opportunities for the company include a new aerial refueling tanker, the next-generation long-range bomber, space radar, unmanned vehicles, satellite communications systems, restricted programs, technical services and information technology contracts, and several international and homeland security programs. In pursuit of these opportunities, Northrop Grumman continues to focus on operational and financial performance for continued growth in 2008 and beyond.

Northrop Grumman has historically concentrated its efforts in high technology areas such as stealth, airborne and space surveillance, battle management, systems integration, defense electronics, and information technology. The company has a significant presence in federal and civil information systems; the manufacture of combatant ships including aircraft carriers and submarines; space technology; command, control, communications, computers, intelligence, surveillance, and reconnaissance (C4ISR); and missile systems. The company believes that its programs are a high priority for national defense. Nevertheless, under budgetary pressures, there remains the possibility that one or more of them may be reduced, extended, or terminated by the company s U.S. Government customers.

The company provides certain product warranties that require repair or replacement of non-conforming items for a specified period of time. Most of the company s product warranties are provided under government contracts, the costs of which are generally incorporated into contract pricing.

Prime contracts with various agencies of the U.S. Government and subcontracts with other prime contractors are subject to numerous procurement regulations, including the False Claims Act and The International Traffic in Arms Regulations promulgated under the Arms Export Control Act, with noncompliance found by any one agency possibly resulting in fines, penalties, debarment, or suspension from receiving additional contracts with all U.S. Government agencies. Given the company s dependence on U.S. Government business, suspension or debarment could have a material adverse effect on the company.

See Risk Factors located in Part I, Item 1A for a more complete description of risks faced by the company and the defense industry.

BUSINESS ACQUISITIONS

2007 In January 2007, the company acquired Essex Corporation (Essex) for approximately $590 million in cash, including estimated transaction costs of $15 million, and the assumption of debt totaling $23 million. Essex provides signal processing services and products, and advanced optoelectronic imaging for U.S. government intelligence and defense customers. The operating results of Essex are reported in the Mission Systems segment.

In July 2007, the company and Science Applications International Corporation (SAIC) reorganized their joint venture AMSEC, LLC (AMSEC), by dividing AMSEC along customer and product lines. AMSEC is a full-service supplier that provides engineering, logistics and technical support services primarily to Navy ship and aviation programs. Under the reorganization plan, the company retained the ship engineering, logistics and technical service businesses under the AMSEC name (the AMSEC Businesses) and, in exchange, SAIC received the aviation, combat systems and strike force integration services businesses from AMSEC (the Divested Businesses). This reorganization was treated as a step acquisition for the acquisition of SAIC s interests in the AMSEC Businesses, with the company recognizing a pre-tax gain of $23 million for the effective sale of its interests in the Divested Businesses. The operating results of the AMSEC Businesses and transaction gain have been reported in the Ships segment. Prior to the reorganization, the company accounted for AMSEC, LLC under the equity method. The consolidated financial statements reflect preliminary estimates of the fair value of the assets acquired and liabilities assumed and the related allocation of the purchase price for the entities acquired. Management does not expect adjustments to these estimates, if any, to have a material effect on the company s consolidated financial position or results of operations.

During the third quarter of 2007, the company acquired Xinetics Inc., reported in the Space Technology segment, and the remaining 61 percent of Scaled Composites, LLC, reported in the Integrated Systems segment, for an aggregate amount of approximately $100 million in cash. The consolidated financial statements reflect

NORTHROP GRUMMAN CORPORATION

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

2006 There were no significant acquisitions during 2006.

2005 The company acquired Confluent RF Systems Corporation (Confluent), reported in the Integrated Systems segment, for $42 million in cash, which included transaction costs of $2 million, and Integic Corporation (Integic), reported in the Information Technology segment, for $319 million in cash, which included transaction costs of $6 million.

BUSINESS DISPOSITIONS

2007 During the second quarter of 2007, management announced its decision to exit the remaining Interconnect Technologies (ITD) business reported within the Electronics segment. Sales for this business for the years ended December 31, 2007, 2006, and 2005, were $14 million, $35 million, and $89 million, respectively. The shut-down was completed during the third quarter of 2007 and costs associated with the shutdown were not material. The results of this business are reported as discontinued operations in the consolidated statements of income, net of applicable income taxes, for all periods presented.

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

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

2005 The company sold Teldix GmbH (Teldix) for $57 million in cash and recognized an after-tax gain of $14 million in discontinued operations. 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.

CONTRACTS

The majority of the company s business is generated from long-term government contracts for development, production, and service activities. Government contracts typically include the following cost elements: direct material, labor and subcontracting costs, and certain indirect costs including allowable general and administrative costs. Unless otherwise specified in a contract, costs billed to contracts with the U.S. Government are determined under the requirements of the Federal Acquisition Regulation (FAR) and Cost Accounting Standards (CAS) regulations as allowable and allocable costs. Examples of costs incurred by the company and not billed to the U.S. Government in accordance with the requirements of the FAR and CAS regulations include, but are not limited to, certain legal costs, lobbying costs, charitable donations, and advertising costs.

The company s long-term contracts typically fall into one of two broad categories:

Flexibly Priced Contracts Includes both cost-type and fixed-price incentive contracts. Cost-type contracts provide for reimbursement of the contractor s allowable costs incurred plus a fee that represents profit. Cost-type contracts generally require that the contractor use its best efforts to accomplish the scope of the work within some specified time and some stated dollar limitation. Fixed-price incentive contracts also provide for

NORTHROP GRUMMAN CORPORATION

reimbursement of the contractor s allowable costs, but are subject to a cost-share limit which affects profitability. Fixed-price incentive contracts effectively become firm fixed-price contracts once the cost-share limit is reached.

