

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION Washington, DC 20549

(Mark One)

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

For the quarterly period ended September 30, 2002

OR

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

For the transition period from _____ to _____

Commission file number 1-2384

TRW Inc.

(Exact name of registrant as specified in its charter)

Ohio

(State or other jurisdiction of
incorporation or organization)

34-0575430

(I.R.S. Employer
Identification No.)

1900 Richmond Road, Cleveland, Ohio 44124

(Address of principal executive offices)
(Zip Code)

(216) 291-7000

(Registrant's telephone number, including area code)

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

Yes No

As of November 4, 2002, there were 129,542,099 shares of
TRW Common Stock, \$0.625 par value, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Statements of Operations (unaudited)

TRW Inc. and subsidiaries

(In millions except per share data)	Quarter ended September 30		Nine months ended September 30	
	2002	2001	2002	2001
Sales	\$3,946	\$3,593	\$12,065	\$11,501
Cost of sales	3,439	3,091	10,438	9,966
Gross profit	507	502	1,627	1,535
Administrative and selling expenses	195	211	621	654
Research and development expenses	83	95	276	288
Interest expense	90	117	295	368
Amortization of intangible assets and goodwill in 2001	4	36	12	84
Other (income)expense-net	(19)	178	(37)	226
Earnings(loss) from continuing operations before income taxes and extraordinary items	154	(135)	460	(85)
Income taxes(benefit)	59	(42)	163	(12)
Earnings(loss) from continuing operations before extraordinary items	95	(93)	297	(73)
Discontinued operations, net of income taxes	(82)	13	(754)	51
Earnings(loss) before extraordinary items	13	(80)	(457)	(22)
Extraordinary items, net of income taxes	—	—	2	—
Net earnings(loss)	\$ 13	\$ (80)	\$ (455)	\$ (22)
Per share of common stock				
Diluted earnings per share				
Earnings(loss) from continuing operations before extraordinary items	\$ 0.74	\$ (0.75)	\$ 2.33	\$ (0.58)
Discontinued operations	(0.64)	0.10	(5.92)	0.40
Extraordinary items	—	—	0.02	—
Net earnings(loss)	\$ 0.10	\$ (0.65)	\$ (3.57)	\$ (0.18)
Basic earnings per share				
Earnings(loss) from continuing operations before extraordinary items	\$ 0.74	\$ (0.75)	\$ 2.33	\$ (0.58)
Discontinued operations	(0.64)	0.10	(5.92)	0.40
Extraordinary items	—	—	0.02	—
Net earnings(loss)	\$ 0.10	\$ (0.65)	\$ (3.57)	\$ (0.18)
Dividends declared	\$0.175	\$ 0.35	\$ 0.35	\$ 0.70
Shares used in computing per share amounts				
Diluted	129.1	125.2	127.4	124.5
Basic	128.6	125.2	127.4	124.5

Balance Sheets (unaudited)

TRW Inc. and subsidiaries

(In millions)	September 30 2002	December 31 2001
Assets		
Current assets		
Cash and cash equivalents	\$ 313	\$ 213
Accounts receivable	1,684	1,418
Interest in securitized receivables	214	162
Inventories	622	575
Prepaid expenses	156	160
Deferred income taxes	312	201
Assets of business held for sale	1,650	2,018
Total current assets	4,951	4,747
Property, plant and equipment-on the basis of cost	8,179	7,924
Less accumulated depreciation and amortization	5,013	4,641
Total property, plant and equipment-net	3,166	3,283
Intangible assets	543	586
Less accumulated amortization	295	272
Intangible assets-net	248	314
Goodwill	2,613	2,417
Investments in affiliated companies	111	243
Other notes and accounts receivable	170	204
Other assets	280	480
Prepaid pension cost	3,032	2,756
	<u>\$14,571</u>	<u>\$14,444</u>
Liabilities and shareholders' investment		
Current liabilities		
Short-term debt	\$ 763	\$ 115
Trade accounts payable	1,709	1,575
Current portion of long-term debt	100	724
Liabilities of business held for sale	431	423
Other current liabilities	2,023	2,029
Total current liabilities	5,026	4,866
Long-term debt	4,768	4,865
Long-term liabilities	1,765	1,827
Deferred income taxes	922	626
Minority interests in subsidiaries	87	74
Shareholders' investment		
Capital stock	81	79
Other capital	491	480
Retained earnings	1,954	2,468
Treasury shares-cost in excess of par value	(234)	(372)
Accumulated other comprehensive income(loss)	(289)	(469)
Total shareholders' investment	2,003	2,186
	<u>\$14,571</u>	<u>\$14,444</u>

Statements of Cash Flows (unaudited)

