NORTHROP GRUMMAN CORP /DE/
Form 10-K
February 02, 2015

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

FORM 10-K

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

For the fiscal year ended December 31, 2014
or

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

For the transition period from to Commission file number 1-16411

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

DELAWARE	80-0640649
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2980 Fairview Park Drive, Falls Church, Virginia 22042 (703) 280-2900
(Address and telephone number of principal executive offices)

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

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 *

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.
Yes * 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 *

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No *

Indicate by check mark 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. o

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

Large accelerated filer x	Accelerated filer *	Non-accelerated filer *	Smaller reporting company *

(Do not check if a smaller reporting company)

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

Yes * No x

As of June 30, 2014, 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 $24.9 billion.

As of January 29, 2015, 198,405,799 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Northrop Grumman Corporation's Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A for the 2015 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

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NORTHROP GRUMMAN CORPORATION

PART I
Item 1. Business
HISTORY AND ORGANIZATION
History
Northrop Grumman Corporation (herein referred to as "Northrop Grumman," the "company," "we," "us," or "our") is a leading global security company. We offer a broad portfolio of capabilities and technologies that enable us to deliver innovative products, systems and solutions for applications that range from undersea to outer space and into cyberspace. We provide products, systems and solutions in unmanned systems; cyber; command, control, communications and computers (C4), intelligence, surveillance, and reconnaissance (C4ISR); strike aircraft; and logistics and modernization to government and commercial customers worldwide through our four segments: Aerospace Systems, Electronic Systems, Information Systems and Technical Services. We participate in many high-priority defense and government programs in the United States (U.S.) and abroad. We conduct most of our business with the U.S. Government, principally the Department of Defense (DoD) and intelligence community. We also conduct business with foreign, state and local governments and domestic and international commercial customers. For a discussion of risks associated with our operations, see Risk Factors in Part I, Item 1A.
The company originally was formed in Hawthorne, California in 1939, as Northrop Aircraft Incorporated and was reincorporated in Delaware in 1985, as Northrop Corporation. Northrop Aircraft Incorporated was a principal developer of flying wing technology, including the B-2 Stealth Bomber. The company developed into one of the largest defense contractors in the world through a series of acquisitions, as well as organic growth. In 1994, we acquired Grumman Corporation (Grumman), after which time the company was renamed Northrop Grumman Corporation. 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, we 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 2001, we acquired Litton Industries, a global electronics and information technology company, and one of the nation's leading full service shipbuilders. In 2002, we acquired TRW Inc., 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. In 2011, the company completed the spin-off to its shareholders of Huntington Ingalls Industries, Inc. (HII). HII operates our former Shipbuilding business, which was acquired in 2001, through the acquisitions of Newport News Shipbuilding and Litton Industries.
Organization
From time to time, we acquire or dispose of businesses and realign contracts, programs or business areas among and within our operating segments. Internal realignments are designed to more fully leverage existing capabilities and enhance development and delivery of products and services. The operating results for all periods presented have been revised to reflect these changes made through December 31, 2014. We are currently aligned into four operating segments: Aerospace Systems, Electronic Systems, Information Systems and Technical Services. See Note 3 to our consolidated financial statements in Part II, Item 8 for further information.
AEROSPACE SYSTEMS
Aerospace Systems, headquartered in Redondo Beach, California, is a leader in the design, development, integration and production of manned aircraft, unmanned systems, spacecraft, high-energy laser systems, microelectronics and other systems and subsystems. Aerospace Systems' customers, primarily U.S. Government agencies, use these systems in mission areas including intelligence, surveillance and reconnaissance (ISR), communications, battle management, strike operations, electronic warfare, earth observation, satellite communications, space science and space exploration. The segment consists of four business areas: Unmanned Systems, Military Aircraft Systems, Space Systems, and Strategic Programs & Technology.
Unmanned Systems - designs, develops, manufactures, and integrates ISR unmanned systems for tactical and strategic missions. Key ISR programs include the RQ-4 Global Hawk reconnaissance system, a proven high-altitude

long-endurance system providing near real-time high resolution imagery of large geographical areas; the Triton aircraft system providing real-time ISR over vast ocean and coastal regions; the trans-Atlantic North Atlantic Treaty Organization (NATO) Alliance Ground Surveillance (AGS) system for multinational theater operations, peacekeeping missions, and disaster relief efforts; the Fire Scout aircraft system providing unprecedented situational awareness and precision targeting support; the Navy Unmanned Combat Air System demonstrating an unmanned combat air vehicle for carrier-based operations; and the Common Mission Management System, providing high performance service based on ground control solutions enabling unmanned mission capabilities.

Military Aircraft Systems - designs, develops, manufactures, and integrates airborne C4ISR, electronic warfare mission systems, and long range strike and tactical aircraft systems. Key airborne C4ISR programs include the E-2D Advanced Hawkeye and Joint Surveillance Target Attack Radar System (JSTARS). Electronic warfare includes the EA-18G Growler and EA-6B Prowler airborne electronic attack weapon systems in addition to the design, development, and integration of laser weapon systems for air, sea, and ground platforms. This business area also designed, developed and manufactured the B-2 Spirit bomber and now provides sustainment and upgrade services for the B-2, the nation's most advanced long range strike aircraft system. Tactical aircraft includes the design, development, manufacture and integration of F/A-18 aft sections and F-35 center sections.

Space Systems - designs, develops, manufactures, and integrates spacecraft systems, subsystems, sensors and communications payloads in support of space science and C4ISR. Key programs include the James Webb Space Telescope, a large infrared telescope being built for the National Aeronautics and Space Administration that will be deployed in space to study the origins of the universe; Advanced Extremely High Frequency payloads providing survivable, protected communications to U.S. forces; and restricted programs.

Strategic Programs & Technology - creates and matures advanced technologies and innovative concepts to provide affordable solutions addressing current and future customer needs. The Strategic Programs & Technology business area maintains a broad portfolio of contracts ranging from development of components to prototypes to initial operational systems across the air, land and space domains.

ELECTRONIC SYSTEMS

Electronic Systems, headquartered in Linthicum, Maryland, is a leader in the design, development, manufacture and support of solutions for sensing, understanding, anticipating and controlling the operating environment for our global military, civil and commercial customers. Electronic Systems provides a variety of defense electronics and systems, airborne fire control radars, situational awareness systems, early warning systems, electronic warfare systems, air defense radars and management systems, navigation systems, communications systems, marine power and propulsion systems, space systems and logistics services. The segment consists of three business areas: Intelligence, Surveillance, Reconnaissance & Targeting Systems, Land & Self Protection Systems, and Navigation & Maritime Systems.

Intelligence, Surveillance, Reconnaissance & Targeting Systems - delivers products and services for space satellite applications, airborne and ground-based surveillance, multi-sensor processing, analysis and dissemination for combat units and national agencies, both domestic and international. These systems provide battle space awareness, missile defense, command and control, combat avionics (fire control radars, multi-function apertures and pods), airborne electro-optical/infrared (EO/IR) targeting systems and postal automation systems. Key programs include airborne fire control radars such as the Scalable Agile Beam Radar (SABR), which provides affordable Active Electronically Scanned Array (AESA) capabilities for domestic and international fighters; the F-35 fire control radar, a multi-function AESA radar for the U.S. Armed Forces and a large number of international partners; EO/IR systems such as the LITENING targeting pod and the Distributed Aperture System (DAS), a 360 degree spherical situational awareness system; airborne surveillance radars such as the Multirole Electronically Scanned Array (MESA) for Airborne Early Warning & Control (AEW&C), which provides air-to-air and air-to-surface coverage; and space systems such as the Space-Based Infrared System (SBIRS), which provides data for missile surveillance, missile defense, technical intelligence and battlespace characterization.

Land & Self Protection Systems - delivers products, systems and services that support ground-based, helicopter and fixed wing platforms (manned and unmanned) with sensor and protection systems. A major product line of this business area consists of systems that perform threat detection and countermeasures that defeat infrared and radio frequency (RF) guided missile and tracking systems. This business area also provides integrated electronic warfare capability, communications and intelligence systems, unattended ground sensors, automatic test equipment, advanced threat simulators, ground-based air defense and multi-function radars, situational awareness systems, laser/electro-optical systems and digitized and open architecture cockpits and applications. Key programs include the

Ground/Air Task Oriented Radar (G/ATOR), which is a ground-based multi-mission radar designed to detect and track a wide variety of threats; the TPS-78 ground-based radar, which provides air defense and air surveillance for the global market; the Large Aircraft Infrared Countermeasures (LAIRCM), which is an infrared countermeasure system designed to protect aircraft against man-portable (shoulder-launched) infrared-guided surface-to-air missiles; and the AN/APR-39, which provides rapid identification and continuous radar threat warning for today's complex battlefields.

Navigation & Maritime Systems - delivers products and services to domestic and international defense, civil and commercial customers supporting smart navigation, shipboard radar surveillance, ship control, machinery control and integrated combat management systems for naval surface ships; high-resolution undersea sensors for mine hunting, situational awareness and other applications; unmanned marine vehicles; shipboard missile and encapsulated payload launch systems, propulsion and power generation systems, nuclear reactor instrumentation and control and acoustic sensors for submarines and aircraft carriers; inertial navigation systems for all domains (air, land, sea, and space); and embedded Global Positioning Systems. Key programs include the AN/SPQ-9B Anti-Ship Missile Defense radar, which provides the US Navy’s cruisers and destroyers with situational awareness and contact information from aircraft, cruise missiles, surface vessels and periscope detection; inertial navigation and positioning products for a range of platforms including ships, aircraft, spacecraft and weapons systems.

In addition to the product and service lines discussed above, our Electronic Systems segment also includes Advanced Concepts & Technologies (AC&T), which develops next-generation systems to position the segment in key developing markets. AC&T focuses on understanding customer mission needs; conceiving affordable, innovative and open solutions; and demonstrating the readiness and effectiveness of Electronic Systems' products. AC&T focuses on the following enterprise-wide and cross cutting technology development thrust areas: RF systems; EO/IR systems; multi-function systems; modular open systems architectural approaches and designs; precision navigation and timing capabilities; and secure and trusted solutions.

INFORMATION SYSTEMS

Information Systems, headquartered in McLean, Virginia, is a leading provider of advanced solutions for the DoD, national intelligence, federal civilian, state, international and commercial customers. Products and services focus on the fields of command and control (C2), communications, cyber, air and missile defense, intelligence processing, civil security, health technology and government support systems. The segment consists of seven business areas: Cyber, C2, Communications, ISR, Integrated Air and Missile Defense (IAMD), Civil and Health.

Cyber - provides full spectrum solutions that address cyber security threats, cyber mission management and special cyber systems. Cyber offerings span intelligence, defense, federal, state, international and commercial customers, providing dynamic cyber defense and specialized cyber systems and services in support of critical government missions. This business specializes in active defense, malware detection, analytics platforms and large scale cyber solutions for national security applications.

C2 - provides net-enabled C2, battle management, command center integration, combat support systems, mission-enabling solutions and critical infrastructure protection systems. C2 systems support operations, managing assets and forces employed to accomplish national and military missions, and optimizing legacy platforms, sensors and weapons systems. These systems are installed in operational and command centers world-wide and across DoD services, joint commands and the international security community.

Communications - provides the underlying networks, network management, gateway systems and radio frequency devices that support national military C4ISR missions and help make C4ISR more integrated and interoperable. Communications capabilities include gateways and products for aircraft interoperability, multi-function avionics, software defined radios and protected communications.

ISR - delivers systems and services in Signals Intelligence (SIGINT), airborne reconnaissance, geospatial intelligence and data fusion, specializing in the collection, processing, and exploitation of data to achieve a deep understanding of the environment. Offerings include intelligence integration, large scale information processing, multi-source intelligence, big data applications and geo-location techniques.

IAMD - provides integration and interoperability of net-enabled battle management, sensors, targeting and surveillance systems, air and missile defense C2, missile warning systems and critical situational awareness for weapons and fire control systems. This business provides solutions for both domestic and international customers, advanced IAMD integration with land and air assets, and cost effective flexible architectures.

Civil - provides civilian IT solutions, civil financial operations, public safety systems, law enforcement and state programs. This business is a provider in global homeland security and public safety, federal law enforcement information sharing and analysis, and IT systems and services that enable civil missions and satisfy infrastructure and back office requirements.

Health - provides healthcare expertise combined with IT capabilities to support effective healthcare services and efficient health and human services systems. Capabilities include benefits management, population health, clinical data integration and health analytics. This business provides system engineering and integration, affordable national healthcare IT, and solutions to meet health and human services challenges.

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Key programs for the Information Systems segment include the Joint National Integration Center Research and Development (JRDC) contract, which supports the technical infrastructure, modeling and simulation, test and evaluation, and management of the Missile Defense Agency network at multiple sites; the Battlefield Airborne Communications Node (BACN), a high-altitude, airborne communications and information gateway system that provides situational awareness and C2 coordination between warfighters and commanders; the Communications, Navigation and Identification (CNI) integrated avionics system for the F-35 Joint Strike Fighter based on software-defined technology with advanced capabilities for interoperability; and the Integrated Air and Missile Defense Battle Command System (IBCS), a C2 system that delivers a single, unambiguous view of the battlespace with enhanced aircraft and missile tracking improving the ability of combatant commanders and air defenders to make critical decisions within seconds.

TECHNICAL SERVICES

Technical Services, headquartered in Herndon, Virginia, is a leader in innovative and affordable logistics, modernization and sustainment support and also provides an array of other advanced technology and engineering services, including space, missile defense, nuclear security, training and simulation. The segment consists of two business areas: Integrated Logistics and Modernization; and Mission Solutions and Readiness.

Integrated Logistics and Modernization - provides complete life cycle support and weapon system sustainment and modernization products and services, and provides direct support to warfighters while delivering aircraft and subsystem maintenance, repair and overhaul (MRO). Competencies include aircraft and electronics sustaining engineering, supply chain management services, manned and unmanned weapons systems deployed logistics support, field services and on-going maintenance and technical assistance, and delivering rapid response in support of global customers. Key programs include KC-10 Contractor Logistics Support (CLS), which provides total weapons systems CLS to the Air Force for the entire fleet of 59 KC-10 aircraft; Intercontinental Ballistic Missile (ICBM) Systems, which provides systems engineering and integration for the land-based leg of the U.S. nuclear deterrent force; UK Airborne Warning and Control System (AWACS), which provides through life management of the UK Royal Air Force fleet of E-3D AWACS aircraft; KC-30A Multi-Role Tanker Transport (MRTT) which provides through life support for the Royal Australian Air Force (RAAF) KC-30A air to air refueling aircraft; and AAQ24 LAIRCM, which provides repair, testing, component spare procurement, logistics, and data collection related to directional infrared counter measures systems used on multiple fixed and rotary wing aircraft.

Mission Solutions and Readiness - provides realistic and comprehensive training through live, virtual and constructive domains, innovative and diverse training applications ranging from battle command to professional military education, sustainment and modernization of tactical vehicles, high technology and engineering services in the areas of nuclear security, space and launch services, civil engineering and military range-sensor-instrumentation operations. Key programs include Ministry of the National Guard Training Support (MNG TSC), through our interest in a joint venture for which we consolidate the financial results, which provides equipment fielding, training and maintenance, simulator training and operations, tactical exercise development, logistics and operations support and English language training to the Saudi Arabian National Guard; the Mission Command Training Program (MCTP), the Army's premier leadership and staff training exercise program at the tactical and operational level; and Fort Irwin Logistics Services Support, which provides a full range of logistics support services and operates a large-scale maintenance and repair program of both tracked and tactical wheeled vehicles.

