MGM MIRAGE
Form 10-K
March 13, 2006

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

FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [FEE REQUIRED]**

For the fiscal year ended December 31, 2005

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]**

For the transition period __________ to __________

Commission File No. 0-16760

MGM MIRAGE
(Exact name of Registrant as specified in its charter)

DELAWARE	**88-0215232**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

3600 Las Vegas Boulevard South Las Vegas, Nevada 89109
(Address of principal executive office) (Zip Code)
(702) 693-7120
(Registrant s telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, $.01 Par Value	**New York Stock Exchange**

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

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

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

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the 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:__________

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The aggregate market value of the Registrant s Common Stock held by non-affiliates of the Registrant as of June 30, 2005 (based on the closing price on the New York Stock Exchange Composite Tape on June 30, 2005 was $5.1 billion. As of March 10, 2006, 284,758,777 shares of Registrant s Common Stock, $.01 par value, were outstanding.

Portions of the Registrant s definitive Proxy Statement for its 2006 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

Overview

MGM MIRAGE is one of the largest gaming companies in the world. We believe that we own the world s finest collection of casino resorts. Our strategy is predicated on creating resorts of memorable character, treating our employees well and providing superior service for our guests. MGM MIRAGE was organized as MGM Grand, Inc. on January 29, 1986 and is a Delaware corporation. MGM MIRAGE acts largely as a holding company and its operations are conducted through wholly-owned subsidiaries. MGM MIRAGE is referred to as the Company or the Registrant, and together with our subsidiaries may also be referred to as we, us or our.

Acquisition of Mandalay Resort Group

On April 25, 2005, we closed our merger with Mandalay Resort Group (Mandalay) under which we acquired Mandalay for $71 in cash for each share of common stock of Mandalay. The total acquisition cost, including the assumption of debt and transaction costs, was approximately $7.3 billion. As a result of the acquisition we are a much larger company, with ownership of or investments in 26 casino resorts versus 13, over 66,000 employees versus 40,000, and total assets of over $20 billion versus $11 billion. The acquisition expands our portfolio of resorts on the Las Vegas Strip, provides additional sites for future development and expands our employee and customer bases significantly.

Our Operating Casino Resorts

We have provided below certain information about our casino resorts as of December 31, 2005. Except as otherwise indicated, we wholly own and operate the resorts shown below.

Name and Location	Number of Guestrooms and Suites	Approximate Casino Square Footage	Slots (1)	Gaming Tables (2)
Las Vegas Strip, Nevada (3)				
Bellagio	3,933	155,000	2,409	143
MGM Grand Las Vegas	5,044	156,000	2,593	172
Mandalay Bay (4)	4,756	157,000	1,949	127
The Mirage	3,044	118,000	2,056	109
Luxor	4,403	100,000	1,778	88
Treasure Island (TI)	2,885	90,000	1,800	64
New York-New York	2,024	84,000	1,867	85
Excalibur	3,990	100,000	1,762	73
Monte Carlo	3,002	102,000	1,726	74
Circus Circus Las Vegas (5)	3,764	133,000	2,364	92
Subtotal	36,845	1,195,000	20,304	1,027
Other Nevada				
Primm Valley Resorts *(Primm)* (6)	2,642	137,000	2,854	94
Circus Circus Reno *(Reno)*	1,572	69,000	1,369	52
Silver Legacy 50% owned *(Reno)*	1,710	87,000	1,707	68
Gold Strike *(Jean)*	811	37,000	737	15
Nevada Landing *(Jean)*	303	36,000	733	14
Colorado Belle *(Laughlin)*	1,173	50,000	1,167	39
Edgewater *(Laughlin)*	1,356	57,000	1,099	33
Railroad Pass *(Henderson)*	120	13,000	347	6

Other Domestic Operations				
MGM Grand Detroit *(Detroit, Michigan)*	N/A	75,000	2,841	72
Beau Rivage *(Biloxi, Mississippi)* (7)	N/A	N/A	N/A	N/A
Gold Strike *(Tunica, Mississippi)*	1,133	40,000	1,345	48
Borgata 50% owned *(Atlantic City, NewJersey)*	2,000	125,000	3,572	133
Grand Victoria 50% owned *(Elgin, Illinois)*	N/A	34,000	1,100	37
Grand Total	49,665	1,955,000	39,175	1,638

(1) Includes slot machines, video poker machines and other electronic gaming devices.

(2) Includes blackjack (21), baccarat, craps, roulette and other table games; does not include poker.

(3) Excludes Boardwalk, which closed in January 2006.

(4) Includes the Four Seasons Hotel with 424 guest rooms and THEhotel with 1,117 suites.

(5) Includes Slots-a-Fun.

(6) Includes Primm Valley, Buffalo Bill s and Whiskey Pete s, along with the Primm Center gas station and convenience store.

(7) Beau Rivage sustained significant damage in late August 2005 as a result of Hurricane Katrina and has been closed since. We expect to reopen Beau Rivage in the third quarter of 2006.

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Bellagio

Bellagio is widely recognized as one of the premier destination resorts in the world. Located at the heart of the Las Vegas Strip, Bellagio is the only casino resort to earn the prestigious Five Diamond award from the American Automobile Association (AAA), which it has earned for the last five years. The resort is richly decorated, including a conservatory filled with unique botanical displays that change with the seasons. At the front of Bellagio is an eight-acre lake featuring over 1,000 fountains that come alive at regular intervals in a choreographed ballet of water, music and lights. Bellagio features 200,000 square feet of convention space for the discerning group planner. For both business and leisure customers, Bellagio s restaurants offer the finest choices, including Five Diamond award winners Picasso and Le Cirque. Entertainment options include *O*, produced and performed by Cirque du Soleil, the Light nightclub, and several other bars and lounges. Leisure travelers can also enjoy Bellagio s expansive pool, world-class spa and Gallery of Fine Arts.

MGM Grand Las Vegas

MGM Grand Las Vegas, located on the corner of the Las Vegas Strip and Tropicana Avenue, is one of the largest casino resorts in the world, and is the largest to receive the AAA's Four Diamond award. The resort s guest rooms feature unique themes, including: West Wing, a recently remodeled area offering boutique-style rooms; Skylofts, ultra-suites on the 29^{th} floor featuring the ultimate in personal service; and the exclusive Mansion for premium gaming customers. MGM Grand Las Vegas features an extensive array of restaurants, including two new restaurants by renowned chef Joël Robuchon, Craftsteak, NOBHILL, SeaBlue, Pearl, Shibuya and Fiamma Trattoria. Other amenities include the Studio 54 nightclub, Tabu, the Ultra Lounge, Teatro, numerous retail shopping outlets, a 380,000 square foot state-of-the-art conference center, and an extensive pool and spa complex. During 2005, the resort opened a state-of-the-art poker room and a renovated sports book.

Entertainment options at MGM Grand Las Vegas include *KÀ*, by Cirque du Soleil, performed in a custom-designed theatre seating almost 2,000 guests; headliner entertainment in the Hollywood Theatre; and *La Femme*. The MGM Grand Garden is a special events center with a seating capacity of over 16,000 that provides a venue for concerts by such stars as Madonna, Paul McCartney, the Rolling Stones, U2 and others, as well as championship boxing and other sporting events.

We own a 50% interest in The Signature at MGM Grand, a condominium hotel development adjacent to the resort. The other 50% is owned by an affiliate of Turnberry Associates. All three luxury condominium towers are currently under construction. When complete, The Signature at MGM Grand will consist of over 1,700 total residences, and we will have the opportunity to rent the condominiums to third parties on behalf of owners who elect to have us do so.

Mandalay Bay

Mandalay Bay is the first major resort on the Las Vegas Strip to greet visitors arriving by automobile from southern California. This AAA Four Diamond, South Seas-themed resort features numerous restaurants, such as Charlie Palmer s Aureole, Wolfgang Puck s Trattoria Del Lupo, China Grill, Hubert Keller s Fleur de Lys, and Border Grill. Mandalay Bay s pool area consists of an 11-acre tropical lagoon with numerous pools, a surfing beach, a lazy river, and Moorea Beach, a European-style ultra beach. Mandalay Bay also has a 30,000-square-foot spa. Mandalay Bay offers multiple entertainment venues that include a 12,000-seat special events arena, a 1,760-seat showroom featuring the Broadway hit *Mamma Mia!*, the House of Blues, and the Rumjungle restaurant and nightclub. In addition, Mandalay Bay features the Shark Reef, exhibiting sharks and rare sea predators.

Included within Mandalay Bay is a Four Seasons Hotel with its own lobby, restaurants and pool and spa, providing visitors with a luxury five-diamond hospitality experience. THEhotel is an all-suite hotel tower within the Mandalay Bay complex. THEhotel includes its own spa and fitness center, a lounge and two restaurants, including Mix Las Vegas, created by famed chef Alain Ducasse and located on the top floor of THEhotel.

The Mandalay Bay Conference Center is a convention and meeting complex adjacent to Mandalay Bay. The complex includes more than one million square feet of exhibit space. With this building and Mandalay Bay s original conference center, Mandalay Bay offers almost two million gross square feet of conference and exhibit space. Connecting Mandalay Bay to Luxor is Mandalay Place, a retail center that includes approximately 90,000 square feet of retail space and approximately 40 boutique stores and restaurants, including stores by GF Ferre, Nike Golf and Urban Outfitters, restaurants by celebrity chefs Pierro Selvaggio, Hubert Keller and Rick Moonen, and the burlesque club Forty Deuce.

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The Mirage

The Mirage is a luxurious, tropically-themed resort located on a site shared with TI at the center of the Las Vegas Strip. The Mirage is recognized by AAA as a Four Diamond resort. The exterior of the resort is landscaped with palm trees, abundant foliage and more than four acres of lagoons and other water features centered around a 54-foot volcano and waterfall. Each evening, the volcano erupts at regular intervals, with flames that spectacularly illuminate the front of the resort. Inside the front entrance is an atrium with a tropical garden and additional water features capped by a 100-foot-high glass dome, designed to replicate the sights, sounds and fragrances of the South Seas. Located at the rear of the hotel, adjacent to the swimming pool area, is a dolphin habitat featuring Atlantic bottlenose dolphins and *The Secret Garden of Siegfried & Roy*, an attraction that allows guests to view the beautiful exotic animals of Siegfried & Roy, the world-famous illusionists.

The Mirage features a wide array of restaurants, including Kokomos, Fin, Stack, Cravings, and Carnegie Deli. Several of these restaurants have been recently opened or renovated. Entertainment at The Mirage includes a show featuring Danny Gans, the renowned singer/impersonator, in The Danny Gans Theatre. We recently opened Jet, a 16,000-square foot nightclub. We are also constructing a custom theatre for a new Cirque du Soleil production based on the works of The Beatles, scheduled to open in mid-2006. The Mirage also has numerous retail shopping outlets and 170,000 square feet of convention space, including the 90,000-square foot Mirage Events Center.

Luxor

Luxor is an Egyptian-themed hotel and casino complex situated between Mandalay Bay and Excalibur, which are all connected by a tram. Luxor offers 20,000 square feet of convention space, a 20,000-square-foot spa, the RA nightclub, and food and entertainment venues on three different levels beneath a soaring hotel atrium. Above the pyramid s casino, the property offers a special format motion base ride and an IMAX 2D/3D theater. Luxor s other public areas include restaurants, several cocktail lounges and a variety of specialty shops. Recently, the Luxor opened the Broadway hit musical *Hairspray* and added new headline entertainment from comedian Carrot Top.

