

NORTHROP GRUMMAN CORP /DE/
Form 10-Q
April 25, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2018

or

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

Commission File Number 1-16411

NORTHROP GRUMMAN CORPORATION

(Exact name of registrant as specified in its charter)

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

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

(Registrant's telephone number, including area code)

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check

if a Smaller reporting company
smaller reporting company)

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act.

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

Yes No

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

As of April 20, 2018, 174,384,166 shares of common stock were outstanding.

Table of Contents

NORTHROP GRUMMAN CORPORATION

TABLE OF CONTENTS

	Page
<u>PART I – FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Statements of Earnings and Comprehensive Income</u>	<u>1</u>
<u>Condensed Consolidated Statements of Financial Position</u>	<u>2</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>3</u>
<u>Condensed Consolidated Statements of Changes in Shareholders' Equity</u>	<u>4</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	
<u>1. Basis of Presentation</u>	<u>5</u>
<u>2. Pending Acquisition of Orbital ATK</u>	<u>9</u>
<u>3. Earnings Per Share, Share Repurchases and Dividends on Common Stock</u>	<u>9</u>
<u>4. Income Taxes</u>	<u>10</u>
<u>5. Fair Value of Financial Instruments</u>	<u>11</u>
<u>6. Investigations, Claims and Litigation</u>	<u>11</u>
<u>7. Commitments and Contingencies</u>	<u>13</u>
<u>8. Retirement Benefits</u>	<u>14</u>
<u>9. Stock Compensation Plans and Other Compensation Arrangements</u>	<u>15</u>
<u>10. Segment Information</u>	<u>16</u>
<u>11. Recast 2017 Financial Information</u>	<u>20</u>
<u>Report of Independent Registered Public Accounting Firm</u>	<u>22</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
<u>Overview</u>	<u>23</u>
<u>Consolidated Operating Results</u>	<u>24</u>
<u>Segment Operating Results</u>	<u>25</u>
<u>Product and Service Analysis</u>	<u>28</u>
<u>Backlog</u>	<u>28</u>
<u>Liquidity and Capital Resources</u>	<u>29</u>
<u>Critical Accounting Policies, Estimates and Judgments</u>	<u>30</u>
<u>Accounting Standards Updates</u>	<u>30</u>
<u>Forward-Looking Statements and Projections</u>	<u>30</u>
<u>Contractual Obligations</u>	<u>31</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>31</u>
Item 4. <u>Controls and Procedures</u>	<u>32</u>
<u>PART II – OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>33</u>
Item 1A. <u>Risk Factors</u>	<u>33</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>33</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>33</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>33</u>
Item 5. <u>Other Information</u>	<u>33</u>
Item 6. <u>Exhibits</u>	<u>34</u>
<u>Signatures</u>	<u>35</u>

Table of Contents

NORTHROP GRUMMAN CORPORATION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(Unaudited)

\$ in millions, except per share amounts	Three Months	
	Ended March 31	
	2018	2017
Sales		
Product	\$4,289	\$3,997
Service	2,446	2,413
Total sales	6,735	6,410
Operating costs and expenses		
Product	3,265	2,983
Service	1,905	1,867
General and administrative expenses	711	698
Operating income	854	862
Other income (expense)		
Interest expense	(143)	(75)
Net FAS (non-service) pension benefit (expense)	120	(18)
Other, net	40	19
Earnings before income taxes	871	788
Federal and foreign income tax expense	132	138
Net earnings	\$739	\$650
Basic earnings per share	\$4.24	\$3.72
Weighted-average common shares outstanding, in millions	174.3	174.8
Diluted earnings per share	\$4.21	\$3.69
Weighted-average diluted shares outstanding, in millions	175.4	176.1
Net earnings (from above)	\$739	\$650
Other comprehensive income		
Change in unamortized benefit plan costs, net of tax	86	99
Change in cumulative translation adjustment	(2)	4
Other, net	(1)	2
Other comprehensive income, net of tax	83	105
Comprehensive income	\$822	\$755

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

Table of Contents

NORTHROP GRUMMAN CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Unaudited)

\$ in millions	March 31, 2018	December 31, 2017
Assets		
Cash and cash equivalents	\$ 10,369	\$ 11,225
Accounts receivable, net	1,241	1,054
Unbilled receivables, net	3,869	3,465
Inventoried costs, net	435	398
Prepaid expenses and other current assets	243	445
Total current assets	16,157	16,587
Property, plant and equipment, net of accumulated depreciation of \$5,119 for 2018 and \$5,066 for 2017	4,285	4,225
Goodwill	12,455	12,455
Deferred tax assets	474	447
Other non-current assets	1,424	1,414
Total assets	\$ 34,795	\$ 35,128
Liabilities		
Trade accounts payable	\$ 1,395	\$ 1,661
Accrued employee compensation	1,204	1,382
Advance payments and amounts in excess of costs incurred	1,479	1,761
Other current liabilities	2,337	2,288
Total current liabilities	6,415	7,092
Long-term debt, net of current portion of \$868 for 2018 and \$867 for 2017	14,392	14,399
Pension and other post-retirement benefit plan liabilities	5,362	5,511
Other non-current liabilities	946	994
Total liabilities	27,115	27,996
Commitments and contingencies (Note 7)		
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: 2018—174,382,256 and 2017—174,085,619	174	174
Paid-in capital	—	44
Retained earnings	13,205	11,632
Accumulated other comprehensive loss	(5,699)	(4,718)
Total shareholders' equity	7,680	7,132
Total liabilities and shareholders' equity	\$ 34,795	\$ 35,128
The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.		