SELECTED FINANCIAL DATA AND SEGMENT OPERATING RESULTS

For a more complete understanding of our business, see Selected Financial Data in Part II, Item 6. For a more complete understanding of our segment financial information, see Segment Operating Results in Part II, Item 7 and Note 3 to the consolidated financial statements in Part II, Item 8.

CUSTOMER CONCENTRATION

Our primary customer is the U.S. Government. Sales to the U.S. Government (which excludes foreign military sales - a method to sell U.S. defense equipment and services to foreign governments through the DoD) accounted for approximately 85 percent of total sales in each of the years ended December 31, 2014, 2013 and 2012. International sales (which include foreign military sales) accounted for $3.0 billion, $2.5 billion and $2.1 billion, or 13 percent, 10 percent and 8 percent, of total sales for the years ended December 31, 2014, 2013 and 2012, respectively. No single program accounted for more than ten percent of total sales during any period presented. See Risk Factors in Part I, Item 1A.

COMPETITIVE CONDITIONS

We compete with many companies in the defense, intelligence and federal markets. BAE Systems, Boeing, Booz Allen Hamilton, Finmeccanica, General Dynamics, L-3 Communications, Lockheed Martin, Raytheon and Thales are some of our primary competitors. Key characteristics of our industry include long operating cycles and intense competition, which is evident through the number of bid protests (competitor protests of U.S. Government procurement awards) and the number of competitors bidding on program opportunities.

It is common in the defense 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 competitor, become a subcontractor for the ultimate prime contracting company. It is not unusual to compete for a contract award with a peer company and, simultaneously, perform as a supplier to or a customer of that same competitor on other contracts, or vice versa.

SEASONALITY

No material portion of our business is considered to be seasonal.

BACKLOG

At December 31, 2014, total backlog was $38.2 billion, compared with $37.0 billion at the end of 2013. Of the backlog at December 31, 2014, approximately $19.3 billion is expected to be converted into sales in 2015. For further information, see Backlog in Part II, Item 7.

RESEARCH AND DEVELOPMENT

See Note 1 to the consolidated financial statements in Part II, Item 8.

INTELLECTUAL PROPERTY

We routinely apply for and own a number of U.S. and foreign patents related to the products and services we provide. We also develop and protect intellectual property as trade secrets. In addition to owning a large portfolio of proprietary intellectual property, we license some intellectual property rights to and from third parties. The U.S. Government typically holds licenses to patents developed in the performance of U.S. Government contracts and may use or authorize others to use the inventions covered by these patents for certain purposes. See Risk Factors in Part I, Item 1A.

RAW MATERIALS

We have not experienced significant delays in the supply or availability of raw materials, nor have we experienced a significant price increase for raw materials. See Risk Factors in Part I, Item 1A.

EMPLOYEE RELATIONS

We believe that we maintain good relations with our 64,300 employees, of which approximately 2,800 are covered by 14 collective agreements. We negotiated renewals of two of our collective agreements in 2014 and expect to negotiate renewals of five of our collective agreements in 2015. See Risk Factors in Part I, Item 1A.

REGULATORY MATTERS

Government Contract Security Restrictions

Certain programs with the U.S. Government that are prohibited by the customer from being publicly discussed are generally referred to as “restricted” in this Form 10-K. The consolidated financial statements and financial information in this Form 10-K reflect the operating results of our entire company, including restricted programs, under accounting principles generally accepted in the United States of America (GAAP).

Contracts

We generate the majority of our business from long-term contracts with the U.S. Government for development, production and support activities. Unless otherwise specified in a contract, allowable and allocable costs are billed to contracts with the U.S. Government under the requirements of the Federal Acquisition Regulation (FAR) and U.S. Government Cost Accounting Standards (CAS) regulations. Examples of costs incurred by us 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, lobbying costs, certain legal costs, charitable donations, advertising costs, interest expense and unallowable employee compensation and benefit costs.

Our long-term contracts typically fall into one of two broad categories:
Cost-type contracts – Cost-type contracts include cost plus fixed fee, award fee and incentive fee contracts. Cost-type contracts provide for reimbursement of the contractor’s allowable costs incurred plus a fee. 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. Fees on cost-type contracts can be fixed in terms of dollar value or percentage of costs. Award and incentive fees are based on performance criteria such as cost, schedule, quality and technical performance. Award fees are determined and earned based on customer evaluation of the company's performance against negotiated criteria, and are intended to provide motivation for excellence in contract performance. Incentive fees that are based on cost provide for an initially negotiated fee to be adjusted later, typically using a formula to measure performance against the associated criteria, based on the relationship of total allowable costs to total target costs. Award and incentive fees that can reasonably be estimated and are deemed reasonably assured are recorded over the performance period of the contract.
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, absent changes in scope by the customer. Certain fixed-price incentive fee contracts provide for reimbursement of the contractor’s allowable costs plus a fee up to a ceiling amount, typically through a cost-sharing ratio that affects profitability. These types of fixed-price incentive fee contracts effectively become firm fixed-price contracts once the cost-share ceiling is reached. Time-and-materials contracts are considered fixed-price contracts as they specify a fixed hourly rate for each labor hour charged.
See Note 1 to our consolidated financial statements in Part II, Item 8 and Risk Factors in Part I, Item 1A.
The following table summarizes sales for the year ended December 31, 2014, recognized by contract type and customer:

($ in millions)	U.S. Government	Other Customers[1]	Total	Percent of Total	
Cost-type contracts	$11,691	$506	$12,197	51	%
Fixed-price contracts	8,394	3,388	11,782	49	%
Total sales	$20,085	$3,894	$23,979	100	%

(1) Other customer sales include foreign military sales.
Profit margins may vary materially depending on, among other things, negotiated contract fee arrangements, achievement of performance objectives and the stage of performance at which the right to receive fees, particularly under incentive and award fee contracts, is determined.
We monitor our policies and procedures with respect to our contracts on a regular basis to enhance consistent application under similar terms and conditions, as well as compliance with applicable government regulations and laws. In addition, costs incurred and allocated to contracts with the U.S. Government are routinely audited by the Defense Contract Audit Agency.

Environmental

Our manufacturing operations are subject to and affected by federal, state, local and foreign laws and regulations relating to the protection of the environment. In 2010, we established goals for the reduction of water use and solid waste through implementation of best management practices; those goals were achieved as of December 31, 2014. In addition, after achieving the greenhouse gas (GHG) reduction goals established by the company in 2009, we announced in 2014 our commitment to reduce GHG emissions by 2020 from our 2010 GHG emissions level.
We have incurred and expect to continue to incur capital and operating costs to comply with applicable environmental laws and regulations and to achieve our environmental sustainability commitments. See Risk Factors in Part I, Item 1A; Note 1 and Note 11 to the consolidated financial statements in Part II, Item 8.

EXECUTIVE OFFICERS

See Part III, Item 10, for information about our executive officers.

AVAILABLE INFORMATION

Our principal executive offices are located at 2980 Fairview Park Drive, Falls Church, Virginia 22042. Our telephone number is (703) 280-2900 and our home page on the Internet is www.northropgrumman.com.

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Our annual reports 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 our website as soon as reasonably practicable after we file them with the Securities and Exchange Commission (SEC). You can learn more about us by reviewing our SEC filings on the investor relations page of our website.

The SEC also maintains a website at www.sec.gov that contains reports, proxy statements and other information about SEC registrants, including Northrop Grumman Corporation. You may also obtain these materials at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

References to our website and the SEC's website in this report are provided as a convenience and do not constitute, and should not be viewed as, incorporation by reference of the information contained on, or available through, such websites. Such information should not be considered a part of this report, unless otherwise expressly incorporated by reference in this report.

Item 1A. Risk Factors

Our consolidated financial position, results of operations and cash flows are subject to various risks, many of which are not exclusively within our control, that may cause actual performance to differ materially from historical or projected future performance. We urge you to consider carefully the risk factors described below in evaluating the information contained in this report as the outcome of one or more of these risks could have a material adverse effect on our financial position, results of operations and/or cash flows.

We depend heavily on a single customer, the U.S. Government, for a substantial portion of our business. Changes in this customer's priorities and spending could have a material adverse effect on our financial position, results of operations and/or cash flows.

Our primary customer is the U.S. Government, from which we derived approximately 85 percent of our total sales during each of the past several years. The U.S. Government is implementing significant reductions in government spending and other significant program changes. We cannot predict the impact on existing, follow-on, replacement or future programs from potential changes in priorities due to changes in defense spending levels, military strategy and planning and/or changes in social-political priorities.

The U.S. Government generally has the ability to terminate contracts, in whole or in part, without prior notice, for its convenience or for default based on performance. In the event of termination for the U.S. Government's convenience, contractors are generally protected by provisions covering reimbursement for costs incurred on the contracts and profit on those costs up to the amount authorized under the contract, but not the anticipated profit that would have been earned had the contract been completed. Termination by the U.S. Government of a contract due to our default could require us to pay for re-procurement costs in excess of the original contract price, net of the value of work accepted from the original contract, as well as other damages. Termination of a contract due to our default could have a material adverse effect on our financial position, results of operations and/or cash flows and could have a material adverse effect on our ability to compete for other contracts.

The U.S. Government also has the ability to stop work under a contract for a limited period of time for its convenience. It is possible that the U.S. Government could invoke this ability across a limited or broad number of contracts. In the event of a stop work order, contractors are typically protected by provisions covering reimbursement for costs incurred on the contract to date and for costs associated with the temporary stoppage of work on the contract. However, such temporary stoppages and delays could introduce inefficiencies and result in financial and other damages for which we may not be able to negotiate full recovery from the U.S. Government. They could also ultimately result in termination for convenience or reduced future orders.

A significant shift in government priorities to programs in which we do not participate and/or reductions in funding for or the termination of programs in which we do participate, unless offset by other programs and opportunities, could have a material adverse effect on our financial position, results of operations and/or cash flows.

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

U.S. Government programs are subject to annual congressional budget authorization and appropriation processes. For many programs, Congress appropriates funds on a fiscal year basis even though the program performance period may extend over several years. Consequently, programs are often partially funded initially and additional funds are committed only as Congress makes further appropriations. If we incur costs in excess of funds obligated on a contract, we may be at risk for reimbursement of those costs unless and until additional funds are obligated to the contract. We cannot predict the extent to which total funding and/or funding for individual programs will be included, increased or reduced as part of the annual budget process ultimately approved by Congress or in separate supplemental appropriations or continuing resolutions, as applicable. Plans adopted by the U.S. Government, along with pressures on, and uncertainty surrounding, the federal budget, sequestration, the appropriations process, and the permissible federal debt limit, could adversely affect the funding for individual programs and delay purchasing or payment decisions by our customers. In the event government funding for our significant programs becomes unavailable, or is reduced or delayed, our contract or subcontract under such programs may be terminated or adjusted by the U.S. Government or the prime contractor.

The statutory limit on the amount of permissible federal debt (the debt ceiling) was suspended until March 15, 2015. If the existing debt ceiling is not raised, we may be required to continue to perform for some period of time on certain of our U.S. Government contracts even if the U.S. Government is unable to make timely payments. An extended debt ceiling breach could negatively affect the U.S. Government's timely payment of our billings, resulting in delayed cash collection, and have significant consequences for our company, our employees, our suppliers and the defense industry.

The budget environment, including sequestration as currently mandated, and uncertainty surrounding the appropriations processes, remain significant long-term risks. Considerable uncertainty exists regarding how future budget and program decisions will unfold and what challenges budget reductions will present for the defense industry. We believe continued budget pressures will have serious negative consequences for the security of our country, the defense industrial base, including Northrop Grumman, and the customers, employees, suppliers, investors, and communities that rely on companies in the defense industrial base. Members of Congress continue to discuss various options to address sequestration in future budget planning, but we cannot predict the outcome of these efforts. It is likely budget and program decisions made in this environment will have long-term implications for our company and the entire defense industry.

Long term funding for certain programs in which we participate may be reduced, delayed or cancelled. In addition, budget cuts could adversely affect the viability of our subcontractors and suppliers, and our employee base. While we believe that our business is well-positioned in areas that the Department of Defense (DoD) has indicated are areas of focus for future defense spending, the long-term impact of the Budget Control Act, other defense spending cuts, and the ongoing fiscal debates remain uncertain.

Significant delays or reductions in appropriations, an extended debt ceiling breach, and/or future budget and program decisions may negatively impact our business and programs and could have a material adverse effect on our financial position, results of operations and/or cash flows.

We are subject to various investigations, claims and litigation that could ultimately be resolved against us.

The size, nature and complexity of our business make us susceptible to investigations, claims, and litigation, particularly those involving governments. We are and may become subject to investigations, claims and administrative, civil or criminal litigation globally and across a broad array of matters, including, but not limited to, government contracts, false claims, products liability, fraud, environmental, intellectual property, tax, export/import, labor, health and safety, employee benefits and improper payments. These matters could divert financial and management resources and result in fines, penalties, compensatory, treble or other damages or non-monetary relief. Government regulations also provide that certain allegations against a contractor may lead to suspension or debarment from government contracts or suspension of export privileges for the company or one or more of its components. Suspension or debarment could have a material adverse effect on the company because of our reliance on government contracts and export authorizations. An investigation, claim or litigation, even if fully indemnified or insured, could also negatively impact our reputation among our customers and the public, and make it more difficult for us to compete effectively or obtain adequate insurance in the future. Investigations, claims or litigation could have a material adverse effect on our financial position, results of operations and/or cash flows.

Our international business exposes us to additional risks.

Sales to customers outside the U.S. are an increasingly important component of our strategy. Our international business is subject to numerous political and economic factors, legal requirements, cross-cultural considerations and other risks associated with doing business in foreign countries. These risks differ in some respects from those associated with our U.S. business and our exposure to such risks may increase if our international business continues to grow as we anticipate.

Our international business is subject to both U.S. and foreign laws and regulations, including, without limitation, regulations relating to import-export controls, technology transfer restrictions, repatriation of earnings, data privacy and protection, investment, exchange controls, the Foreign Corrupt Practices Act (FCPA) and other anti-corruption laws, the anti-boycott provisions of the U.S. Export Administration Act, labor and employment, taxes, security restrictions and intellectual property. Failure by us, our employees, or others working on our behalf to comply with these laws and regulations could result in administrative, civil, or criminal liabilities, including suspension or debarment from government contracts or suspension of our export privileges.

Changes in regulations, political leadership and environment, or security risks may dramatically affect our ability to conduct or continue to conduct business in international markets. Our international business may also be impacted by changes in foreign national priorities and government budgets, as well as global economic conditions and fluctuations in foreign currency exchange rates. Our international contracts may include industrial cooperation agreements requiring specific in-country purchases, investments, manufacturing agreements or other financial obligations, known as offset obligations, and provide for significant penalties if we fail to meet such requirements.

The services and products we provide internationally, including those provided by subcontractors, are sometimes in countries with unstable governments and/or developing legal systems, in areas of military conflict or at military installations. This increases the risk of political dynamics or an incident resulting in harm or loss of life to our employees, subcontractors or other third parties, or in loss of property or damage to our products. It also exposes the company to additional financial, contractual and legal risks. Accidents or incidents that occur in connection with our international operations could also result in negative publicity, which could adversely affect our reputation and make it more difficult for us to compete for future contracts or attract and retain employees or result in the loss of existing and future contracts.