Treasure Island (TI)

TI is a Caribbean-themed resort located next to The Mirage and also holds the AAA Four Diamond rating. TI and The Mirage are connected by a monorail and a pedestrian bridge links TI to the Fashion Show Mall through a re-designed north entrance. TI features several restaurants, including Dishes, Isla Mexican Kitchen, Kahunaville, and Canter s Deli. Bars and lounges at TI include Mist and Tangerine, which features indoor/outdoor space with views of the Las Vegas Strip and nightly burlesque entertainment. The showroom at TI features *Mystère*, produced and performed by Cirque du Soleil. The Sirens of TI Show is performed at the front of the resort, providing a significant presence to visitors on the Las Vegas Strip and beckoning visitors into TI.

New York-New York

New York-New York is located at the corner of the Las Vegas Strip and Tropicana Avenue. Pedestrian bridges link New York-New York with both MGM Grand Las Vegas and Excalibur. The architecture at New York-New York replicates many of New York City s landmark buildings and icons, including the Statue of Liberty, the Empire State Building, Central Park, the Brooklyn Bridge and a Coney Island-style roller coaster. The casino features highly themed interiors including *Park Avenue* with retail shops, a *Central Park* setting in the central casino area, and *Little Italy* with its traditional food court set inside a typical residential neighborhood. New York-New York also features several restaurants and numerous bars and lounges, including nationally recognized Coyote Ugly and ESPNZone and Nine Fine Irishmen, an authentic Irish Pub. Entertainment includes *Zumanity* by Cirque du Soleil and headline performer Rita Rudner.

Excalibur

Excalibur is a castle-themed hotel and casino complex situated immediately north of Luxor at the corner of the Las Vegas Strip and Tropicana Avenue. Excalibur s public areas include a Renaissance fair, a medieval village, an amphitheater with a seating capacity of nearly 1,000 where mock jousting tournaments and costume drama are presented nightly, two dynamic motion theaters, various artisans booths and medieval games of skill. In addition, Excalibur has a buffet restaurant, several themed restaurants, as well as several snack bars, cocktail lounges and a variety of specialty shops. The property also features a 13,000-square-foot spa. Excalibur, Luxor and Mandalay are connected by a tram, allowing guests to easily travel among these resorts.

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Monte Carlo

Through the acquisition of Mandalay we now own 100% of Monte Carlo, which is located on the Las Vegas Strip adjacent to New York-New York. Monte Carlo has a palatial style reminiscent of the Belle Époque, the French Victorian architecture of the late 19th century. The resort has amenities such as fine dining at Andre s, a brew pub featuring live entertainment, a health spa, a beauty salon, and a 1,200-seat theatre featuring the world-renowned magician Lance Burton.

Circus Circus Las Vegas

Circus Circus Las Vegas is a circus-themed hotel and casino complex situated on the north end of the Las Vegas Strip. From a Big Top above the casino, Circus Circus Las Vegas offers its guests a variety of circus acts performed daily, free of charge. A mezzanine area overlooking the casino has a circus midway with carnival-style games and an arcade that offers a variety of amusements and electronic games. Specialty restaurants, a buffet, a coffee shop, snack bars, several cocktail bars and a variety of specialty shops are also available to guests. The Adventuredome, covering approximately five acres, offers theme park entertainment that includes thrills rides for adults and children, themed carnival-style midway games, an arcade, food kiosks and souvenir shops, all in a climate-controlled setting under a giant space-frame dome.

Primm Valley Resorts

The Primm Valley Resorts consist of three hotel-casinos on both sides of Interstate 15 at the California/Nevada state line in Primm, Nevada, approximately 40 miles south of Las Vegas. Buffalo Bill s Resort & Casino, Primm Valley Resort & Casino, Whiskey Pete s Hotel & Casino, Primm Valley Golf Club and three gas stations including the Primm Center (collectively, the Primm Valley Resorts) form a major destination location and offer visitors driving from California the first opportunity to wager upon entering Nevada and the last opportunity before leaving.

Primm Valley Resorts offer an array of amenities and attractions, including a 25,000-square foot conference center, numerous restaurants, and a variety of amusement rides. The 6,100-seat Star of the Desert Arena hosts top-name entertainers. Connected to Primm Valley Resorts is the Fashion Outlet of Las Vegas, a shopping mall containing approximately 400,000 square feet of retail space with over 100 retail outlet stores. The Fashion Outlet is owned and operated by a third party.

Circus Circus Reno

Circus Circus Reno is a circus-themed hotel and casino complex situated in downtown Reno, Nevada. Like its sister property in Las Vegas, Circus Circus Reno offers its guests a variety of circus acts performed daily, free of charge. A mezzanine area has a circus midway with carnival-style games and an arcade that offers a variety of amusements and electronic games. The property also has specialty restaurants, a buffet, a coffee shop, a deli/bakery, a snack bar, cocktail lounges, a gift shop and specialty shops.

Silver Legacy

Through a wholly-owned entity, we are a 50% participant with Eldorado Limited Liability Company in Circus and Eldorado Joint Venture, which owns and operates Silver Legacy, a hotel-casino and entertainment complex situated in downtown Reno, Nevada. Silver Legacy is located between Circus Circus Reno and the Eldorado Hotel & Casino, which is owned and operated by an affiliate of our joint venture partner at Silver Legacy. Silver Legacy is connected at the mezzanine level with Circus Circus Reno and the Eldorado by enclosed climate-controlled skyways above the streets between the respective properties. The resort s exterior is themed to evoke images of historical Reno. Silver Legacy features several restaurants and bars, a special events center, custom retail shops, a health spa and an outdoor pool and sun deck.

Gold Strike

This property is an Old West -themed hotel-casino located on the east side of Interstate-15 in Jean, Nevada. Jean is located approximately 25 miles south of Las Vegas and approximately 15 miles north of the California-Nevada state line. The property has, among other amenities, a swimming pool and spa, several restaurants, a banquet center, a gift shop and an arcade. The casino has a stage bar with regularly scheduled live entertainment and a casino bar.

Nevada Landing

Nevada Landing is a turn-of-the-century riverboat-themed hotel-casino located in Jean across Interstate 15 from Gold Strike. Nevada Landing includes a specialty restaurant, a full-service coffee shop, a buffet, a snack bar, a gift shop, a swimming pool and spa and a 300-guest banquet facility.

Colorado Belle

Colorado Belle is situated on the bank of the Colorado River in Laughlin, Nevada, approximately 90 miles south of Las Vegas. Colorado Belle features a 600-foot replica of a Mississippi riverboat, and also includes a buffet, a coffee shop, specialty restaurants, a microbrewery, snack bars and cocktail lounges, as well as a gift shop and other specialty shops.

Edgewater

Edgewater is located adjacent to Colorado Belle along the Colorado River. Edgewater s facilities include a specialty restaurant, a coffee shop, a buffet, a snack bar and cocktail lounges.

Railroad Pass

Railroad Pass is located in Henderson, Nevada, a suburb located southeast of Las Vegas, and is situated along US Highway 93, the direct route between Las Vegas and Phoenix, Arizona. The property includes, among other amenities, full-service restaurants, a buffet, a gift shop, a swimming pool and a banquet facility. In contrast with our other Nevada properties, Railroad Pass caters to local residents, particularly from Henderson and Boulder City.

MGM Grand Detroit

MGM Grand Detroit is our interim casino facility in Detroit, Michigan. MGM Grand Detroit is one of three casinos licensed in Detroit and is operated by MGM Grand Detroit, LLC. MGM Grand Detroit, Inc., our wholly-owned subsidiary, holds a controlling interest in MGM Grand Detroit, LLC. A minority interest in MGM Grand Detroit, LLC is held by Partners Detroit, LLC, a Michigan limited liability company owned by residents and entities located in the Detroit metropolitan area. MGM Grand Detroit s interior is decorated in an Art Deco motif with themed bars, a VIP lounge and several restaurants. The site is conveniently located off the Howard Street exit from the John C. Lodge Expressway in downtown Detroit, and has parking for over 3,000 vehicles in two parking garages and additional on-site covered parking.

Beau Rivage

Beau Rivage sustained significant damage in late August 2005 as a result of Hurricane Katrina and has been closed since. We expect to reopen Beau Rivage in stages beginning in the third quarter of 2006. The damage was primarily concentrated on the lower levels, including the casino, restaurant and retail areas. We intend to rebuild Beau Rivage at its existing beachfront site where Interstate 110 meets the Gulf Coast in Biloxi, Mississippi. When fully reopened, Beau Rivage will include 1,740 guest rooms, over 2,000 slot machines and 90 table games, new and restored restaurants, a state-of-the-art convention center, and pool and spa amenities. Construction is also continuing on a world-class golf course, Fallen Oak, designed by renowned golf course architect Tom Fazio, to be located approximately 20 miles from the resort and scheduled to open in November 2006.

Gold Strike-Tunica

Gold-Strike Tunica is a dockside casino located along the Mississippi River, 20 miles south of Memphis and approximately three miles west of Mississippi State Highway 61, a major north/south highway connecting Memphis with Tunica County. The property features an 800-seat showroom, a coffee shop, a specialty restaurant, a buffet, a snack bar and several cocktail lounges. Gold Strike-Tunica is part of a three-casino development covering approximately 72 acres. The other two casinos are owned and operated by unaffiliated third parties. We also own an undivided one-half interest in an additional 388 acres of land that may be used for future development.

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Borgata

The Borgata Hotel Casino and Spa is located at Renaissance Pointe in Atlantic City, New Jersey. In addition to its 2,000 guest rooms and suites and extensive gaming floor, Borgata includes several specialty restaurants, retail shops, a European-style health spa, meeting space and unique entertainment venues. Borgata was the first new casino in Atlantic City in over 13 years when it opened in July 2003. Through a wholly-owned subsidiary, we own 50% of the limited liability company that owns Borgata. Boyd Gaming Corporation (Boyd) owns the other 50% and also operates the resort.

Borgata is currently expanding its gaming and non-gaming amenities, adding 36 casino table games and 500 slot machines, expanding its poker room and race book, and adding additional restaurant, entertainment and other amenities. This $200 million project is expected to be completed in the second quarter of 2006. Additionally, Borgata has plans to add another hotel tower, the Water Club at Borgata, featuring 800 guestrooms and suites, along with a new spa, parking garage and meeting rooms. This $325 million project is expected to be completed in late 2007. Neither project is expected to require contributions from us, as existing operating cash flow and Borgata s recently renegotiated bank credit facility is anticipated to provide for the cost of the expansions.

Grand Victoria

Through wholly-owned entities, we are a 50% participant with RBG, L.P. in an entity which owns Grand Victoria, a Victorian-themed riverboat casino and land-based entertainment complex in Elgin, Illinois, a suburb approximately 40 miles northwest of downtown Chicago. The riverboat offers dockside gaming, which means its operation is conducted at dockside without cruising. The property also features a dockside complex that contains an approximately 83,000-square-foot pavilion with a buffet, a fine dining restaurant, a VIP lounge and a gift shop.

Golf Courses

We own and operate an exclusive world-class golf course, Shadow Creek, designed by Tom Fazio and located approximately ten miles north of our Las Vegas Strip resorts. Shadow Creek is ranked 3rd in Golf Digest s ranking of America s 100 Greatest Public Courses. We also own and operate the Primm Valley Golf Club, located four miles south of the Primm Valley Resorts in California, which includes two 18-hole championship courses. These golf courses were also designed by Tom Fazio.