TRW Inc. and subsidiaries

(In millions)	Nine months ended September 30	
	2002	2001
Operating activities		
Net earnings(loss)	\$(455)	\$ (22)
Adjustments to reconcile net earnings(loss) to net cash provided by operating activities:		
Discontinued operations	754	(51)
Depreciation and amortization	468	506
Pension income	(193)	(184)
Net gain on sale of assets	(31)	(199)
Asset impairment charges	31	346
Pending and threatened litigation	—	97
Deferred income taxes	79	(51)
Other-net	53	83
Changes in assets and liabilities, net of effects of businesses acquired or divested:		
Accounts receivable, net	(302)	36
Accounts receivable securitized	43	—
Inventories	(36)	11
Trade accounts payable	87	(40)
Prepaid expenses and other liabilities	7	(95)
Other-net	109	112
Net cash provided by operating activities of continuing operations	614	549
Investing activities		
Capital expenditures including other intangibles	(350)	(440)
Net proceeds from sales of assets	94	169
Other-net	17	(79)
Net cash used in investing activities of continuing operations	(239)	(350)
Financing activities		
Increase(decrease) in short-term debt	397	(391)
Proceeds from debt in excess of 90 days	478	998
Principal payments on debt in excess of 90 days	(991)	(811)
Dividends paid	(67)	(132)
Other-net	(78)	100
Net cash used in financing activities of continuing operations	(261)	(236)
Effect of exchange rate changes on cash	9	10
Net cash (used in)provided by discontinued operations	(23)	1
Increase(decrease) in cash and cash equivalents	100	(26)
Cash and cash equivalents at beginning of period	213	248
Cash and cash equivalents at end of period	\$ 313	\$ 222

NOTES TO FINANCIAL STATEMENTS

(unaudited)

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. In the opinion of management, all adjustments consisting of normal recurring accruals considered necessary for a fair presentation have been included. Operating results for the three-month and nine-month periods ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Current Report on Form 8-K filed on September 3, 2002.

Reclassifications

The Company's Aeronautical Systems business is reported as discontinued operations, net of applicable income taxes in the Statement of Operations for all periods presented. In addition, the assets and liabilities of the Aeronautical Systems business have been reclassified as held for sale.

Certain amounts in the prior year financial statements and related notes have been reclassified to conform to the current year presentation.

TRW and Northrop Grumman Merger Agreement

On June 30, 2002 the Company, Northrop Grumman Corporation (Northrop) and Richmond Acquisition Corp., a wholly-owned subsidiary of Northrop, entered into a definitive merger agreement, whereby Northrop will acquire all of the Company's outstanding common stock and the Company will become a wholly-owned subsidiary of Northrop. In the merger, each share of the Company's common stock will be converted into the right to receive a number of shares of Northrop common stock equal to the exchange ratio. The exchange ratio is calculated by dividing \$60 by the average closing sale prices for a share of Northrop common stock on the New York Stock Exchange during the five consecutive trading days ending on (and including) the second trading day prior to the date the merger is completed. However, in no event will the exchange ratio be greater than 0.5357 (\$60/\$112) or less than 0.4348 (\$60/\$138), even if the actual average price per share of Northrop common stock used to calculate the exchange ratio is less than \$112 or greater than \$138. On October 16, 2002, the European Commission announced that it had completed its review and approved the transaction. The statutory waiting period applicable to the merger pursuant to the U.S. Hart-Scott-Rodino Act expired on October 15, 2002, although the Department of Justice is still reviewing the transaction. Northrop and the Company have agreed that they will notify the Justice Department of their intent to complete the transaction no sooner than ten business days prior to the earlier of Northrop's stockholders meeting or the Company's shareholders meeting relating to the merger. The merger requires approval by the shareholders of the Company and Northrop and both companies have scheduled special meetings of shareholders for December 11, 2002 to vote on the proposed merger. Northrop has announced that after the completion of the merger, it plans to separate the Company's automotive business, either through a sale or a spin-off of the business to shareholders.

If the transaction contemplated by the merger agreement with Northrop is consummated, the Company will become a wholly-owned subsidiary of Northrop. The closing of the merger will constitute an event of default under the Company's revolving credit agreements, long-term bank loan agreements and accounts receivable securitization program. Such an event of default would provide the lenders under the Company's revolving credit facilities and outstanding term loans the right to accelerate payment of borrowings under and cancel the agreements. Such an event of default would also be cause for termination of the Company's accounts receivable securitization program. The Company plans to repay

or restructure such indebtedness or facilities, negotiate waivers of any such termination events or make alternative arrangements in conjunction with Northrop to avoid a disruption in the Company's sources of liquidity. However, there can be no assurance as to the nature or adequacy of any plans or arrangements that may be ultimately implemented.

Accounting Pronouncements

Effective January 1, 2002, the Company adopted Financial Accounting Standards Board (FASB) SFAS 141, "Business Combinations," SFAS 142, "Goodwill and Intangible Assets," and SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 141 requires that acquisitions entered into after June 30, 2001 are to be accounted for using the purchase method and establishes criteria to be used in determining whether acquired intangible assets are to be separated from goodwill. As a result of the Company's analysis, only the value of assembled workforce of approximately \$54 million was reclassified from intangible assets to goodwill at January 1, 2002.