The occurrence and impact of these factors is difficult to predict, but one or more of them could have a material adverse effect on our financial position, results of operations and/or cash flows.

Our reputation and our ability to do business may be impacted by the improper conduct of employees, agents, business partners or joint ventures in which we participate.

We have implemented extensive policies, procedures, training and other compliance controls to prevent misconduct by employees, agents or others working on our behalf or with us that would violate the applicable laws of the jurisdictions in which we operate, including laws governing improper payments to government officials, the protection of export controlled or classified information, cost accounting and billing, competition and data privacy. However, we cannot ensure that we will prevent all such misconduct committed by our employees, agents, subcontractors or others working on our behalf or with us, and this risk of improper conduct may increase as we expand globally. In addition, in the ordinary course of our business we form and are members of joint ventures, some of which we do not control. We may be unable to prevent misconduct or other violations of applicable laws by these joint ventures. Improper actions by our employees, agents, business partners or joint ventures could subject us to administrative, civil or criminal investigations and monetary and non-monetary penalties, including suspension and debarment, which could negatively impact our reputation and ability to conduct business and could have a material adverse effect on our financial position, results of operations and/or cash flows.

We use estimates when accounting for contracts. Contract cost growth or changes in estimated contract revenues and costs could affect our profitability and our 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 our contracts, the estimation of total revenues and costs at completion is complicated and subject to many variables. Incentives, awards or penalties related to performance on contracts are considered in estimating revenue and profit rates when there is sufficient information to assess anticipated performance. Suppliers' assertions are also assessed and considered in estimating costs and profitability.

Our operating income can be adversely affected when we experience increased contract costs. Reasons for contract cost growth may include: design issues; the nature and complexity of the work to be performed, including technical or quality issues; production challenges, including those resulting from the availability and timeliness of customer funding, unavailability or reduced productivity of labor or the effect of any delays in performance; the availability, performance, quality or financial strength of significant subcontractors; supplier issues, including the costs, timeliness and availability of materials and components; the effect of any changes in laws or regulations; actions deemed necessary for long-term customer satisfaction; and natural disasters or environmental matters.

Our risk varies with the type of contract. Due to their nature, fixed-price contracts inherently tend to have more risk than cost type contracts. In 2014, approximately half of our sales were derived from fixed-price contracts. We typically enter into fixed-price contracts where costs can be more reasonably estimated based on experience. In addition, our contracts contain provisions relating to cost controls and audit rights. If the terms specified in our contracts are not met, our profitability may be reduced and we may incur a loss. Fixed-price development work comprises a small portion of our fixed-price contracts. This type of work is inherently more uncertain as to future events than production contracts, and, as a result, there is typically 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 typically reduced. 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. Under cost type contracts, allowable costs incurred by the contractor are generally subject to reimbursement plus a fee. We often enter into cost type contracts for development programs with complex design and technical challenges. These cost type programs typically have award or incentive fees that are subject to uncertainty and may be earned over extended periods or towards the end of the contract. In these cases, the associated financial risks are primarily in recognizing profit, which ultimately may not be earned, or program cancellation if cost, schedule, or technical performance issues arise.

Because of the significance of the judgment 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 could have a material adverse effect upon the profitability of one or more of the affected contracts and on our overall financial position, results of operations and/or cash flows. See Critical Accounting Policies, Estimates and Judgments in Part II, Item 7.

Our business could be negatively impacted by cyber and other security threats or disruptions.

As a defense contractor, we face various cyber and other security threats, including attempts to gain unauthorized access to sensitive information and networks; insider threats; threats to the safety of our directors, officers and employees; threats to the security of our facilities and infrastructure; and threats from terrorist acts or other acts of aggression. Our customers, suppliers and subcontractors face similar threats. Although we utilize various procedures and controls to monitor and mitigate the risk of these threats, there can be no assurance that these procedures and controls will be sufficient. These threats could lead to losses of sensitive information or capabilities, harm to personnel, infrastructure or products, and/or damage to our reputation as well as our or our suppliers' or subcontractors' ability to perform on our contracts.

Cyber threats are evolving and include, but are not limited to, malicious software, destructive malware, attempts to gain unauthorized access to data, disruption or denial of service attacks, and other electronic security breaches that could lead to disruptions in mission critical systems, unauthorized release of confidential or otherwise protected information (ours or that of our customers or partners), and corruption of data, networks or systems. In addition, we could be impacted by cyber threats or other disruptions or vulnerabilities found in products we use or in our partners' or customers' systems that are used in connection with our business. These events, if not prevented or effectively mitigated, could damage our reputation, require remedial actions and lead to loss of business, regulatory actions, potential liability and other financial losses.

We provide cyber and information technology systems, products and services to various customers (government and commercial) who also face cyber threats. Our systems, products and services may themselves be subject to cyber threats and/or they may not be able to detect or deter threats, or effectively to mitigate resulting losses. These losses could adversely affect our customers and our company.

The impact of these factors is difficult to predict, but one or more of them could result in the loss of information or capabilities, harm to individuals or property, damage to our reputation, loss of business, regulatory actions and potential liability, any one of which could have a material adverse effect on our financial position, results of operations and/or cash flows.

Pension and medical expenses associated with our retirement benefit plans may fluctuate significantly depending upon changes in actuarial assumptions, future investment performance of plan assets and legislative or other regulatory actions.

A substantial portion of our current and retired employee population is covered by pension and other post-retirement benefit plans, the costs of which are dependent upon various assumptions, including estimates of rates of return on benefit plan assets, discount rates for future payment obligations, mortality assumptions, rates of future cost growth and trends for future costs. In addition, funding requirements for benefit obligations of our pension and other post-retirement benefit plans are subject to legislative and other government regulatory actions.

Recently, the Society of Actuaries released revised mortality tables, which update life expectancy assumptions. In consideration of these tables, we modified the mortality assumptions used in determining our FAS (GAAP Financial Accounting Standards) pension and post-retirement benefit obligations as of December 31, 2014, which will have a related impact on our annual FAS benefit expense in future years. We also updated the mortality assumptions used in determining our future CAS benefit expense. We expect the adoption of new mortality assumptions for purposes of funding our plans will likely trail the adoption for both FAS and CAS purposes. The new mortality assumptions may result in additional funding requirements dependent upon the funded status of our plans. These expectations presume all other assumptions remain constant and there are no changes to applicable funding regulations.

Additionally, due to government regulations including the impact of CAS harmonization, pension plan cost recoveries under our U.S. Government contracts occur in different periods from when those pension costs are recognized for financial statement purposes or when pension funding is made. These timing differences could have a material adverse effect on our cash flows. The cost accounting rules have been revised in order to partially harmonize the measurement and period of assignment of defined benefit pension plan costs allocable to U.S. Government contracts and the minimum required contribution under the Employee Retirement Income Security Act of 1974 (ERISA), as amended by the Pension Protection Act (PPA) of 2006. These rules better align, but do not eliminate, mismatches between ERISA funding requirements and CAS pension costs for U.S. Government CAS covered contracts.

Changes in estimates and assumptions associated with our pension and other post-retirement benefit plans could have a material adverse effect on our financial position, results of operations and/or cash flows.

Our earnings and profitability depend, in part, on subcontractor performance and financial viability as well as raw material and component availability and pricing.

We rely on other companies to provide raw materials and major components and subsystems for our products and to produce hardware elements and sub-assemblies, provide intellectual property, and perform some of the services we provide to our customers. Disruptions or performance problems caused by our subcontractors and suppliers could have an adverse effect on our ability to meet our commitments to customers.

Our ability to perform our obligations on time could be adversely affected if one or more of our subcontractors or suppliers were unable to provide the agreed-upon products or materials or perform the agreed-upon services in a timely and cost-effective manner. Changes in economic conditions, including changes in defense budgets or credit availability, could adversely affect the financial stability of our subcontractors and suppliers and/or their ability to perform. The inability of our suppliers to perform could also result in the need for us to transition to alternate suppliers, which could result in significant incremental cost and delay or the need for us to provide other supplemental means to support our existing suppliers.

In connection with our U.S. Government contracts, we are required to procure certain materials, components and parts from supply sources approved by the customer. In some cases, there may be only one supplier for certain components. If a sole source supplier cannot meet our needs, we may be unable to find a suitable alternative. Consistent with the industry's efforts, our procurement practices are intended to reduce the likelihood of our procurement of counterfeit or unauthorized parts or materials. In some circumstances, we must rely on certifications from our subcontractors and suppliers regarding their compliance with applicable laws and regulations regarding the parts or materials we procure. If certifications received from our subcontractors or suppliers are inaccurate, if we are unable to procure or experience significant delays in supply deliveries of needed materials, components, intellectual property or parts, or if what we receive is counterfeit or otherwise improper, it could have a material adverse effect on our financial position, results of operations and/or cash flows.

Competition within our markets and an increase in bid protests may affect our ability to win new contracts and result in reduced revenues and market share.

We operate in highly competitive markets and our competitors may have more extensive or specialized engineering, manufacturing, marketing capabilities or financial capacity or be willing to accept more risk or lower profitability in competing for contracts. We have seen, and anticipate we will continue to see, increased competition in some of our core markets, especially as a result of the reduction in budgets for many U.S. Government agencies and our customer’s continued focus on affordability and competition. We are facing increasing competition in our domestic and international markets from U.S., foreign and multinational firms. Additionally, some customers, including the

DoD, may turn to commercial contractors, rather than traditional defense contractors, for some products and services, or may utilize small business contractors or determine to source work internally rather than hiring a contractor.

We also are seeing an increasing number of bid protests from unsuccessful bidders on new program awards. Bid protests could result in contract modifications or the award decision being reversed and loss of the contract award. Even where a bid protest does not result in the loss of an award, the resolution can extend the time until the contract activity can begin, and delay earnings.

If we are unable to continue to compete successfully against our current or future competitors, or prevail in a protest, we may experience declines in future revenues and market share, which could, over time, have a material adverse effect on our financial position, results of operations and/or cash flows.

As a U.S. Government contractor, we are subject to various procurement and other laws and regulations applicable to our industry and we could be adversely affected by changes in such laws and regulations or any negative findings by the U.S. Government as to our compliance with them.

U.S. Government contractors must comply with many significant procurement regulations and other specific legal requirements. These regulations and other requirements, although customary in government contracts, increase our performance and compliance costs and risks and are regularly evolving. New laws, regulations or procurement requirements or changes to current ones (including, for example, regulations related to limits on recovery of employee compensation costs, counterfeit parts, specialty metals and conflict minerals), can significantly increase our costs and risks and reduce our profitability.

We operate in a highly regulated environment and are routinely audited and reviewed by the U.S. Government and its agencies, such as the Defense Contract Audit Agency (DCAA), Defense Contract Management Agency (DCMA) and the DoD Inspector General. These agencies review performance under our contracts, our cost structure and our compliance with applicable laws, regulations and standards, as well as the adequacy of our systems and processes in meeting government requirements. Costs ultimately found to be unallowable or improperly allocated to a specific contract will not be reimbursed or must be refunded if already reimbursed. If an audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties, sanctions, forfeiture of profits or suspension or debarment. Whether or not illegal activities are alleged, the U.S. Government has the ability to decrease or withhold certain payments when it deems systems subject to its review to be inadequate, with significant financial impact. In addition, we could suffer serious reputational harm if allegations of impropriety were made against us.

Our industry has experienced, and we expect it will continue to experience, significant changes to business practices as a result of an increased focus on affordability, efficiencies, recovery of costs and a reprioritization of available defense funds to key areas for future defense spending. As a result of certain of these initiatives, we have experienced and may continue to experience an increased number of audits and/or a lengthened period of time required to close open audits. More recently, the thresholds for certain allowable costs, including compensation costs, have been significantly reduced; others are being challenged, debated and, in certain cases, modified, all with potentially significant financial costs to the company. In connection with these cost reduction initiatives, the U.S. Government is also pursuing alternatives to shift additional responsibility and performance risks to the contractor.

We also are subject to and expected to perform in compliance with a vast array of federal laws, including but not limited to the Truth in Negotiations Act, the False Claims Act, the Procurement Integrity Act, CAS, FAR, the International Traffic in Arms Regulations promulgated under the Arms Export Control Act, the Close the Contractor Fraud Loophole Act and the FCPA. If we are found to have violated the law, or are found not to have acted responsibly as defined by the law, we may be subject to reductions of the value of contracts; contract modifications or termination; the withholding of payments from our customer; the loss of export privileges; the assessment of penalties, fines, or compensatory, treble or other damages; or suspension or debarment.

If we do not comply with the laws, regulations and processes to which we are subject or if business practices change significantly, including with respect to the thresholds for allowable costs, it could have a material adverse effect on our financial position, results of operations and/or cash flows.

Our business is subject to disruption caused by natural and/or environmental disasters that could adversely affect our profitability and our overall financial position.

We have significant operations located in regions that may be exposed to earthquakes, damaging storms and other natural disasters. Our business also may be subject to environmental disasters. Our subcontractors and suppliers are also subject to natural and environmental disasters that could affect their ability to deliver or perform under a contract. Although preventative measures may help to mitigate damage, the damage and disruption resulting from natural and environmental disasters may be significant.

Natural and environmental disasters could also disrupt our and our subcontractors' and suppliers' workforce, electrical and other power distribution networks, including computer and internet operation and accessibility, and the critical industrial infrastructure needed for normal business operations.

If insurance or other risk transfer mechanisms are unavailable or insufficient to recover all costs or if we experience a significant disruption to our business due to a natural or environmental disaster, it could have a material adverse effect on our financial position, results of operations and/or cash flows.

Our insurance coverage, customer indemnifications or other liability protections may be inadequate to cover all of our significant risks or our insurers may deny coverage of or be unable to pay for material losses we incur, which could adversely affect our profitability and overall financial position.

We endeavor to obtain insurance agreements from financially solid, highly rated counterparties in established markets to cover significant risks and liabilities (including, for example, natural disasters and product liability). Not every risk or liability can be insured, and, for risks that are insurable, the policy limits and terms of coverage reasonably obtainable in the market may not be sufficient to cover all actual losses or liabilities incurred. Even if insurance coverage is available, we may not be able to obtain it at a price or on terms acceptable to us. Disputes with insurance carriers over policy terms or the insolvency of one or more of our insurers may significantly affect the amount or timing of cash flows and, if litigation over coverage terms with the insurer becomes necessary, an outcome unfavorable to us may adversely affect us.

In some circumstances we may be entitled to certain legal protections or indemnifications from our customers through contractual provisions, laws, regulations or otherwise. However, these protections are not always available, are typically subject to certain terms or limitations and may not be sufficient to cover all losses or liabilities incurred.

If available insurance coverage, customer indemnifications and/or other legal protections are not sufficient to cover our risks or losses, it could have a material adverse effect on our financial position, results of operations and/or cash flows.

We provide products and services related to nuclear operations, which subjects us to various environmental, regulatory, financial and other risks.