Firm Fixed-Price Contracts A firm fixed-price contract is a contract in which the specified scope of work is agreed to for a price that is a pre-determined, negotiated amount and not generally subject to adjustment regardless of costs incurred by the contractor.

The following table summarizes 2007 revenue recognized by contract type and customer:

($ in millions)	U.S. Government	Other Customers	Total	Percent of Total
Flexibly priced	$ 21,554	$ 746	$ 22,300	70%
Firm fixed-price	7,146	2,572	9,718	30%
Total	$ 28,700	$ 3,318	$ 32,018	100%

Contract Fees Negotiated contract fee structures, for both flexibly priced and fixed-price contracts include, but are not limited to: fixed-fee amounts, cost sharing arrangements to reward or penalize for either under or over cost target performance, positive award fees, and negative penalty arrangements. Profit margins may vary materially depending on the negotiated contract fee arrangements, percentage-of-completion of the contract, the achievement of performance objectives, and the stage of performance at which the right to receive fees, particularly under incentive and award fee contracts, is finally determined.

Positive Award Fees Certain contracts contain provisions consisting of award fees based on performance criteria such as: cost, schedule, quality, and technical performance. Award fees are determined and earned based on an evaluation by the customer of the company s performance against such negotiated criteria. Award fee contracts are widely used throughout the company s operating segments. Examples of significant long-term contracts with substantial negotiated award fee amounts are the KEI, SDD, E-2D SDD, LPD, and DDG-1000 programs.

Compliance and Monitoring On a regular basis, the company monitors its policies and procedures with respect to its contracts to ensure consistent application under similar terms and conditions as well as compliance with all applicable government regulations. In addition, costs incurred and allocated to contracts with the U.S. Government are routinely audited by the Defense Contract Audit Agency.

CRITICAL ACCOUNTING POLICIES, ESTIMATES, AND JUDGMENTS

Revenue Recognition

Overview The majority of the company s business is derived from long-term contracts for the construction of facilities, production of goods, and services provided to the federal government, which are accounted for under the provisions of Accounting Research Bulletin No. 45 *Accounting for Long-Term Construction-Type Contracts*, American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 81-1 *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, and the AICPA Audit and Accounting Guide, *Audits of Federal Government Contractors*. The company classifies contract revenues as product sales or service revenues depending on the predominant attributes of the relevant underlying contracts. The company also enters into contracts that are not associated with the federal government, such as contracts to provide certain services to non-federal government customers. The company accounts for those contracts in accordance with the Securities and Exchange Commission s Staff Accounting Bulletin No. 104, *Revenue Recognition*, and other relevant revenue recognition accounting literature.

The company considers the nature of these contracts and the types of products and services provided when it determines the proper accounting method for a particular contract.

Percentage-of-Completion Accounting The company generally recognizes revenues from its long-term contracts under the cost-to-cost and the units-of-delivery measures of the percentage-of-completion method of accounting. The percentage-of-completion method recognizes income as work on a contract progresses. For

NORTHROP GRUMMAN CORPORATION

most contracts, sales are calculated based on the percentage of total costs incurred in relation to total estimated costs at completion of the contract. For certain contracts with large up-front purchases of material, primarily in the Ships segment, sales are generally calculated based on the percentage that direct labor costs incurred bear to total estimated direct labor costs. The units-of-delivery measure is a modification of the percentage-of-completion method, which recognizes revenues as deliveries are made to the customer generally using unit sales values in accordance with the contract terms. The company estimates profit as the difference between total estimated revenue and total estimated cost of a contract and recognizes that profit over the life of the contract based on deliveries.

The use of the percentage-of-completion method depends on the ability of the company to make reasonably dependable cost estimates for the design, manufacture, and delivery of its products and services. Such costs are typically incurred over a period of several years, and estimation of these costs requires the use of judgment. Sales under cost-type contracts are recorded as costs are incurred.

Many contracts contain positive and negative profit incentives based upon performance relative to predetermined targets that may occur during or subsequent to delivery of the product. These incentives take the form of potential additional fees to be earned or penalties to be incurred. Incentives and award fees that can be reasonably assured and reasonably estimated are recorded over the performance period of the contract. Incentives and award fees that cannot be reasonably assured and reasonably estimated are recorded when awarded or at such time as a reasonable estimate can be made.

Other 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 on current and prior periods. Hence, the effect of the changes on future periods of contract performance is recognized as if the revised estimates had been the original estimates. A significant change in an estimate on one or more contracts could have a material effect on the company s consolidated financial position or results of operations.

Certain Service Contracts Revenue under contracts to provide services to non-federal government customers are generally recognized when services are performed. Service contracts include operations and maintenance contracts, and outsourcing-type arrangements, primarily in the Information and Services business. Revenue under such contracts is generally recognized on a straight-line basis over the period of contract performance, unless evidence suggests that the revenue is earned or the obligations are fulfilled in a different pattern. Costs incurred under these service contracts are expensed as incurred, except that direct and incremental set-up costs are capitalized and amortized over the life of the agreement. Operating profit related to such service contracts may fluctuate from period to period, particularly in the earlier phases of the contract.

Service contracts that include more than one type of product or service are accounted for under the provisions of Emerging Issues Task Force Issue No. 00-21 *Revenue Arrangements with Multiple Deliverables*. Accordingly, for applicable arrangements, revenue recognition includes the proper identification of separate units of accounting and the allocation of revenue across all elements based on relative fair values.