SFAS 142 sets forth the accounting for goodwill and intangible assets already recorded. Commencing January 1, 2002, goodwill is no longer being amortized. Goodwill was tested for impairment by comparing the assets' fair values to their carrying values. During the second quarter, management completed the valuations of its reporting units and based on the valuations, goodwill was determined not to be impaired. With the adoption of SFAS 142, the Company also reassessed the useful lives and residual values of all acquired intangible assets to make any necessary amortization period adjustments, which resulted in no adjustments being made. In accordance with SFAS 142, amounts in 2001 have not been restated.

The following table reflects the reconciliation of reported earnings(loss) from continuing operations before extraordinary items to adjusted net earnings(loss) and related per share amounts for the exclusion of goodwill amortization.

(In millions except per share data)	Quarter ended September 30		Nine months ended September 30	
	2002	2001	2002	2001
Net earnings(loss)				
Reported earnings(loss) from continuing operations before extraordinary items	\$ 95	\$ (93)	\$ 297	\$ (73)
Add back: Goodwill amortization, net of tax	—	18	—	53
Adjusted earnings(loss) from continuing operations before extraordinary items	95	(75)	297	(20)
Reported discontinued operations, net of tax	(82)	13	(754)	51
Add back: Goodwill amortization, net of tax	—	5	—	14
Extraordinary items, net of tax	—	—	2	—
Adjusted net earnings(loss)	\$ 13	\$ (57)	\$ (455)	\$ 45
Per share of common stock				
Diluted and Basic				
Reported earnings(loss) from continuing operations before extraordinary items	\$ 0.74	\$(0.75)	\$ 2.33	\$(0.58)
Add back: Goodwill amortization, net of tax	—	0.15	—	0.42
Adjusted earnings(loss) from continuing operations before extraordinary items	0.74	(0.60)	2.33	(0.16)
Reported discontinued operations, net of tax	(0.64)	0.10	(5.92)	0.40
Add back: Goodwill amortization, net of tax	—	0.04	—	0.12
Extraordinary items, net of tax	—	—	0.02	—
Adjusted net earnings(loss)	\$ 0.10	\$(0.46)	\$(3.57)	\$ 0.36

SFAS 143, "Accounting for Asset Retirement Obligations," requires the fair value of a liability for asset retirement obligations to be recorded in the period in which it is incurred. The statement applies to a company's legal or contractual obligation associated with the retirement of a tangible long-lived asset that resulted from the acquisition, construction or development or through the normal operation of a long-lived asset. The statement is effective for the Company beginning January 1, 2003. Management has evaluated the impact of SFAS 143 and believes that its adoption should not have a material effect on the Company's financial position or results of operations.

SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," addresses the accounting and reporting for the impairment or disposal of long-lived assets. The statement provides a consistent method to value long-lived assets to be disposed of and broadens the presentation of discontinued operations. The adoption of SFAS 144 did not have a material effect on the Company's financial statements.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS 145 requires gains and losses on extinguishments of debt to be reclassified as income or loss from continuing operations rather than as extraordinary items as previously required by SFAS 4, "Reporting Gains and Losses from Extinguishment of Debt." SFAS 145 also amends SFAS 13 requiring certain modifications to capital leases to be treated as sale-leaseback transactions and to subleases when the original lessee remains a secondary obligor, or guarantor. The provisions of SFAS 145 related to the rescission of SFAS 4 are effective for the Company on January 1, 2003. The extraordinary gains recorded for the extinguishment of debt in the first quarter of 2002 will be reclassified into earnings from continuing operations when the statement is adopted. The remaining provisions of SFAS 145 were effective for transactions and reporting subsequent to May 15, 2002. The adoption of SFAS 145 did not have a material impact to the Company's financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 requires that a liability for costs associated with exit or disposal activities be recognized when the liability is incurred rather than when an entity commits to an exit plan. SFAS 146 also provides that the liability be initially measured at fair value. The statement is effective for the Company beginning January 1, 2003. Management will evaluate the impact of SFAS 146 upon adoption.

Other (Income)Expense-Net

(In millions)	Quarter ended September 30		Nine months ended September 30	
	2002	2001	2002	2001
Net gain on sale of assets	\$ (4)	\$(174)	\$(31)	\$(199)
Asset impairments	21	257	24	322
Pending and threatened litigation	—	97	—	97
(Earnings)loss of affiliates	(5)	5	(4)	26
Foreign currency exchange	1	(1)	2	(4)
Favorable litigation ruling	(25)	—	(25)	—
Miscellaneous other (income)expense	(7)	(6)	(3)	(16)
	<u>\$(19)</u>	<u>\$ 178</u>	<u>\$(37)</u>	<u>\$ 226</u>

During the third quarter of 2002, the Company recorded asset impairment charges primarily related to the write-down of investments in affiliates.

During the third quarter of 2001, the Company recorded net gain on sale of assets, which primarily included the sales of RF Micro Devices, Inc. (RFMD) common stock, and asset impairment charges of \$257 million, primarily related to its investment in Astrolink. In addition to the third quarter of 2001 asset impairment charges, the Company recorded asset impairment charges of \$65 million related to its investment in, and its share of asset impairment recorded by Endwave Corporation (Endwave) in the nine months ended September 30, 2001.