Table of Contents

NORTHROP GRUMMAN CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

\$ in millions	Three Months	
	Ended March 31	
	2018	2017
Operating activities		
Net earnings	\$739	\$650
Adjustments to reconcile to net cash used in operating activities:		
Depreciation and amortization	122	104
Stock-based compensation	19	17
Deferred income taxes	(55)	(9)
Changes in assets and liabilities:		
Accounts receivable, net	(187)	(317)
Unbilled receivables, net	(404)	(665)
Inventoried costs, net	(37)	(27)
Prepaid expenses and other assets	13	(53)
Accounts payable and other liabilities	(590)	(357)
Income taxes payable, net	197	152
Retiree benefits	(56)	86
Other, net	2	(20)
Net cash used in operating activities	(237)	(439)
Investing activities		
Capital expenditures	(305)	(216)
Other, net	(2)	2
Net cash used in investing activities	(307)	(214)
Financing activities		
Common stock repurchases	—	(229)
Cash dividends paid	(198)	(166)
Payments of employee taxes withheld from share-based awards	(79)	(90)
Net (payments to) proceeds from credit facilities	(14)	—
Other, net	(21)	—
Net cash used in financing activities	(312)	(485)
Decrease in cash and cash equivalents	(856)	(1,138)
Cash and cash equivalents, beginning of year	11,225	2,541
Cash and cash equivalents, end of period	\$10,369	\$1,403

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

Table of Contents

NORTHROP GRUMMAN CORPORATION

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

\$ in millions, except per share amounts	Three Months	
	Ended March 31	
	2018	2017
Common stock		
Beginning of year	\$ 174	\$ 175
Common stock repurchased	—	(1)
Shares issued for employee stock awards and options	—	1
End of period	174	175
Paid-in capital		
Beginning of year	44	—
Stock compensation	(44)	—
End of period	—	—
Retained earnings		
Beginning of year	11,632	10,734
Impact from adoption of ASU 2018-02 and ASU 2016-01 (See Note 1)	1,064	—
Common stock repurchased	—	(215)
Net earnings	739	650
Dividends declared	(195)	(159)
Stock compensation	(35)	(72)
End of period	13,205	10,938
Accumulated other comprehensive loss		
Beginning of year	(4,718)	(5,546)
Impact from adoption of ASU 2018-02 and ASU 2016-01 (See Note 1)	(1,064)	—
Other comprehensive income, net of tax	83	105
End of period	(5,699)	(5,441)
Total shareholders' equity	\$ 7,680	\$ 5,672
Cash dividends declared per share	\$ 1.10	\$ 0.90

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

Table of Contents

NORTHROP GRUMMAN CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. BASIS OF PRESENTATION

Principles of Consolidation and Reporting

These unaudited condensed consolidated financial statements (the “financial statements”) include the accounts of Northrop Grumman Corporation and its subsidiaries and joint ventures or other investments for which we consolidate the financial results (herein referred to as “Northrop Grumman,” the “company,” “we,” “us,” or “our”). 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.

The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP” or “FAS”) and in accordance with the rules of the Securities and Exchange Commission (SEC) for interim reporting. The financial statements include adjustments of a normal recurring nature considered necessary by management for a fair presentation of the company’s unaudited condensed consolidated financial position, results of operations and cash flows.

The results reported in these financial statements are not necessarily indicative of results that may be expected for the entire year. These financial statements should be read in conjunction with the information contained in the company’s Annual Report on Form 10-K for the year ended December 31, 2017 (2017 Annual Report on Form 10-K).

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

As previously announced, effective January 1, 2018, we adopted Accounting Standards Codification (ASC) Topic 606, Revenue from Contracts with Customers, and Accounting Standards Update (ASU) No. 2017-07, Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, using the full retrospective method. The adoption of these standards are reflected in the amounts and disclosures set forth in this Form 10-Q and the effect of these standards on the company’s unaudited condensed consolidated statement of earnings and comprehensive income for the three months ended March 31, 2017 and unaudited condensed consolidated statement of financial position as of December 31, 2017 is reflected in Note 11.

Accounting Estimates

Preparation of the financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements, as well as the reported amounts of sales 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.

Revenue Recognition

The majority of our sales are derived from long-term contracts with the U.S. Government for the production of goods, the provision of services, or a combination of both. The company classifies sales as product or service based on the predominant attributes of each contract.

Under ASC Topic 606, the company recognizes revenue for each separately identifiable performance obligation in a contract representing a promise to transfer a distinct good or service to a customer. In most cases, goods and services provided under the company’s contracts are accounted for as single performance obligations due to the complex and integrated nature of our products and services. These contracts generally require significant integration of a group of goods and/or services to deliver a combined output. In some contracts, the company provides multiple distinct goods or services to a customer, most commonly when a contract covers multiple phases of the product lifecycle (development, production, maintenance and/or support). In those cases, the company accounts for the distinct contract deliverables as separate performance obligations and allocates the transaction price to each performance obligation based on its relative standalone selling price, which is generally estimated using the cost plus a reasonable margin approach of ASC Topic 606. Warranties are provided on certain contracts, but do not typically provide for services

beyond standard assurances and are therefore not within the scope of ASC Topic 606. Likewise, our

-5-

Table of Contents

NORTHROP GRUMMAN CORPORATION

accounting for costs to obtain or fulfill a contract was not significantly impacted by the adoption of ASC Topic 606 as these costs are not material.

A contract modification exists when the parties to a contract approve a change in the scope or price of a contract. Contracts are often modified for changes in contract specifications or requirements. Most of the company's contract modifications are for goods or services that are not distinct in the context of the contract and are therefore accounted for as part of the original performance obligation through a cumulative estimate-at-completion (EAC) adjustment. The company recognizes revenue as control is transferred to the customer, either over time or at a point in time. In general, our U.S. government contracts contain termination for convenience clauses that generally entitle the customer to goods produced and/or in-process. Similarly, our non-U.S. government contracts generally contain contractual termination clauses or entitle the company to payment for work performed to date for goods and services that do not have an alternative use. As control is effectively transferred as we perform on our contracts and we are typically entitled to cost plus a reasonable margin for work in process if the contract is terminated, we generally recognize revenue over time on a cost-to-cost basis (cost incurred relative to total cost estimated at completion) as the company believes this represents the most appropriate measurement towards satisfaction of its performance obligations. Revenue for contracts in which the control of goods produced does not transfer until delivery to the customer is recognized at a point in time (i.e. typically upon delivery).