Future Development

Project CityCenter

In November 2004 we announced a plan to develop a multi-billion dollar urban metropolis, Project CityCenter, on 66 acres of land on the Las Vegas Strip, between Bellagio and Monte Carlo. Project CityCenter will feature a 4,000-room casino resort designed by world-famous architect Cesar Pelli; two 400-room non-gaming boutique hotels, one of which will be managed by luxury hotelier Mandarin Oriental; approximately 470,000 square feet of retail shops, dining and entertainment venues; and approximately 2.3 million square feet of residential space in over 2,900 luxury condominium and condominium-hotel units in multiple towers.

As currently contemplated, we believe Project CityCenter will cost approximately $7 billion, excluding preopening and land costs. After estimated proceeds of $2.5 billion from the sale of residential units, we believe the net project cost will be approximately $4.5 billion. We expect to complete the design work for Project CityCenter in mid-2006 and expect the project to open in 2009. The design, budget and schedule of Project CityCenter are still preliminary, and the ultimate timing, cost and scope of Project CityCenter are subject to risks attendant to large-scale projects.

Detroit, Michigan

MGM Grand Detroit, LLC has operated an interim casino facility in downtown Detroit since July 1999. In August 2002 the Detroit City Council approved revised development agreements with our subsidiary and two other developers. The revised development agreement released us and the City from certain of the obligations under the original agreement and significantly changed other provisions of the original agreement.

In April 2005, the 6th Circuit Court of Appeals lifted its injunction prohibiting commencement of construction of the permanent hotel and casino complexes. We have obtained land and began construction on our permanent facility, which will be located near the site of our interim facility. The permanent facility is expected to open in late 2007 at a cost of approximately $765 million, including land and preopening costs, and will feature a 400-room hotel, 100,000-square foot casino, numerous restaurant and entertainment amenities, and spa and convention facilities. The complete design, timing and cost of the permanent facility are at a preliminary stage, and are subject to risks attendant to large-scale projects.

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Macau

We own 50% of MGM Grand Paradise Limited, an entity which is developing, and will operate, MGM Grand Macau, a hotel-casino resort in Macau S.A.R. Pansy Ho Chiu-king owns the other 50% of MGM Grand Paradise Limited. MGM Grand Macau will be located on a prime waterfront site and will feature at least 345 table games and 1,035 slots with room for significant expansion. Other features will include a 600-room hotel, a luxurious spa, convertible convention space, a variety of dining destinations, and other attractions. Construction of MGM Grand Macau, which is estimated to cost $1.1 billion including license and land rights and preopening costs, began in the second quarter of 2005 and the resort is anticipated to open in late 2007. The complete design, timing, cost and scope of the project are at a preliminary stage and are subject to the risks attendant to large-scale projects. We have invested $180 million in the venture, and are committed to loaning the venture up to $100 million. The venture has obtained commitments from lenders for a credit facility sufficient, along with equity contributions and shareholder loans, to fund the construction of MGM Grand Macau.

New York Racing Association

We have entered into a definitive agreement with the New York Racing Association (NYRA) to manage video lottery terminals (VLTs) at NYRA s Aqueduct horseracing facility in metropolitan New York. We will assist in the development of the approximately $170 million facility, including providing project financing, and will manage the facility for a term of five years, extended automatically if the financing provided by us is not fully repaid, for a fee. Recent legislative changes will allow us to operate the VLTs past the expiration date of the current NYRA franchise agreement.

Atlantic City, New Jersey

We own approximately 130 acres on Renaissance Pointe in Atlantic City, New Jersey. We lease 10 acres to Borgata under long-term leases for use in its current operations and for its expansion. Of the remaining 120 acres, approximately 72 acres are suitable for development. We lease nine of these acres to Borgata on a short-term basis for surface parking and a portion of the remaining acres consists of common roads, landscaping and master plan improvements which we designed and developed as required by our agreement with Boyd. We own an additional 15 developable acres in the Marina District near Renaissance Pointe.

We must apply for and receive numerous governmental permits and satisfy other conditions before construction of a new resort on the Renaissance Pointe site could begin. No assurance can be given that we will develop a casino resort in New Jersey, or its ultimate schedule, size, configuration or cost if we do develop a casino resort.

United Kingdom

We continue to pursue development opportunities in the United Kingdom. We have entered into agreements or have formed strategic alliances with several companies in order to further these development efforts. We are currently pursuing opportunities in Birmingham, Glasgow, Newcastle and Sheffield. These opportunities are subject to certain conditions, including obtaining regional casino licenses and regulatory approvals, and the implementation of an acceptable tax regime. The Gambling Act 2005 includes authorization for only one initial regional casino (unlimited table games and a maximum of 1,250 slot machines) and eight large casinos (unlimited table games and a maximum of 150 slot machines), a significant reduction from previous proposals. The Gambling Act 2005 allows for an increase in the number of regional casinos, but it is uncertain whether more regional casinos will be approved in the near term.

Singapore

In 2005 we agreed to form a joint venture with CapitaLand, a listed company in Singapore, to pursue one of two gaming licenses in Singapore. We will own 60% of the joint venture and would manage the resort. In April 2005, we and our partner CapitaLand, together with 11 other applicants, were successful in qualifying for the second round of the proposal process for the development of an integrated resort complex in the Marina Bayfront of Singapore. The Singapore government issued the request for proposals in the fourth quarter of 2005 and we are in the process of preparing our proposal response. Only three other bidders have indicated they expect to submit responses for the Marina site.

Other

We regularly evaluate possible expansion and acquisition opportunities in both the domestic and international markets. These opportunities may include the ownership, management and operation of gaming and other entertainment facilities in Nevada or in states other than Nevada or outside of the United States. We may undertake these opportunities either alone or in cooperation with one or more third parties. Development and operation of any gaming facility in a new jurisdiction is subject to many contingencies. Several of these contingencies are outside of our control and may include the passage of appropriate gaming legislation, the issuance of necessary permits, licenses and approvals, the availability of appropriate financing and the satisfaction of other conditions. We cannot be sure that we will decide or be able to proceed with any acquisition or expansion opportunities.

Operations

We operate primarily in one segment, the operation of casino resorts, which includes offering gaming, hotel, dining, entertainment, retail and other resort amenities. Giving effect to the Mandalay merger, over half of our net revenue is now derived from non-gaming activities, a higher percentage than many of our competitors, as our operating philosophy is to provide a complete resort experience for our guests, including non-gaming amenities which command a premium price based on their quality. We believe that we own several of the premier casino resorts in the world, and a main focus of our strategy is to continually reinvest in these resorts to maintain our competitive advantage.

As a resort-based company, our operating results are highly dependent on the volume of customers at our resorts, which in turn impacts the price we can charge for our hotel rooms and other amenities. We also generate a significant portion of our operating income from the high-end gaming segment, which can cause variability in our results.

Most of our revenue is essentially cash-based, through customers wagering with cash or paying for non-gaming services with cash or credit cards. Our resorts, like many in the industry, generate significant operating cash flow. Our industry is capital intensive and we rely heavily on the ability of our resorts to generate operating cash flow to repay debt financing, fund maintenance capital expenditures and provide excess cash for future development.

Our results of operations do not tend to be seasonal in nature, though a variety of factors can affect the results of any interim period, including the timing of major Las Vegas conventions, the amount and timing of marketing and special events for our high-end customers, and the level of play during major holidays, including New Year and Chinese New Year. Our significant convention and meeting facilities allow us to maximize hotel occupancy and customer volumes during off-peak times such as mid-week or during traditionally slower leisure travel periods, which also leads to better labor utilization.

All of our casino resorts operate 24 hours each day, every day of the year, with the exception of Grand Victoria which operates 22 hours a day, every day of the year. Our primary casino operations are owned and managed by us. Other resort amenities may be owned and operated by us, owned by us but managed by third parties for a fee, or leased to third parties. We generally have an operating philosophy that prefers ownership of amenities, since guests have direct contact with staff in these areas and we prefer to control all aspects of the guest experience. However, we do lease space to retail and food and beverage operators in certain situations, particularly for branding opportunities. We also operate many managed outlets, utilizing third party management for specific expertise in areas such as restaurants and nightclubs, as well as for branding opportunities. Since we believe that the number of walk-in customers also affects the success of our casino resorts, we design our facilities to maximize their attraction to guests of other hotels.

We utilize technology to maximize revenue and efficiency in our operations. We are in the process of combining our Players Club with Mandalay s One Club program. When the process is complete, Players Club will link our major resorts, and consolidate all slots and table games activity for customers with a Players Club account. Under the combined program, customers will qualify for benefits across all of these resorts, regardless of where they play. We believe that our Players Club enables us to more effectively market to our customers. A significant portion of the slot machines at our resorts operate with International Game Technology s EZ-Pay cashless gaming system, including the Mandalay resorts where we recently converted many of the slot machines to EZ-Pay . We believe that this system enhances the customer experience and increases the revenue potential of our slot machines.

Technology is a critical part of our strategy in non-gaming operations and administrative areas as well. Our hotel systems include yield management modules which allow us to maximize occupancy and room rates. Additionally, these systems capture most charges made by our customers during their stay, including allowing customers of any of our resorts to charge meals and services at other MGM MIRAGE resorts to their hotel accounts. We are implementing a new hotel management system at all our resorts in 2006 and 2007, which we expect will enhance our guest service and improve our yield management across our portfolio of resorts.

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Marketing and Competition

General

Our casino resorts generally operate in highly competitive environments. We compete against other gaming companies as well as other hospitality and leisure and business travel companies. Our primary methods of competing successfully in a competitive environment include:

- Locating our resorts in desirable leisure and business travel markets, and operating at superior sites within those markets.
- Constructing and maintaining high-quality resorts and facilities, including luxurious guestrooms along with premier dining, entertainment and retail amenities;
- Recruiting, training and retaining well-qualified and motivated employees who provide superior and friendly customer service;
- Providing unique, must-see entertainment attractions; and
- Developing distinctive and memorable marketing and promotional programs.

Customers and Competition

Our Las Vegas casino resorts compete for customers with a large number of other hotel-casinos in the Las Vegas area, including major hotel-casinos on or near the Las Vegas Strip, major hotel-casinos in the downtown area, which is about five miles from the center of the Strip, and several major facilities elsewhere in the Las Vegas area. According to the Las Vegas Convention and Visitors Authority, there were approximately 133,200 guestrooms in Las Vegas at December 31, 2005, up 1% from approximately 131,500 rooms at December 31, 2004. Las Vegas visitor volume was 38.6 million in 2005, a 3% increase from the 37.4 million reported for 2004. The principal segments of the Las Vegas gaming market are leisure travel, premium gaming customers, conventions, including small meetings and corporate incentive programs, and tour and travel. Our high-end properties, which include Bellagio, MGM Grand Las Vegas, Mandalay Bay, and The Mirage, appeal to the upper end of each market segment, balancing their business by using the convention and tour and travel segments to fill the mid-week and off-peak periods. Our marketing strategy for TI, New York-New York, Luxor and Monte Carlo is aimed at attracting middle- to upper-middle-income wagerers, largely from the leisure travel and, to a lesser extent, the tour and travel segments. Excalibur and Circus Circus Las Vegas generally cater to the value-oriented and middle-income leisure travel and tour and travel segments.

Outside Las Vegas, our other wholly-owned Nevada operations, including those in Reno and Laughlin, compete with each other and with many other similar sized and larger operations. A significant portion of our customers at these resorts come from California. We believe the expansion of Native American gaming has had a negative impact on all of our Nevada resorts not located on the Las Vegas Strip, and the anticipated additional expansion in California could have a further adverse effect on these resorts. Our Nevada resorts not located in Las Vegas appeal primarily to middle-income customers attracted by room, food and beverage and entertainment prices that are lower than those offered by major Las Vegas hotel-casinos. Our target customer for these resorts is the value-oriented leisure traveler and the value-oriented local customer.

