NCR CORP
Form 10-Q
August 04, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2006

Commission File Number 001-00395

NCR CORPORATION

(Exact name of registrant as specified in its charter)

Maryland	**31-0387920**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

1700 South Patterson Blvd.

Dayton, Ohio 45479

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: (937) 445-5000

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 x   No ¨

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.

Large accelerated filer x   Accelerated filer ¨   Non-accelerated filer ¨

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

Number of shares of common stock, $0.01 par value per share, outstanding as of July 31, 2006, was approximately 180.2 million.

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Part I. Financial Information

Item 1. Financial Statements

Condensed Consolidated Statements of Operations (Unaudited)

In millions, except per share amounts

	Three Months Ended June 30		Six Months Ended June 30	
	2006	**2005**	**2006**	**2005**
Product revenue	$ 805	$ 762	$ 1,442	$ 1,440
Service revenue	726	708	1,372	1,373
Total revenue	1,531	1,470	2,814	2,813
Cost of products	534	495	936	933
Cost of services	572	579	1,101	1,113
Selling, general and administrative expenses	264	265	509	523
Research and development expenses	58	58	118	117
Total operating expenses	1,428	1,397	2,664	2,686
Income from operations	103	73	150	127
Interest expense	6	6	12	12
Other income, net	(5)	(12)	(14)	(4)
Income before income taxes	102	79	152	119
Income tax expense (benefit)	24	(48)	33	(38)
Net income	$ 78	$ 127	$ 119	$ 157
Net income per common share				
Basic	$ 0.43	$ 0.68	$ 0.66	$ 0.84
Diluted	$ 0.42	$ 0.67	$ 0.64	$ 0.82
Weighted average common shares outstanding				
Basic	181.1	186.2	181.4	186.3
Diluted	184.2	190.3	184.6	190.8

See Notes to Condensed Consolidated Financial Statements.

See Note 1 for impact of change in accounting.

Shares outstanding and per share amounts reflect a two-for-one stock split effective on January 21, 2005.

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Condensed Consolidated Balance Sheets (Unaudited)

In millions, except per share amounts

	June 30, 2006	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	$ 747	$ 810
Accounts receivable, net	1,301	1,305
Inventories, net	665	595
Other current assets	253	217
Total current assets	2,966	2,927
Property, plant and equipment, net	372	378
Goodwill	148	129
Prepaid pension cost	1,012	976
Deferred income taxes	545	522
Other assets	366	355
Total assets	$ 5,409	$ 5,287
Liabilities and stockholders equity		
Current liabilities		
Short-term borrowings	$ 2	$ 2
Accounts payable	484	490
Payroll and benefits liabilities	231	292
Customer deposits and deferred service revenue	495	444
Other current liabilities	428	417
Total current liabilities	1,640	1,645
Long-term debt	305	305
Pension and indemnity plan liabilities	575	557
Postretirement and postemployment benefits liabilities	264	259
Income taxes	323	307
Other liabilities	159	158
Minority interests	22	21
Total liabilities	3,288	3,252
Commitments and contingencies (Note 8)		
Stockholders equity		
Preferred stock: par value $0.01 per share, 100.0 shares authorized, no shares issued and outstanding at June 30, 2006 and December 31, 2005 respectively		
Common stock: par value $0.01 per share, 500.0 shares authorized, 180.2 and 181.7 shares issued and outstanding at June 30, 2006 and December 31, 2005 respectively	2	2
Paid-in capital	702	794
Retained earnings	1,637	1,518
Accumulated other comprehensive loss	(220)	(279)
Total stockholders equity	2,121	2,035

Total liabilities and stockholders equity	$ 5,409	$ 5,287

See Notes to Condensed Consolidated Financial Statements.

Shares issued reflect a two-for-one stock split effective on January 21, 2005.

See Note 1 for changes to prior period financial statements for change in accounting.

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Condensed Consolidated Statements of Cash Flows (Unaudited)

In millions

	Six Months Ended June 30	
	2006	**2005**
Operating activities		
Net Income	$ 119	$ 157
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	78	86
Stock-based compensation expense	14	2
Excess tax benefit from stock-based compensation	(12)	
Deferred income taxes	18	
Non-cash income tax adjustment		(64)
Other adjustments to income, net	(1)	(1)
Changes in assets and liabilities:		
Receivables	4	125
Inventories	(65)	(15)
Current payables and accrued expenses	(67)	(142)
Deferred service revenue and customer deposits	50	42
Employee severance and pension	34	38
Other assets and liabilities	(26)	(65)
Net cash provided by operating activities	146	163
Investing activities		
Expenditures for property, plant and equipment	(38)	(32)
Proceeds from sales of property, plant and equipment	12	7
Additions to capitalized software	(44)	(37)
Other investing activities and business acquisitions, net	(31)	2
Net cash used in investing activities	(101)	(60)
Financing activities		
Purchases of Company common stock	(186)	(218)
Excess tax benefit from stock-based compensation	12	
Proceeds from employee stock plans	61	102
Net cash used in financing activities	(113)	(116)
Effect of exchange rate changes on cash and cash equivalents	5	(13)
Decrease in cash and cash equivalents	(63)	(26)
Cash and cash equivalents at beginning of period	810	750
Cash and cash equivalents at end of period	$ 747	$ 724

See Notes to Condensed Consolidated Financial Statements.