Operating Segments

As a result of the sale of Aeronautical Systems, the business is reported as discontinued operations.

(In millions)	Quarter ended September 30		Nine months ended September 30	
	2002	2001	2002	2001
Sales				
Automotive	\$2,545	\$2,327	\$ 7,956	\$ 7,634
Systems	905	761	2,602	2,349
Space & Electronics	496	505	1,507	1,518
Sales	\$3,946	\$3,593	\$12,065	\$11,501
Profit(loss) before taxes				
Automotive	\$ 120	\$ 92	\$ 407	\$ 298
Systems	62	40	186	141
Space & Electronics	26	(47)	103	(53)
Profit(loss) before taxes	208	85	696	386
Corporate expense and other	(10)	(152)	(59)	(221)
Financing costs	(92)	(118)	(303)	(371)
Net employee benefits income	48	50	126	121
Earnings(loss) from continuing operations before income taxes and extraordinary items	\$ 154	\$ (135)	\$ 460	\$ (85)

Goodwill amortization included in each segment for the third quarter and the nine months ended September 30, 2001, respectively, was \$18 million and \$49 million for Automotive and \$4 million and \$13 million for Systems. Goodwill amortization included in Space & Electronics for the nine months ended September 30, 2001 was \$1 million.

Intersegment sales

(In millions)	Quarter ended September 30		Nine months ended September 30	
	2002	2001	2002	2001
Automotive	\$ 1	\$ —	\$ 1	\$ 2
Systems	41	44	125	139
Space & Electronics	8	15	20	45

Inventories

(In millions)	September 30 2002	December 31 2001
Finished products and work in process	\$351	\$324
Raw materials and supplies	271	251
	<u>\$622</u>	<u>\$575</u>

Supplemental Cash Flow Information

(In millions)	Nine months ended September 30	
	2002	2001
Interest paid, net of amount capitalized	\$263	\$317
Income taxes paid, net of refunds	8	17

Restructurings

Automotive

Severance costs and plant closing accruals related to restructuring plans, including reorganizing and downsizing operations, were \$145 million at December 31, 2001. During the nine months ended September 30, 2002, additional net charges of \$11 million before tax were recorded primarily in cost of sales, of which \$2 million was recorded in the third quarter. For the third quarter and nine months ended September 30, 2002, \$30 million and \$81 million, respectively, was used for severance payments and costs related to the consolidation of certain facilities. A gross reduction of over 1,500 employees as well as the closure of three manufacturing facilities related to these restructuring programs were achieved during the nine months ended September 30, 2002. The majority of the remaining balance of \$75 million is expected to be used by the end of 2002.

Corporate

During 2001, the Company announced restructuring actions to reduce employee headcount and related costs. The Company had restructuring reserves of \$10 million for severance and related costs at December 31, 2001. During the nine months ended September 30, 2002, \$6 million was used primarily for severance payments, of which \$1 million was used in the third quarter. In the third quarter of 2002, the Company returned to profit \$2 million as a result of changes in circumstances as to the extent of the program. The balance of \$2 million is expected to be used by the end of 2002.

Asset Impairments

During the nine months ended September 30, 2002, the Company recorded before tax asset impairment charges of \$19 million, of which \$17 million was recorded during the third quarter. These charges related to the write-down of investments as a result of declines in market values which were determined by management to be other than temporary. The charges were primarily recorded in other (income)expense-net. In addition, before tax asset impairment charges for the nine months ended September 30, 2002 of \$12 million were recorded, of which \$11 million was in the third quarter, related to the write-down of other assets. These charges were recorded in cost of sales and other (income)expense-net. The assets were written down to fair value based upon current market values of the assets.

Accounts Receivable Securitized

During the fourth quarter of 2001, the Company established a \$350 million accounts receivable securitization program. Under this program, the Company sells accounts receivable to a wholly-owned, fully consolidated, bankruptcy remote, special purpose subsidiary, TRW Receivables Inc. In contemplation of the sale of the Company's Aeronautical Systems business, TRW Receivables Inc. sold back the accounts receivable of the participating Aeronautical Systems units. At the same time, the size of the securitization program was reduced from \$350 million to \$325 million. The outstanding balance of receivables sold to the special purpose subsidiary at September 30, 2002 was \$522 million compared to \$489 million at December 31, 2001, of which \$64 million related to Aeronautical Systems. The undivided interest in the receivables portfolio sold to the financial conduits at September 30, 2002 was \$308 million compared to \$327 million at December 31, 2001. The loss on sale for the third quarter and nine months of 2002 was \$2 million and \$5 million, respectively, and was recorded in other (income)expense-net.

The table below summarizes certain cash flow information of the special purpose subsidiary for the nine months ended September 30, 2002:

(In millions)

Average monthly proceeds from receivables securitization	\$ 315
Monthly accumulation of proceeds from receivables securitization	2,831

This transaction is accounted for as a sale of the receivables under the provisions of SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities."