Cost Estimation The cost estimation process requires significant judgment and is based upon the professional knowledge and experience of the company s engineers, program managers, and financial professionals. Factors that are considered in estimating the work to be completed and ultimate contract recovery include the availability and productivity of labor, the nature and complexity of the work to be performed, the effect of change orders, the availability of materials, the effect of any delays in performance, availability and timing of funding from the customer, and the recoverability of any claims included in the estimates to complete. A significant change in an estimate on one or more programs could have a material effect on the company s consolidated financial position or results of operations. Contract cost estimates are updated at least annually and more frequently as determined by events or circumstances. Cost and revenue estimates for each significant contract are generally reviewed and reassessed quarterly.

NORTHROP GRUMMAN CORPORATION

When estimates of total costs to be incurred on a contract exceed estimates of total revenue to be earned, a provision for the entire loss on the contract is recorded to cost of sales in the period the loss is determined. Loss provisions are first offset against costs that are included in inventoried assets, with any remaining amount reflected in liabilities.

Purchase Accounting and Goodwill

Overview The purchase price of an acquired business is allocated to the underlying tangible and intangible assets acquired and liabilities assumed based upon their respective fair market values, with the excess recorded as goodwill. Such fair market value assessments require judgments and estimates that can be affected by contract performance and other factors over time, which may cause final amounts to differ materially from original estimates. Adjustments to fair value assessments are recorded to goodwill over the purchase price allocation period (typically not exceeding twelve months) with the exception of certain adjustments related to income tax uncertainties, the resolution of which may extend beyond the purchase price allocation period.

Acquisition Accruals The company has established certain accruals in connection with indemnities and other contingencies from its acquisitions and divestitures. These accruals and subsequent adjustments have been recorded during the purchase price allocation period for acquisitions and as events occur for divestitures. The accruals were determined based upon the terms of the purchase or sales agreements and, in most cases, involve a significant degree of judgment. Management has recorded these accruals in accordance with its interpretation of the terms of the purchase or sale agreements, known facts, and an estimation of probable future events based on management s experience.

Goodwill The company performs impairment tests for goodwill as of November 30th of each year, or when evidence of potential impairment exists. In order to test for potential impairment, the company uses a discounted cash flow analysis, corroborated by comparative market multiples where appropriate.

The principal factors used in the discounted cash flow analysis requiring judgment are the projected results of operations, weighted average cost of capital (WACC), and terminal value assumptions. The WACC takes into account the relative weights of each component of the company s consolidated capital structure (equity and debt) and represents the expected cost of new capital adjusted as appropriate to consider lower risk profiles associated with longer term contracts and barriers to market entry. The terminal value assumptions are applied to the final year of the discounted cash flow model.

Due to the many variables inherent in the estimation of a reporting unit s fair value and the relative size of the company s recorded goodwill, differences in assumptions may have a material effect on the results of the company s impairment analysis.

Litigation, Commitments, and Contingencies

Overview The company is subject to a range of claims, lawsuits, environmental and income tax matters, and administrative proceedings that arise in the ordinary course of business. Estimating liabilities and costs associated with these matters requires judgment and assessment based upon professional knowledge and experience of management and its internal and external legal counsel. In accordance with SFAS No. 5, *Accounting for Contingencies,* amounts are recorded as charges to earnings when management, after taking into consideration the facts and circumstances of each matter, including any settlement offers, has determined that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The ultimate resolution of any such exposure to the company may vary from earlier estimates as further facts and circumstances become known.

Environmental Accruals The company is subject to the environmental laws and regulations of the jurisdictions in which it conducts operations. The company records an accrual to provide for the costs of expected environmental obligations when management becomes aware that an expenditure will be incurred and the amount of the liability can be reasonably estimated. Factors which could result in changes to the company s assessment of probability, range of loss, and environmental accruals include: modification of planned remedial actions, increase or decrease in the estimated time required to remediate, discovery of more extensive

NORTHROP GRUMMAN CORPORATION

contamination than anticipated, results of efforts to determine legally responsible parties, changes in laws and regulations or contractual obligations affecting remediation requirements, and improvements in remediation technology. 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 financial position, results of operation, or cash flows.

Litigation Accruals Litigation accruals are recorded as charges to earnings when management, after taking into consideration the facts and circumstances of each matter, including any settlement offers, has determined that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The ultimate resolution of any exposure to the company may vary from earlier estimates as further facts and circumstances become known. Based upon the information available, the company believes that the resolution of any of these various claims and legal proceedings would not have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

Uncertain Tax Positions Effective January 1, 2007, the company measures and records uncertain tax positions in accordance with Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48 *Accounting for Uncertainty in income Taxes an Interpretation of FASB Statement No. 109.* FIN 48 prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Only tax positions meeting the more-likely-than-not recognition threshold may be recognized or continue to be recognized in the financial statements. The timing and amount of accrued interest is determined by the applicable tax law associated with an underpayment of income taxes. If a tax position does not meet the minimum statutory threshold to avoid payment of penalties, the company recognizes an expense for the amount of the penalty in the period the tax position is claimed in the tax return of the company. The company recognizes interest accrued related to unrecognized tax benefits in income tax expense. Penalties, if probable and reasonably estimable, are recognized as a component of income tax expense. See Note 12 to the consolidated financial statements in Part II, Item 8. Prior to 2007, the company recorded accruals for tax contingencies and related interest when it determined that it was probable that a liability had been incurred and the amount of the contingency could be reasonably estimated based on specific events such as an audit or inquiry by a taxing authority. Under existing GAAP, changes in accruals associated with uncertainties arising from the resolution of pre-acquisition contingencies of acquired businesses are charged or credited to goodwill. Adjustments to other tax accruals are generally recorded in earnings in the period they are determined.