Contract Estimates

Use of the cost-to-cost method requires us to make reasonably dependable estimates regarding the revenue and cost associated with the design, manufacture and delivery of our products and services. The company estimates profit on these contracts as the difference between total estimated sales and total estimated cost at completion and recognizes that profit as costs are incurred. Significant judgment is used to estimate total revenue and cost at completion.

Contract sales may include estimates of variable consideration, including cost or performance incentives (such as award and incentive fees), contract claims and requests for equitable adjustment (REAs). Variable consideration is included in total estimated sales to the extent it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. We estimate variable consideration at the most likely amount to which we expect to be entitled.

We recognize changes in estimated contract sales or costs and the resulting changes in contract profit on a cumulative basis. Cumulative EAC adjustments represent the cumulative effect of the changes on current and prior periods; sales and operating margins in future periods are recognized as if the revised estimates had been used since contract inception. If it is determined that a loss is expected to result on an individual performance obligation, the entire amount of the estimable future loss, including an allocation of general and administrative (G&A) costs, is charged against income in the period the loss is identified. Each loss provision is first offset against costs included in unbilled accounts receivable or inventoried costs; remaining amounts are reflected in current liabilities.

Significant EAC adjustments on a single contract could have a material effect on the company's financial statements. When such adjustments occur, we generally disclose the nature, underlying conditions and financial impact of the adjustments. No discrete event or adjustments to an individual contract were material to the financial statements during the three months ended March 31, 2018 and 2017.

The following table presents the effect of aggregate net EAC adjustments:

	Three Months Ended March 31	
\$ in millions, except per share data	2018	2017
Operating Income	\$116	\$141
Net Earnings ⁽¹⁾	92	92
Diluted earnings per share ⁽¹⁾	0.52	0.52

⁽¹⁾ Based on statutory tax rates in effect for each period presented.

Revenue recognized from performance obligations satisfied in previous reporting periods was \$133 million and \$145 million for the three months ended March 31, 2018 and 2017, respectively.

Backlog

Backlog represents the future sales we expect to recognize on firm orders received by the company and is equivalent to the company's remaining performance obligations at the end of each period. It comprises both funded backlog (firm orders for which funding is authorized and appropriated) and unfunded backlog. Unexercised contract options

-6-

Table of Contents

NORTHROP GRUMMAN CORPORATION

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.

Company backlog as of March 31, 2018 was \$42.3 billion. We expect to recognize approximately 50 percent and 75 percent of our March 31, 2018 backlog as revenue over the next 12 and 24 months, respectively, with the remainder to be recognized thereafter.

Contract Assets and Liabilities

For each of the company's contracts, the timing of revenue recognition, customer billings, and cash collections results in a net contract asset or liability at the end of each reporting period. Fixed-price contracts are typically billed to the customer either using progress payments, whereby amounts are billed monthly as costs are incurred or work is completed, or performance based payments, which are based upon the achievement of specific, measurable events or accomplishments defined and valued at contract inception. Cost-type contracts are typically billed to the customer on a monthly or semi-monthly basis.

Contract assets consist of unbilled receivables, primarily related to long-term contracts where revenue recognized under the cost-to-cost method exceeds amounts billed to customers. Unbilled receivables are classified as current assets and, in accordance with industry practice, include amounts that may be billed and collected beyond one year due to the long-cycle nature of many of our contracts. Accumulated contract costs in unbilled receivables include direct production costs, factory and engineering overhead, production tooling costs, and, for government contracts, allowable G&A. Unbilled receivables also include certain estimates of variable consideration described above. These contract assets are not considered a significant financing component of the company's contracts as the payment terms are intended to protect the customer in the event the company does not perform on its obligations under the contract. Contract liabilities include advance payments and billings in excess of revenue recognized. Certain customers make advance payments prior to the satisfaction of the company's obligations on the contract. These amounts are recorded as contract liabilities until such obligations are satisfied, either over time as costs are incurred or at a point in time when deliveries are made. Contract liabilities are not a significant financing component as they are generally utilized to pay for contract costs within a one-year period or are used to ensure the customer meets contractual requirements.

Net contract assets (liabilities) are as follows:

\$ in millions	March 31, December 31, \$		%	
	2018	2017	Change	Change
Unbilled receivables, net	\$ 3,869	\$ 3,465	\$ 404	12 %
Advance payments and amounts in excess of costs incurred	(1,479)	(1,761)	282	(16)%
Net contract assets (liabilities)	\$ 2,390	\$ 1,704	\$ 686	40 %

The amount of revenue recognized for the three months ended March 31, 2018 and 2017 that was included in the opening contract liability balances was \$706 million and \$578 million, respectively.

The change in the balances of the company's contract assets and liabilities primarily results from timing differences between company performance and customer payments. The increase in net contract assets during the three months ended March 31, 2018, is principally due to higher sales on restricted programs and the timing of collections on certain Manned Aircraft programs at Aerospace Systems.

Disaggregation of Revenue

See Note 10 for information regarding the company's sales by customer type, contract type and geographic region for each of our segments. We believe those categories best depict how the nature, amount, timing and uncertainty of our revenue and cash flows are affected by economic factors.

Table of Contents

NORTHROP GRUMMAN CORPORATION

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

\$ in millions	March 31, 2018	December 31, 2017
Unamortized benefit plan costs, net of tax benefit of \$1,968 for 2018 and \$3,056 for 2017	\$ (5,560)	\$ (4,586)
Cumulative translation adjustment	(138)	(136)
Other, net	(1)	4
Total accumulated other comprehensive loss	\$ (5,699)	\$ (4,718)

Unamortized benefit plan costs as of March 31, 2018 reflect a reclassification from accumulated other comprehensive loss to retained earnings of \$1.1 billion of stranded tax effects resulting from the Tax Cuts and Jobs Act (the “2017 Tax Act”). This reclassification resulted from the company’s early adoption of ASU 2018-02 on January 1, 2018. See “Accounting Standards Updates” below for more information.