Outside Nevada, our wholly-owned resorts mainly compete for customers in local gaming markets, where location is a critical success factor. In Tunica, Mississippi, one of our competitors is closer to Memphis, the area s principal market. In addition, we compete with gaming operations in surrounding jurisdictions and other leisure destinations in each region. For instance, in Detroit, Michigan we also compete with a casino in nearby Windsor, Canada. In Biloxi, Mississippi we also compete with regional riverboat and land-based casinos in Louisiana, Native American casinos in central Mississippi, the south Florida leisure market, and with casinos in the Bahamas.

Our unconsolidated affiliates mainly compete for customers against casino resorts in their respective markets, and in some cases against our wholly-owned operations. Much like our wholly-owned resorts, our unconsolidated affiliates compete through the quality of amenities, the value of the experience offered to guests, and the location of their resorts.

Our Company s facilities also compete for gaming customers with hotel-casino operations located in other areas of the United States and other parts of the world, and for leisure and business travelers with non-gaming tourist destinations such as Hawaii, Florida and cruise ships. Our hotel-casinos compete to a lesser extent with state-sponsored lotteries, off-track wagering, card parlors, and other forms of legalized gaming in the United States.

Marketing

We advertise on radio, television and billboards and in newspapers and magazines in selected cities throughout the United States and overseas, as well as on the Internet and by direct mail. We also advertise through our regional marketing offices located in major United States and foreign cities. A key element of marketing to premium gaming customers is personal contact by our marketing personnel. Direct marketing is also important in the convention segment. We maintain Internet websites which inform customers about our resorts and allow our customers to reserve hotel rooms and make restaurant and show reservations. We also operate call centers to allow customer contact by phone to make hotel, restaurant and show reservations.

We utilize our world-class golf courses in marketing programs at our Las Vegas Strip and other Nevada resorts. Our major Las Vegas resorts offer luxury suite packages that include golf privileges at Shadow Creek. In connection with our marketing activities, we also invite our premium gaming customers to play Shadow Creek on a complimentary basis. We use Primm Valley Golf Club for marketing purposes at our Las Vegas and Primm resorts, including offering room and golf packages at special rates.

Competitive Risks

The principal negative factors relating to our competitive position are:

- Our limited geographic diversification-our major resorts are concentrated on the Las Vegas Strip and some of our largest competitors operate in more gaming markets than we do;

- There are a number of gaming facilities located closer to where our customers live than our resorts;

- Our guestroom, dining and entertainment prices are often higher than those of most of our competitors in each market, although we believe that the quality of our facilities and services is also higher;

- Our hotel-casinos compete to some extent with each other for customers. Bellagio, MGM Grand Las Vegas, Mandalay Bay and The Mirage, in particular, compete for some of the same premium gaming customers; and

- Additional new hotel-casinos and expansion projects at existing Las Vegas hotel-casinos are under construction or have been proposed. We are unable to determine to what extent increased competition will affect our future operating results.

Control Over Gaming Activities

General

In connection with the supervision of gaming activities at our casinos, we maintain stringent controls on the recording of all receipts and disbursements. These controls include:

- Locked cash boxes on the casino floor;

- Daily cash and coin counts performed by employees who are independent of casino operations;

- Constant observation and supervision of the gaming area;

- Observation and recording of gaming and other areas by closed-circuit television;

- Constant computer monitoring of our slot machines; and

- Timely analysis of deviations from expected performance.

Issuance of Markers

Marker play represents a significant portion of the table games volume at Bellagio, MGM Grand Las Vegas, Mandalay Bay and The Mirage. Our other facilities do not emphasize marker play to the same extent, although we offer markers to customers at certain of those casinos as well.

We maintain strict controls over the issuance of markers and aggressively pursue collection from those customers who fail to pay their marker balances timely. These collection efforts are similar to those used by most large corporations when dealing with overdue customer accounts, including the mailing of statements and delinquency notices, personal contacts, the use of outside collection agencies and civil litigation. A significant portion of our Company s accounts receivable, for amounts unpaid resulting from markers which are not collectible through banking channels, is owed by major casino customers from the Far East. The collectibility of unpaid markers is affected by a number of factors, including changes in currency exchange rates and economic conditions in the customers home countries.

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In Nevada, Mississippi, Michigan, and Illinois, amounts owed for markers which are not timely paid are enforceable under state laws. All other states are required to enforce a judgment for amounts owed for markers entered into in Nevada, Mississippi, Illinois or Michigan which are not timely paid, pursuant to the Full Faith and Credit Clause of the United States Constitution. Amounts owed for markers which are not timely paid are not legally enforceable in some foreign countries, but the United States assets of foreign customers may be reached to satisfy judgments entered in the United States.

Employees and Labor Relations

As of December 31, 2005, we had approximately 54,500 full-time and 12,000 part-time employees. At that date, we had collective bargaining contracts with unions covering approximately 29,000 of our employees. We consider our employee relations to be good.

Regulation and Licensing

The gaming industry is highly regulated, and we must maintain our licenses and pay gaming taxes to continue our operations. Each of our casinos is subject to extensive regulation under the laws, rules and regulations of the jurisdiction where it is located. These laws, rules and regulations generally concern the responsibility, financial stability and character of the owners, managers, and persons with financial interest in the gaming operations. Violations of laws in one jurisdiction could result in disciplinary action in other jurisdictions. A more detailed description of the regulations to which we are subject is contained in Exhibit 99 to this Annual Report on Form 10-K, which Exhibit is incorporated herein by reference.

Our businesses are subject to various federal, state and local laws and regulations in addition to gaming regulations. These laws and regulations include, but are not limited to, restrictions and conditions concerning alcoholic beverages, environmental matters, employees, currency transactions, taxation, zoning and building codes, and marketing and advertising. Such laws and regulations could change or could be interpreted differently in the future, or new laws and regulations could be enacted. Material changes, new laws or regulations, or material differences in interpretations by courts or governmental authorities could adversely affect our operating results.

Forward-looking Statements

(Cautionary Statements Under the Private Securities Litigation Reform Act of 1995)

This Form 10-K and our 2005 Annual Report to Stockholders contain some forward-looking statements. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They contain words such as anticipate, estimate, expect, project, intend, plan, believe, may, could, might and other words or p meaning in connection with any discussion of future operating or financial performance. In particular, these include statements relating to future actions, new projects, future performance, the outcome of contingencies such as legal proceedings and future financial results. From time to time, we also provide oral or written forward-looking statements in our Forms 10-Q and 8-K, press releases and other materials we release to the public. Any or all of our forward-looking statements in this Form 10-K, in our 2005 Annual Report to Stockholders and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in this Form 10-K for example, government regulation and the competitive environment will be important in determining our future results. Consequently, no forward-looking statement can be guaranteed. Our actual future results may differ materially.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our Forms 10-K, 10-Q and 8-K reports to the Securities and Exchange Commission. Also note that we provide the following discussion of risks, uncertainties and possible inaccurate assumptions relevant to our business. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.

You should also be aware that while we from time to time communicate with securities analysts, we do not disclose to them any material non-public information, internal forecasts or other confidential business information. Therefore, you should not assume that we agree with any statement or report issued by any analyst, irrespective of the content of the statement or report. To the extent that reports issued by securities analysts contain projections, forecasts or opinions, those reports are not our responsibility.

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Factors that May Affect Our Future Results

You should be aware that the occurrence of any of the events described in this section and elsewhere in this report or in any other of our filings with the SEC could have a material adverse effect on our business, financial position, results of operations and cash flows. In evaluating us, you should consider carefully, among other things, the risks described below.

We have significant indebtedness. At December 31, 2005, we had approximately $12.4 billion of indebtedness. The interest rate on a large portion of our long-term debt will be subject to fluctuation based on changes in short-term interest rates and the level of debt-to-EBITDA (as defined) under the provisions of our senior credit facility. Our current bank credit agreements and the indentures governing our debt securities do not prohibit us from borrowing additional funds in the future. Our interest expense could increase as a result of these factors. Additionally, our indebtedness could increase our vulnerability to general adverse economic and industry conditions, limit our flexibility in planning for or reacting to changes in our business and industry, limit our ability to borrow additional funds and place us at a competitive disadvantage compared to other less leveraged competitors. Our ability to reduce our outstanding debt will be subject to our future cash flows, other capital requirements and other factors, some of which are not within our control.

Our casinos in Las Vegas and elsewhere are destination resorts that compete with other destination travel locations throughout the United States and the world. We do not believe that our competition is limited to a particular geographic area, and gaming operations in other states or countries could attract our customers. To the extent that new casinos enter our markets or hotel room capacity is expanded by others in major destination locations, competition will increase. Major competitors, including new entrants, have either recently expanded their hotel room capacity or are currently expanding their capacity or constructing new resorts in Las Vegas. Also, the recent growth of gaming in areas outside Las Vegas, including California, has increased the competition faced by our operations in Las Vegas and elsewhere. In particular, as large scale gaming operations in Native American tribal lands increase, competition will increase.

The expansion of Native American gaming in California has already impacted our operations. According to the California Gambling Control Commission, more than 60 compacts with tribes had been approved by the federal government as of December 31, 2005, with more than 50 of the tribes legally operating casinos in California in accordance with these compacts. Additional expansion of gaming in California could have an adverse impact on our results of operations.

The ownership and operation of gaming facilities are subject to extensive federal, state and local laws, regulations and ordinances, which are administered by the relevant regulatory agencies in each jurisdiction. These laws, regulations and ordinances vary from jurisdiction to jurisdiction, but generally concern the responsibility, financial stability and character of the owners and managers of gaming operations as well as persons financially interested or involved in gaming operations. As such, our gaming regulators can require us to disassociate ourselves from suppliers or business partners found unsuitable by the regulators. For a summary of gaming regulations that affect our business, see Regulation and Licensing. The regulatory environment in any particular jurisdiction may change in the future and any such change could have a material adverse effect on our results of operations. In addition, we are subject to various gaming taxes, which are subject to possible increase at any time. For instance, the gaming tax rate in Michigan was increased in 2004.

Our business is affected by economic and market conditions in the markets in which we operate and in the locations our customers reside. Bellagio, MGM Grand Las Vegas, Mandalay Bay and The Mirage are particularly affected by economic conditions in the Far East, and all of our Nevada resorts are affected by economic conditions in the United States, and California in particular. A recession or economic slowdown could cause a reduction in visitation to our resorts, which would adversely affect our operating results.

Certain of our casino properties are located in areas that may be subject to extreme weather conditions, including, but not limited to, hurricanes. Such extreme weather conditions may interrupt our operations, damage our properties, and reduce the number of customers who visit our facilities in such areas. Although we maintain both property and business interruption insurance coverage for certain extreme weather conditions, such coverage is subject to deductibles and limits on maximum benefits, including limitation on the coverage period for business interruption, and we cannot assure you that we will be able to fully insure such losses or fully collect, if at all, on claims resulting from such extreme weather conditions. Furthermore, such extreme weather conditions may interrupt or impede access to our affected properties and may cause visits to our affected properties to decrease for an indefinite period. For example, in August 2005, Hurricane Katrina caused significant damage to our Beau Rivage resort. See Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Statement Impact of Hurricane Katrina.

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We are a large consumer of electricity and other energy. Accordingly, increases in energy costs, such as those experienced recently may have a negative impact on our operating results. Additionally, higher energy and gasoline prices which affect our customers may result in reduced visitation to our resorts and a reduction in our revenues. For example, Nevada Power, which supplies power to our Las Vegas resorts, recently submitted a rate request which would significantly increase our cost of electricity at those resorts.