Retirement Benefits

Overview Assumptions used in determining projected benefit obligations and the fair values of plan assets for the company s pension plans and other postretirement benefits plans are evaluated annually by management in consultation with its outside actuaries. In the event that the company determines that plan amendments or changes in the assumptions are warranted, future pension and postretirement benefit expenses could increase or decrease.

Assumptions The principal assumptions that have a significant effect on the company s consolidated financial position and results of operations are the discount rate, the expected long-term rate of return on plan assets, and the health care cost trend rates. For certain plan assets where the fair market value is not readily determinable, such as real estate, private equity investments and hedge funds, estimates of fair value are determined using the best information available.

Discount Rate The discount rate represents the interest rate that should be used to determine the present value of future cash flows currently expected to be required to settle the pension and postretirement benefit obligations. The discount rate is generally based on the yield on high-quality corporate fixed-income investments. At the end of each year, the discount rate is primarily determined based on the results of a hypothetical long-term bond portfolio matching the expected cash inflows with the expected benefit payments

NORTHROP GRUMMAN CORPORATION

for each benefit plan. Taking into consideration the factors noted above, the company s weighted-average pension composite discount rate was 6.22 percent at December 31, 2007, and 5.97 percent at December 31, 2006.

Expected Long-Term Rate of Return The expected long-term rate of return on plan assets represents the average rate of earnings expected on the funds invested to provide for anticipated future benefit payment obligations. For 2007 and 2006, the company assumed an expected long-term rate of return on plan assets of 8.5 percent.

Changes in the discount rate and expected long-term rate of return on plan assets within the range indicated below would have had the following impacts on 2007 pension and other postretirement benefits results:

$ in millions	.25 Percentage Point Increase	.25 Percentage Point Decrease
(Decrease) Increase Due To Change In Assumptions Used To Determine Net Periodic Benefit Costs For The Year Ended December 31, 2007		
Discount rate	$ (38)	$ 40
Expected long-term rate of return on plan assets	(54)	54
(Decrease) Increase Due To Change In Assumptions Used To Determine Benefit Obligations For The Year Ended December 31, 2007		
Discount rate	$ (741)	$ 774

Health Care Cost Trend Rates The health care cost trend rates represent the annual rates of change in the cost of health care benefits based on estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, and changes in the health status of the plan participants. For 2007, the company assumed an expected initial health care cost trend rate of 8 percent and an ultimate health care cost trend rate of 5 percent. In 2006, the company assumed an expected initial health care cost trend rate of 8.75 percent and an ultimate health care cost trend rate of 5 percent.

Differences in the initial through the ultimate health care cost trend rates within the range indicated below would have had the following impact on 2007 postretirement benefit results:

$ in millions	1-Percentage-Point Increase	1-Percentage-Point Decrease
Increase (Decrease) From Change In Health Care Cost Trend Rates To		
Postretirement benefit expense	$ 9	$ (9)
Postretirement benefit liability	85	(91)

CONSOLIDATED OPERATING RESULTS

Selected financial highlights are presented in the table below.

Year Ended December 31

$ in millions, except per share	**2007**	2006	2005
Sales and service revenues	**$ 32,018**	$ 30,113	$ 29,978
Cost of sales and service revenues	**29,012**	27,649	27,778
Operating margin	**3,006**	2,464	2,200
Interest expense, net	**308**	303	334
Other, net	**(12)**	125	199
Federal and foreign income taxes	**883**	713	669
Diluted earnings per share from continuing operations	**5.16**	4.46	3.84
Net cash provided by operating activities	**2,890**	1,756	2,627

NORTHROP GRUMMAN CORPORATION

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

	Year Ended December 31		
$ in millions	**2007**	2006	2005
Product sales	**$ 18,730**	$ 18,394	$ 19,471
Service revenues	**13,288**	11,719	10,507
Sales and service revenues	**$ 32,018**	$ 30,113	$ 29,978

2007 Revenues for principal product businesses in Aerospace, Electronics, and Ships during 2007 grew at a combined rate of approximately 3 percent over 2006, reflecting sales growth in Electronics and Ships, partially offset by reduced sales in Aerospace. The sales growth at Electronics and Ships was due to volume improvements across most business areas, while the sales reduction in Aerospace was anticipated as a number of contracts transitioned from development to production in 2007. Revenue for principal services businesses in Information & Services during 2007 grew approximately 11 percent over 2006 due largely to double digit growth at Information Technology and Technical Services segments, resulting from increased volume on contracts that were newly awarded in 2006 and growth across the board on other contracts.

2006 Revenues for the principal product segments of Integrated Systems, Space Technology and Electronics were relatively flat in 2006 as compared to 2005, and revenues for the Ships segment declined approximately $500 million due primarily to the effects of the damage to the Gulf Coast shipyards caused by Hurricane Katrina in August 2005. Service revenues for the principal services businesses grew principally in the Information Technology and Technical Services segments, which each had revenue increases in excess of $225 million in 2006. Revenues for Mission Systems, the company s other mainly services business, were relatively flat on a year over year basis.