Unamortized benefit plan costs consist primarily of net after-tax actuarial losses totaling \$5.7 billion and \$4.7 billion as of March 31, 2018 and December 31, 2017, respectively. Net actuarial gains or losses are re-determined annually or upon remeasurement events and principally arise from changes in the interest rate used to discount our benefit obligations and differences between expected and actual returns on plan assets.

Reclassifications from accumulated other comprehensive loss to net earnings related to the amortization of benefit plan costs were \$86 million and \$99 million, net of taxes, for the three months ended March 31, 2018 and 2017, respectively. The reclassifications represent the amortization of net actuarial losses and prior service credits, and are included in the computation of net periodic pension cost. See Note 8 for further information.

Reclassifications from accumulated other comprehensive loss to net earnings relating to cumulative translation adjustments and effective cash flow hedges were not material for the three months ended March 31, 2018 and 2017.

Related Party Transactions

The company had no material related party transactions in any period presented.

Accounting Standards Updates

On February 14, 2018, the Financial Accounting Standards Board (FASB) issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 allows companies to reclassify stranded tax effects resulting from the 2017 Tax Act from accumulated other comprehensive income to retained earnings. As described above, the company elected to early adopt ASU 2018-02 on January 1, 2018, which resulted in a reclassification of \$1.1 billion of stranded tax effects, principally related to our unamortized benefit plan costs, from accumulated other comprehensive loss to retained earnings. This reclassification included \$73 million of other income tax effects related to a reduction in the federal benefit associated with state taxes. Adoption of ASU 2018-02 did not have a material impact on the company’s results of operations and/or cash flows.

On March 10, 2017, the FASB issued ASU No. 2017-07, Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. ASU 2017-07 requires employers that sponsor defined benefit pension and/or other post-retirement benefit plans to report the service cost component of net benefit cost in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. Employers are required to present the other components of net benefit costs in the income statement separately from the service cost component and outside a subtotal of income from operations. Additionally, only the service cost component of net periodic pension cost is eligible for asset capitalization. We adopted ASU 2017-07 on January 1, 2018 using the retrospective method. See Note 11 for information regarding the effect of adopting ASU 2017-07 on our unaudited condensed consolidated statement of earnings and comprehensive income for the three months ended March 31, 2017. Adoption of ASU 2017-07 did not have a material impact on our consolidated statements of financial position and/or cash flows.

On February 25, 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). ASU 2016-02 supersedes existing lease guidance, including ASC 840 - Leases. Among other things, ASU 2016-02 requires recognition of a right-of-use

asset and liability for future lease payments for contracts that meet the definition of a lease and requires disclosure of certain information about leasing arrangements. ASU 2016-02 will be effective January 1, 2019, although early adoption is permitted, and may be adopted using a modified retrospective transition method that applies the new lease requirements at the beginning of the earliest period presented in the financial statements. The

-8-

Table of Contents

NORTHROP GRUMMAN CORPORATION

FASB has proposed a change that would allow a company to elect an optional transition method that applies the new lease requirements through a cumulative-effect adjustment in the period of adoption. We expect to adopt the standard on January 1, 2019 using the proposed optional transition method if finalized in its current form. We are reviewing our leases to determine the effect ASU 2016-02 will have on the company's consolidated financial position, annual results of operations and/or cash flows. We currently expect the right-of-use assets and lease liabilities recognized upon adoption will each approximate our future minimum lease payments, as disclosed in our Annual Reports on Form 10-K. We do not expect ASU 2016-02 to have a material impact on our annual results of operations and/or cash flows. On January 5, 2016, the FASB issued ASU No. 2016-01, Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 requires equity investments that are not accounted for under the equity method of accounting or that do not result in consolidation of the investee to be measured at fair value with changes recognized in net earnings. ASU 2016-01 also eliminates the available-for-sale classification for equity investments that recognized changes in fair value as a component of other comprehensive income. We adopted ASU 2016-01 on January 1, 2018 using the modified retrospective method, which resulted in a \$4 million (net of tax) cumulative-effect adjustment from accumulated other comprehensive loss to retained earnings. Adoption of ASU 2016-01 did not have a material impact on our results of operations and/or cash flows.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). Topic 606 supersedes previous revenue recognition guidance, including ASC 605-35, Revenue Recognition - Construction-Type and Production-Type Contracts, and outlines a single set of comprehensive principles for recognizing revenue under U.S. GAAP. Among other things, it requires companies to identify contractual performance obligations and determine whether revenue should be recognized at a point in time or over time. The primary impact of the adoption of ASC Topic 606 was that, in most cases, the accounting for those contracts where we previously recognized revenue as units were delivered changed under ASC Topic 606 such that we now recognize revenue as costs are incurred. In addition, for certain of our contracts, there is a change in the number of performance obligations under ASC Topic 606, which has altered the timing of revenue and margin recognition.

We adopted ASC Topic 606 on January 1, 2018 using the full retrospective method. We applied the transition practical expedient related to remaining performance obligations for reporting periods presented before the date of initial application. No other practical expedients were applied. The cumulative effect of adopting ASC Topic 606 was a \$148 million increase to retained earnings at January 1, 2016. See Note 11 for information regarding the effect of adopting ASC Topic 606 on our unaudited condensed consolidated statement of earnings and comprehensive income for the three months ended March 31, 2017 and unaudited condensed consolidated statement of financial position as of December 31, 2017.

Other accounting standards updates issued, but not effective until after March 31, 2018, are not expected to have a material effect on the company's unaudited condensed consolidated financial position, annual results of operations and/or cash flows.