Executive Officers of the Registrant

The following table sets forth, as of March 1, 2006, the name, age and position of each of our executive officers. Executive officers are elected by and serve at the pleasure of the Board of Directors.

Name	Age	Position
J. Terrence Lanni	62	Chairman and Chief Executive Officer
James J. Murren	44	President, Chief Financial Officer, Treasurer and Director
John T. Redmond	47	President and Chief Executive Officer of MGM Grand Resorts, LLC and Director
Robert H. Baldwin	55	President and Chief Executive Officer of Mirage Resorts, Incorporated, President of Project CityCenter and Director
Gary N. Jacobs	60	Executive Vice President, General Counsel, Secretary and Director
Glenn D. Bonner	54	Senior Vice President and Chief Information Officer
Daniel J. D Arrigo	37	Senior Vice President Finance
Alan Feldman	47	Senior Vice President Public Affairs
Bruce Gebhardt	58	Senior Vice President Global Security
Phyllis A. James	53	Senior Vice President and Senior Counsel
Punam Mathur	45	Senior Vice President Corporate Diversity and Community Affairs
Cynthia Kiser Murphey	48	Senior Vice President Human Resources
Shawn T. Sani	40	Senior Vice President Taxes
Robert C. Selwood	50	Senior Vice President Accounting
Bryan L. Wright	42	Senior Vice President, Assistant General Counsel and Assistant Secretary

Mr. Lanni has served as Chairman of the Company since July 1995. He served as Chief Executive Officer of the Company from June 1995 to December 1999, and since March 2001. Prior thereto, he served in various executive capacities at Caesars World, Inc., including its President and Chief Operating Officer from 1981 to 1995.

Mr. Murren has served as President of the Company since December 1999, as Chief Financial Officer since January 1998 and as Treasurer since November 2001. He served as Executive Vice President of the Company from January 1998 to December 1999. Prior thereto, he was Managing Director and Co-Director of Research for Deutsche Morgan Grenfell, having served that firm in various other capacities since 1984.

Mr. Redmond has served as President and Chief Executive Officer of MGM Grand Resorts, LLC since March 2001. He served as Co-Chief Executive Officer of the Company from December 1999 to March 2001. He served as President and Chief Operating Officer of Primadonna Resorts from March 1999 to December 1999. He served as Vice Chairman of MGM Grand Detroit, LLC from April 1998 to February 2000, and as its Chairman since February 2000. He served as Senior Vice President of MGM Grand Development, Inc. from August 1996 to September 1998. Prior thereto, he was Senior Vice President and Chief Financial Officer of Caesars World, Inc. s Caesars Palace and Desert Inn hotel-casinos and served in various other senior operational and development positions with Caesars World, Inc.

Mr. Baldwin has served as President and Chief Executive Officer of Mirage Resorts since June 2000 and as President of Project CityCenter since March 2005. He served as Chief Financial Officer and Treasurer of Mirage Resorts from September 1999 to June 2000. He was President and Chief Executive Officer of Bellagio, LLC from June 1996 to March 2005. He served as President and Chief Executive Officer of The Mirage from August 1987 to April 1997.

Mr. Jacobs has served as Executive Vice President and General Counsel of the Company since June 2000 and as Secretary since January 2002. Prior thereto, he was a partner with the law firm of Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, LLP, and is currently of counsel to that firm.

Mr. Bonner has served as Senior Vice President and Chief Information Officer of the Company since January 2005. He served as Vice President Chief Information Officer of the Company from June 2000 to January 2005ceeff;padding-left:2px;padding-top:2px;padding-bottom:2px;padding-right:2px;">

5,892

Long-term debt, net of current portion
6,418

5,925

Pension and other post-retirement benefit plan liabilities
5,962

6,555

Other non-current liabilities
854

965

Total liabilities
18,518

19,337

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: 2015—195,111,898 and 2014—198,930,240
195

199

Paid-in capital
—

—

Retained earnings
11,843

12,392

Accumulated other comprehensive loss
(5,290
)

(5,356
)
Total shareholders’ equity
6,748

7,235

Total liabilities and shareholders’ equity
$
25,266

$
26,572

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

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NORTHROP GRUMMAN CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

$ in millions	Three Months Ended March 31 2015	2014
Operating activities		
Net earnings	$484	$579
Adjustments to reconcile to net cash used in operating activities:		
Depreciation and amortization	99	109
Stock-based compensation	24	22
Excess tax benefits from stock-based compensation	(105)	(68)
Deferred income taxes	204	40
Changes in assets and liabilities:		
Accounts receivable, net	(325)	(531)
Inventoried costs, net	(76)	(66)
Prepaid expenses and other assets	16	(6)
Accounts payable and other liabilities	(889)	(755)
Income taxes payable	366	279
Retiree benefits	(440)	14
Other, net	(12)	(19)
Net cash used in operating activities	$(654)	$(402)
Investing activities		
Capital expenditures	(117)	(60)
Other investing activities, net	2	(72)
Net cash used in investing activities	(115)	(132)
Financing activities		
Common stock repurchases	(825)	(570)
Net proceeds from issuance of long-term debt	600	—
Cash dividends paid	(156)	(132)
Other financing activities, net	(67)	(29)
Net cash used in financing activities	(448)	(731)
Decrease in cash and cash equivalents	(1,217)	(1,265)
Cash and cash equivalents, beginning of year	3,863	5,150
Cash and cash equivalents, end of period	$2,646	$3,885

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

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NORTHROP GRUMMAN CORPORATION

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

	Three Months Ended March 31	
$ in millions, except per share amounts	2015	2014
Common stock		
Beginning of year	$199	$218
Common stock repurchased	(5)	(5)
Shares issued for employee stock awards and options	1	2
End of period	195	215
Paid-in capital		
Beginning of year	—	848
Common stock repurchased	—	(560)
Stock compensation	—	(7)
Other	—	11
End of period	—	292
Retained earnings		
Beginning of year	12,392	12,538
Common stock repurchased	(854)	—
Net earnings	484	579
Dividends declared	(142)	(134)
Stock compensation	(37)	—
End of period	11,843	12,983
Accumulated other comprehensive loss		
Beginning of year	(5,356)	(2,984)
Other comprehensive income, net of tax	66	63
End of period	(5,290)	(2,921)
Total shareholders' equity	$6,748	$10,569
Cash dividends declared per share	$0.70	$0.61

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

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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 include the accounts of Northrop Grumman Corporation and subsidiaries (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 accompanying unaudited condensed consolidated financial statements are prepared in accordance with the rules of the Securities and Exchange Commission (SEC) for interim reporting purposes. These 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 unaudited condensed consolidated financial statements are not necessarily indicative of results that may be expected for the entire year. These unaudited condensed consolidated financial statements should be read in conjunction with the information contained in the company’s 2014 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.

Accounting Estimates

The accompanying unaudited condensed consolidated 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 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 United States (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. The company estimates profit on contracts as the difference between total estimated sales and total estimated cost of a contract at completion and recognizes that profit either as costs are incurred (cost-to-cost) or as units are delivered (units-of-delivery). The company classifies sales as product or service depending upon the predominant attributes of the contract.

We recognize changes in estimated contract sales, costs or profits using the cumulative catch-up method of accounting. This method recognizes, in the current period, the cumulative effect of the changes on current and prior periods; sales and profit in future periods of contract performance are recognized as if the revised estimates had been used since contract inception. If it is determined that a loss will result from the performance of a contract, the entire amount of the estimable future loss is charged against income in the period the loss is identified. Loss provisions are first offset against any costs that are included in unbilled accounts receivable or inventoried costs, and any remaining amount is reflected in liabilities.

Significant changes in estimates on a single contract could have a material effect on the company's unaudited condensed consolidated financial position or results of operations. Where such changes occur, we generally disclose the nature, underlying conditions and financial impact of the change. No discrete event or adjustments to an individual contract were material to the accompanying unaudited condensed consolidated financial statements.

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NORTHROP GRUMMAN CORPORATION

The effect of aggregate net changes in contract estimates recognized using the cumulative catch-up method of accounting is as follows:

	Three Months Ended March 31	
$ in millions, except per share data	2015	2014
Operating Income	$187	$197
Net Earnings (1)	122	128
Diluted earnings per share (1)	0.61	0.58

(1) Based on statutory tax rates

As of March 31, 2015, the recognized amounts related to contract claims and requests for equitable adjustment are not material individually or in aggregate. In addition, as of March 31, 2015, the company does not have any contract terminations in process that we anticipate would have a material effect on our unaudited condensed consolidated financial position, or our annual results of operations and/or cash flows.

Related Party Transactions

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

Accounting Standards Updates

On May 28, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers. ASU 2014-09 supersedes existing revenue recognition guidance, including Accounting Standards Codification (ASC) No. 605-35, Revenue Recognition - Construction-Type and Production-Type Contracts. ASU 2014-09 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. These concepts, as well as other aspects of ASU 2014-09, may change the method and/or timing of revenue recognition for certain of our contracts. ASU 2014-09 will be effective January 1, 2017; however, a delay in the effective date is currently being considered by the FASB, which we expect will result in at least a one year deferral. ASU 2014-09 may be applied either retrospectively or through the use of a modified-retrospective method. We are currently evaluating both methods of adoption as well as the effect ASU 2014-09 will have on the company’s consolidated financial position, annual results of operations and cash flows.

Other accounting standards updates effective after March 31, 2015, 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.

Shareholders' Equity

The company records the difference between the cost of shares repurchased and their par value as well as tax withholding in excess of related stock compensation expense as a reduction of paid-in capital to the extent available and then as a reduction of retained earnings.

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

$ in millions	March 31, 2015	December 31, 2014
Unamortized benefit plan costs, net of tax benefit of $3,336 as of March 31, 2015 and $3,395 as of December 31, 2014	$(5,220)	$(5,316)
Cumulative translation adjustment	(70)	(41)
Net unrealized gain on marketable securities and cash flow hedges, net of tax	—	1
Total accumulated other comprehensive loss	$(5,290)	$(5,356)

Unamortized benefit plan costs consist primarily of net after-tax actuarial losses totaling $5.5 billion and $5.6 billion as of March 31, 2015 and December 31, 2014, 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 income to net earnings related to the amortization of benefit plan costs were $96 million and $38 million, net of taxes, for the three months ended March 31, 2015 and

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2014, respectively. The reclassifications represent the amortization of net actuarial losses and prior service credits for the company's retirement benefit plans, and are included in the computation of net periodic pension cost (See Note 8 for further information).

Reclassifications from accumulated other comprehensive income to net earnings, relating to cumulative translation adjustments, marketable securities and effective cash flow hedges for the three months ended March 31, 2015 and 2014, respectively, were not material. Reclassifications for cumulative translation adjustments and marketable securities are recorded in other income, and reclassifications for effective cash flow hedges are recorded in operating income.

2. 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.

Diluted Earnings Per Share

Diluted earnings per share includes the dilutive effect of awards granted to employees under stock-based compensation plans. The dilutive effect of these securities totaled 2.8 million shares and 4.1 million shares for the three months ended March 31, 2015 and 2014, respectively. The weighted-average diluted shares outstanding would exclude stock options with exercise prices in excess of the average market price of the company's common stock during the period; however, we had no such stock options outstanding for the three months ended March 31, 2015 and 2014.