Cost of Sales and General and Administrative Expenses
Cost of sales and general and administrative expenses are comprised of the following:

	Year Ended December 31		
$ in millions	**2007**	2006	2005
Cost of Sales and Service Revenues			
Cost of product sales	**$ 14,474**	$ 14,380	$ 15,543
% of product sales	***77.3%***	*78.2%*	*79.8%*
Cost of service revenues	**11,330**	10,242	9,355
% of service revenues	***85.3%***	*87.4%*	*89.0%*
General and administrative expenses	**3,208**	3,027	2,880
% of total sales and service revenues	***10.0%***	*10.1%*	*9.6%*

Cost of Sales and Service Revenues	**$ 29,012**	$ 27,649	$ 27,778

Cost of Product Sales and Service Revenues
2007 Cost of product sales during 2007 increased $94 million, or 1 percent, over 2006 while decreasing 90 basis points as a percentage of product sales over the same period. Cost of service sales during 2007 increased $1.1 billion, or 11 percent, over 2006 while decreasing 214 basis points as a percentage of service sales over the same period. Cost of product sales in 2007 increased over 2006 due largely to the sales volume increase described above, partially offset by improved program performance at Integrated Systems, Space Technology and Ships. Cost of service revenues in 2007 increased over 2006 due primarily to higher sales volume at Information & Services. The margin rate improvement was primarily driven by improved margin rate performance on service revenues by segments principally in the product businesses.

2006 Cost of product sales during 2006 decreased $1.2 billion, or 7 percent, over 2005 while decreasing 160 basis points as a percentage of product sales over the same period. Cost of service sales during 2006 increased

NORTHROP GRUMMAN CORPORATION

$887 million, or 9 percent, over 2005 while decreasing 164 basis points as a percentage of service sales over the same period. Cost of product sales in 2006 declined over 2005 due largely to the sales volume decreases described above, improved program performance across all of the principal product segments and the absence of contract charges from Hurricane Katrina. Cost of product sales in 2005 included charges of $165 million due to the impacts of Hurricane Katrina on ship construction contracts in process when the hurricane occurred in August 2005. Cost of service revenues increased in 2006 due to higher volume at Information Technology and Technical Services, partially offset by improved cost performance at Mission Systems & Technical Services.

General and Administrative Expenses In accordance with industry practice and the regulations that govern the cost accounting requirements for government contracts, most general corporate expenses incurred at both the segment and corporate locations are considered allowable and allocable costs on government contracts and such costs, for most components of the company, are allocated to contracts in progress on a systematic basis and contract performance factors include this cost component as an element of cost. General and administrative expenses primarily relate to segment operations. General and administrative expenses remained at a constant rate of approximately 10 percent of sales in 2007 and 2006. General and administrative expenses as a percentage of sales increased from 9.6 percent in 2005 to 10.1 percent in 2006. The increase in 2006 is due primarily to higher property insurance, litigation, and bid and proposal costs, partially offset by lower IR&D.

Operating Margin

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

Operating margin represents segment operating margin (see section entitled Segment Operating Results) adjusted for a number of factors that do not affect the segments as follows:

	Year Ended December 31		
$ in millions	**2007**	2006	2005
Segment operating margin	**$ 3,103**	$ 2,807	$ 2,421
Unallocated expenses	**(224)**	(306)	(200)
Net pension adjustment	**127**	(37)	(21)
Total operating margin	**$ 3,006**	$ 2,464	$ 2,200

Segment Operating Margin

2007 Segment operating margin for the year ended December 31, 2007 increased $296 million, or 11 percent, as compared to the same period in 2006. Total segment operating margin was 9.7 percent and 9.3 percent of total sales and service revenues for the years ended December 31, 2007, and 2006, respectively. See the Segment Operating Results section below for further information.

2006 Segment operating margin for the year ended December 31, 2006 increased $386 million, or 16 percent, as compared to the same period in 2005. Total segment operating margin was 9.3 percent and 8.1 percent of total sales and service revenues for the years ended December 31, 2006, and 2005, respectively. See the Segment Operating Results section below for further information.

Unallocated Expenses Unallocated expenses for the year ended December 31, 2007 decreased $82 million, or 27 percent, as compared with the same period in 2006. The decrease was primarily due to $98 million in lower post-retirement benefit costs determined under GAAP as a result of a plan design change in 2006 and $36 million lower legal and investigative provisions, partially offset by an increase in other costs including $18 million in higher litigation expenses. During the third quarter 2006, the company recorded a $112.5 million pre-tax provision for its settlement offer to the U.S. Department of Justice and a restricted customer.

NORTHROP GRUMMAN CORPORATION

Net Pension Adjustment The net pension adjustment reflects the excess pension expense determined in accordance with GAAP over the pension expense allocated to the operating segments under CAS. The net pension adjustment increased income by $127 million in 2007, as compared with an expense of $37 million and $21 million in 2006 and 2005, respectively. The reduction in 2007 GAAP pension cost primarily results from higher returns on plan assets and a voluntary pre-funding in the fourth quarter of 2006.

Interest Expense, net

Interest expense, net for 2007 was comparable to 2006. Interest expense, net for the year ended December 31, 2006, was $303 million, a decrease of $31 million, or 9 percent, in 2006 as compared with 2005. The decrease was primarily due to a lower average debt balance in 2006 resulting from debt maturities totaling $1.2 billion in 2006.

Other, net

2007 Other, net for the year ended December 31, 2007 was $12 million expense, a decrease of $137 million, as compared with 2006. During 2006, the company sold its remaining 9.7 million TRW Automotive (TRW Auto) shares, generating pre-tax gains of $111 million.