2. PENDING ACQUISITION OF ORBITAL ATK

On September 17, 2017, the company entered into a definitive merger agreement to acquire all of the outstanding shares of Orbital ATK, Inc. (Orbital ATK) for approximately \$7.8 billion in cash, plus the assumption of approximately \$1.4 billion in net debt (the "Orbital ATK Acquisition"). Under the terms of the merger agreement, Orbital ATK shareholders are to receive all-cash consideration of \$134.50 per share. We expect to fund the Orbital ATK Acquisition with the proceeds from our debt financing completed in October 2017 and cash on hand. On November 29, 2017, Orbital ATK shareholders approved the proposed Orbital ATK Acquisition. On February 12, 2018, the European Commission approved the proposed Orbital ATK Acquisition. We currently expect the transaction to close in the first half of 2018, after receiving regulatory approvals. Upon completion of the Orbital ATK Acquisition, we plan to establish Orbital ATK as a new, fourth business sector named Northrop Grumman Innovation Systems.

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

Basic Earnings Per Share

We calculate basic earnings per share by dividing net earnings by the weighted-average number of shares of common stock outstanding during each period.

-9-

Table of Contents

NORTHROP GRUMMAN CORPORATION

Diluted Earnings Per Share

Diluted earnings per share primarily include the dilutive effect of awards granted to employees under stock-based compensation plans. The dilutive effect of these securities totaled 1.1 million shares and 1.3 million shares for the three months ended March 31, 2018 and 2017, respectively.

Share Repurchases

On September 16, 2015, the company's board of directors authorized a share repurchase program of up to \$4.0 billion of the company's common stock (the "2015 Repurchase Program"). Repurchases under the 2015 Repurchase Program commenced in March 2016. As of March 31, 2018, repurchases under the 2015 Repurchase Program totaled \$1.7 billion; \$2.3 billion remained under this share repurchase authorization. By its terms, the 2015 Repurchase Program is set to expire when we have used all authorized funds for repurchases.

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, in the periods presented, has not made any purchases of common stock other than in connection with these publicly announced repurchase programs.

The table below summarizes the company's share repurchases to date under the authorizations described above:

Repurchase Program Authorization Date	Amount Authorized (in millions)	Total Shares Retired (in millions)	Average Price Per Share ⁽¹⁾	Date Completed	Shares Repurchased (in millions) Three Months Ended March 31	
					2018	2017
September 16, 2015	\$ 4,000	7.4	\$ 222.93		—	0.9

⁽¹⁾ Includes commissions paid.

Dividends on Common Stock

In January 2018, the company increased the quarterly common stock dividend 10 percent to \$1.10 per share from the previous amount of \$1.00 per share.

In May 2017, the company increased the quarterly common stock dividend 11 percent to \$1.00 per share from the previous amount of \$0.90 per share.

4. INCOME TAXES

\$ in millions	Three Months Ended March 31	
	2018	2017
Federal and foreign income tax expense	\$ 132	\$ 138
Effective income tax rate	15.2 %	17.5 %

The company's effective tax rate of 15.2 percent for the three months ended March 31, 2018 was lower as compared with the same period in 2017 principally due to the reduction of the U.S. corporate income tax rate from 35 percent to 21 percent as a result of the 2017 Tax Act. Both periods reflect comparable tax benefits associated with research credits. In addition, the company's effective tax rate for the three months ended March 31, 2018 includes \$26 million of excess tax benefits related to employee share-based compensation. The company's effective tax rate for the three months ended March 31, 2017 included \$47 million of excess tax benefits related to employee share-based compensation, a \$42 million benefit recognized in connection with the Congressional Joint Committee on Taxation's approval of the Internal Revenue Service (IRS) examination of the company's 2012-2013 tax returns, a \$22 million benefit recognized for additional research credits claimed on our prior year tax returns and \$15 million of domestic manufacturing deductions.

In December 2017, the 2017 Tax Act was enacted. The 2017 Tax Act includes a number of changes to previous U.S. tax laws that impact the company, most notably a reduction of the U.S. corporate income tax rate from 35 percent to 21 percent for tax years beginning after December 31, 2017. The company recognized the income tax effects of the 2017 Tax Act in the financial statements included in its 2017 Annual Report on Form 10-K in accordance with Staff Accounting Bulletin No. 118, which provides SEC staff guidance for the application of ASC Topic 740, Income Taxes, in the reporting period in which the 2017 Tax Act was signed into law. During the three months ended March

-10-

Table of Contents

NORTHROP GRUMMAN CORPORATION

31, 2018, the company did not recognize any changes to the provisional amounts recorded in its 2017 Annual Report on Form 10-K in connection with the 2017 Tax Act as the company is continuing to collect the information necessary to complete those calculations.

We file income tax returns in the U.S. federal jurisdiction and in various state and foreign jurisdictions. Our 2014-2015 federal tax returns and our refund claims related to our 2007-2011 federal tax returns are currently under IRS examination. The company believes it is reasonably possible that within the next twelve months we may resolve certain matters related to the examination of the 2014-2015 tax years, which may result in reductions of our unrecognized tax benefits up to \$115 million and income tax expense up to \$30 million.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

The company holds a portfolio of marketable securities consisting of securities to partially fund non-qualified employee benefit plans. These securities are included in other non-current assets in the unaudited condensed consolidated statements of financial position.

The company's derivative portfolio consists primarily of foreign currency forward contracts. Where model-derived valuations are appropriate, the company utilizes the income approach to determine the fair value and uses the applicable London Interbank Offered Rate (LIBOR) swap rates.

The following table presents the financial assets and liabilities we record at fair value on a recurring basis identified by the level of inputs used to determine fair value:

\$ in millions	March 31, 2018			December 31, 2017		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	Financial Assets (Liabilities)					
Marketable securities	\$347	\$ 1	\$348	\$352	\$ 1	\$353
Derivatives	—	1	1	—	—	—

The notional value of the company's derivative portfolio at March 31, 2018 and December 31, 2017, was \$83 million and \$89 million, respectively. The portion of notional value designated as a cash flow hedge at March 31, 2018 and December 31, 2017 was \$7 million and \$8 million, respectively. The derivative fair values and related unrealized gains/losses at March 31, 2018 and December 31, 2017 were not material.