Share Repurchases

The table below summarizes the company’s share repurchases:

Repurchase Program Authorization Date	Amount Authorized (in millions)	Total Shares Retired (in millions)	Average Price Per Share[3]	Date Completed	Shares Repurchased (in millions) Three Months Ended March 31 2015	2014
May 15, 2013 [1]	$4,000	32.8	$121.97	March 2015	2.7	4.8
December 4, 2014[2]	$3,000	2.6	$161.18		2.6	—

(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.

(2) 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"). Repurchases under the 2014 Repurchase Program commenced in March 2015 upon the completion of the company's 2013 Repurchase Program. As of March 31, 2015, repurchases under the 2014 Repurchase Program totaled $0.4 billion; $2.6 billion remained under this share repurchase authorization. By its terms, the 2014 Repurchase Program will expire when we have used all authorized funds for repurchases.

(3) 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.

Dividends on Common Stock

In May 2014, the company increased the quarterly common stock dividend 15 percent to $0.70 per share from the previous amount of $0.61 per share.

3. SEGMENT INFORMATION

The company is aligned into four segments: Aerospace Systems, Electronic Systems, Information Systems and Technical Services. The company, from time to time, acquires or disposes of businesses and realigns contracts, programs or business areas among and within our segments. Portfolio shaping and internal realignments are

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designed to more fully leverage existing capabilities and enhance development and delivery of products and services. The following table presents sales and operating income by segment:

	Three Months Ended March 31	
$ in millions	2015	2014
Sales		
Aerospace Systems	$2,498	$2,420
Electronic Systems	1,681	1,644
Information Systems	1,574	1,577
Technical Services	770	697
Intersegment eliminations	(566)	(490)
Total sales	5,957	5,848
Operating income		
Aerospace Systems	315	324
Electronic Systems	247	268
Information Systems	166	162
Technical Services	68	68
Intersegment eliminations	(61)	(65)
Total segment operating income	735	757
Reconciliation to total operating income:		
Net FAS/CAS pension adjustment	83	110
Unallocated corporate expenses	(38)	(22)
Total operating income	$780	$845

Net FAS/CAS Pension Adjustment

The net FAS (GAAP Financial Accounting Standards)/CAS (U.S. Government Cost Accounting Standards) pension adjustment reflects the difference between pension expense charged to contracts and included as cost in segment operating income and pension expense determined in accordance with GAAP. The decrease in net FAS/CAS pension adjustment is principally due to an increase in FAS expense, as a result of changes in our FAS discount rate and mortality assumptions as of December 31, 2014. The increase in FAS expense was partially offset by higher CAS expense resulting from updated mortality assumptions.

Unallocated Corporate Expenses

Unallocated corporate expenses include the portion of corporate expenses not considered allowable or allocable under applicable CAS regulations and the Federal Acquisition Regulation, and are therefore not allocated to the segments. Such costs consist of a portion of management and administration, legal, environmental, compensation costs, retiree benefits, and certain unallowable costs such as lobbying activities, among others. Unallocated corporate expenses increased for the three months ended March 31, 2015 due to higher deferred state taxes resulting from the company's $500 million discretionary pension contribution in the quarter.

4. INCOME TAXES

	Three Months Ended March 31	
$ in millions	2015	2014
Federal and foreign income tax expense	$220	$207
Effective income tax rate	31.3%	26.3%

The company's higher effective tax rate for the three months ended March 31, 2015, reflects the absence of a $51 million benefit for the partial resolution of the Internal Revenue Service (IRS) examination of our 2007-2009 tax

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returns recognized in the first quarter of 2014. The remaining matters related to our 2007 - 2009 tax returns and issues related to our 2010 - 2011 tax returns are currently before the IRS Office of Appeals. The company believes it is reasonably possible that within the next 12 months we will resolve the remaining matters on our 2007-2011 tax returns. The combined resolution of these items, excluding interest, could result in a reduction of our unrecognized tax benefits up to $75 million and a reduction of our income tax expense up to $40 million.

The company files income tax returns in the U.S. federal jurisdiction, and in various state and foreign jurisdictions. The IRS is conducting an examination of the company's tax returns for the years 2012 and 2013. Open tax years related to state and foreign jurisdictions remain subject to examination, but are not expected to have a material effect on the company’s unaudited condensed consolidated financial statements.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents comparative carrying value and fair value information for our financial assets and liabilities:

$ in millions	March 31, 2015 Carrying Value	March 31, 2015 Fair Value	December 31, 2014 Carrying Value	December 31, 2014 Fair Value
Financial Assets (Liabilities)				
Marketable securities				
Trading	$327	$327	$331	$331
Available-for-sale	4	4	5	5
Derivatives	6	6	1	1
Long-term debt, including current portion	$(6,528)	$(7,492)	$(5,928)	$(6,726)

There were no transfers of financial instruments between the three levels of fair value hierarchy during the three months ended March 31, 2015.

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

Investments in Marketable Securities

The company holds a portfolio of marketable securities to partially fund non-qualified employee benefit plans consisting of securities that are classified as either trading or available-for-sale. These assets are recorded at fair value on a recurring basis and substantially all of these instruments are valued using Level 1 inputs, with an immaterial amount valued using Level 2 inputs. As of March 31, 2015 and December 31, 2014, marketable securities of $331 million and $336 million, respectively, were included in other non-current assets in the unaudited condensed consolidated statements of financial position.

Derivative Financial Instruments and Hedging Activities

The company's derivative portfolio consists primarily of foreign currency forward contracts. The notional value of the company's derivative portfolio at March 31, 2015 and December 31, 2014, was $140 million and $146 million, respectively. The portion of notional value designated as cash flow hedges at March 31, 2015 and December 31, 2014, was $24 million and $34 million, respectively.

Derivative financial instruments are recognized as assets or liabilities in the unaudited condensed consolidated financial statements and measured at fair value on a recurring basis. Substantially all of these instruments are valued using Level 2 inputs. 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.

Unrealized gains or losses on the effective portion of cash flow hedges are reclassified from other comprehensive income to operating income upon the recognition of the underlying hedged transaction. Hedge contracts not designated for hedge accounting and the ineffective portion of cash flow hedges are recorded in other income. The derivative fair values and related unrealized gains/losses at March 31, 2015 and December 31, 2014, were not material.

Long-term Debt

The fair value of long-term debt is calculated using Level 2 inputs based on interest rates available for debt with terms and maturities similar to the company's existing debt arrangements.

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Debt Issuance
In February 2015, the company issued $600 million of unsecured senior notes due April 15, 2045 with a fixed interest rate of 3.85 percent (the Notes). Interest on the Notes is payable semi-annually in arrears. The Notes are subject to redemption at the company's discretion at any time, or from time to time, prior to maturity in whole or in part at the greater of the principal amount of the Notes or an applicable "make-whole" amount, plus accrued and unpaid interest. We are using the net proceeds from this offering for general corporate purposes, including the funding of a $500 million voluntary contribution to our pension plans in the first quarter of 2015 and debt repayment.

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 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. Although the ultimate outcome of these matters ("the FSS matters," collectively), including any possible loss, cannot be predicted or 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, 2015), 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, 2015) 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, 2015). 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 $34 million as of March 31, 2015), 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. At yet to be specified future dates, the court is expected to hear testimony from witnesses and 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 is one of several defendants in litigation brought by the Orange County Water District in Orange County Superior Court in California on December 17, 2004, for alleged contribution to volatile organic chemical

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contamination of the County's shallow groundwater. The lawsuit includes counts against the defendants for violation of the Orange County Water District Act, the California Super Fund Act, negligence, nuisance, trespass and declaratory relief. Among other things, the lawsuit seeks unspecified damages for the cost of remediation, payment of attorney fees and costs, and punitive damages. Trial on the statutory claims (those based on the Orange County Water District Act, the California Super Fund Act and declaratory relief) concluded on September 25, 2012. On October 29, 2013, the court issued its decision in favor of the defendants on the statutory claims. On May 9, 2014, the court granted defendants' dispositive motions on the remaining tort causes of action. Notice of entry of judgment was filed on July 1, 2014. The Orange County Water District filed a notice of appeal on August 28, 2014. The Orange County Water District's opening brief is due on June 8, 2015.

The company is 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. 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, and other than with respect to the FSS matters discussed separately above, the company does not believe that the outcome of any matter 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, 2015, or its annual results of operations or cash flows.

7. COMMITMENTS AND CONTINGENCIES

Guarantees of Subsidiary Performance Obligations

From time to time in the ordinary course of business, the company guarantees obligations of its subsidiaries under certain contracts. Generally, the company is liable under such an arrangement only if its subsidiary is unable to perform under its contract. Historically, the company has not incurred any substantial liabilities resulting from these guarantees.

In addition, the company’s subsidiaries may enter into joint ventures, teaming and other business arrangements (collectively, Business Arrangements) to support the company’s products and services in domestic and international markets. The company generally strives to limit its exposure under these arrangements to its subsidiary’s investment in the Business Arrangements or to the extent of such subsidiary’s obligations under the applicable contract. In some cases, however, the company may be required to guarantee performance by the Business Arrangements and, in such cases, the company generally strives to obtain cross-indemnification from the other members of the Business Arrangements.

At March 31, 2015, the company is not aware of any existing event of default that would require it to satisfy any of these guarantees.

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 the 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 matters raised by the U.S. Government. 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 estimable, and the outcome of any such matters would not have a material adverse effect on its unaudited condensed consolidated financial position as of March 31, 2015, or its annual results of operations and/or cash flows.

Environmental Matters

The estimated cost to complete remediation at certain current or formerly owned or leased sites has been accrued where the company believes, based on the facts and circumstances known to the company, it is probable the company will incur costs to address environmental impacts and the costs are reasonably estimable. As of March 31, 2015, management estimates the range of reasonably possible future costs for environmental remediation is between $362 million and $795 million, before considering the amount recoverable through overhead charges on U.S. Government contracts. At March 31, 2015, the amount within that range accrued for probable environmental remediation costs was

$377 million, of which $148 million is recorded in other current liabilities and $229 million is recorded in other non-current liabilities. A portion of the environmental remediation costs is expected to be recoverable through overhead charges on U.S. Government contracts and, accordingly, such amounts are deferred in inventoried costs and other non-current assets. As of March 31, 2015, $74 million is deferred in inventoried costs and $119 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

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projects progress, or as changes in facts and circumstances occur, will materially affect the estimated liability accrued, we do not anticipate 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, 2015, or its annual results of operations and/or cash flows.

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, 2015, there were $270 million of stand-by letters of credit and guarantees and $160 million of surety bonds outstanding.

Indemnifications

The company has retained 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, 2015, or its annual results of operations and/or cash flows.

Operating Leases

Rental expense for operating leases was $81 million and $72 million for the three months ended March 31, 2015 and 2014, respectively. These amounts are net of immaterial amounts of sublease rental income.

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	2015	2014	2015	2014
Components of net periodic benefit cost				
Service cost	$121	$114	$9	$8
Interest cost	306	315	24	26
Expected return on plan assets	(494)	(467)	(22)	(21)
Amortization of:				
Prior service credit	(15)	(15)	(7)	(7)
Net loss from previous years	171	82	6	2
Net periodic benefit cost	$89	$29	$10	$8

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. Additionally, in the first quarter of 2015, we made a voluntary pension contribution of $500 million.

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

	Three Months Ended March 31	
$ in millions	2015	2014
Defined benefit pension plans	$525	$21
Post-retirement benefit plans	6	7
Defined contribution plans	85	73

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9. STOCK COMPENSATION PLANS AND OTHER COMPENSATION ARRANGEMENTS

Stock Awards

In February 2015, the company granted certain employees 0.2 million restricted stock rights (RSRs) and 0.4 million restricted performance stocks rights (RPSRs) under the company's long-term incentive stock plan, with a grant date aggregate fair value of $87 million. The RSRs will typically vest on the third anniversary of the grant date, while the RPSRs will vest and pay out based on the achievement of financial metrics for the three-year period ending December 31, 2017.