Financial Instruments

Foreign currency forward contracts – The Company manufactures and sells its products in countries throughout the world. As a result, it is exposed to fluctuations in foreign currency exchange rates. The Company enters into forward contracts and, to a lesser extent, purchased currency options to hedge portions of its foreign currency denominated forecasted revenues, purchases and the subsequent cash flows. The critical terms of the hedges are the same as the underlying forecasted transactions, and the hedges are considered to be perfectly effective to offset the changes in fair value of cash flows from the hedged transactions. Gains or losses on these instruments, which mature at various dates through April 2007, are generally recorded in other comprehensive income(loss) until the underlying transaction is recognized in net earnings. The earnings impact is reported in the Statements of Operations in the same account as the underlying transaction. The Company designated these contracts as cash flow hedges. The fair values of foreign currency forward contracts related to the Aeronautical Systems business are reported in the Balance Sheets in assets and liabilities of business held for sale.

In addition, the Company enters into certain foreign currency forward contracts that are not treated as hedges under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" to hedge recognized foreign currency transactions. Gains and losses on these contracts are recorded in net earnings and are substantially offset by the earnings effect of the revaluation of the underlying foreign currency denominated transaction.

At September 30, 2002, the Company had foreign currency derivative contracts outstanding with a notional amount of \$1.8 billion, denominated principally in the U.S. dollar, the euro and the British pound, of which \$1.2 billion related to the Aeronautical Systems business. Foreign exchange contracts are placed with a number of major financial institutions to minimize credit risk. No collateral is held in relation to the contracts, and the Company anticipates that these financial institutions will satisfy their obligations under the contracts. The fair market value of the foreign currency derivative contracts was a gain of \$33 million at September 30, 2002.

Interest rate swap agreements – The Company enters into interest rate swaps to manage the risks and costs associated with its financing activities. The net payments or receipts under the agreements are recognized as an adjustment to interest expense. At September 30, 2002, the Company had \$100 million notional principal amount of interest rate swaps outstanding that converted a portion of its variable rate debt to a fixed rate through August 2005. The interest rate swaps have a fair market value loss of \$14 million at September 30, 2002. These agreements were designated as cash flow hedges.

Forward share sale agreements – The Company hedges certain equity investments in publicly traded companies. These instruments protect the forecasted cash flows resulting from the sale of shares in the Company's investments in RFMD and Applera Corporation – Celera Genomics Group (Celera). The fair market value of these hedges as of September 30, 2002 was a \$207 million gain. These agreements were designated as cash flow hedges.

The following table represents the movement of amounts reported in other comprehensive income(loss) of deferred cash flow hedges, net of tax.

(In millions)	Quarter ended September 30		Nine months ended September 30	
	2002	2001	2002	2001
Beginning balance	\$79	\$(57)	\$ (2)	\$ —
Net change in derivative fair value and other movements	21	53	100	(8)
Amounts reclassified to earnings	(7)	2	(5)	6
Other comprehensive income(loss)	\$93	\$ (2)	\$ 93	\$ (2)

Debt and Credit Agreements

The Company amended and restated the revolving credit agreement that expired on January 22, 2002 in a reduced aggregate amount of \$1.25 billion with 20 banks and established a new expiration date of January 21, 2003. The Company has an option to extend the maturity of outstanding borrowings at that time to January 21, 2004. The Company also refinanced \$250 million of commercial paper borrowings by entering into a term loan agreement with 10 banks due January 25, 2005. The interest rate under the agreements is either the prime rate or a rate based on London Interbank Offered Rate (LIBOR), at the option of the Company.

The Company repaid \$300 million of medium-term notes that matured during the first quarter of 2002. Interest on the notes was based on three-month LIBOR. A subsidiary of the Company also completed an unsolicited repurchase of £5.4 million of its 10.875 percent bonds due 2020 during the first quarter of 2002. The repurchase resulted in an extraordinary gain of \$4 million before taxes (\$2 million after taxes, or \$0.02 per share).

During the second quarter of 2002, the Company repaid \$400 million of fixed rate notes that matured.

Preference Stock Redemption

On August 30, 2002, the Company redeemed all outstanding shares of its Cumulative Serial Preference Stock II, \$4.40 Convertible Series 1 at a redemption price of \$104 per share and all outstanding shares of its Cumulative Serial Preference Stock II, \$4.50 Convertible Series 3 at a redemption price of \$100 per share.