2006 Other, net for the year ended December 31, 2006 was $125 million income, a decrease of $74 million, or 37 percent, from 2005 income of $199 million. During 2005, the company sold 7.3 million TRW Auto shares and approximately 3.4 million Endwave shares, which generated pre-tax gains of $70 million and $95 million, respectively, as compared to the $111 million pre-tax gain in 2006 resulting from the sale of the remaining TRW Auto stock.

Federal and Foreign Income Taxes

2007 The company s effective tax rate on income from continuing operations for the year ended December 31, 2007, was 33 percent compared with 31 percent in 2006. During 2007, the company reached a partial settlement agreement with the U.S. Internal Revenue Service (IRS) regarding its audit of the company s tax years ended 2001 2003 resulting in a tax benefit of $22 million.

2006 The company s effective tax rate on income from continuing operations for 2006 and 2005 was 31 percent and 32 percent, respectively. During 2006, the company received final approval from the U.S. Congress Joint Committee on Taxation for the agreement previously reached with the IRS regarding its 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, due to the reversal of previously established expense provisions. The company also recognized a net tax benefit of $18 million in 2006 related to tax credits associated with qualified wages paid to employees affected by Hurricane Katrina.

Diluted Earnings Per Share from Continuing Operations

2007 Diluted earnings per share from continuing operations for 2007 was $5.16 per share, an increase of 16 percent from $4.46 per share in 2006. Earnings per share are based on weighted-average diluted shares outstanding of 354.3 million for 2007 and 358.6 million for 2006. The weighted-average diluted shares outstanding used to calculate earnings per share includes the dilutive impact of the mandatorily redeemable preferred stock.

2006 Diluted earnings per share from continuing operations for 2006 was $4.46 per share, an increase of 16 percent from $3.84 per share in 2005. Earnings per share are based on weighted-average diluted shares outstanding of 358.6 million for 2006 and 363.2 million for 2005. For 2006, weighted-average diluted shares outstanding used to calculate earnings per share includes the dilutive impact of the mandatorily redeemable preferred stock.

Net Cash Provided by Operating Activities

2007 Net cash provided by operating activities in 2007 increased $1.1 billion as compared with 2006, and reflects lower pension contributions, higher net income, and continued trade working capital reductions. Pension plan contributions totaled $342 million in 2007, of which $200 million was voluntarily pre-funded compared

NORTHROP GRUMMAN CORPORATION

with contributions of $1.2 billion in 2006, of which $800 million was voluntarily pre-funded. Cash collected from customers increased by $2 billion, and cash paid to suppliers and employees increased by $635 million in 2007 as compared with 2006.

Net cash provided by operating activities for 2007 included the receipt of $125 million of insurance proceeds related to Hurricane Katrina, $52 million of federal and state income tax refunds, and $21 million of interest.

2006 Net cash provided by operating activities in 2006 decreased $871 million as compared with 2005, primarily due to contributions to the company s pension plans. Cash collected from customers decreased by $166 million, and cash paid to suppliers and employees increased by $361 million in 2006 as compared with 2005. Net cash provided by operating activities for 2006 included the receipt of $100 million of insurance proceeds related to Hurricane Katrina, $60 million of federal and state income tax refunds, and $45 million of interest. Net cash provided by operating activities in 2006 includes contributions to the company s pension plans totaling $1.2 billion, of which $800 million was voluntarily pre-funded as compared to contributions of $415 million in 2005, of which $203 million was voluntarily pre-funded.

SEGMENT OPERATING RESULTS

	Year Ended December 31		
$ in millions	**2007**	2006	2005
Sales and Service Revenues			
Information & Services			
Mission Systems	**$ 5,931**	$ 5,494	$ 5,494
Information Technology	**4,486**	3,962	3,736
Technical Services	**2,177**	1,858	1,617
Aerospace			
Integrated Systems	**5,067**	5,500	5,489
Space Technology	**3,133**	2,923	2,866
Electronics	**6,906**	6,543	6,513
Ships	**5,788**	5,321	5,786
Intersegment eliminations	**(1,470)**	(1,488)	(1,523)
Sales and service revenues	**$ 32,018**	$ 30,113	$ 29,978
Operating Margin			
Information & Services			
Mission Systems	**$ 566**	$ 519	$ 424
Information Technology	**329**	342	322
Technical Services	**120**	120	100
Aerospace			
Integrated Systems	**591**	551	499
Space Technology	**261**	245	219
Electronics	**813**	754	709
Ships	**538**	393	249
Intersegment eliminations	**(115)**	(117)	(101)

Segment operating margin	**$ 3,103**	$ 2,807	$ 2,421

Realignments The company, from time to time, will realign contracts, programs or business areas among or within its operating segments that possess similar customers, expertise, and capabilities. These realignments are designed to more fully leverage existing capabilities and enhance development and delivery of products and services. In January 2007, certain programs and business areas were transferred among Information Technology, Mission Systems, Space Technology, and Technical Services. The operating results for all periods presented have been revised to reflect these changes. See a description of the segment business areas and specific realignments located in Part I, Item 1.

NORTHROP GRUMMAN CORPORATION

Subsequent Realignments In January 2008, the Newport News and Ship Systems sectors were realigned into a single segment called Northrop Grumman Shipbuilding to enable the company to more effectively utilize its shipbuilding assets and deploy its talented shipbuilders, processes, technologies, production facilities and planned capital investment to meet customer needs. This realignment had no impact on the company s consolidated financial position, results of operations, cash flows, or segment reporting.