We provide products and services used in nuclear-related activities (including nuclear-powered platforms) and support nuclear-related operations of third parties. This subjects us to various extraordinary risks, including potential liabilities relating to nuclear-related incidents and the harmful effects on the environment and human health that may result from such nuclear-related activities, operations or incidents, as well as the storage, handling and disposal of radioactive materials. We may be subject to reputational harm and potential liabilities arising out of a nuclear incident, whether or not the cause was within our control. Under some circumstances, the U.S. Government and prime contractors provide for certain indemnification and other protection under certain of our government related contracts, including pursuant to, or in connection with, Public Law 85-804, the Price-Anderson Nuclear Industries Indemnity Act and the Terrorism Risk Insurance Reauthorization Act, for certain nuclear-related risks. If there was a nuclear incident or other nuclear-related damages, and that indemnification or other protection was not available to cover our losses and liabilities, it could have a material adverse effect on our financial position, results of operations and/or cash flows.

Changes in future business conditions could cause business investments and/or recorded goodwill and other long-lived assets to become impaired, resulting in substantial losses and write-downs that would reduce our operating income.

Goodwill accounts for approximately half of our total assets. Market-based inputs to the calculations in the impairment test, such as weighted average cost of capital and terminal value (based on market comparisons) could change significantly from our current assumptions. Additionally, the carrying values of our reporting units are significantly influenced by a number of factors, particularly the discount rate used to determine our net pension liability. We continue to monitor the recoverability of the carrying value of our goodwill and other long-lived assets. Significant write-offs of goodwill or other long-lived assets could have a material adverse effect on our financial condition and/or results of operations.

Our future success depends, in part, on our ability to develop new products and new technologies and maintain technologies, facilities, equipment and a qualified workforce to win new competitions and meet the needs of our customers.

Many of the markets in which we operate are characterized by rapidly changing technologies. The product, program and service needs of our customers change and evolve regularly. Our success in the competitive defense industry depends upon our ability to develop technologically advanced and innovative products and services and market these products and services to our customers. Our success also depends on our ability to provide the people, technologies, facilities, equipment and financial capacity needed to deliver those products and services with maximum efficiency. If we fail to maintain our competitive position, we could lose a significant amount of future business to our competitors, which would negatively impact our ability to generate favorable financial results and maintain market share.

Our operating results are heavily dependent upon our ability to attract and retain sufficient personnel with requisite skills and/or security clearances. If qualified personnel become scarce or difficult to attract or retain in our industry for geographic, compensation-related or other reasons, we could experience higher labor, recruiting or training costs in order to attract and retain necessary employees. Failure to maintain a qualified workforce would result in significant difficulty in performing under our contracts.

Certain of our employees are covered by collective agreements. We generally have been able to renegotiate renewals to expiring agreements without significant disruption of operating activities. If we experience difficulties with renewals and renegotiations of existing collective agreements or if our employees pursue new collective representation, we could incur additional expenses and may be subject to work stoppages. Any such expenses or delays could adversely affect our programs served by employees who are covered by such agreements or representation.

If we are unable to develop new products and technologies or attract and retain a qualified workforce, we may be unable to maintain our competitive position and our future success could be adversely affected.

Many of our 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 our control. Failure to meet these obligations could adversely affect our profitability and future prospects.

We design, develop and manufacture technologically advanced and innovative products and services, which are applied by our customers in a variety of environments. Problems and delays in development or delivery, or system failures, as a result of issues with respect to design, technology, intellectual property rights, labor, inability to achieve learning curve assumptions, manufacturing materials or components could prevent us from meeting requirements and create significant risk.

In addition, our products cannot be tested and proven in all situations and are otherwise subject to unforeseen problems. Examples of unforeseen problems that could negatively affect revenue and profitability include loss on launch of spacecraft, loss of aviation platforms, premature failure of products that cannot be accessed for repair or replacement, problems with design, quality and workmanship, country of origin of procured materials, delivery of subcontractor components or services and 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 profitability could be inaccurate cost estimates, design issues, human factors, 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 we previously received.

Certain contracts, primarily involving space satellite systems, contain provisions that entitle the customer to recover fees in the event of failure of the system upon launch or subsequent deployment for less than a specified period of time. Under such terms, we could be required to forfeit fees previously recognized and/or collected.

If we are unable to meet our performance obligations due to issues regarding the design, development or manufacture of our products or services, or we experience launch, platform or satellite system failures, it could have an adverse impact on our current and future business.

Unforeseen environmental costs could have an adverse effect on our financial position, results of operations and/or cash flows.

Our operations are subject to and affected by a variety of federal, state, local and foreign environmental laws and regulations. In addition, we could be affected by future laws or regulations, including those imposed in response to climate change concerns and other actions. Compliance with current and future environmental laws and regulations currently requires, and is expected to continue to require, significant operating and capital costs. We may be required to incur additional costs in excess of those anticipated as a result of, among other things, new laws and regulations, stricter enforcement of existing laws and regulations, imposition of new cleanup requirements, discovery of previously unknown or more extensive contamination, litigation involving environmental impacts or sanctions or penalties or a determination that certain environmental costs are unallowable. In addition, if other identified responsible parties are insolvent or otherwise unable to pay their share of such costs, we may be required to incur additional costs in excess of those anticipated.

Environmental laws and regulations provide for substantial fines and criminal sanctions for violations. These laws and regulations may limit our operations or require the installation of costly pollution control equipment or operational changes to limit pollution emissions or discharges and/or decrease the likelihood of accidental hazardous substance releases. We also incur, and expect to continue to incur, costs to comply with current environmental laws and regulations related to the cleanup of pollutants previously released into the environment. In addition, if we were found to be in violation of the Federal Clean Air Act or the Clean Water Act, the facility or facilities involved in the violation could be placed by the Environmental Protection Agency (EPA) on a list maintained by the General Services Administration of facilities that generally cannot be used in performing on U.S. Government contracts until the violation is corrected.

The impact of these factors is difficult to predict, but one or more of them could have an adverse effect on our financial position, results of operations and/or cash flows.

We may be unable adequately to protect our intellectual property rights, which could affect our ability to compete.

We own many U.S. and foreign patents, trademarks, copyrights, and other forms of intellectual property, and we license certain intellectual property rights to and from third parties. The U.S. Government generally holds licenses to certain intellectual property that we develop in performance of government contracts, and it may use or authorize others to use certain such intellectual property, typically for government purposes. More recently, we believe the U.S. Government has asserted or sought to obtain more extensive rights in intellectual property. The U.S. Government's efforts could result in a decrease in our ability to control the use of certain of our intellectual property rights in a government contracting environment. Our intellectual property is also subject to challenge, invalidation, misappropriation or circumvention by third parties.

We also rely significantly upon proprietary technology, information, processes and know-how that are not protected by patents. We seek to protect this information through trade secret or confidentiality agreements with our employees, consultants, subcontractors and other parties, as well as through other measures. These agreements and other measures may not provide adequate protection for our unpatented proprietary information. In the event of an infringement of our intellectual property rights, a breach of a confidentiality agreement or divulgence of proprietary information, we may not have adequate legal remedies to maintain our intellectual property. Litigation to determine the scope of intellectual property rights, even if ultimately successful, could be costly and could divert management's attention away from other aspects of our business. In addition, our trade secrets may otherwise become known or be independently developed by competitors. In some instances, we have licensed the proprietary intellectual property of others, but we may be unable in the future to secure the necessary licenses to use such intellectual property on commercially reasonable terms. Moreover, the laws concerning intellectual property rights vary among countries and the protection provided to our intellectual property by these laws and foreign courts may not be the same as the remedies available under U.S. law.

If we are unable adequately to control or protect our intellectual property rights against claims by the U.S. Government or others, or otherwise procure necessary intellectual property, it could have an adverse effect on our financial position, results of operations and/or cash flows.

Unanticipated changes in our tax provisions or exposure to additional tax liabilities could affect our profitability and cash flow.

We are subject to income and other taxes in the U.S. and foreign jurisdictions. Changes in applicable domestic or foreign tax laws and regulations, or their interpretation and application, including the possibility of retroactive effect, could affect our tax expense and profitability. For example, a change in the U.S. corporate tax rate would result in a remeasurement of our net deferred tax assets through the income tax provision because our deferred tax assets are measured at the current statutory tax rate. In addition, the final determination of any tax audits or related litigation could be materially different from our historical income tax provisions and accruals. Changes in our tax provision or an increase in our tax liabilities, whether due to changes in applicable law and regulations, the interpretation or application thereof, changes in the tax rate or a final determination of tax audits or litigation, could have an adverse effect on our financial position, results of operations and/or cash flows.

The spin-off of our former Shipbuilding business may expose us to potential claims, liabilities and reputational harm.

In connection with the spin-off transaction, we entered into a number of agreements with HII setting forth certain rights and obligations of the parties after the separation. For example, under the Separation and Distribution Agreement, from and after the spin-off transaction, each of HII and Northrop Grumman is generally responsible for the debts, liabilities and other obligations related to the business or businesses that it owns and operates following the consummation of the spin-off. It is possible that a court would disregard the allocation agreed to between us and HII, and require that we assume responsibility for certain obligations allocated to HII (for example, tax and/or environmental liabilities), particularly if HII were to refuse or were unable to pay or perform such obligations.

In addition, third parties could seek to hold us responsible for any of the liabilities or obligations for which HII has agreed to be responsible and/or to indemnify us, directly or indirectly. The indemnity related rights we have under our agreements with HII may not be sufficient to protect us against such liabilities. Even if we ultimately succeed in recovering from HII or the U.S. Government any amounts for which we are held liable, we may be required to record these losses ourselves until such time as the indemnity contribution is paid. In addition, certain indemnities that we may be required to provide HII are not subject to a cap, may be significant, and could negatively impact our business.

In connection with the spin-off transaction, we received a letter ruling from the IRS and an opinion of counsel confirming that we and our shareholders would not recognize any taxable income, gain or loss for U.S. federal income tax purposes as a result of the merger, the internal reorganization or the distribution, except that our shareholders who received cash in lieu of fractional shares would recognize gain or loss with respect to such cash. Nevertheless, if the merger, the internal reorganization or the distribution were ultimately determined to be taxable for U.S. federal income tax purposes, we and our shareholders could be subject to additional income tax liabilities.

The impact of these factors is difficult to predict, but one or more of them could cause reputational harm and could have an adverse effect on our financial position, results of operations and/or cash flows.

Item 1B. Unresolved Staff Comments

None.

FORWARD-LOOKING STATEMENTS AND PROJECTIONS

This Form 10-K and the information we are incorporating by reference contain statements, other than statements of historical fact, that constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as “expect,” “intend,” “may,” “could,” “plan,” “project,” “forecast,” “believe,” “estimate,” “c
“anticipate,” “trends,” "goals" and similar expressions generally identify these forward-looking statements. Forward-looking statements include, among other things, statements relating to our future financial condition, results of operations and cash flows. Forward-looking statements are based upon assumptions, expectations, plans and projections that we believe to be reasonable when made, but which may change over time. These statements are not guarantees of future performance and inherently involve a wide range of risks and uncertainties that are difficult to predict. Specific risks that could cause actual results to differ materially from those expressed or implied in these forward-looking statements include, but are not limited to, those identified under Risk Factors in Part I, Item 1A and other important factors disclosed in this report and from time to time in our other filings with the SEC.

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

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NORTHROP GRUMMAN CORPORATION

Item 2. Properties

At December 31, 2014, we had approximately 34 million square feet of floor space at 485 separate locations, primarily in the U.S., for manufacturing, warehousing, research and testing, administration and various other uses. At December 31, 2014, we leased to third parties approximately 350,000 square feet of our owned and leased facilities, and had vacant floor space of approximately 1 million square feet.

At December 31, 2014, we had major operations at the following locations:

AEROSPACE SYSTEMS

Carson, El Segundo, Manhattan Beach, Mojave, Palmdale, Redondo Beach and San Diego, CA; Melbourne and St. Augustine, FL; Devens, MA; Moss Point, MS; and Bethpage, NY.

ELECTRONIC SYSTEMS

Azusa, Sunnyvale and Woodland Hills, CA; Apopka, FL; Rolling Meadows, IL; Annapolis, Elkridge, Halethorpe, Linthicum and Sykesville, MD; Williamsville, NY; Cincinnati, OH; Salt Lake City, UT; and Charlottesville, VA. Locations outside the U.S. include France, Germany and Italy.

INFORMATION SYSTEMS

Huntsville, AL; McClellan, Redondo Beach, San Diego and San Jose, CA; Aurora and Colorado Springs CO; Annapolis Junction, MD; Bellevue, NE; Beavercreek, OH; and Chantilly, Chester, Fairfax, Herndon, McLean and Richmond, VA.

TECHNICAL SERVICES

Sierra Vista, AZ; Warner Robins, GA; Lake Charles, LA; Hill Air Force Base, UT; and Herndon, VA.

CORPORATE

Falls Church and Lebanon, VA and Irving, TX.

The following is a summary of our floor space at December 31, 2014:

Square feet (in thousands)	Owned	Leased	U.S. Government Owned/Leased	Total
Aerospace Systems	6,335	5,629	1,930	13,894
Electronic Systems	8,224	2,380	—	10,604
Information Systems	658	5,868	—	6,526
Technical Services	145	1,841	1	1,987
Corporate	657	596	—	1,253
Total	16,019	16,314	1,931	34,264

We maintain our properties in good operating condition and believe that the productive capacity of our properties is adequate to meet current contractual requirements and those for the foreseeable future.

Item 3. Legal Proceedings

We have provided information about certain legal proceedings in which we are involved in Note 10 to the consolidated financial statements in Part II, Item 8.

We are a party to various investigations, lawsuits, claims and other legal proceedings, including government investigations and claims, that arise in the ordinary course of our business. These types of matters could result in fines; penalties; compensatory, treble or other damages; or non-monetary relief. U.S. Government regulations also provide that certain allegations against a contractor may lead to suspension or debarment from future U.S. Government contracts or suspension of export privileges for the company or one or more of its components. Suspension or debarment could have a material adverse effect on the company because of our reliance on government contracts and authorizations. The nature of legal proceedings is such that we cannot assure the outcome of any particular matter. However, based on information available to us to date and other than as noted in Note 10 to the consolidated financial statements, we do not believe that the outcome of any matter currently pending against the company is likely to have a material adverse effect on the company's consolidated financial position as of December 31, 2014, its annual results of operations and/or cash flows. For further information on the risks we face from existing and future investigations, lawsuits, claims and other legal proceedings, please see Risk Factors in Part I, Item 1A.

Item 4. Mine Safety Disclosures

No information is required in response to this item.

NORTHROP GRUMMAN CORPORATION

PART II

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

COMMON STOCK

We have 800,000,000 shares authorized at a $1 par value per share, of which 198,930,240 shares and 217,599,230 shares were outstanding as of December 31, 2014 and 2013, respectively.

PREFERRED STOCK

We have 10,000,000 shares authorized at a $1 par value per share, of which no shares were issued and outstanding as of December 31, 2014 and 2013.

MARKET INFORMATION

Our common stock is listed on the New York Stock Exchange and trades under the symbol NOC.

The following table sets forth, for the periods indicated, the intraday high and low prices of our common stock as reported in the consolidated reporting system for the New York Stock Exchange Composite Transactions.

	2014	2013
January to March	$109.17 to $125.37	$64.20 to $70.21
April to June	116.11 to 126.00	69.13 to 84.34
July to September	118.23 to 134.24	81.74 to 99.10
October to December	118.24 to 153.19	92.51 to 116.19

HOLDERS

The approximate number of common stockholders was 26,699 as of January 29, 2015.