There were no transfers of financial instruments between the three levels of the fair value hierarchy during the three months ended March 31, 2018.

The carrying value of cash and cash equivalents approximates fair value.

Long-term Debt

The estimated fair value of long-term debt was \$15.4 billion and \$16.0 billion as of March 31, 2018 and December 31, 2017, respectively. We calculated the fair value of long-term debt using Level 2 inputs, based on interest rates available for debt with terms and maturities similar to the company's existing debt arrangements. The carrying value of long-term debt was \$15.3 billion as of March 31, 2018 and December 31, 2017. The current portion of long-term debt is recorded in Other current liabilities in the unaudited condensed consolidated statements of financial position.

6. INVESTIGATIONS, CLAIMS AND LITIGATION**Litigation**

On May 4, 2012, the company commenced an action, Northrop Grumman Systems Corp. v. United States, in the U.S. Court of Federal Claims. This lawsuit relates to an approximately \$875 million firm fixed price contract awarded to the company in 2007 by the U.S. Postal Service (USPS) for the construction and delivery of flats sequencing systems (FSS) as part of the postal automation program. The FSS have been delivered. The company's lawsuit is based on various theories of liability. The complaint seeks approximately \$63 million for unpaid portions of the contract price, and approximately \$115 million based on the company's assertions that, through various acts and omissions over the life of the contract, the USPS adversely affected the cost and schedule of performance and materially altered the company's obligations under the contract. The United States responded to the company's complaint with an answer,

denying most of the company's claims, and counterclaims seeking approximately \$410 million, less certain amounts outstanding under the contract. The principal counterclaim alleges that the company delayed its performance and caused damages to the USPS because USPS did not realize certain costs savings as

-11-

Table of Contents

NORTHROP GRUMMAN CORPORATION

early as it had expected. On April 2, 2013, the U.S. Department of Justice informed the company of a False Claims Act complaint relating to the FSS contract that was filed under seal by a relator in June 2011 in the U.S. District Court for the Eastern District of Virginia. On June 3, 2013, the United States filed a Notice informing the Court that the United States had decided not to intervene in this case. The relator alleged that the company violated the False Claims Act in a number of ways with respect to the FSS contract, alleged damage to the USPS in an amount of at least approximately \$179 million annually, alleged that he was improperly discharged in retaliation, and sought an unspecified partial refund of the contract purchase price, penalties, attorney's fees and other costs of suit. The relator later voluntarily dismissed his retaliation claim and reasserted it in a separate arbitration, which he also ultimately voluntarily dismissed. On September 5, 2014, the court granted the company's motion for summary judgment and ordered the relator's False Claims Act case be dismissed with prejudice. On December 19, 2014, the company filed a motion for partial summary judgment asking the court to dismiss the principal counterclaim referenced above. On June 29, 2015, the Court heard argument and denied that motion without prejudice to filing a later motion to dismiss. On February 16, 2018, both the company and the United States filed motions to dismiss many of the claims and counterclaims in whole or in part. The United States also filed a motion seeking to amend its answer and counterclaim, including to reduce its counterclaim to approximately \$193 million. Although the ultimate outcome of these matters ("the FSS matters," collectively), including any possible loss, cannot be predicted or reasonably estimated at this time, the company intends vigorously to pursue and defend the FSS matters.

On August 8, 2013, the company received a court-appointed expert's report in litigation pending in the Second Federal Court of the Federal District in Brazil brought by the Brazilian Post and Telegraph Corporation (ECT), a Brazilian state-owned entity, against Solystic SAS (Solystic), a French subsidiary of the company, and two of its consortium partners. In this suit, commenced on December 17, 2004, and relatively inactive for some period of time, ECT alleges the consortium breached its contract with ECT and seeks damages of approximately R\$111 million (the equivalent of approximately \$34 million as of March 31, 2018), plus interest, inflation adjustments and attorneys' fees, as authorized by Brazilian law, which amounts could be significant over time. The original suit sought R\$89 million (the equivalent of approximately \$27 million as of March 31, 2018) in damages. In October 2013, ECT asserted an additional damage claim of R\$22 million (the equivalent of approximately \$7 million as of March 31, 2018). In its counterclaim, Solystic alleges ECT breached the contract by wrongfully refusing to accept the equipment Solystic had designed and built and seeks damages of approximately €31 million (the equivalent of approximately \$38 million as of March 31, 2018), plus interest, inflation adjustments and attorneys' fees, as authorized by Brazilian law. The Brazilian court retained an expert to consider certain issues pending before it. On August 8, 2013 and September 10, 2014, the company received reports from the expert, which contain some recommended findings relating to liability and the damages calculations put forth by ECT. Some of the expert's recommended findings were favorable to the company and others were favorable to ECT. In November 2014, the parties submitted comments on the expert's most recent report. On June 16, 2015, the court published a decision denying the parties' request to present oral testimony. At some future point, the court is expected to issue a decision on the parties' claims and counterclaims that could accept or reject, in whole or in part, the expert's recommended findings.

The company previously identified and disclosed to the U.S. Government various issues relating primarily to time-charging practices of some employees working on a particular program with remote deployments. The Department of Justice is continuing to investigate this matter, and the company is cooperating in that investigation. Depending upon the ultimate outcome of this matter, the company could be subject to damages, civil or criminal fines, penalties or other sanctions, and suspension or debarment actions; however, we cannot at this point predict the outcome.