Earnings Per Share

(In millions except per share data)	Quarter ended September 30		Nine months ended September 30	
	2002	2001	2002	2001
Numerator				
Earnings(loss) from continuing operations before extraordinary items	\$ 95.2	\$ (93.1)	\$ 296.9	\$ (72.7)
Discontinued operations	(82.2)	12.3	(754.2)	50.4
Earnings(loss) before extraordinary items	13.0	(80.8)	(457.3)	(22.3)
Extraordinary items	—	—	2.5	—
Net earnings(loss)	13.0	(80.8)	(454.8)	(22.3)
Preferred stock dividends	—	(0.1)	(0.3)	(0.4)
Numerator for basic earnings per share — net earnings(loss) available to common shareholders	13.0	(80.9)	(455.1)	(22.7)
Effect of dilutive securities				
Preferred stock dividends	—	0.1	0.3	0.4
Numerator for diluted earnings per share — net earnings(loss) available to common shareholders	\$ 13.0	\$ (80.8)	\$ (454.8)	\$ (22.3)
Denominator				
Denominator for basic earnings per share — weighted-average common shares	128.6	125.2	127.4	124.5
Effect of dilutive securities				
Convertible preferred stock	(1.3)	—	—	—
Employee stock options	1.8	—	—	—
Dilutive potential common shares	0.5	—	—	—
Denominator for diluted earnings per share — adjusted weighted-average shares after assumed conversions	129.1	125.2	127.4	124.5
Earnings Per Share				
Diluted:				
Earnings(loss) from continuing operations before extraordinary items	\$ 0.74	\$ (0.75)	\$ 2.33	\$ (0.58)
Discontinued operations	(0.64)	0.10	(5.92)	0.40
Extraordinary items	—	—	0.02	—
Net earnings(loss)	\$ 0.10	\$ (0.65)	\$ (3.57)	\$ (0.18)
Basic:				
Earnings(loss) from continuing operations before extraordinary items	\$ 0.74	\$ (0.75)	\$ 2.33	\$ (0.58)
Discontinued operations	(0.64)	0.10	(5.92)	0.40
Extraordinary items	—	—	0.02	—
Net earnings(loss)	\$ 0.10	\$ (0.65)	\$ (3.57)	\$ (0.18)

Comprehensive Income(Loss)

The components of comprehensive income(loss), net of tax, including components related to discontinued operations, for the third quarter and nine months of 2002 and 2001 are as follows:

(In millions)	Quarter ended September 30		Nine months ended September 30	
	2002	2001	2002	2001
Net earnings(loss)	\$ 13	\$ (80)	\$(455)	\$ (22)
Foreign currency exchange gain(loss)	(34)	145	153	(44)
Unrealized loss on securities	—	(228)	(68)	(231)
Unrealized gain(loss) on cash flow hedges	14	55	95	(2)
Minimum pension liability	(1)	—	—	—
Comprehensive income(loss)	\$ (8)	\$(108)	\$(275)	\$(299)

The components of accumulated other comprehensive income(loss), net of tax, including components related to discontinued operations, at September 30, 2002 and December 31, 2001 are as follows:

(In millions)	September 30 2002	December 31 2001
Foreign currency exchange loss	\$(371)	\$(524)
Unrealized gain on securities	50	118
Unrealized gain(loss) on cash flow hedges	93	(2)
Minimum pension liability adjustments	(61)	(61)
Accumulated other comprehensive income(loss)	\$ (289)	\$(469)

Contingencies

Various claims, lawsuits and administrative proceedings with respect to commercial, product liability and environmental matters are pending or threatened against the Company or its subsidiaries, arising from the ordinary course of business.

Further, claims may be asserted in the future for events not currently known by management. Although the ultimate liability from these potential claims cannot be ascertained at September 30, 2002, management does not anticipate that any related liability, after consideration of insurance recovery, would have a material adverse effect on the Company's financial position.

During 1996, the United States Department of Justice (DOJ) advised the Company that it had been named as a defendant in lawsuits brought by a former employee of the Company originally filed under seal in 1994 and 1995 in the United States District Court for the Central District of California under the qui tam provisions of the civil False Claims Act. The DOJ subsequently advised that it would intervene in the litigation. In a consolidated complaint filed jointly by the former employee and the DOJ, it is alleged that the Company misclassified various costs and improperly charged those costs to certain of its federal contracts, that the United States has incurred substantial damages, and that the Company is liable for treble damages, penalties, post-judgment interest, costs (including attorneys' fees) and "all other proper relief." All substantive allegations against the Company have been denied in the Company's answer to the consolidated complaint. The Company cannot currently predict the outcome of this lawsuit.

In October 2000, Kelsey-Hayes Company (formerly known as Fruehauf Corporation) was served with a grand jury subpoena relating to a criminal investigation being conducted by the U.S. Attorney for the Southern District of Illinois. The U.S. Attorney has informed the Company that the investigation relates to

possible wrongdoing by Kelsey-Hayes Company and others involving certain loans made by Kelsey-Hayes Company's then parent corporation to Fruehauf Trailer Corporation, the handling of the trailing liabilities of Fruehauf Corporation and actions in connection with the 1996 bankruptcy of Fruehauf Trailer Corporation. Kelsey-Hayes Company became a wholly-owned subsidiary of TRW upon TRW's acquisition of LucasVarity in 1999. The Company is cooperating with the investigation and is unable to predict the outcome of the investigation at this time.

On May 6, 2002, ArvinMeritor Inc. filed suit against the Company in the United States District Court for the Eastern District of Michigan, claiming breach of contract and breach of warranty in connection with certain tie rod ends that the Company supplied to ArvinMeritor and the voluntary recall of some of these tie rod ends. ArvinMeritor subsequently recalled all of the tie rod ends, and claims that it is entitled to reimbursement by the Company for the costs associated with both the products recalled by the Company and those recalled by ArvinMeritor on its own. ArvinMeritor is seeking an undisclosed amount of compensatory and consequential damages. Management believes the Company has meritorious defenses and intends to defend vigorously the claims asserted against the Company, but cannot predict the outcome of this lawsuit.