DIVIDENDS

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

	2014	2013
January to March	$0.61	$0.55
April to June	0.70	0.61
July to September	0.70	0.61
October to December	0.70	0.61
Total	$2.71	$2.38

NORTHROP GRUMMAN CORPORATION

PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFLIATED PURCHASERS

The table below summarizes our repurchases of common stock during the three months ended December 31, 2014:

Period	Number of Shares Purchased(1)	Average Price Paid per Share(2)	Numbers of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs ($ in millions)
October	1,960,600	$ 125.94	1,960,600	$ 799
November	1,230,310	136.40	1,230,310	632
December	1,266,013	145.55	1,266,013	3,447
Total	4,456,923	$ 134.40	4,456,923	$ 3,447

(1) On May 15, 2013, the company's board of directors authorized a share repurchase program of up to $4.0 billion of the company’s common stock ("2013 Repurchase Program"). Repurchases under the 2013 Repurchase Program commenced in September 2013. As of December 31, 2014, repurchases under the 2013 Repurchase Program totaled $3.6 billion; $447 million remained under this share repurchase authorization. By its terms, the 2013 Repurchase Program will expire when we have used all authorized funds for repurchases. On December 4, 2014, the company's board of directors authorized a new share repurchase program of up to an additional $3.0 billion of the company's common stock ("2014 Repurchase Program"). By its terms, repurchases under the 2014 Repurchase Program will commence upon completion of the 2013 Repurchase Program and will expire when we have used all authorized funds for repurchases.

(2) Includes commissions paid.

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

NORTHROP GRUMMAN CORPORATION

STOCK PERFORMANCE GRAPH

Comparison of Cumulative Five Year Total Return
Among Northrop Grumman Corporation, the S&P 500 Index,
and the S&P Aerospace & Defense Index

(1) Assumes $100 invested at the close of business on December 31, 2009, 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. In March 2011, we completed the spin-off of Huntington Ingalls Industries, Inc. (HII). Our shareholders received one share of HII common stock for every six shares of our common stock held on the record date. The effect of the spin-off is reflected in the cumulative total return as a reinvested dividend.

(3) The S&P Aerospace & Defense Index is comprised of The Boeing Company, General Dynamics Corporation, Honeywell International Inc., L-3 Communications, Lockheed Martin Corporation, Northrop Grumman Corporation, Precision Castparts Corporation, Raytheon Company, Rockwell Collins, Inc., Textron, 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) This graph is not deemed to be "filed" with the U.S. Securities and Exchange Commission (SEC) or subject to the liabilities of Section 18 of the Securities and Exchange Act of 1934 (the Exchange Act), and should not be deemed to be incorporated by reference into any of our prior or subsequent filings under the Securities Act of 1933 or the Exchange Act.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

For a description of securities authorized under our equity compensation plans, see Note 13 to our consolidated financial statements in Part II, Item 8.

NORTHROP GRUMMAN CORPORATION

Item 6. Selected Financial Data

The data presented in the following table is derived from the audited consolidated financial statements and other information. 2011 and 2010 data is adjusted to reflect the effects of discontinued operations.

SELECTED FINANCIAL DATA

	Year Ended December 31				
$ in millions, except per share amounts	2014	2013	2012	2011	2010
Sales					
U.S. Government	$20,085	$21,278	$22,268	$23,432	$25,061
Other customers[1]	3,894	3,383	2,950	2,980	3,082
Total sales	23,979	24,661	25,218	26,412	28,143
Operating income	3,196	3,123	3,130	3,276	2,827
Earnings from continuing operations	2,069	1,952	1,978	2,086	1,904
Basic earnings per share, from continuing operations	$9.91	$8.50	$7.96	$7.54	$6.41
Diluted earnings per share, from continuing operations	9.75	8.35	7.81	7.41	6.32
Cash dividends declared per common share	2.71	2.38	2.15	1.97	1.84
Year-End Financial Position					
Total assets	$26,572	$26,381	$26,543	$25,411	$31,410
Notes payable to banks and long-term debt	5,928	5,930	3,935	3,948	4,724
Other long-term obligations[2]	7,520	4,018	7,043	5,005	4,007
Financial Metrics					
Net cash provided by continuing operations	$2,593	$2,483	$2,640	$2,347	$2,056
Free cash flow from continuing operations[3]	2,032	2,119	2,309	1,855	1,471
Other Information					
Company-sponsored research and development expenses	$569	$507	$520	$543	$580
Total backlog	38,199	37,033	40,809	39,515	46,842
Square footage at year-end (in thousands)	34,264	34,500	35,053	37,397	38,218
Number of employees at year-end	64,300	65,300	68,100	72,500	79,600

(1) Other customer sales include foreign military sales.

(2) Other long-term obligations include pension and other post-retirement benefit plan liabilities, deferred compensation, unrecognized tax benefits, environmental liabilities and other long-term obligations.

(3) Free cash flow from continuing operations is a non-GAAP financial measure and is calculated as cash provided by continuing operations less capital expenditures. See Liquidity and Capital Resources – Free Cash Flow in Part II, Item 7 for more information on this measure.

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

OVERVIEW

Political and Economic Environment

The U.S. Government continues to face substantial fiscal and economic challenges, which affect funding for its discretionary and non-discretionary budgets. Part I of the Budget Control Act of 2011 (Budget Control Act) provided for a reduction in planned defense budgets by at least $487 billion over a ten year period. Part II mandated substantial additional reductions, through a process known as “sequestration,” which took effect in March 2013.

In December 2013, Congress passed the National Defense Authorization Act (NDAA). Congress also passed, and the President signed into law, the Bipartisan Budget Act of 2013, which set discretionary spending levels for fiscal year (FY) 2014 and FY 2015. The legislation provided for additional budget funding of approximately $63 billion over FY 2014 and FY 2015. The additional funding alleviated some budget cuts that would otherwise have been instituted through sequestration in FY 2014 and FY 2015.

In February 2014, the President signed into law the Temporary Debt Limit Extension Act, suspending the statutory limit on the amount of permissible federal debt (the debt ceiling) until March 15, 2015. If the existing debt ceiling is not raised, we may be required to continue to perform for some period of time on certain of our U.S. Government contracts even if the U.S. Government is unable to make timely payments. An extended debt ceiling breach could negatively affect the U.S. Government's timely payment of our billings, resulting in delayed cash collection, and have significant consequences for our company, our employees, our suppliers and the defense industry.

In March 2014, the DoD released its Quadrennial Defense Review (QDR), a congressionally-mandated report that discusses the DoD’s long-term strategies and priorities. The QDR recommends spending above the sequester levels and identifies potential impacts if sequester caps are imposed again in 2016. In July 2014, the National Defense Panel, a bi-partisan group of senior civilians and military officers appointed by Congress to review the QDR, recommended repealing the 2011 Budget Control Act and returning to higher defense funding levels. It is unclear whether or how the results of these strategic reviews could impact future budget plans.

In December 2014, Congress passed and the President signed into law the Consolidated and Further Appropriations Act of 2015, providing for federal spending levels for FY 2015 consistent with the Bipartisan Budget Act of 2013. The Administration is currently preparing its FY 2016 budget request, which is expected to be submitted to Congress in the first calendar quarter of 2015. Congressional authorization and appropriation of defense and other spending for FY 2016 and beyond (including whether by appropriations bills or continuing resolutions) and the application of sequestration remain marked by significant debate and an uncertain schedule. Congress and the Administration also continue to debate the debt ceiling, among other fiscal issues, as they negotiate plans for long-term national fiscal policy. The outcome of these debates could have a significant impact on defense spending broadly and the company's programs in particular.

The budget environment, including sequestration as currently mandated, remains a significant long-term risk. Considerable uncertainty exists regarding how future budget and program decisions will unfold and what challenges budget reductions will present for the defense industry. We believe continued budget pressures will have serious negative consequences for the security of our country, the defense industrial base, including Northrop Grumman, and the customers, employees, suppliers, investors, and communities that rely on companies in the defense industrial base. Members of Congress continue to discuss various options to address sequestration in future budget planning, but we cannot predict the outcome of these efforts. It is likely budget and program decisions made in this environment will have long-term impacts on our company and the entire defense industry.

We believe spending on recapitalization, modernization and maintenance of defense, intelligence, and homeland security assets will continue to be a national priority. Future defense spending is expected to include the development and procurement of new manned and unmanned military platforms and systems, along with advanced electronics and software to enhance the capabilities of existing individual systems and provide real-time integration of surveillance, information management, strike and battle management platforms. We expect significant new competitive opportunities to include long range strike, missile defense, command and control, network communications, enhanced situational awareness, satellite systems, restricted programs, cyber, technical services and information technology, as well as numerous homeland security programs.

The company believes it has additional international opportunities (direct and foreign military sales), beyond those realized today, to sell its products and services outside the U.S. market, particularly in the domains of unmanned systems, cyber, C4ISR, logistics and manned military aircraft. The Administration has been addressing and supporting export control reforms that could enhance our ability to take advantage of these opportunities. The company is dedicating additional resources to expanding its international sales with emphases on Australia, the Middle East, Asia and Europe. To the extent these efforts are successful, increases in international awards, sales, profits and cash flows may offset, or partially offset, potential declines resulting from the U.S. political and economic environment described above.

For further information on the risks we face from the current political and economic environment, see Risk Factors in Part I, Item 1A.

Operating Performance Assessment

We manage and assess our business based on our performance on contracts and programs (typically two or more closely-related contracts). Sales from our portfolio of long-term contracts are primarily recognized using the cost-to-cost method of percentage of completion accounting, but in some cases the units-of-delivery method of percentage of completion accounting is utilized. As a result, sales tend to fluctuate in concert with costs incurred across our large portfolio of contracts. Due to Federal Acquisition Regulation (FAR) rules that govern our U.S Government business and related Cost Accounting Standards (CAS), most types of costs are allocable to U.S. Government contracts, and we do not focus on individual cost groupings (such as manufacturing, engineering and design labor costs, subcontractor costs, material costs, overhead costs and general and administrative costs), as much as we do on total contract cost, which is the key driver of our sales and operating income.

In evaluating our operating performance, we look primarily at changes in sales and operating income, including the effects of meaningful changes in operating income as a result of changes in contract estimates. Where applicable, significant fluctuations in operating performance attributable to individual contracts or programs, or changes in a specific cost element across multiple contracts, are described in our analysis. Based on this approach and the nature of our operations, the discussion below of results of operations first focuses on our four segments before distinguishing between products and services. Changes in sales are generally described in terms of volume, deliveries or other indicators of sales activity, and contract mix. For purposes of this discussion, volume generally refers to increases or decreases in sales or cost from production/service activity levels or delivery rates. Performance generally refers to changes in contract operating margin rates for the period, as well as the continuing effect of prior cumulative catch-up adjustments. Both are primarily related to the changes in estimates referred to above.

CONSOLIDATED OPERATING RESULTS

Selected financial highlights are presented in the table below:

	Year Ended December 31		
$ in millions, except per share amounts	2014	2013	2012
Sales	$23,979	$24,661	$25,218
Operating costs and expenses	20,783	21,538	22,088
Operating income	3,196	3,123	3,130
Operating margin rate	13.3 %	12.7 %	12.4 %
Federal and foreign income tax expense	$868	$911	$987
Effective income tax rate	29.6 %	31.8 %	33.3 %
Net earnings	$2,069	$1,952	$1,978
Diluted earnings per share	$9.75	$8.35	$7.81
Net cash provided by operating activities	$2,593	$2,483	$2,640

Sales

Sales for 2014 decreased $682 million, or 3 percent, as compared with 2013. Sales for 2013 decreased $557 million, or 2 percent, as compared with 2012.

The table below shows the variances in segment sales from the respective prior years:

	Variance from Prior Year			
$ in millions	2014		2013	
Aerospace Systems	$(17)	0%	$37	0%
Electronic Systems	(198)	(3%)	199	3%
Information Systems	(374)	(6%)	(760)	(10%)
Technical Services	(44)	(2%)	(176)	(6%)
Intersegment sales elimination	(49)	3%	143	(7%)
Total sales variance	$(682)	(3%)	$(557)	(2%)

For further information by segment refer to Segment Operating Results below, and for product and service detail, refer to the Product and Service Analysis section that follows Segment Operating Results.

Operating Costs and Expenses

Operating costs and expenses primarily comprise labor, material, subcontractor and overhead costs, and are generally allocated to contracts as incurred. In accordance with industry practice and the regulations that govern cost accounting requirements for government contracts, most general management and corporate expenses incurred at the segment and corporate locations are considered allowable and allocable costs. Allowable and allocable general and administrative costs are allocated on a systematic basis to contracts in progress.

Operating costs and expenses comprise the following:

	Year Ended December 31		
$ in millions	2014	2013	2012
Product Costs	$10,431	$10,623	$10,415
Service Costs	7,947	8,659	9,223
General and administrative expenses	2,405	2,256	2,450
Operating costs and expenses	$20,783	$21,538	$22,088

2014 – Product costs as a percentage of product sales for 2014 were 74.4 percent, as compared to 75.7 percent during 2013. The decrease is mainly due to the settlements described in the Segment Operating Results section below, and the continuing benefit of higher margin rates resulting from previous net favorable adjustments. Service costs as a percentage of service sales for 2014 were 79.8 percent, as compared to 81.5 percent during 2013. The decrease was mainly due to improved performance across a number of service programs at Information Systems and the continuing benefit of higher margin rates resulting from previous net favorable adjustments at Aerospace Systems.

2013 – Product costs as a percentage of product sales for 2013 were 75.7 percent, as compared to 75.3 percent during 2012; the increase is primarily due to lower product operating margins in newly awarded programs at Information Systems. Service costs as a percentage of service sales for 2013 were 81.5 percent, as compared to 81.0 percent during 2012; the increase is primarily due to lower service operating margins at Aerospace Systems and Information Systems.

For further information regarding product and service sales and costs, see the Product and Service Analysis section that follows Segment Operating Results.

2014 – General and administrative expenses as a percentage of total sales increased to 10.0 percent in 2014, from 9.1 percent in 2013. The increase largely reflects increased investment for future business.

2013 – General and administrative expenses as a percentage of total sales decreased to 9.1 percent in 2013, from 9.7 percent in 2012. The decrease reflects lower indirect costs principally related to cost reduction initiatives at Information Systems, as well as lower bid and proposal expenses.

Operating Income

We define operating income as sales less operating costs and expenses, which includes general and administrative expenses. Changes in estimated contract operating margin at completion, resulting from changes in estimated sales, operating costs and expenses, are recorded using the cumulative catch-up method of accounting, which in aggregate can have a significant effect on our reported sales and operating income in each of our reporting periods. Cumulative catch-up adjustments are presented in the table below:

	Year Ended December 31		
$ in millions	2014	2013	2012
Favorable adjustments	$922	$1,044	$1,270
Unfavorable adjustments	(258)	(291)	(285)
Net favorable adjustments	$664	$753	$985

Net cumulative catch-up adjustments by segment are presented in the table below:

	Year Ended December 31		
$ in millions	2014	2013	2012
Aerospace Systems	$372	$394	$436
Electronic Systems	207	312	426
Information Systems	73	49	120
Technical Services	44	43	53
Eliminations	(32)	(45)	(50)
Net favorable adjustments	$664	$753	$985

Federal and Foreign Income Taxes

2014 – Our effective tax rate for 2014 was 29.6 percent, as compared with 31.8 percent in 2013. The company's lower effective tax rate for 2014 reflects a $51 million benefit for the partial resolution of its 2007-2009 Internal Revenue Service (IRS) examination.