We are engaged in remediation activities relating to environmental conditions allegedly resulting from historic operations at the former United States Navy and Grumman facilities in Bethpage, New York. For over 20 years, we have worked closely with the United States Navy, the United States Environmental Protection Agency, the New York State Department of Environmental Conservation, the New York State Department of Health and other federal, state and local governmental authorities, to address legacy environmental conditions in Bethpage. We have incurred, and

expect to continue to incur, as included in Note 7, substantial remediation costs related to these environmental conditions. The remediation standards or requirements to which we are subject may change and costs may increase materially. The State of New York has notified us that it intends to seek to impose additional remedial requirements and, among other things, is evaluating natural resource damages. In addition, we are and may become a party to various legal proceedings and disputes related to remediation and/or alleged environmental impacts in Bethpage, including with federal and state entities, local municipalities and water districts, insurance carriers and class action plaintiffs. These Bethpage matters could result in additional costs, fines, penalties, sanctions, compensatory or other damages (including natural resource damages), determinations on allocation, allowability and coverage, and non-

-12-

Table of Contents

NORTHROP GRUMMAN CORPORATION

monetary relief. We cannot at this time predict or reasonably estimate the potential cumulative outcomes or ranges of possible liability of these aggregate Bethpage matters.

The company is a party to various other investigations, lawsuits, claims, enforcement actions and other legal proceedings, including government investigations and claims, that arise in the ordinary course of our business. The nature of legal proceedings is such that we cannot assure the outcome of any particular matter. However, based on information available to the company to date, the company does not believe that the outcome of any of these other matters pending against the company is likely to have a material adverse effect on the company's unaudited condensed consolidated financial position as of March 31, 2018, or its annual results of operations and/or cash flows.

7. COMMITMENTS AND CONTINGENCIES

U.S. Government Cost Claims

From time to time, the company is advised of claims by the U.S. Government concerning certain potential disallowed costs, plus, at times, penalties and interest. When such findings are presented, the company and U.S. Government representatives engage in discussions to enable the company to evaluate the merits of these claims, as well as to assess the amounts being claimed. Where appropriate, provisions are made to reflect the company's estimated exposure for such potential disallowed costs. Such provisions are reviewed periodically using the most recent information available. The company believes it has adequately reserved for disputed amounts that are probable and reasonably estimable, and that the outcome of any such matters would not have a material adverse effect on its unaudited condensed consolidated financial position as of March 31, 2018, or its annual results of operations and/or cash flows.

Environmental Matters

The table below summarizes management's estimate of the range of reasonably possible future costs for environmental remediation, the amount accrued within that range, and the deferred costs expected to be recoverable through overhead charges on U.S. Government contracts as of March 31, 2018 and December 31, 2017:

\$ in millions	Range of Reasonably Possible Future Costs ⁽¹⁾	Accrued	Deferred
		Costs ⁽²⁾	Costs ⁽³⁾
March 31, 2018	\$410 - \$789	\$ 416	\$ 211
December 31, 2017	405 - 792	410	207

Estimated remediation costs are not discounted to present value. The range of reasonably possible future costs does not take into consideration amounts expected to be recoverable through overhead charges on U.S. Government contracts.

⁽²⁾ As of March 31, 2018, \$151 million is recorded in other current liabilities and \$265 million is recorded in other non-current liabilities.

⁽³⁾ As of March 31, 2018, \$79 million is deferred in prepaid expenses and other current assets and \$132 million is deferred in other non-current assets. These amounts are evaluated for recoverability on a routine basis.

Although management cannot predict whether new information gained as our environmental remediation projects progress, or as changes in facts and circumstances occur, will materially affect the estimated liability accrued, except with respect to Bethpage, we do not anticipate that future remediation expenditures associated with our currently identified projects will have a material adverse effect on the company's unaudited condensed consolidated financial position as of March 31, 2018, or its annual results of operations and/or cash flows. With respect to Bethpage, as described in Note 6, we cannot at this time estimate the range of reasonably possible additional future costs that could result from potential changes to remediation standards or requirements to which we are subject.

Financial Arrangements

In the ordinary course of business, the company uses standby letters of credit and guarantees issued by commercial banks and surety bonds issued principally by insurance companies to guarantee the performance on certain obligations. At March 31, 2018, there were \$192 million of stand-by letters of credit and guarantees and \$196 million of surety bonds outstanding.

Indemnifications

The company has provided indemnification for certain environmental, income tax and other potential liabilities in connection with certain of its divestitures. The settlement of these liabilities is not expected to have a material adverse effect on the company's unaudited condensed consolidated financial position as of March 31, 2018, or its annual results of operations and/or cash flows.

-13-

Table of Contents

NORTHROP GRUMMAN CORPORATION

Operating Leases

Rental expense for operating leases for the three months ended March 31, 2018 and 2017 was \$92 million and \$89 million, respectively. These amounts are net of immaterial amounts of sublease rental income.

Credit Facilities

In December 2016, a subsidiary of the company entered into a two-year credit facility, with two additional one-year option periods, in an aggregate principal amount of £120 million (the equivalent of approximately \$170 million as of March 31, 2018) (the “2016 Credit Agreement”). The company exercised the first option to extend the maturity to December 2019. The 2016 Credit Agreement is guaranteed by the company. At March 31, 2018, there was £90 million (the equivalent of approximately \$127 million) outstanding under this facility, which bears interest at a rate of LIBOR plus 1.10 percent. All of the borrowings outstanding under this facility mature less than one year from the date of issuance, but may be renewed under the terms of the facility. Based on our intent and ability to refinance the obligations on a long-term basis, substantially all of the borrowings are classified as non-current.

The company also maintains a five-year unsecured credit facility in an aggregate principal amount of \$1.6 billion that matures in July 2020. At March 31, 2018, there was no balance outstanding under this facility.

At March 31, 2018, the company was in compliance with all covenants under its credit agreements.