On October 1, 2002, International Truck & Engine Corporation notified the National Highway Traffic Safety Administration of a program to effect a voluntary safety recall of hydraulic anti-lock brake systems electronic control units manufactured by Kelsey-Hayes Company. On October 1, 2002, International Truck's parent filed a Current Report on Form 8-K (a) disclosing that it seeks to recover costs associated with its voluntary recall from the manufacturer of the electronic control units and (b) indicating that it expects to record a pre-tax charge of approximately \$51 million for estimated recall costs. On October 3, 2002, Kelsey-Hayes Company filed a declaratory judgment action against International Truck in the Circuit Court for the County of Oakland, Michigan seeking a judgment declaring that International Truck has no right to recover any of the costs associated with the voluntary recall. Management believes the Kelsey-Hayes' claim is meritorious and intends to prosecute vigorously, but cannot predict the outcome of this lawsuit.

The Company and certain of its subsidiaries have been subject in recent years to some asbestos-related claims. Management believes that such claims will not have a material adverse effect on the Company's financial condition or results of operations. In general, these claims seek damages for illnesses alleged to have resulted from exposure to asbestos used in certain components sold by the Company and/or its subsidiaries.

The vast majority of these claims name as defendants numerous manufacturers and suppliers of a wide variety of products allegedly containing asbestos. Management believes that, to the extent that any of the products sold by the Company's automotive-related subsidiaries and at issue in these cases contained asbestos, the asbestos was encapsulated. Based upon several years of experience with such claims, management believes that only a small proportion of the claimants has or will ever develop any asbestos-related impairment.

Total annual settlement costs in connection with asbestos-related claims over the last five years as well as legal fees and expenses to defend these cases have been immaterial. These claims are strongly disputed and it has been the Company's policy to defend against them aggressively. The Company and its subsidiaries have been successful in obtaining dismissal of many cases without any payment whatsoever. Moreover, there is significant insurance coverage with solvent carriers with respect to these claims.

Taking into account established reserves, management believes that the ultimate resolution of each of the foregoing matters will not have a material effect on the Company's financial condition or results of operations. The resolution of one or more of such matters may have a material effect on cash flow for the period in which such matters are resolved.

Sale of Aeronautical Systems

On October 1, 2002, the Company completed the sale of its Aeronautical Systems business that was previously announced in June 2002. In accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the results of operations of this business are reported as discontinued operations, net of applicable income taxes, for all periods presented. In addition, the assets and liabilities of the Aeronautical Systems business have been reclassified as held for sale. As a result of the sale, an updated valuation of the business under SFAS 142 was conducted in the second quarter of 2002. The valuation resulted in impairment of goodwill of \$483 million in the second quarter of 2002. In addition, an adjustment to the loss on the sale of \$110 million after taxes was recorded in the third quarter of 2002 due primarily to an additional curtailment loss of the UK pension plan resulting from a further decline in pension asset values, additional translation losses and expenses. These adjustments were reflected in the Statement of Operations for the nine-month period ended September 30, 2002.

The results of Aeronautical Systems were as follows:

(In millions)	Quarter ended September 30		Nine months ended September 30	
	2002	2001	2002	2001
Sales	\$266	\$269	\$ 756	\$804
Earnings(loss) from operations	\$ 41	\$ 19	\$(406)	\$ 77
Loss on sale	(79)	—	(261)	—
Earnings(loss) before taxes	(38)	19	(667)	77
Income taxes	44	6	87	26
Earnings(loss) from discontinued operations	<u>\$ (82)</u>	<u>\$ 13</u>	<u>\$(754)</u>	<u>\$ 51</u>

The major classes of assets and liabilities for Aeronautical Systems were as follows:

(In millions)	September 30 2002	December 31 2001
Accounts receivable	\$ 222	\$ 178
Inventories	222	188
Intangible assets – net	344	336
Property, plant and equipment	308	259
Goodwill	331	744
Other assets	223	313
Total assets	<u>\$1,650</u>	<u>\$2,018</u>
Accounts payable	\$ 146	\$ 167
Other liabilities	285	256
Total liabilities	<u>\$ 431</u>	<u>\$ 423</u>

Independent Accountants' Review Report

Audit Committee of the
Board of Directors
TRW Inc.

We have reviewed the accompanying unaudited balance sheet of TRW Inc. and subsidiaries as of September 30, 2002, and the related unaudited statements of operations for the three-month and nine-month periods ended September 30, 2002 and 2001, and statements of cash flows for the nine-month periods ended September 30, 2002 and 2001, included in the Form 10-Q of TRW Inc. for the quarterly period ended September 30, 2002. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, which will be performed for the full year with the objective of expressing 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 the financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States.