Also in January 2008, the company announced the transfer of certain programs and assets from the Mission Systems segment to the Space Technology segment, effective July 1, 2008. This transfer will allow Mission Systems to focus on the rapidly growing command, control, communications, computers, intelligence, surveillance, and reconnaissance business, and the missiles business will be an integrated element of the company s Aerospace business growth strategy. In addition, certain Electronics businesses were transferred to Mission Systems effective January 2008. The transfer of these businesses is not expected to have a material effect on the company s consolidated financial position, results of operations, or cash flows.

These subsequent realignments have not been reflected in any of the accompanying financial information.

KEY SEGMENT FINANCIAL MEASURES

Operating Performance Assessment and Reporting
The company manages and assesses the performance of its businesses based on its performance on individual contracts and programs obtained generally from government organizations using the financial measures referred to below, with consideration given to the Critical Accounting Policies, Estimates and Judgments described on page 29. Based on this approach and the nature of the company s operations, the discussion of consolidated results of operations generally focuses around the company s seven reportable segments versus distinguishing between products and services. Product sales are predominantly generated in the Electronics, Integrated Systems, Space Technology and Ships segments, while the majority of the company s service revenues are generated by the Information Technology, Mission Systems and Technical Services segments.

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

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

Segment Operating Margin
Segment operating margin reflects the performance of segment contracts. Excluded from this measure are certain costs not directly associated with contract performance, including the portion of corporate expenses such as management

and administration, legal, environmental, certain compensation and other retiree benefits, and other expenses not considered allowable or allocable under applicable CAS regulations and the FAR, and therefore not allocated to the segments. Changes in segment operating margin are typically expressed in terms of volume, as discussed above, or performance. Performance refers to changes in contract margin rates. These changes typically relate to profit recognition associated with revisions to total estimated costs at completion of the contract (EAC) that reflect improved (or deteriorated) operating performance on a particular contract. Operating margin changes are accounted for on a cumulative to date basis at the time an EAC change is recorded.

NORTHROP GRUMMAN CORPORATION

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

Program Descriptions
For convenience, a brief description of certain programs discussed in this Form 10-K are included in the Glossary of Programs beginning on page 54.

INFORMATION & SERVICES

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

	Year Ended December 31		
$ in millions	**2007**	2006	2005
Funded Contract Acquisitions	**$ 6,032**	$ 6,108	$ 4,877
Sales and Service Revenues	**5,931**	5,494	5,494
Segment Operating Margin	**566**	519	424
As a percentage of segment sales	**9.5%**	9.4%	7.7%

Funded Contract Acquisitions
2007 Mission Systems funded contract acquisitions decreased $76 million, or 1 percent, in 2007 as compared with 2006, primarily due to $626 million lower funded contract acquisitions in Missile Systems, partially offset by $401 million higher funded contract acquisitions in ISR and $164 million higher funded contract acquisitions in C3. The decrease in Missile Systems is due to timing of funding on the Intercontinental Ballistic Missile (ICBM) and Kinetic Energy Interceptors (KEI) programs and receipt of delayed funding upon approval of the federal defense budget during the first quarter of 2006. The increase in ISR is related to the acquisition of Essex. The increase in C3 is due to higher funding across various programs. Significant funded contract acquisitions in 2007 included $603 million for the ICBM program, $223 million for the Joint National Integration Center Research and Development (JRDC) program, $188 million for the F-22 program, $169 million for the KEI program, $137 million for the Ground-Based Midcourse Fire Control and Communications (GFC/C) program and $118 million for the Force XXI Battle Brigade and Below (FBCB2) Installation Kits (I-Kits) program.

2006 Mission Systems funded contract acquisitions increased $1.2 billion, or 25 percent, in 2006 as compared with 2005, primarily due to the receipt of delayed funding upon approval of the fiscal year 2006 federal defense budget, the timing of funding received in the KEI program and the timing of a production award in the ICBM program. Significant acquisitions in 2006 included $1 billion for the ICBM program, $348 million for the KEI program, $217 million for the JRDC program, $176 million for the F-22 program, $164 million for the F-35 program, $155 million for the Space Based Space Surveillance (SBSS) program, and $118 million for the Command Post Platform (CPP) program.

Sales and Service Revenues

2007 Mission Systems revenue increased $437 million, or 8 percent, as compared with 2006. The increase was due to $279 million in higher sales in ISR, $131 million in higher sales in Missile Systems and $52 million in higher sales in C3. The increase in ISR is principally due to the acquisition of Essex. The increase in Missile Systems is primarily due to increased scope and funding levels in the KEI, JRDC, ICBM and National Team Battle Management Command and Control (BMC2) programs. The increase in C3 is due to higher volume in several programs, including the FBCB2 I-Kits program, partially offset by lower volume in the F-35 development

NORTHROP GRUMMAN CORPORATION

program as hardware development in 2006 winds down in 2007 and reduced scope and deliveries accelerated into 2006 in the F-22 program.

2006 Mission Systems revenue remained unchanged in 2006 when compared with 2005. The higher sales volume across multiple programs including SBSS, CPP, FBCB2 Systems Engineering and Integration (SE&I) and GFC/C were offset by lower sales volume in a restricted program and reduced production volume in the ICBM program.