2013 – Our effective tax rate for 2013 was 31.8 percent, as compared with 33.3 percent in 2012. The company's lower effective tax rate for 2013 includes a $37 million benefit for the American Taxpayer Relief Act, enacted in January 2013, which reinstated research tax credits for 2012 and 2013, and a $21 million benefit for higher section 199 manufacturing deductions than in prior year.

Net Earnings

2014 – Net earnings for 2014 increased by $117 million, or 6 percent, as compared with 2013. The higher earnings are primarily due to an increase in net FAS (GAAP Financial Accounting Standards)/CAS pension adjustment and the lower effective tax rate described above, which were partially offset by an increase in unallocated corporate expenses. For further information regarding net FAS/CAS pension adjustment and unallocated corporate expenses, see the Segment Operating Results section.

2013 – Net earnings for 2013 decreased $26 million, or 1 percent, as compared with 2012. The lower earnings reflect lower segment operating income, partially offset by the lower effective tax rate described above. For further information regarding segment operating income, see the Segment Operating Results section.

Diluted Earnings Per Share

2014 – Diluted earnings per share for 2014 increased by $1.40, or 17 percent, as compared with 2013. The increase reflects lower weighted-average shares outstanding resulting from shares repurchased in 2013 and 2014 and the higher net earnings discussed above.

2013 – Diluted earnings per share for 2013 increased by $0.54, or 7 percent, as compared with 2012. The increase principally reflects lower weighted-average shares outstanding resulting from shares repurchased in 2012 and 2013.

Net Cash Provided by Operating Activities

2014 – Net cash provided by operating activities for 2014 increased by $110 million, or 4 percent, as compared with 2013, principally due to a $500 million voluntary pre-tax pension contribution made in April 2013, partially offset by changes in trade working capital during 2014.

NORTHROP GRUMMAN CORPORATION

2013 – Net cash provided by operating activities for 2013 decreased by $157 million, or 6 percent, as compared with 2012, principally due to higher voluntary pension contributions in 2013, partially offset by changes in trade working capital. In 2013, we contributed $579 million to our pension plans, of which $500 million was voluntarily pre-funded, as compared with $367 million in 2012, of which $300 million was voluntarily pre-funded.

SEGMENT OPERATING RESULTS

Basis of Presentation

We are aligned in four segments: Aerospace Systems, Electronic Systems, Information Systems and Technical Services. This section discusses segment sales, operating income and operating margin rates. The reconciliation of segment sales to total sales is provided in Note 3 to the consolidated financial statements in Part II, Item 8. The reconciliation of segment operating income to total operating income, as well as discussion of the reconciling items, is provided in Note 3 to the consolidated financial statements in Part II, Item 8. For purposes of the discussion in this Segment Operating Results section, references to operating income and operating margin rate reflect segment operating income and segment operating margin rate.

In 2014, the company acquired Qantas Defence Services Pty Limited (QDS), now called Northrop Grumman Integrated Defence Services Pty Limited (Northrop Grumman IDS) for a final purchase price of $85 million in cash. Northrop Grumman IDS provides integrated logistics, sustainment and modernization support primarily to Australian government and military customers. The fair value of the assets acquired and liabilities assumed and the results of operations of Northrop Grumman IDS are included in the Technical Services segment. These amounts were not material to the company's consolidated financial statements.

For a more complete description of each segment’s products and services, see the business descriptions in Part I, Item 1.

Segment Operating Income

Segment operating income, as reconciled below, is a non-GAAP measure and is used by management as an internal measure of financial performance for our operating segments. Segment operating income reflects total earnings from our four segments, including allocated pension expense recognized under CAS and excludes unallocated corporate items, including FAS pension expense.

	Year Ended December 31		
$ in millions	2014	2013	2012
Segment operating income	$3,099	$3,080	$3,176
Segment operating margin rate	12.9 %	12.5 %	12.6 %

2014 - Segment operating income for 2014 increased by $19 million, or 1 percent, as compared with 2013. The increase in segment operating income was principally due to a $75 million benefit realized in connection with agreements reached with the U.S. Government to settle certain claims relating to use of the company's intellectual property and a terminated program and a segment operating margin benefit of approximately $45 million as a result of lower 2014 CAS costs due to the Highway and Transportation Funding Act of 2014 (HATFA) legislation described below, which more than offset the impact of lower sales volume.

2013 - Segment operating income for 2013 decreased by $96 million, or 3 percent, as compared with 2012. The decrease in segment operating income was principally due to lower sales. The decrease in operating margin rate reflects lower net favorable adjustments in 2013, partially offset by higher contract margin rates across our portfolio resulting from several factors, including the continuing effect of prior net favorable adjustments.

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The table below reconciles segment operating income to total operating income by including the impact of net FAS/CAS pension adjustments, as well as certain corporate-level expenses, which are not considered allowable or allocable under applicable CAS or FAR:

	Year Ended December 31		
$ in millions	2014	2013	2012
Segment operating income	$3,099	$3,080	$3,176
CAS pension expense	384	542	506
Less: FAS pension expense	(115)	(374)	(374)
Net FAS/CAS pension adjustment	269	168	132
Unallocated corporate expenses	(169)	(119)	(168)
Other	(3)	(6)	(10)
Total operating income	$3,196	$3,123	$3,130

Net FAS/CAS Pension Adjustment

For financial statement purposes, we account for our employee pension plans in accordance with GAAP under FAS. However, the cost of these plans is charged to our contracts in accordance with the FAR and the related CAS that govern such plans. The net FAS/CAS pension adjustment reflects the difference of pension expense charged to contracts and included as cost in segment operating income less pension expense determined in accordance with GAAP.

2014 - The increase in net FAS/CAS pension adjustment is principally due to a reduction in FAS expense, largely due to the increase in our FAS discount rate assumptions as of December 31, 2013. The reduction in FAS expense was partially offset by lower CAS expense due to the passage of HATFA, which included provisions that reduce the amount of CAS expense charged to our contracts.

2013 - The increase in net FAS/CAS pension adjustment reflects an update for actual demographic experience as of January 1, 2013, which resulted in an increase to the company's 2013 CAS expense.

Unallocated Corporate Expenses

Unallocated corporate expenses generally include the portion of corporate expenses, other than FAS pension costs, not considered allowable or allocable under applicable CAS and FAR rules, and therefore not allocated to the segments, such as a portion of management and administration, legal, environmental, certain compensation and retiree benefits, and other expenses.

2014 - The increase in unallocated corporate expense for 2014, as compared to 2013, is primarily due to increases in year-over-year provisions for environmental matters.

2013 - The decrease in unallocated corporate expenses for 2013, as compared to 2012, is primarily due to lower year-over-year provisions for disallowed costs and litigation matters and the favorable settlement of overhead claims, partially offset by changes in deferred tax assets due to lower blended state income tax rates.

AEROSPACE SYSTEMS

	Year Ended December 31		
$ in millions	2014	2013	2012
Sales	$9,997	$10,014	$9,977
Operating income	1,315	1,215	1,218
Operating margin rate	13.2%	12.1%	12.2%

2014 - Aerospace Systems sales for 2014 were comparable to 2013, and include the impact of the settlements described in the Segment Operating Income section above. Excluding the settlements, Aerospace Systems had lower sales in unmanned, space and manned military aircraft programs. The decrease in unmanned programs reflects declines of $136 million on Global Hawk due to lower production activity and $111 million on Fire Scout as a result of lower development activity. These declines were partially offset by $135 million of higher volume on the NATO

Alliance Ground Surveillance (AGS) program. The decrease in space programs was mainly due to lower volume on the James Webb Space Telescope (JWST) and Advanced Extremely High Frequency (AEHF) programs. The decrease in manned military aircraft programs was primarily the result of lower volume on the Joint Surveillance

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Target Attack Radar System, F-35 and B-2 programs, partially offset by higher volume of $87 million on the E-2D Advanced Hawkeye program.

Operating income for 2014 increased $100 million, or 8 percent, and operating margin rate increased to 13.2 percent, from 12.1 percent. Higher operating income and margin rate in 2014 were primarily due to the settlements described above and improved performance.

2013 - Aerospace Systems sales for 2013 were slightly higher than 2012, due to higher volume on manned military aircraft programs, offset by lower volume on unmanned and space programs. The increase in manned military aircraft programs reflects higher sales of $107 million from increased deliveries on the F-35 program, as well as higher volume on the B-2 and E-2D Advanced Hawkeye programs, partially offset by lower volume on various other programs. The decrease for unmanned programs reflects lower sales of $295 million on the Global Hawk program largely due to ramp-down on sustainment, support and logistics contracts, partially offset by higher sales of $187 million on the NATO AGS program resulting from ramp-up activities. The decrease in space programs reflects lower volume for restricted programs due to ramp-down activities, and higher volume on the JWST and AEHF programs.

Operating income and operating margin rate for 2013 were comparable to 2012. Operating income and operating margin rate also reflect the impact of a forward loss recognized on a restricted program, which was offset by the continuing effect of higher contract margin rates across the segment principally related to prior net favorable adjustments.

ELECTRONIC SYSTEMS

	Year Ended December 31		
$ in millions	2014	2013	2012
Sales	$6,951	$7,149	$6,950
Operating income	1,148	1,226	1,187
Operating margin rate	16.5 %	17.1 %	17.1 %

2014 - Electronic Systems sales for 2014 decreased $198 million, or 3 percent, as compared with 2013. Lower sales are principally due to lower volume for land and self-protection programs, including lower deliveries of $174 million on infrared countermeasures and laser systems; lower volume for domestic intelligence, surveillance, reconnaissance and targeting programs, including $93 million of lower deliveries on combat avionics; and $109 million of lower volume for navigation and maritime programs. The declines were partially offset by higher sales of $178 million on international programs.

Operating income for 2014 decreased $78 million, or 6 percent, and operating margin rate decreased to 16.5 percent from 17.1 percent. Operating income and margin rate for 2014 declined primarily due to a reduction in net favorable adjustments, lower volume and the absence in 2014 of the benefit from the reversal of a $26 million non-programmatic risk reserve in 2013.

2013 - Electronic Systems sales for 2013 increased $199 million, or 3 percent, as compared with 2012. The increase was due to higher sales on international programs of $244 million and space programs, partially offset by lower sales on navigation and maritime systems programs of $132 million due to decreased deliveries, as well as lower volume on laser systems programs associated with in-theater force reductions.

Operating income for 2013 increased $39 million, or 3 percent, as compared with 2012, consistent with the higher sales volume described above. Operating margin rate was comparable with 2012, and reflects higher margin rates on our current portfolio of programs, a reduction in net favorable adjustments and the reversal of a $26 million non-programmatic risk reserve.

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INFORMATION SYSTEMS

	Year Ended December 31		
$ in millions	2014	2013	2012
Sales	$6,222	$6,596	$7,356
Operating income	611	633	761
Operating margin rate	9.8 %	9.6 %	10.3 %

2014 - Information Systems sales for 2014 decreased $374 million, or 6 percent, as compared with 2013. Sales principally declined as a result of lower volume of $294 million on C2 programs and $62 million on Communications programs due to in-theater force reductions, reduced funding levels and the wind-down of various programs.

Operating income for 2014 decreased $22 million, or 3 percent, and operating margin rate increased to 9.8 percent from 9.6 percent. The lower operating income is primarily a result of the lower sales described above. The higher operating margin rate reflects additional operating income resulting from improved performance.

2013 - Information Systems sales for 2013 decreased $760 million, or 10 percent, as compared with 2012. The sales decline includes a $98 million impact for the transfer of intercompany efforts to our corporate shared services organization. Excluding the transfer, 2013 sales declined 9 percent due to lower funding levels, including the impacts of sequestration, and lower volume for programs impacted by in-theater force reductions and contract completions.

Operating income for 2013 decreased $128 million, or 17 percent, as compared with 2012. Operating margin rate decreased to 9.6 percent in 2013 from 10.3 percent in 2012. Lower operating income and operating margin rate were primarily due to the lower sales volume described above and a $73 million reduction in net favorable adjustments compared with the prior year.

TECHNICAL SERVICES

	Year Ended December 31		
$ in millions	2014	2013	2012
Sales	$2,799	$2,843	$3,019
Operating income	261	262	268
Operating margin rate	9.3 %	9.2 %	8.9 %

2014 - Technical Services sales for 2014 decreased $44 million, or 2 percent, as compared with 2013. The decrease was primarily due to lower volume on the InterContinental Ballistic Missile (ICBM), Hunter and Combined Tactical Training Range programs, which were partially offset by growth in international sales, principally as a result of the acquisition of QDS in the first quarter of 2014.

Operating income and margin rate for 2014 were comparable to 2013.

2013 - Technical Services sales for 2013 decreased $176 million, or 6 percent, as compared with 2012. The decrease was primarily due to lower sales of $127 million on the ICBM and integrated logistics and modernization programs, as well as portfolio shaping efforts.

Operating income for 2013 decreased $6 million, or 2 percent, as compared with 2012. Operating margin rate increased to 9.2 percent in 2013 from 8.9 percent in 2012. Lower operating income was driven by the lower sales volume described above, partially offset by higher operating margin rate primarily due to improved performance across a number of programs.

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PRODUCT AND SERVICE ANALYSIS

The following table presents product and service sales and operating costs and expenses by segment:

	Year Ended December 31					
$ in millions	2014		2013		2012	
Segment Information:	Sales	Costs	Sales	Costs	Sales	Costs
Aerospace Systems						
Product	$7,986	$ 6,897	$8,210	$7,197	$8,729	$7,704
Service	2,011	1,785	1,804	1,602	1,248	1,055
Electronic Systems						
Product	5,532	4,622	5,574	4,612	5,346	4,438
Service	1,419	1,181	1,575	1,311	1,604	1,325
Information Systems						
Product	1,335	1,244	990	895	708	606
Service	4,887	4,367	5,606	5,068	6,648	5,989
Technical Services						
Product	184	173	210	191	213	196
Service	2,615	2,365	2,633	2,390	2,806	2,555
Segment Totals						
Total Product	$15,037	$12,936	$14,984	$12,895	$14,996	$12,944
Total Service	10,932	9,698	11,618	10,371	12,306	10,924
Intersegment eliminations	(1,990)	(1,754)	(1,941)	(1,685)	(2,084)	(1,826)
Total Segment[1]	$23,979	$ 20,880	$24,661	$21,581	$25,218	$22,042

(1) The reconciliation of segment operating income to total operating income, as well as a discussion of the reconciling items, is included in the Segment Operating Results section above.

Product Sales and Product Costs

2014 - Product sales for 2014 were slightly higher than 2013, primarily due to higher product sales at Information Systems, offset by lower product sales at Aerospace Systems. The increase at Information Systems was primarily due to higher product sales on certain restricted and C2 programs. The decrease at Aerospace Systems was primarily driven by lower product volume in unmanned and space programs, partially offset by the settlements described in the Segment Operating Results section above.

Product costs for 2014 were slightly higher than 2013, primarily due to higher product costs at Information Systems, offset by lower product costs at Aerospace Systems, consistent with the changes in product sales described above.

2013 - Product sales for 2013 were comparable with 2012, primarily due to lower product sales at Aerospace Systems, offset by higher product sales at Information Systems and Electronic Systems. The decrease at Aerospace Systems reflects the revision in the classification of certain operations, maintenance and sustainment contracts from product to service in 2013. The increase at Information Systems was primarily due to newly awarded product contracts and the increase at Electronic Systems was primarily driven by higher volume as described in the Segment Operating Results section above.