We have previously audited, in accordance with auditing standards generally accepted in the United States, the balance sheet of TRW Inc. as of December 31, 2001, and the related statements of operations, cash flows, and changes in shareholders' investment for the year then ended (not presented herein), and in our report dated January 22, 2002 (except for the "Discontinued Operations" note, as to which the date is August 27, 2002), we expressed an unqualified opinion on those financial statements. Those financial statements and our report on them are included in the Form 8-K of TRW Inc. filed on September 3, 2002. In our opinion, the information set forth in the accompanying balance sheet as of December 31, 2001 is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Cleveland, Ohio
October 16, 2002

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

On October 1, 2002, the Company completed the sale of its Aeronautical Systems business that had been announced in June 2002. The results of operations of this business are reported as discontinued operations, net of applicable income taxes, for all periods presented. In addition, the assets and liabilities of the Aeronautical Systems business have been reclassified as held for sale. Refer to the Sale of Aeronautical Systems note to financial statements for further discussion.

On June 30, 2002 the Company, Northrop Grumman Corporation (Northrop) and Richmond Acquisition Corp., a wholly-owned subsidiary of Northrop, entered into a definitive merger agreement, whereby Northrop will acquire all of the Company's outstanding common stock and the Company will become a wholly-owned subsidiary of Northrop. In the merger, each share of the Company's common stock will be converted into the right to receive a number of shares of Northrop common stock equal to the exchange ratio. The exchange ratio is calculated by dividing \$60 by the average closing sale prices for a share of Northrop common stock on the New York Stock Exchange during the five consecutive trading days ending on (and including) the second trading day prior to the date the merger is completed. However, in no event will the exchange ratio be greater than 0.5357 (\$60/\$112) or less than 0.4348 (\$60/\$138), even if the actual average price per share of Northrop common stock used to calculate the exchange ratio is less than \$112 or greater than \$138. On October 16, 2002, the European Commission announced that it had completed its review and approved the transaction. The statutory waiting period applicable to the merger pursuant to the U.S. Hart-Scott-Rodino Act expired on October 15, 2002, although the Department of Justice is still reviewing the transaction. Northrop and the Company have agreed that they will notify the Justice Department of their intent to complete the transaction no sooner than ten business days prior to the earlier of Northrop's stockholders meeting or the Company's shareholders meeting relating to the merger. The merger requires approval by the shareholders of the Company and Northrop and both companies have scheduled special meetings of shareholders for December 11, 2002 to vote on the proposed merger. Northrop has announced that after the completion of the merger, it plans to separate the Company's automotive business, either through a sale or a spin-off of the business to shareholders.

Results of Operations

(In millions except per share data)

	Quarter ended September 30				Nine months ended September 30			
	2002	2001	Change	Percent Inc (Dec)	2002	2001	Change	Percent Inc (Dec)
Sales	\$3,946	\$3,593	\$ 353	10%	\$12,065	\$11,501	\$ 564	5%
Segment profit from continuing operations before taxes and extraordinary items	208	85	123	147%	696	386	310	81%
Earnings(loss) from continuing operations before extraordinary items	95	(93)	188	nm	297	(73)	370	nm
Discontinued operations	(82)	13	(95)	nm	(754)	51	(805)	nm
Extraordinary items	—	—	—	nm	2	—	2	nm
Net earnings(loss)	13	(80)	93	nm	(455)	(22)	(433)	nm
Diluted earnings(loss) per share:								
Continuing operations before extraordinary items	0.74	(0.75)	1.49	nm	2.33	(0.58)	2.91	nm
Discontinued operations	(0.64)	0.10	(0.74)	nm	(5.92)	0.40	(6.32)	nm
Extraordinary items	—	—	—	nm	0.02	—	0.02	nm
Net earnings(loss)	0.10	(0.65)	0.75	nm	(3.57)	(0.18)	(3.39)	nm
Effective tax rate from continuing operations	38.4%	31.2%			35.5%	14.6%		

nm – not meaningful

The third quarter 2002 sales of \$3,946 million increased 10 percent compared to \$3,593 million in the third quarter of 2001. The increase was the result of higher automotive production volumes of \$178 million, primarily in North America, a net increase in sales in the defense businesses of approximately \$135 million and the favorable effects of foreign currency exchange of \$72 million, partially offset by lower pricing of \$27 million.

Earnings from continuing operations before extraordinary items for the third quarter of 2002 were \$95 million, or \$0.74 per share, compared to a loss of \$93 million, or \$0.75 per share, for the third quarter of 2001. Net earnings and net earnings per share for the third quarter 2002 were \$13 million, or \$0.10 per share, compared to a net loss of \$80 million, or \$0.65 per share, in 2001. The Company reported a net loss from discontinued operations of \$82 million after tax, or \$0.64 per share, for the third quarter of 2002, of which earnings from operations were \$28 million after tax, or \$0.21 per share, compared to earnings from operations of \$13 million after tax, or \$0.10 per share, in the third quarter of 2001. Adjusting the third quarter of 2001 for the effect of adopting SFAS 142 on January 1, 2002, third quarter net earnings from continuing operations for 2001 would have increased by \$18 million, or \$0.15 per share.