Segment Operating Margin
2007 Mission Systems operating margin increased $47 million, or 9 percent, in 2007 as compared with 2006. The increase includes net performance improvements of $22 million driven by cost improvements achieved based on increases in customer order quantities in the FBCB2 I-Kits program, final negotiation of award fee earned on the National Team BMC2 program, lower labor costs and favorable pricing of supplier procured materials in the CPP program and elimination of risk associated with hardware obsolescence in the GFC/C program. Net performance improvements were partially offset by $12 million in higher amortization of purchased intangibles. Volume changes contributed to the 2007 operating margin increase primarily due to the acquisition of Essex.

2006 Mission Systems operating margin increased $95 million, or 22 percent, in 2006 as compared with 2005. The increase includes net performance improvements across multiple programs including a successful flight test and favorable award fee scores on the GFC/C program, successful cost and risk management in the fixed price development portion of the Global Combat Support System Army/Tactical program, continued success in fielding Communication, Navigation and Identification (CNI) systems in the F-22 production program and a decrease of $26 million in amortization of purchased intangibles. The increase in operating margin as a percentage of segment sales over 2005 is due to the net performance improvements mentioned above.

Information Technology
Information Technology is a premier provider of IT systems engineering and systems integration for the DoD, national intelligence, federal, civilian, state, and local agencies, and commercial customers. Products and services are grouped into the following business areas: Intelligence; Civilian Agencies; Commercial, State & Local (CS&L); and Defense.

	Year Ended December 31		
$ in millions	**2007**	2006	2005
Funded Contract Acquisitions	**$ 4,400**	$ 4,613	$ 3,700
Sales and Service Revenues	**4,486**	3,962	3,736
Segment Operating Margin	**329**	342	322
As a percentage of segment sales	**7.3%**	8.6%	8.6%

Funded Contract Acquisitions
2007 Information Technology funded contract acquisitions decreased $213 million, or 5 percent, in 2007 as compared to 2006, primarily reflecting decreases of $203 million in Intelligence and $98 million in CS&L, partially offset by an increase of $109 million in Defense. A significant amount of the Intelligence funded contract acquisitions decrease was related to the early funding of contracts in 2006. Significant non-restricted funded acquisitions in 2007 included $214 million for the Virginia IT outsourcing program, $146 million for the Network Centric Solutions program, $140 million for the Systems and Software Engineering Services program, and $139 million for the National Geospatial-Intelligence Agency Enterprise Engineering program.

2006 Information Technology funded contract acquisitions increased $913 million, or 25 percent, in 2006 as compared to 2005, primarily reflecting increases of $527 million in Intelligence, $322 million in CS&L, and $226 million in Defense, partially offset by a decrease of $160 million in Civilian Agencies. The increase in Intelligence was primarily related to the early funding of contracts. Significant non-restricted funded contract acquisitions in 2006 included $319 million for the New York City Wireless program, $231 million for the

NORTHROP GRUMMAN CORPORATION

National Geospatial-Intelligence Agency Enterprise Engineering program, $130 million for the Systems and Software Engineering Services program, and $100 million for the Defense Threat Reduction Agency program.

Sales and Service Revenues
2007 Information Technology revenue increased $524 million, or 13 percent, in 2007 as compared with 2006. The increase was primarily due to $275 million in higher sales volume in CS&L, $222 million in higher sales in Intelligence, and $133 million in higher sales in Defense, partially offset by $73 million in lower sales in Civilian Agencies. The increase in CS&L is associated with the effect of a full year of sales from new programs awarded in 2006, including the New York City Wireless, Virginia IT outsourcing, and San Diego County IT outsourcing programs. The increase in Intelligence is due to new restricted program wins and higher volume on existing programs. The increase in Defense is due to increased volume on various existing programs and new business wins. The decrease in Civilian Agencies is primarily due to customer program budget reductions, and program completions.

2006 Information Technology revenue increased $226 million, or 6 percent, in 2006 as compared with 2005. The increase was primarily due to $105 million in higher sales volume in Intelligence, $101 million in higher sales volume in Defense, and $57 million in higher sales volume in CS&L, partially offset by $36 million in lower sales in Civilian Agencies. The increase in Intelligence is due to new restricted program wins and higher volume on various existing programs. The increase in Defense is due to increased volume on various existing programs. The increase in CS&L is due to higher volume associated with new programs awarded in 2006, including the Virginia IT outsourcing, San Diego County IT outsourcing, and New York City Wireless programs. The decrease in Civilian Agencies is primarily due to customer program budget reductions and program completions.

Segment Operating Margin
2007 Information Technology operating margin decreased $13 million, or 4 percent, in 2007 as compared to 2006. The decrease in operating margin was driven by $28 million in increased amortization of deferred and other outsourcing costs on large IT outsourcing programs compared to the prior period, partially offset by margin on new business wins and the effects of increased volume on several Intelligence, CS&L, and Defense programs. The operating margin decrease also reflects $22 million in discretionary spending for internal information systems infrastructure expected to yield future cost improvements. The decrease in operating margin as a percentage of segment sales is primarily due to the timing of service contract costs and amortization of deferred and other outsourcing costs on large IT outsourcing programs.

2006 Information Technology operating margin increased $20 million, or 6 percent, in 2006 as compared to 2005. The increase was driven by higher sales volume in Intelligence, Defense, and CS&L, primarily on the Virginia IT outsourcing program. The increase also reflects $5 million lower amortization expense for purchased intangibles.

Technical Services
Technical Services is a leading provider of infrastructure, base, range, logistical and sustainment support, and also provides a wide-array of technical services including training and simulation. Services are grouped into the following business areas: Systems Support (SSG); Training and Simulation (TSG); and Life Cycle Optimization and Engineering (LCOE).