Product costs for 2013 were comparable with 2012, primarily due to lower product costs at Aerospace Systems, offset by higher product costs at Information Systems and Electronic Systems. The decrease at Aerospace Systems was consistent with the classification change noted above. The decrease was offset by newly awarded product contracts at Information Systems and higher sales volume at Electronic Systems, as described above.

Service Sales and Service Costs

2014 - Service sales for 2014 decreased $686 million, or 6 percent, as compared with 2013. The decrease was primarily driven by lower service sales at Information Systems, principally from reduced volume on restricted work and the impacts of in-theater force reductions as described in the Segment Operating Results section above. Service costs for 2014 decreased $673 million, or 6 percent, as compared with 2013 consistent with the change in service sales described above.

2013 - Service sales for 2013 decreased $688 million, or 6 percent, as compared with 2012, primarily due to lower service sales at Information Systems partially offset by higher service sales at Aerospace Systems. The decrease at Information Systems is due to lower service sales across a number of programs, as described in the Segment Operating Results section above. The higher service sales at Aerospace Systems reflects the revision in the classification of certain contracts from product to service, as described above, and higher volume on certain military aircraft service contracts in 2013.

Service costs for 2013 decreased $553 million, or 5 percent, as compared with 2012, primarily due to lower service volume at Information Systems, partially offset by higher service sales at Aerospace Systems, consistent with the change in service sales described above.

BACKLOG

Total backlog includes both funded backlog (firm orders for which funding is authorized and appropriated) and unfunded backlog. Unexercised contract options and indefinite delivery indefinite quantity (IDIQ) contracts are not included in backlog until the time the option or IDIQ task order is exercised or awarded. For multi-year service contracts with non-U.S. Government customers having no stated contract values, backlog includes only the amounts committed by the customer. Backlog is converted into sales as costs are incurred or deliveries are made.

Backlog consisted of the following at December 31, 2014 and 2013:

	2014			2013
$ in millions	Funded	Unfunded	Total Backlog	Total Backlog
Aerospace Systems	$9,438	$10,625	$20,063	$18,321
Electronic Systems	6,845	2,870	9,715	9,037
Information Systems	2,963	3,152	6,115	6,864
Technical Services	2,127	179	2,306	2,811
Total backlog	$21,373	$16,826	$38,199	$37,033

Approximately $19.3 billion of the $38.2 billion total backlog at December 31, 2014, is expected to be converted into sales in 2015. U.S. Government orders comprised 82 percent of total backlog at the end of 2014. International orders, including foreign military sales, accounted for 14 percent of total backlog at the end of 2014. Domestic commercial backlog represented 4 percent of total backlog at the end of 2014.

New Awards

2014 - The estimated value of contract awards recorded during 2014 was $25.0 billion. Significant new awards during 2014 include $4.1 billion for the E-2D Advanced Hawkeye program, $1.4 billion for the Global Hawk program, $1.3 billion for the F-35 program, $727 million for the B-2 program and $560 million for the Virginia Class Submarine program.

2013 - The estimated value of contract awards recorded during 2013 was $21.9 billion. On a net basis, awards during 2013 totaled $20.9 billion, reflecting $1 billion of adjustments during the first half of the year to reduce Information Systems unfunded backlog principally associated with expired periods of performance on active contracts, including several previously awarded task orders on IDIQ contracts. Significant new awards in 2013 include $2.2 billion for the F-35 program, $1.3 billion for the E-2D Advanced Hawkeye program, $866 million for the AEHF program, $694 million for the B-2 program, and $632 million for the Triton program.

LIQUIDITY AND CAPITAL RESOURCES

We endeavor to ensure the most efficient conversion of operating income into cash for deployment in our business and to maximize shareholder value. In addition to our cash position, we use various financial measures to assist in capital deployment decision-making, including cash provided by operating activities, free cash flow, net debt-to-equity and net debt-to-capital. We believe these measures are useful to investors in assessing our financial performance and condition.

During the second quarter of 2013, the company's board of directors authorized a new share repurchase program of up to $4.0 billion of the company’s common stock ("2013 Repurchase Program"). At the same time, the company announced its plan to repurchase shares with the goal of retiring approximately 25 percent of its then outstanding shares (60 million shares) by the end of 2015, market conditions permitting. As of December 31, 2014, we had repurchased 42.2 million shares towards that goal. Additionally, during the fourth quarter of 2014, the company's board of directors authorized a new share repurchase program of up to an additional $3.0 billion of the company's common stock ("2014 Repurchase Program"). By its terms, repurchases under the 2014 Repurchase Program will commence upon completion of the 2013 Repurchase Program.

Cash balances and cash generated from operating activities, supplemented by borrowings under credit facilities and/or in the capital markets, if needed, are expected to be sufficient to fund our operations for at least the next 12 months. As of December 31, 2014, the amount of cash, cash equivalents and marketable securities held outside of the U.S. by foreign subsidiaries was $537 million. We currently do not anticipate repatriating these balances to fund domestic operations. Capital expenditure commitments were $533 million at December 31, 2014, and are expected to be paid with cash on hand.

The table below summarizes the key components of cash flow provided by operating activities:

	Year Ended December 31		
$ in millions	2014	2013	2012
Net earnings	$2,069	$1,952	$1,978
Non-cash items(1)	731	724	726
Changes in assets and liabilities:			
Trade working capital	(121)	54	19
Retiree benefits	(17)	(281)	(71)
Other, net	(69)	34	(12)
Net cash provided by operating activities	$2,593	$2,483	$2,640

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

Free Cash Flow

Free cash flow is defined as cash provided by operating activities less capital expenditures. We believe free cash flow is a useful measure for investors to consider as it represents the cash flow the company has available after capital spending to invest for future growth, strengthen the balance sheet and/or return to shareholders through dividends and share repurchases. Free cash flow is a key factor in our planning for and consideration of strategic acquisitions, the payment of dividends and stock repurchases.

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

The table below reconciles cash provided by operating activities to free cash flow:

	Year Ended December 31		
$ in millions	2014	2013	2012
Net cash provided by operating activities	$2,593	$2,483	$2,640
Less: Capital expenditures	(561)	(364)	(331)
Free cash flow	$2,032	$2,119	$2,309

2014 – Free cash flow for 2014 decreased $87 million, or 4 percent as compared with 2013. The decrease was principally driven by higher capital expenditures due to a ramp up of investments in our Aerospace Systems' Centers of Excellence, partially offset by an increase in net cash provided by operating activities, as described in the Consolidated Operating Results Section above. We currently expect capital expenditures to continue to increase in 2015.

2013 – Free cash flow for 2013 decreased $190 million, or 8 percent, as compared with 2012. The decrease was principally driven by higher voluntary pension contributions in 2013. We contributed $579 million to our pension plans during 2013 as compared with $367 million in 2012.

Credit Facilities

The company maintains an unsecured credit facility in an aggregate principal amount of $1.775 billion (the Credit Agreement). The Credit Agreement contains customary terms and conditions, including covenants restricting the company's ability to sell all or substantially all of its assets, merge or consolidate with another entity or undertake other fundamental changes and incur liens. The company also cannot permit the ratio of its debt to capitalization (as set forth in the Credit Agreement) to exceed 65 percent. At December 31, 2014, the company was in compliance with all covenants under the Credit Agreement and there was no balance outstanding under this facility.

Other Sources and Uses of Capital

Additional Capital – We believe we can obtain additional capital, if necessary for long-term liquidity, from such sources as the public or private capital markets, the sale of assets, sale and leaseback of operating assets, and leasing rather than purchasing new assets. We have an effective shelf registration statement on file with the SEC, which allows us to access capital in a timely manner.

Financial Arrangements – See Note 11 to the consolidated financial statements in Part II, Item 8.

Contractual Obligations

The following table presents our contractual obligations as of December 31, 2014, and the estimated timing of future cash payments:

$ in millions	Total	2015	2016- 2017	2018- 2019	2020 and beyond
Long-term debt	$5,925	$3	$113	$1,557	$4,252
Interest payments on long-term debt	3,711	279	545	498	2,389
Operating leases	840	267	354	141	78
Purchase obligations(1)	7,974	4,150	2,379	544	901
Other long-term liabilities(2)	1,116	326	325	135	330
Total contractual obligations	$19,566	$5,025	$3,716	$2,875	$7,950

(1) A “purchase obligation” is defined as an agreement to purchase goods or services that is enforceable and legally binding on us and that specifies all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum, or variable price provisions; and the approximate timing of the transaction. These amounts are primarily comprised of open purchase order commitments to suppliers and subcontractors pertaining to funded contracts.

(2) Other long-term liabilities, including their current portions, primarily consist of total accrued environmental reserves, deferred compensation and other miscellaneous liabilities, of which $142 million is related to environmental reserves recorded in other current liabilities. It excludes obligations for uncertain tax positions of $235 million, as the timing of such payments, if any, cannot be reasonably estimated.

The table above also excludes estimated minimum funding requirements for retirement and other post-retirement benefit plans, as set forth by the Employee Retirement Income Security Act, as amended (ERISA). For further information about future minimum contributions for these plans, see Note 12 to the consolidated financial statements in Part II, Item 8. Further details regarding long-term debt and operating leases can be found in Notes 9 and 11, respectively, to the consolidated financial statements in Part II, Item 8.

CRITICAL ACCOUNTING POLICIES, ESTIMATES, AND JUDGMENTS

Our consolidated financial statements are based on the application of U.S. GAAP, which require us to make estimates and assumptions about future events that affect the amounts reported in our consolidated financial statements and the accompanying notes. We employ judgment in making our estimates in consideration of historical experience, currently available information and various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from our estimates and assumptions, and any such differences could be material to our consolidated financial statements. We believe the following accounting policies are critical to the understanding of our consolidated financial statements and require the use of significant management judgment in their application. For a summary of our significant accounting policies, see Note 1 to the consolidated financial statements, Part II, Item 8.

Revenue Recognition

Due to the long-term nature of our contracts, we generally recognize revenue using the percentage-of-completion method of accounting as work on our contracts progresses, which requires us to make reasonably dependable estimates for the design, manufacture and delivery of our products and services. In accounting for these contracts, we utilize either the cost-to-cost or the units-of-delivery method of percentage-of-completion accounting, with cost-to-cost being the predominant method.

Contract sales may include estimated amounts not contractually agreed to by the customer, including cost or performance incentives (such as award and incentive fees), un-priced change orders, claims and requests for equitable adjustment. Amounts pertaining to cost and/or performance incentives are included in estimated contract sales when they are reasonably estimable.

Our cost estimation process is based on the professional knowledge of our engineers, program managers and financial professionals, and draws on their significant experience and judgment. We prepare estimates-at-completion (EACs) for our contracts which include an estimated contract operating margin based initially on estimated contract sales and cost. Since contract costs are typically incurred over a period of several years, estimation of these costs requires the use of judgment. Factors considered in estimating the cost of the work to be completed include the availability, productivity and cost of labor, the nature and complexity of work to be performed, the effect of change orders, availability and cost of materials, the effect of any delays in performance and the level of indirect cost allocations.

We generally review and reassess our sales, cost and profit estimates for each significant contract at least annually or more frequently as determined by the occurrence of events, changes in circumstances and evaluations of contract performance to reflect the latest reliable information available. Changes in estimates of contract sales and cost are frequent. The company performs on a broad portfolio of long-term contracts, including the development of complex and customized military platforms and systems, as well as advanced electronic equipment and software, that often include technology at the forefront of science. Changes in estimates occur for a variety of reasons, including changes in contract scope, the resolution of risk at lower or higher cost than anticipated, unanticipated risks affecting contract costs, availability, performance or other issues with our subcontractors or suppliers, changes in indirect cost allocations, such as overhead and general and administrative expenses, and changes in estimated award and incentive fees. EACs are also adjusted to reflect estimated risks related to contract performance. These risks typically include technical, schedule and performance risk based on our evaluation of the contract effort. Similarly, the changes in estimates may include identified opportunities for operating margin improvement.

For the impacts of changes in estimates on our consolidated statement of earnings and comprehensive (loss) income, see the Consolidating Operating Results section above and Note 1 to the consolidated financial statements in Part II, Item 8.

Goodwill

Overview – We allocate the purchase price of acquired businesses to the underlying tangible and intangible assets acquired and liabilities assumed based upon their respective fair values, with the excess recorded as goodwill. Such fair 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 the fair value of purchased assets and liabilities after the initial measurement period are recognized in net earnings.

Impairment Testing – We test for impairment of goodwill annually at each of our reporting units, which comprise our operating segments. The results of our annual goodwill impairment test as of December 31, 2014 and 2013, respectively, indicated that the estimated fair value of each reporting unit substantially exceeded its respective carrying value. There were no impairment charges recorded in the years ended December 31, 2014, 2013 and 2012.

In addition to performing an annual goodwill impairment test, an interim impairment test may be required if events occur or circumstances change that suggest goodwill of our reporting units may be impaired during an interim period. Such indicators may include, but are not limited to, the loss of significant business, significant reductions in federal government appropriations or other significant adverse changes in industry or market conditions.

When testing goodwill for impairment, we compare the fair values of each of our reporting units to their respective carrying values. To determine the fair value of our reporting units, we primarily use the income approach based on the cash flows that the reporting unit expects to generate in the future, consistent with our operating plans. This income valuation method requires management to project sales, operating expenses, working capital, capital spending and cash flows for the reporting units over a multi-year period, as well as determine the weighted-average cost of capital

(WACC) used as a discount rate and terminal value assumptions.
The WACC takes into account the relative weights of each component of our 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. Impairment assessment inherently involves management judgments as to assumptions about expected future cash flows and the impact of market conditions on those assumptions. Due to

the many variables inherent in the estimation of a business' fair value and the relative size of our recorded goodwill, differences in assumptions may have a material effect on the results of our impairment analysis.

We corroborate the fair values determined under the income approach using the market valuation method to estimate the fair value of our reporting units, by utilizing industry multiples (including relevant control premiums) of operating earnings.

Retirement Benefits

Overview – The determination of projected benefit obligations and the fair value of plan assets for our pension and other post-retirement plans requires the use of several actuarial assumptions. We perform an annual review of these assumptions in consultation with our outside actuaries. In the event we determine changes in the assumptions are warranted, or as a result of plan amendments, future pension and other post-retirement benefit expense could increase or decrease. The principal assumptions that have a significant effect on our consolidated financial position and annual results of operations are the discount rate, cash balance crediting rate, expected long-term rate of return on plan assets, estimated fair market value of plan assets, and life expectancy for those covered by our pension and other post-retirement benefit plans.