Cash Awards

In February 2015, the company granted certain employees cash units (CUs) and cash performance units (CPUs) with a minimum aggregate payout amount of $34 million and a maximum aggregate payout amount of $190 million. The CUs will vest and settle in cash on the third anniversary of the grant date, while the CPUs will vest and settle in cash based on the achievement of financial metrics for the three-year period ending December 31, 2017.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have reviewed the accompanying condensed consolidated statement of financial position of Northrop Grumman Corporation (the "Corporation") and subsidiaries as of March 31, 2015, and the related condensed consolidated statements of earnings and comprehensive income, cash flows, and changes in shareholders' equity for the three-month periods ended March 31, 2015 and 2014. These interim financial statements are the responsibility of the Corporation's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial position of Northrop Grumman Corporation and subsidiaries as of December 31, 2014, and the related consolidated statements of earnings and comprehensive (loss) income, cash flows, and changes in shareholders' equity for the year then ended (not presented herein); and in our report dated February 2, 2015, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated statement of financial position as of December 31, 2014, is fairly stated, in all material respects, in relation to the consolidated statement of financial position from which it has been derived.

/s/ Deloitte & Touche LLP
McLean, Virginia
April 28, 2015

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

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 commercial customers.

The following discussion should be read along with the unaudited condensed consolidated financial statements included in this Form 10-Q, as well as our 2014 Annual Report on Form 10-K, which provides a more thorough discussion of our systems, products and solutions; political and economic environment; industry outlook; and business trends. See further discussions in the Consolidated Operating Results and Segment Operating Results sections that follow.

Political and Economic Environment

The following is an update of events relating to the company's political and economic environment since the filing of our 2014 Annual Report on Form 10-K.

On February 2, 2015, the President delivered his FY 2016 budget to Congress. The FY 2016 budget seeks an increase in defense and non-defense spending, including $534 billion for the DoD's annual budget and an additional $51 billion for Overseas Contingency Operations. While the President's FY 2016 budget is in line with projections included in his FY 2015 budget, it is approximately $38 billion more than the current DoD appropriations and $34 billion more than the spending caps provided for in the Budget Control Act (BCA). The Administration and Congress continue to debate the defense budget and strategies to address the BCA's spending caps.

The Temporary Debt Limit Extension Act suspended the statutory limit on the amount of permissible federal debt (the debt ceiling) until March 15, 2015. On March 16, 2015, the Treasury Department began taking "extraordinary measures" to finance the government. If the debt ceiling is not raised, it is anticipated that the debt ceiling will be reached later this year.

Operating Performance Assessment and Reporting

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.

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CONSOLIDATED OPERATING RESULTS

Selected financial highlights are presented in the table below:

	Three Months Ended March 31	
$ in millions, except per share amounts	2015	2014
Sales	$5,957	$5,848
Operating costs and expenses	5,177	5,003
Operating income	780	845
Operating margin rate	13.1 %	14.4 %
Federal and foreign income tax expense	220	207
Effective income tax rate	31.3 %	26.3 %
Net earnings	484	579
Diluted earnings per share	2.41	2.63
Net cash used in operating activities	$(654)	$(402)

Sales

Sales for the three months ended March 31, 2015, increased $109 million, or 2 percent, as compared with the same period in 2014.

The table below shows the variances in segment sales from the prior year period:

$ in millions	Three Month Variance	
Aerospace Systems	$78	3 %
Electronic Systems	37	2 %
Information Systems	(3)	—
Technical Services	73	10 %
Intersegment sales elimination	(76)	16 %
Total sales variance	$109	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:

	Three Months Ended March 31	
$ in millions	2015	2014
Product costs	$2,542	$2,533
Service costs	2,000	1,928
General and administrative expenses	635	542
Operating costs and expenses	$5,177	$5,003

Product costs as a percentage of product sales for the three months ended March 31, 2015 were 74.1 percent as compared to 74.3 percent during the same period in 2014; the decrease was mainly due to improved performance partially offset by business mix changes, which resulted in lower volume for mature fixed price production programs

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and higher volume for cost-type development programs. Service costs as a percentage of service sales for the three months ended March 31, 2015 were 79.1 percent, which is comparable with the 79.0 percent during the same period in 2014. For further information regarding product and service sales and costs, see the Product and Service Analysis section that follows Segment Operating Results.

General and administrative expenses as a percentage of total sales for the three months ended March 31, 2015 were 10.7 percent as compared with 9.3 percent during the same period in 2014, principally due to an increase in independent research and development (IR&D).

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:

	Three Months Ended March 31	
$ in millions	2015	2014
Favorable adjustments	$290	$256
Unfavorable adjustments	(103)	(59)
Net favorable adjustments	$187	$197

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

	Three Months Ended March 31	
$ in millions	2015	2014
Aerospace Systems	$111	$125
Electronic Systems	42	57
Information Systems	23	18
Technical Services	14	13
Eliminations	(3)	(16)
Net favorable adjustments	$187	$197

Federal and Foreign Income Tax Expense

The effective tax rates for the three months ended March 31, 2015, was 31.3 percent, as compared with 26.3 percent in 2014. The company's higher effective tax rate for the three months ended March 31, 2015, reflects the absence of a $51 million benefit for the partial resolution of the Internal Revenue Service (IRS) examination of our 2007-2009 tax returns recognized in the first quarter of 2014.

Net Earnings

Net earnings for the three months ended March 31, 2015 was $484 million, as compared with $579 million in 2014. Net earnings decreased $95 million, or 16 percent, principally due to the higher effective tax rate discussed above as well as lower net FAS (GAAP Financial Accounting Standards)/CAS adjustment and segment operating income, both of which are discussed in Segment Operating Results.

Diluted Earnings Per Share

Diluted earnings per share for the three months ended March 31, 2015, decreased $0.22, or 8 percent, as compared with the same period in 2014, reflecting lower earnings, partially offset by lower weighted-average shares outstanding resulting from shares repurchased during 2014 and 2015.

Net Cash Used in Operating Activities

For the three months ended March 31, 2015, net cash used in operating activities increased $252 million, as compared with the same period in 2014, principally driven by a $500 million voluntary pre-tax pension contribution which was partially offset by changes in trade working capital.

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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 unaudited condensed consolidated financial statements in Part I, Item 1. The reconciliation of segment operating income to total operating income, as well as a discussion of the reconciling items, is provided in Note 3 to the unaudited condensed consolidated financial statements in Part I, Item 1. 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.

Segment Operating Income

Segment operating income, as reconciled below, is a non-GAAP measure and is used by management as an internal measure for financial performance of 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.

	Three Months Ended March 31			
$ in millions	2015		2014	
Segment operating income	$735		$757	
Segment operating margin rate	12.3	%	12.9	%

Segment operating income decreased for the three months ended March 31, 2015, principally due to lower segment operating margin rates at three of our sectors, partially offset by higher sales volume.

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.

	Three Months Ended March 31			
$ in millions	2015		2014	
Segment operating income	$780		$757	
CAS pension expense	172		139	
Less: FAS pension expense	(89	)	(29	)
Net FAS/CAS pension adjustment	83		110	
Unallocated corporate expenses	(38	)	(22	)
Total operating income	$780		$845	

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 between pension expense charged to contracts and included as cost in segment operating income and pension expense determined in accordance with GAAP. The decrease in net FAS/CAS pension adjustment is principally due to an increase in FAS expense, as a result of changes in our FAS discount rate and mortality assumptions as of December 31, 2014. The increase in FAS expense was partially offset by higher CAS expense resulting from updated mortality assumptions.

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. Unallocated corporate expenses increased for the three months ended March 31, 2015 due to higher deferred state taxes resulting from the company's $500 million discretionary pension contribution in the quarter.

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AEROSPACE SYSTEMS

	Three Months Ended March 31	
$ in millions	2015	2014
Sales	$2,498	$2,420
Operating income	315	324
Operating margin rate	12.6 %	13.4 %

Aerospace Systems sales for the three months ended March 31, 2015, increased $78 million, or 3 percent, as compared with the same period in 2014, primarily due to higher volume on unmanned and space programs, partially offset by lower volume on manned military aircraft programs. Volume was higher across a number of programs in the unmanned portfolio including the NATO Alliance Ground Surveillance program. The increase in space programs was mainly due to higher volume on restricted programs, partially offset by lower volume on the Advanced Extremely High Frequency program. The decrease in manned military aircraft programs is a result of fewer F/A-18 deliveries due to program ramp-down and the timing of F-35 deliveries, partially offset by a ramp-up of production activities on the E-2D Advanced Hawkeye program.

Operating income for the three months ended March 31, 2015, decreased $9 million, or 3 percent, and operating margin rate decreased to 12.6 percent from 13.4 percent. Operating income and margin rate for 2015 decreased primarily due to less favorable performance and higher unallowable expenses, partially offset by the higher sales volume described above.

ELECTRONIC SYSTEMS

	Three Months Ended March 31	
$ in millions	2015	2014
Sales	$1,681	$1,644
Operating income	247	268
Operating margin rate	14.7 %	16.3 %

Electronic Systems sales for the three months ended March 31, 2015, increased $37 million, or 2 percent, as compared with the same period in 2014. The increase was driven by higher volume on space sensors, marine systems and tactical sensors programs, which were partially offset by lower volume on combat avionics programs.

Operating income for the three months ended March 31, 2015, decreased $21 million, or 8 percent, and operating margin rate decreased to 14.7 percent from 16.3 percent. Operating income and margin rate for 2015 decreased primarily due to business mix changes, which resulted in lower volume for mature fixed price production programs and higher volume for cost-type development programs as well as less favorable performance, primarily in land and self-protection systems.

INFORMATION SYSTEMS

	Three Months Ended March 31	
$ in millions	2015	2014
Sales	$1,574	$1,577
Operating income	166	162
Operating margin rate	10.5 %	10.3 %

Information Systems sales for the three months ended March 31, 2015, were comparable with the same period in 2014. Sales decreases on command and control and civil programs were offset by increases on intelligence, surveillance and reconnaissance, integrated air and missile defense, communications and cyber programs.

Operating income for the three months ended March 31, 2015, increased $4 million, or 2 percent, and operating margin rate increased to 10.5 percent from 10.3 percent primarily due to improved performance resulting from risk retirements associated with program completions.

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TECHNICAL SERVICES

	Three Months Ended March 31	
$ in millions	2015	2014
Sales	$770	$697
Operating income	68	68
Operating margin rate	8.8 %	9.8 %

Technical Services sales for the three months ended March 31, 2015, increased $73 million, or 10 percent, as compared with the same period in 2014. The increase is primarily due to growth in international sales, including higher volume on the Ministry of the National Guard Training Support program, and higher intercompany sales, which more than offset lower volume on the InterContinental Ballistic Missile program.

Operating income for the three months ended March 31, 2015 was consistent with the same period in 2014. Operating margin rate decreased to 8.8 percent from 9.8 percent primarily due to lower income from an unconsolidated joint venture than in the prior year period.