See Note 1 for changes to prior period financial statements for change in accounting.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND ACCOUNTING CHANGE

The accompanying Condensed Consolidated Financial Statements have been prepared by NCR Corporation (NCR, the Company, we or us) without audit pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC) and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments, except for the accounting change described below) necessary for a fair statement of the consolidated results of operations, financial position, and cash flows for each period presented. The unaudited Condensed Consolidated Financial Statements as of December 31, 2005 and for the six months ended June 30, 2005 have been retrospectively adjusted for the accounting change described below. The impact of the change was not material to any prior period or the 2005 Condensed Consolidated Statements of Operations and accordingly, the Company has recorded the cumulative effect of this accounting change in the results of operations for the three and six month periods ended June 30, 2006. The consolidated results for the interim periods are not necessarily indicative of results to be expected for the full year. These financial statements should be read in conjunction with NCR s Form 10-K for the year ended December 31, 2005.

Accounting Change In the second quarter of 2006, the Company changed its method of accounting for reworkable service parts used in its Customer Services maintenance business. The previous accounting method was to classify reworkable service parts as long-lived assets and to depreciate the parts over their estimated useful lives (three to six years). The Company s new method of accounting is to classify reworkable service parts as inventory and to expense the cost of the parts when they are placed in customer equipment under maintenance contracts. The Company believes the inventory method is preferable to its former method because it recognizes expense in the period in which the parts are used and more closely aligns with the management and use of the parts.

The company recorded the change in accounting in accordance with Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* (SFAS 154). SFAS 154 requires that such voluntary accounting changes be made on a retrospective basis and that the Condensed Consolidated Financial Statements be adjusted to apply the inventory method retrospectively to all prior periods.

As a result of applying the accounting change retrospectively, net reworkable service parts of $234 million as of December 31, 2005, are now reflected as current assets in the accompanying unaudited Condensed Consolidated Balance Sheet as reworkable service parts inventory. Prior to the accounting change, this amount was reported as a separate caption under long-term assets. In addition, expenditures, net of proceeds, for reworkable service parts of $43 million, which was part of investing activities, is now reflected in the accompanying unaudited Condensed Consolidated Statement of Cash Flows for the six months ended June 30, 2005 as a part of operating activities. The impact of the accounting change on previously reported income from operations, net income and earnings per share of the current and each prior period was not material. Accordingly, the cumulative effect of the change in accounting method of approximately $0.2 million has been recorded as a decrease in cost of services in the Condensed Consolidated Statements of Operations for the three and six month periods ended June 30, 2006.

Use of Estimates The preparation of financial statements in accordance with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the period reported. Actual results could differ from those estimates.

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2. SUPPLEMENTAL FINANCIAL INFORMATION

In millions	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
Comprehensive Income				
Net income	$ 78	$ 127	$ 119	$ 157
Other comprehensive income, net of tax:				
Unrealized loss on securities	(2)		(1)	(1)
Unrealized (loss) gain on derivatives	(2)	13	(4)	19
Currency translation adjustments	50	(45)	61	(56)
Other adjustments			3	
Total comprehensive income	$ 124	$ 95	$ 178	$ 119

In millions	June 30, 2006	December 31, 2005
Inventories		
Work in process and raw materials	$ 117	$ 96
Finished goods	226	205
Service parts	322	294
Total inventories, net	$ 665	$ 595

3. NEW ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 123 (revised 2004) In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R requires that all share-based payments to employees, including grants of stock options, be recognized in the financial statements based on their fair value. The Company adopted SFAS 123R as of January 1, 2006. See Note 6 for a further discussion of stock compensation and its effect on NCR.

FASB Interpretation No. 48 In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing thresholds and attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of adopting FIN 48 on our financial condition and results of operations.

Proposed Statement of Financial Accounting Standards In March 2006, the FASB issued the proposed standard, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132R.* This exposure draft impacts the valuation of the additional minimum pension liability by recognizing previously unrecognized items, including (i) the unrecognized net transition assets or obligations recognized as an adjustment to retained earnings, and (ii) unrecognized actuarial gain/loss and unrecognized prior service cost/credits recognized as an adjustment to other comprehensive income. The Company is presently reviewing the potential impact of this proposed financial accounting standard.

4. BUSINESS COMBINATIONS

The Company completed four acquisitions during the first six months of 2006 for total consideration of approximately $30 million, which was paid in cash. Goodwill recognized in these transactions amounted to $18 million, and the amount is expected to be fully deductible for tax purposes. Goodwill of $8 million was assigned to the Data Warehousing segment, $3 million was assigned to Retail Store Automation and $7 million was assigned to the Financial Self Service segment. The total amount allocated to identifiable intangible assets was $10 million. The weighted-average amortization period is 5 years for the purchased intangible assets, which consist primarily of intellectual property associated with software.