Discount Rate – The discount rate represents the interest rate that is used to determine the present value of future cash flows currently expected to be required to settle our pension and other post-retirement benefit obligations. The discount rate is generally based on the yield of high-quality corporate fixed-income investments. At the end of each year, the discount rate is determined using a portfolio of bonds matching the notional cash outflows related to benefit payments for each significant benefit plan. Taking into consideration the factors noted above, our weighted-average pension composite discount rate was 4.12 percent at December 31, 2014, and 4.99 percent at December 31, 2013. The effects of a hypothetical change in the discount rate may be nonlinear and asymmetrical for future years as the discount rate changes and the accounting corridor is applied. The accounting corridor is a defined range within which amortization of net gains and losses is not required and is equal to 10 percent of the greater of plan assets or benefit obligations. Holding all other assumptions constant, an increase or decrease of 25 basis points in the December 31, 2014, discount rate assumption would have the following estimated effects on 2014 pension and other post-retirement benefit obligations and 2015 expected pension and other post-retirement expense:

$ increase/(decrease) in millions	25 Basis Point Decrease in Rate	25 Basis Point Increase in Rate
Pension expense	$100	$(96)
Other post-retirement benefit expense	4	(3)
Pension obligation	1,064	(1,008)
Other post-retirement benefit obligation	68	(64)

Cash Balance Crediting Rate - A portion of the company's pension obligation and resulting pension expense is based on a cash balance formula, where participants' hypothetical account balances are accumulated over time with pay-based credits and interest. Interest is credited monthly using the 30-Year Treasury bond rate. The interest crediting rate is part of the cash balance formula and independent of actual pension investment earnings. The cash balance crediting rate tends to move in concert with the discount rate but has an offsetting effect on pension benefit obligations and pension expense in comparison to the discount rate. Although current 30-Year Treasury bond rates are near historically low levels, we expect such bond rates to rise in the future. The cash balance crediting rate assumption has been set to its current level of 2.75 percent as of December 31, 2014, growing to 3.5 percent by 2020. Holding all other assumptions constant, an increase or decrease of 25 basis points in the December 31, 2014, cash balance crediting rate assumption would have the following estimated effects on 2014 pension benefit obligations and 2015 expected pension expense:

$ increase/(decrease) in millions

	25 Basis Point Decrease in Rate	25 Basis Point Increase in Rate
Pension expense	$(25)	$26
Pension obligation	(121)	127

Expected Long-Term Rate of Return on Plan Assets – The expected long-term rate of return on plan assets represents the average rate of earnings expected on funds invested. Through consultation with our investment management team and outside investment advisers, management develops expected long-term returns for each of the plans' strategic asset classes. In addition to our historical investment performance, we consider several factors, including current market data such as yields/price-earnings ratios, historical market returns over long periods and periodic surveys of investment managers' expectations. Using policy target allocation percentages and the asset class expected returns, a weighted-average expected return is calculated.

The assumptions used for pension benefits are consistent with those used for other post-retirement benefits. The long-term rate of return on plan assets used for medical and life benefits is reduced to allow for the impact of tax on expected returns as the earnings of certain Voluntary Employee Beneficiary Association (VEBA) trusts are taxable, unlike the pension trust.

For 2014 and 2013, we assumed an expected long-term rate of return on pension plan assets of 8.0 percent, and assumed an expected long-term rate of return on other post-retirement benefit plan assets of 7.45 percent and 7.33 percent, respectively. For 2015, we have assumed an expected long-term rate of return on plan assets of 8.0 percent on pension plans and 7.58 percent on other post-retirement benefit plans. Holding all other assumptions constant, an increase or decrease of 25 basis points in the December 31, 2014, expected long-term rate of return on plan asset assumption would have the following estimated effects on 2015 pension and other post-retirement benefit expense:

$ increase/(decrease) in millions	25 Basis Point Decrease	25 Basis Point Increase
Pension expense	$62	$(62)
Other post-retirement benefit expense	3	(3)

Estimated Fair Market Value of Plan Assets – For certain plan assets where the fair market value is not readily determinable, such as real estate, private equity and hedge funds, estimates of fair value are determined using the best information available. Estimated fair values on these plan assets are based on redemption values and net asset values, as well as valuation methodologies that include third party appraisals, comparable transactions, discounted cash flow valuation models and public market data.

Mortality Rate – Mortality assumptions are used to estimate life expectancies of plan participants. In October 2014, the Society of Actuaries (SOA) issued updated mortality tables (RP-2014) and a mortality improvement scale (MP-2014), which reflect longer life expectancies than previously projected. In consideration of this information, we studied our historical mortality experience and developed an expectation for continued future mortality improvements. Based on this data and the RP-2014 tables, we updated the mortality assumptions used in calculating our pension and post-retirement benefit obligations recognized at December 31, 2014, and the amounts estimated for our 2015 pension and post-retirement benefit expense. Our updated mortality assumptions resulted in an increase of $1.8 billion in our pension and post-retirement benefit obligations as of December 31, 2014.

For further information regarding our pension and post-retirement benefits, see Risk Factors in Part I, Item 1A and Note 12 to the consolidated financial statements in Part II, Item 8.

Litigation, Commitments and Contingencies

We are subject to a range of claims, investigations, lawsuits, overhead cost claims, environmental matters, income tax matters and administrative proceedings that arise in the ordinary course of business. Estimating liabilities and costs associated with these matters requires judgment based upon the professional knowledge and experience of management and counsel. We determine whether to record a charge to earnings and, if so, what amount based on consideration of the facts and circumstances of each matter as then known to us. Determinations regarding whether to record a charge and, if so, of what amount, reflect management's assessment regarding what is likely to occur; they do not necessarily reflect what management believes should occur. The ultimate resolution of any such exposure to us may vary materially from earlier estimates as further facts and circumstances develop or become known to us.

Environmental Matters - We are subject to environmental laws and regulations in the jurisdictions in which we conduct operations. Factors that could result in changes to the assessment of probability, range of estimated costs and environmental accruals include: modification of planned remedial actions, increase or decrease in the estimated time required to remediate, discovery of more or less extensive contamination than anticipated, results of efforts to involve other responsible parties, financial capabilities of other responsible parties, changes in laws and regulations or contractual obligations affecting remediation requirements or other obligations, and improvements in remediation technology.

For further information on litigation, commitments and contingencies, see Risk Factors in Part I, Item 1A, and Note 1, Note 10 and Note 11 to the consolidated financial statements in Part II, Item 8.

OTHER MATTERS

Off-Balance Sheet Arrangements

As of December 31, 2014, we had no significant off-balance sheet arrangements other than operating leases. For a description of our operating leases, see Note 11 to the consolidated financial statements in Part II, Item 8.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

EQUITY RISK

We are exposed to market risk with respect to our portfolio of trading and available-for-sale marketable securities with a fair value of $336 million at December 31, 2014. These securities are exposed to market volatilities, changes in price and interest rates.

INTEREST RATE RISK

We are exposed to interest rate risk on variable-rate short-term credit facilities for which there were no borrowings outstanding at December 31, 2014. At December 31, 2014, we have $5.9 billion of long-term debt, primarily consisting of fixed-rate debt, with a fair value of approximately $6.7 billion. The terms of our fixed-rate debt obligations do not generally allow investors to demand payment of these obligations prior to maturity. Therefore, we do not have significant exposure to interest rate risk for our fixed-rate debt; however, we do have exposure to fair value risk if we repurchase or exchange long-term debt prior to maturity.

FOREIGN CURRENCY RISK

We are exposed to foreign currency risk with respect to our international operations. We enter into foreign currency forward contracts to manage a portion of the exchange rate risk related to receipts from customers and payments to suppliers denominated in foreign currencies. We do not hold or issue derivative financial instruments for trading purposes. At December 31, 2014, foreign currency forward contracts with a notional amount of $139 million were outstanding. At December 31, 2014, a 10 percent unfavorable foreign exchange rate movement would not have a material impact on our foreign currency forward contracts.

INFLATION RISK

We have generally been able to anticipate increases in costs when pricing our contracts. Bids for longer-term firm fixed-price contracts typically include assumptions for labor and other cost escalations in amounts that historically have been sufficient to cover cost increases over the period of performance.

Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Northrop Grumman Corporation
Falls Church, Virginia

We have audited the accompanying consolidated statements of financial position of Northrop Grumman Corporation and subsidiaries (the "Company") as of December 31, 2014 and 2013, and the related consolidated statements of earnings and comprehensive (loss) income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Northrop Grumman Corporation and subsidiaries at December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2014, based on the criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 2, 2015 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/	Deloitte & Touche LLP
	McLean, Virginia
	February 2, 2015

NORTHROP GRUMMAN CORPORATION

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE (LOSS) INCOME

	Year Ended December 31		
$ in millions, except per share amounts	2014	2013	2012
Sales			
Product	$14,015	$14,033	$13,838
Service	9,964	10,628	11,380
Total sales	23,979	24,661	25,218
Operating costs and expenses			
Product	10,431	10,623	10,415
Service	7,947	8,659	9,223
General and administrative expenses	2,405	2,256	2,450
Operating income	3,196	3,123	3,130
Other (expense) income			
Interest expense	(282)	(257)	(212)
Other, net	23	(3)	47
Earnings before income taxes	2,937	2,863	2,965
Federal and foreign income tax expense	868	911	987
Net earnings	$2,069	$1,952	$1,978
Basic earnings per share	$9.91	$8.50	$7.96
Weighted-average common shares outstanding, in millions	208.8	229.6	248.6
Diluted earnings per share	$9.75	$8.35	$7.81
Weighted-average diluted shares outstanding, in millions	212.1	233.9	253.4
Net earnings (from above)	$2,069	$1,952	$1,978
Other comprehensive (loss) income			
Change in unamortized benefit plan costs, net of tax benefit (expense) of $1,423 in 2014, ($1,177) in 2013 and $860 in 2012	(2,316)	1,790	(1,303)
Change in cumulative translation adjustment	(59)	14	8
Other, net	3	(1)	(2)
Other comprehensive (loss) income, net of tax	(2,372)	1,803	(1,297)
Comprehensive (loss) income	$(303)	$3,755	$681

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

NORTHROP GRUMMAN CORPORATION

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	December 31	
$ in millions	2014	2013
Assets		
Cash and cash equivalents	$3,863	$5,150
Accounts receivable, net	2,806	2,685
Inventoried costs, net	742	698
Deferred tax assets	404	605
Prepaid expenses and other current assets	369	350
Total current assets	8,184	9,488
Property, plant and equipment, net of accumulated depreciation of $4,611 in 2014 and $4,337 in 2013	2,991	2,806
Goodwill	12,466	12,438
Non-current deferred tax assets	1,622	209
Other non-current assets	1,309	1,440
Total assets	$26,572	$26,381
Liabilities		
Trade accounts payable	$1,305	$1,229
Accrued employee compensation	1,441	1,446
Advance payments and amounts in excess of costs incurred	1,713	1,722
Other current liabilities	1,433	1,418
Total current liabilities	5,892	5,815
Long-term debt, net of current portion of $3 in 2014 and $2 in 2013	5,925	5,928
Pension and other post-retirement benefit plan liabilities	6,555	2,954
Other non-current liabilities	965	1,064
Total liabilities	19,337	15,761
Commitments and contingencies (Note 11)		
Shareholders’ equity		
Preferred stock, $1 par value; 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $1 par value; 800,000,000 shares authorized; issued and outstanding: 2014—198,930,240 and 2013—217,599,230	199	218
Paid-in capital	—	848
Retained earnings	12,392	12,538
Accumulated other comprehensive loss	(5,356)	(2,984)
Total shareholders’ equity	7,235	10,620
Total liabilities and shareholders’ equity	$26,572	$26,381

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

NORTHROP GRUMMAN CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31		
$ in millions	2014	2013	2012
Operating activities			
Net earnings	$2,069	$1,952	$1,978
Adjustments to reconcile to net cash provided by operating activities:			
Depreciation and amortization	462	495	510
Stock-based compensation	134	144	183
Excess tax benefits from stock-based compensation	(81)	(43)	(45)
Deferred income taxes	216	128	78
Changes in assets and liabilities:			
Accounts receivable, net	(105)	171	90
Inventoried costs, net	(24)	101	46
Prepaid expenses and other assets	13	(51)	(65)
Accounts payable and other liabilities	(89)	(169)	23
Income taxes payable	84	2	(75)
Retiree benefits	(17)	(281)	(71)
Other, net	(69)	34	(12)
Net cash provided by operating activities	$2,593	$2,483	$2,640
Investing activities			
Capital expenditures	(561)	(364)	(331)
Maturities of short-term investments	—	—	250
Other investing activities, net	(84)	18	(3)
Net cash used in investing activities	(645)	(346)	(84)
Financing activities			
Common stock repurchases	(2,668)	(2,371)	(1,316)
Cash dividends paid	(563)	(545)	(535)
Net proceeds from issuance of long-term debt	—	2,841	—
Payments of long-term debt	—	(877)	—
Other financing activities, net	(4)	103	155
Net cash used in financing activities	(3,235)	(849)	(1,696)
(Decrease) increase in cash and cash equivalents	(1,287)	1,288	860
Cash and cash equivalents, beginning of year	5,150	3,862	3,002
Cash and cash equivalents, end of year	$3,863	$5,150	$3,862

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

NORTHROP GRUMMAN CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Year Ended December 31		
$ in millions, except per share amounts	2014	2013	2012
Common stock			
Beginning of year	$218	$239	$254
Common stock repurchased	(21)	(27)	(21)
Shares issued for employee stock awards and options	2	6	6
End of year	199	218	239
Paid-in capital			
Beginning of year	848	2,924	3,873
Common stock repurchased	(999)	(2,345)	(1,310)
Stock compensation	139	274	359
Other	12	(5)	2
End of year	—	848	2,924
Retained earnings			
Beginning of year	12,538	11,138	9,699
Common stock repurchased	(1,637)	—	—
Net earnings	2,069	1,952	1,978
Dividends declared	(578)	(552)	(539)
End of year	12,392	12,538	11,138
Accumulated other comprehensive loss			
Beginning of year	(2,984)	(4,787)	(3,490)
Other comprehensive (loss) income, net of tax	(2,372)	1,803	(1,297)
End of year	(5,356)	(2,984)	(4,787)
Total shareholders' equity	$7,235	$10,620	$9,514
Cash dividends declared per share	$2.71	$2.38	$2.15

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

NORTHROP GRUMMAN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Northrop Grumman Corporation (herein referred to as "Northrop Grumman," the "company," "we," "us," or "our") is a leading global security company. We provide innovative products, systems and solutions in unmanned systems; cyber; command, control, communications and computers (C4), intelligence, surveillance, and reconnaissance (C4ISR); strike aircraft; and logistics and modernization to government and commercial customers worldwide through our four segments: Aerospace Systems, Electronic Systems, Information Systems and Technical Services. We participate in many high-priority defense and government services programs in the United States (U.S.) and abroad. We offer a broad portfolio of capabilities and technologies that enable us to deliver innovative systems and solutions for applications that range from undersea to outer space and into cyberspace. We conduct most of our business with the U.S. Government, principally the Department of Defense (DoD) and intelligence community. We also conduct business with foreign, state and local governments, and domestic and international commercial customers.

Principles of Consolidation

The consolidated financial statements include the accounts of Northrop Grumman and its subsidiaries. Material intercompany accounts, transactions and profits are eliminated in consolidation. Investments in equity securities and joint ventures where the company has significant influence, but not control, are accounted for using the equity method.

Accounting Estimates

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

Related Party Transactions

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

Revenue Recognition

The majority of our business results are derived from long-term contracts with the U.S. Government for the production of goods, the provision of services, or in some cases, a combination of both. In accounting for these contracts, we utilize either the cost-to-cost or the units-of-delivery method of percentage-of-completion accounting, with cost-to-cost being the predominant method. Generally, sales under cost-reimbursement contracts and construction-type contracts that provide for deliveries at lower volume rates per year or a small number of units are accounted for using the cost-to-cost method. U