PRODUCT AND SERVICE ANALYSIS

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

	Three Months Ended March 31			
$ in millions	2015		2014	
Segment Information:	Sales	Operating Costs and Expenses	Sales	Operating Costs and Expenses
Aerospace Systems				
Product	$1,945	$1,711	$1,973	$1,708
Service	553	472	447	388
Electronic Systems				
Product	1,373	1,177	1,321	1,105
Service	308	257	323	271
Information Systems				
Product	338	297	319	297
Service	1,236	1,111	1,258	1,118
Technical Services				
Product	69	63	56	50
Service	701	639	641	579
Segment Totals				
Total Product	$3,725	$3,248	$3,669	$3,160
Total Service	2,798	2,479	2,669	2,356
Intersegment eliminations	(566)	(505)	(490)	(425)
Total segment[1]	$5,957	$5,222	$5,848	$5,091

(1) The reconciliation of segment operating income to total operating income, as well as a discussion of the reconciling items, is included in Note 3 to the unaudited condensed consolidated financial statements in Part I, Item 1.

Product Sales and Costs

Product sales for the three months ended March 31, 2015 increased $56 million, or 2 percent, as compared with the same period in 2014. The increase was primarily driven by higher product sales at Electronic Systems due to increased volume on space sensors, marine systems and tactical sensor programs, partially offset by lower combat avionics sales, as described in the Segment Operating Results section above.

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Product costs for the three months ended March 31, 2015, increased $88 million, or 3 percent, as compared with the same period in 2014. The increase was primarily driven by the higher product sales described above. In addition, lower product operating margin rates at Electronic Systems, due to business mix changes and less favorable performance, were partially offset by improved performance at Information Systems, as described in the Segment Operating Results section above.

Service Sales and Costs

Service sales for the three months ended March 31, 2015, increased $129 million, or 5 percent, as compared with the same period in 2014. The increase was primarily due to higher service sales at Aerospace Systems and Technical Services. The increase at Aerospace Systems was primarily driven by higher service sales on manned military aircraft and unmanned programs. The increase at Technical Services was primarily driven by higher service sales on international programs, as described in the Segment Operating Results section above.

Service costs for the three months ended March 31, 2015, increased $123 million, or 5 percent, as compared with the same period in 2014. The increase is consistent with the increase in service sales described above. Improved performance on service sales at Aerospace Systems were offset by lower income from an unconsolidated joint venture at Technical Services.

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 as of March 31, 2015, and December 31, 2014:

	March 31, 2015			December 31, 2014
$ in millions	Funded	Unfunded	Total Backlog	Total Backlog
Aerospace Systems	$10,584	$8,801	$19,385	$20,063
Electronic Systems	7,666	2,343	10,009	9,715
Information Systems	3,118	2,842	5,960	6,115
Technical Services	2,639	360	2,999	2,306
Total backlog	$24,007	$14,346	$38,353	$38,199

New Awards

The estimated value of contract awards recorded during the three months ended March 31, 2015 was $6.1 billion. New awards during this period include $807 million for the Ministry of the National Guard Training Support, $606 million for the F-35 program, $360 million for the E-2D Advanced Hawkeye program, $209 million for the B-2 program and $133 million for the F/A-18 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.

In February 2015, the company issued $600 million of unsecured senior notes due April 15, 2045 with a fixed interest rate of 3.85 percent (the Notes). Interest on the Notes is payable semi-annually in arrears. The Notes are subject to redemption at the company's discretion at any time, or from time to time, prior to maturity in whole or in part at the greater of the principal amount of the Notes or an applicable "make-whole" amount, plus accrued and unpaid interest. We are using the net proceeds from this offering for general corporate purposes, including the funding of a $500 million voluntary contribution to our pension plans in the first quarter of 2015 and debt repayment.

The company maintains an unsecured credit facility in an aggregate principal amount of $1.775 billion (the Credit Agreement). At March 31, 2015, the company was in compliance with all covenants under the Credit Agreement and there was no balance outstanding under this facility.

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.

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

	Three Months Ended March 31	
$ in millions	2015	2014
Net earnings	$484	$579
Non-cash items[1]	222	103
Changes in assets and liabilities:		
Trade working capital	(908)	(1,079)
Retiree benefits	(440)	14
Other, net	(12)	(19)
Net cash used in operating activities	$(654)	$(402)

(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 used in operating activities to free cash flow from operations:

	Three Months Ended March 31	
$ in millions	2015	2014
Net cash used in operating activities	$(654)	$(402)
Less: capital expenditures	(117)	(60)
Free cash flow	$(771)	$(462)

Free cash flow for the three months ended March 31, 2015, decreased $309 million, as compared to the same period in 2014, principally driven by a $500 million voluntary pre-tax pension contribution which was partially offset by changes in trade working capital.

CRITICAL ACCOUNTING POLICIES, ESTIMATES AND JUDGMENTS

There have been no material changes to our critical accounting policies, estimates or judgments from those discussed in our 2014 Annual Report on Form 10-K.

ACCOUNTING STANDARDS UPDATES

See Note 1 to our unaudited condensed consolidated financial statements in Part I, Item 1.

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FORWARD-LOOKING STATEMENTS AND PROJECTIONS

This Form 10-Q and the information we are incorporating by reference contains 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 and discussed more fully in the section entitled "Risk Factors" in our Form 10-K for the year ended December 31, 2014. They include:

- our dependence on a single customer, the U.S. Government
- delays or reductions in appropriations for our programs and U.S. Government funding
- investigations, claims and/or litigation
- our international business
- the improper conduct of employees, agents, business partners or joint ventures in which we participate
- the use of accounting estimates for our contracts
- cyber and other security threats or disruptions
- changes in actuarial assumptions associated with our pension and other post-retirement benefit plans
- the performance and financial viability of our suppliers and the availability and pricing of raw materials and components
- competition within our markets
- changes in procurement and other laws and regulations applicable to our industry
- natural and/or environmental disasters
- the adequacy of our insurance coverage, customer indemnifications or other liability protections
- the products and services we provide related to nuclear operations
- changes in business conditions that could impact recorded goodwill or the value of other long-lived assets
- our ability to develop new products and technologies and maintain technologies, facilities, equipment and a qualified workforce
- our ability to meet performance obligations under our contracts
- unforeseen environmental costs
- our ability to protect our intellectual property rights
- changes in our tax provisions or exposure to additional tax liabilities
- the spin-off of our former Shipbuilding business

Additional information regarding these risks and other important factors can be found in the section entitled "Risk Factors" in our Form 10-K for the year ended December 31, 2014 and as 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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CONTRACTUAL OBLIGATIONS

Other than the debt issuance, including associated interest, described in Note 5 of Part I, Item 1, and in the Liquidity and Capital Resources section, there have been no material changes to our contractual obligations from those discussed in our 2014 Annual Report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to our market risks from those discussed in our 2014 Annual Report on Form 10-K.

Item 4. Controls and Procedures

DISCLOSURES CONTROLS AND PROCEDURES

Our principal executive officer (Chairman, Chief Executive Officer and President) and principal financial officer (Corporate Vice President and Chief Financial Officer) have evaluated the company’s disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Securities Exchange Act of 1934 ("the Exchange Act")) as of March 31, 2015, and have concluded that these controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit is accumulated and communicated to management, including the principal executive officer and the principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

During the three months ended March 31, 2015, no change occurred in our internal controls over financial reporting that materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We have provided information about certain legal proceedings in which we are involved in our 2014 Annual Report on Form 10-K, and updated that information in Note 6 to the unaudited condensed consolidated financial statements in Part I, Item 1 of this report.

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 our 2014 Annual Report on Form 10-K, as updated by Note 6 to the unaudited condensed consolidated financial statements in this report, 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 unaudited condensed consolidated financial position as of March 31, 2015, 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 of our 2014 Annual Report on Form 10-K.

Item 1A. Risk Factors

For a discussion of our risk factors please see the section entitled "Risk Factors" in our Form 10-K for the year ended December 31, 2014.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of Equity Securities – The table below summarizes our repurchases of common stock during the three months ended March 31, 2015:

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)
January	929,040	$152.14	929,040	$3,306
February	1,676,000	166.76	1,676,000	3,026
March	2,717,300	161.44	2,717,300	2,588
Total	5,322,340	$161.49	5,322,340	$2,588

(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. 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"). Repurchases under the 2014 Repurchase Program commenced in March 2015 upon the completion of the company's 2013 Repurchase Program. As of March 31, 2015, repurchases under the 2014 Repurchase Program totaled $0.4 billion; $2.6 billion remained under this share repurchase authorization. By its terms, the 2014 Repurchase Program 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.

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Item 3. Defaults Upon Senior Securities
No information is required in response to this item.
Item 4. Mine Safety Disclosures
No information is required in response to this item.
Item 5. Other Information
No information is required in response to this item.

NORTHROP GRUMMAN CORPORATION

Item 6. Exhibits

2.1	Agreement and Plan of Merger among Titan II, Inc. (formerly Northrop Grumman Corporation), Northrop Grumman Corporation (formerly New P, Inc.) and Titan Merger Sub Inc., dated March 29, 2011 (incorporated by reference to Exhibit 10.1 to Form 8-K filed April 4, 2011)
2.2	Separation and Distribution Agreement dated as of March 29, 2011, among Titan II, Inc. (formerly Northrop Grumman Corporation), Northrop Grumman Corporation (formerly New P, Inc.), Huntington Ingalls Industries, Inc., Northrop Grumman Shipbuilding, Inc. and Northrop Grumman Systems Corporation (incorporated by reference to Exhibit 10.2 to Form 8-K filed April 4, 2011)
4.1	Sixth Supplemental Indenture, dated as of February 6, 2015 between Northrop Grumman Corporation and The Bank of New York Mellon, as successor to JPMorgan Chase Bank, Trustee, to Indenture dated as of November 21, 2001 (incorporated by reference to Exhibit 4.1 to Form 8-K filed February 6, 2015)
4.2	Form of 3.850% Senior Note due 2045 (included in Exhibit 4.1) (incorporated by reference to Exhibit 4.2 to Form 8-K filed February 6, 2015)
+10.1	Grant Certificate Specifying the Terms and Conditions Applicable to 2015 Restricted Stock Rights Granted Under the 2011 Long-Term Incentive Stock Plan (incorporated by reference to Exhibit 10.1 to Form 8-K filed February 20, 2015)
+10.2	Grant Certificate Specifying the Terms and Conditions Applicable to 2015 Restricted Performance Stock Rights Granted Under the 2011 Long-Term Incentive Stock Plan (incorporated by reference to Exhibit 10.2 to Form 8-K filed February 20, 2015)
*12(a)	Computation of Ratio of Earnings to Fixed Charges
*15	Letter from Independent Registered Public Accounting Firm
*31.1	Rule 13a-14(a)/15d-14(a) Certification of Wesley G. Bush (Section 302 of the Sarbanes-Oxley Act of 2002)
*31.2	Rule 13a-14(a)/15d-14(a) Certification of Kenneth L. Bedingfield (Section 302 of the Sarbanes-Oxley Act of 2002)
**32.1	Certification of Wesley G. Bush pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
**32.2	Certification of Kenneth L. Bedingfield pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
*101	Northrop Grumman Corporation Quarterly Report on Form 10-Q for the quarter ended March 31, 2015, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Earnings and Comprehensive Income, (ii) Condensed Consolidated Statements of Financial Position, (iii) Condensed Consolidated Statements of Cash Flows, (iv) Condensed Consolidated Statements of Changes in Shareholders’ Equity, and (v) Notes to Condensed Consolidated Financial Statements

\+ Management contract or compensatory plan or arrangement

* Filed with this report

** Furnished with this report

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NORTHROP GRUMMAN CORPORATION
(Registrant)

By: /s/ Michael A. Hardesty

Michael A. Hardesty
Corporate Vice President, Controller and
Chief Accounting Officer
(Principal Accounting Officer)

Date: April 28, 2015

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