8. RETIREMENT BENEFITS

The cost to the company of its retirement plans is shown in the following table:

	Three Months Ended March 31			
	Pension Benefits		Medical and Life Benefits	
\$ in millions	2018	2017	2018	2017
Components of net periodic benefit cost				
Service cost	\$99	\$97	\$5	\$5
Interest cost	290	313	19	21
Expected return on plan assets	(529)	(471)	(25)	(22)
Amortization of:				
Prior service credit	(15)	(15)	(5)	(5)
Net loss from previous years	134	191	—	3
Net periodic benefit cost	\$(21)	\$115	\$(6)	\$2

Changes in Presentation

As discussed in Note 1, we adopted ASU 2017-07 on January 1, 2018 using the retrospective method, which changed the financial statement presentation of service costs and the other components of net periodic benefit cost. The service cost component continues to be included in operating income; however, the other components are now presented in Net FAS (non-service) pension benefit (expense) in the unaudited condensed consolidated statements of earnings and comprehensive income. In addition, interest on service cost and plan administrative expenses which, in some cases, have historically been included in service cost are now consistently presented in the interest cost and amortization of net actuarial loss components, respectively. As a result, the company reclassified interest on service cost of \$4 million and plan administrative expenses of \$13 million from service cost to the interest cost and amortization of net actuarial loss components, respectively, for its pension plans in the three months ended March 31, 2017 to conform to the current year presentation. For the company’s medical and life benefit plans, plan administrative expenses of \$1 million were reclassified from service cost to the amortization of net actuarial loss component for the three months ended March 31, 2017 to conform to the current year presentation. This change in presentation had no impact on net periodic benefit cost.

Employer Contributions

The company sponsors defined benefit pension and post-retirement plans, as well as defined contribution plans. We fund our defined benefit pension plans annually in a manner consistent with the Employee Retirement Income Security Act of 1974, as amended by the Pension Protection Act of 2006, including making voluntary contributions from time to time.

-14-

Table of Contents

NORTHROP GRUMMAN CORPORATION

Contributions made by the company to its retirement plans are as follows:

	Three Months Ended March 31 2018	2017
\$ in millions		
Defined benefit pension plans	\$ 22	\$ 23
Medical and life benefit plans	11	11
Defined contribution plans	104	99

9. STOCK COMPENSATION PLANS AND OTHER COMPENSATION ARRANGEMENTS

Stock Awards

The following table presents the number of restricted stock rights (RSRs) and restricted performance stock rights (RPSRs) granted to employees under the company's long-term incentive stock plan and the grant date aggregate fair value of those stock awards for the periods presented:

	Three Months Ended March 31 2018	2017
in millions		
RSRs granted	0.1	0.1
RPSRs granted	0.2	0.3
Grant date aggregate fair value	\$ 87	\$ 86

RSRs typically vest on the third anniversary of the grant date, while RPSRs generally vest and pay out based on the achievement of financial metrics over a three-year period.

Cash Awards

The following table presents the minimum and maximum aggregate payout amounts related to cash units (CUs) and cash performance units (CPUs) granted to employees in the periods presented:

	Three Months Ended March 31 2018	2017
\$ in millions		
Minimum aggregate payout amount	\$ 35	\$ 35
Maximum aggregate payout amount	196	198

CUs typically vest and settle in cash on the third anniversary of the grant date, while CPUs generally vest and pay out in cash based on the achievement of financial metrics over a three-year period.

Table of Contents

NORTHROP GRUMMAN CORPORATION

10. SEGMENT INFORMATION

The company is aligned in three operating sectors, which also comprise our reportable segments: Aerospace Systems, Mission Systems and Technology Services.

The following table presents sales and operating income by segment:

\$ in millions	Three Months	
	Ended March 31	
	2018	2017
Sales		
Aerospace Systems	\$3,280	\$2,984
Mission Systems	2,883	2,800
Technology Services	1,144	1,190
Intersegment eliminations	(572)	(564)
Total sales	6,735	6,410
Operating income		
Aerospace Systems	341	323
Mission Systems	371	359
Technology Services	122	129
Intersegment eliminations	(72)	(70)
Total segment operating income	762	741
Net FAS (service)/CAS pension adjustment	127	154
Unallocated corporate expenses	(34)	(32)
Other	(1)	(1)
Total operating income	\$854	\$862

Net FAS (Service)/CAS Pension Adjustment

For financial statement purposes, we account for our employee pension plans in accordance with FAS. However, the cost of these plans is charged to our contracts in accordance with the Federal Acquisition Regulation (FAR) and the related U.S. Government Cost Accounting Standards (CAS). The net FAS (service)/CAS pension adjustment reflects the difference between CAS pension expense included as cost in segment operating income and the service cost component of FAS expense included in total operating income. The non-service cost components of FAS expense, which include interest cost, expected return on plan assets, and amortization of prior service credit and net actuarial loss, are presented in Net FAS (non-service) pension benefit (expense) in the unaudited condensed consolidated statements of earnings and comprehensive income as a result of our adoption of ASU 2017-07 discussed in Note 1.

Unallocated Corporate Expenses

Unallocated corporate expenses include the portion of corporate expenses not considered allowable or allocable under applicable CAS or FAR, and therefore not allocated to the segments. Such costs consist of a portion of management and administration, legal, environmental, compensation, retiree benefits and other corporate unallowable costs.

Table of Contents

NORTHROP GRUMMAN CORPORATION

Disaggregation of Revenue

Sales by Customer Type	Three Months Ended March 31			
	2018		2017	
\$ in millions	\$	% ⁽³⁾	\$	% ⁽³⁾
Aerospace Systems				
U.S. Government ⁽¹⁾	\$2,908	89 %	\$2,553	86 %
International ⁽²⁾	271	8 %	309	10 %
Other customers	42	1 %	38	1 %
Intersegment sales	59	2 %	84	3 %
Aerospace Systems sales	3,280	100 %	2,984	100 %
Mission Systems				
U.S. Government ⁽¹⁾	2,190	76 %	2,186	78 %
International ⁽²⁾	379	13 %	354	13 %
Other customers	30	1 %	21	1 %
Intersegment sales	284	10 %	239	8 %
Mission Systems sales	2,883	100 %	2,800	100 %
Technology Services				
U.S. Government ⁽¹⁾	602	53		