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The operating results of these businesses have been included in NCR s results as of the respective closing dates of the acquisitions. The pro forma disclosures otherwise required under FASB Statement No. 141, Business Combinations, are not being provided because the impact of the transactions is not material. The purchase prices of these businesses, reported under Other Investing Activities in the Consolidated Statements of Cash Flows, have been allocated to the estimated fair value of net tangible and intangible assets acquired, with any excess recorded as goodwill.

5. IDENTIFIABLE INTANGIBLE ASSETS

NCR s identifiable intangible assets, reported under Other Assets in the Condensed Consolidated Balance Sheets, were specifically identified when acquired, and are deemed to have finite lives. These intangible assets are being amortized over original periods ranging from four to ten years. The gross carrying amount and accumulated amortization for NCR s identifiable intangible assets were as follows:

In millions	June 30, 2006		December 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Identifiable intangible assets				
Non-Compete arrangements	**$ 5**	**$ (1)**	$ 5	$
Patents			14	(13)
Intellectual property	**59**	**(16)**	48	(12)
Total identifiable intangible assets	**$ 64**	**$ (17)**	$ 67	$ (25)

The increase in the intellectual property since December 31, 2005 is primarily due to our acquisitions described in Note 4 above. The decrease in Patents since December 31, 2005 is due to a patent becoming fully amortized during 2006.

The aggregate amortization expense (actual and estimated) for identifiable intangible assets for the following periods is:

In millions		For the year ended (estimated)				
	Six months ended June 30, 2006	2006	2007	2008	2009	2010
Amortization expense	**$ 6**	$ 12	$ 12	$ 11	$ 10	$ 6

6. STOCK COMPENSATION PLANS

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). The Company adopted the provisions of SFAS 123R as of January 1, 2006 using the modified prospective transition method, which does not require restatement of prior year results. SFAS 123R requires that all share-based payments to employees, including grants of stock options, be recognized as compensation expense in the financial statements based on their fair value.

SFAS 123R resulted in a change in our method of measuring and recognizing the fair value of our stock options and estimating forfeitures for all unvested awards. Additionally, prior to the adoption of SFAS 123R, the Company used the nominal vesting period approach for retirement eligible employees. Using this approach, the Company recognized compensation cost for share-based awards granted prior to 2006 over the stated vesting period for retirement eligible employees. As a result of adopting SFAS 123R, the Company changed its method for recognizing compensation expense for new share-based awards granted to retirement eligible employees. Compensation expense is now recognized over the period from the date of grant to the date retirement eligibility is achieved, if retirement eligibility is expected to occur during the nominal vesting period (non-substantive vesting period approach). Had the Company applied the non-substantive vesting period approach to awards granted prior to 2006, incremental compensation expense would have been immaterial for the three and six months ended June 30, 2006 and for the three and six months ended June 30, 2005 (pro forma).

As of June 30, 2006, the Company s primary types of share-based compensation were stock options and restricted stock (discussed below in this Note). The Company recorded stock-based compensation expense for the periods ended June 30, 2006 and 2005 as follows, the components of which are further described below.

In millions	Three Months Ended June 30		Six Months Ended June 30	
	2006	**2005**	**2006**	**2005**
Stock options	**$ 4**	$	**$ 8**	$
Restricted stock	**3**	1	**6**	2
Total stock-based compensation (pre-tax)	**7**	1	**14**	2
Tax benefit	**(2)**		**(4)**	
Total stock-based compensation, net of tax	**$ 5**	$ 1	**$ 10**	$ 2

As a result of adopting SFAS 123R, the Company recognized $4 million ($3 million after-tax) of expense related to stock options in the second quarter of 2006, which had a $0.02 impact on basic and diluted earnings per share, and for the six months ended June 30, 2006, the Company recognized $8 million ($6 million after-tax) of expense related to stock options, which had a $0.03 impact on basic and diluted earnings per share. Overall, total stock-based compensation expense, which includes expense related to restricted stock, increased $6 million ($4 million after-tax) for the second quarter of 2006 and $12 million ($8 million after-tax) for the six months ended June 30, 2006. Compensation cost capitalized as part of inventory and fixed assets as of June 30, 2006 was immaterial.

The total number of shares authorized to be issued under all share-based plans was 80 million prior to approval by the Company s stockholders of the Stock Incentive Plan and discontinuation of the Management Stock Plan (discussed below in this Note). Although no new awards can be made under the Management Stock Plan, 9 million shares remain authorized for issuance pursuant to the terms of outstanding awards. A total of 12 million shares are authorized to be issued under the Stock Incentive Plan. New shares of the Company s common stock are issued as a result of stock option exercises.

The Company had previously accounted for stock-based employee compensation using the intrinsic value-based method in accordance with Accounting Principles Board Opinion No. 25 (APB No. 25), which required compensation expense for options to be recognized when the market price of the underlying stock exceeded the exercise price on the date of grant. In addition, no compensation expense was recorded for purchases under the ESPP in accordance with APB No. 25. If NCR had recognized stock option-based compensation expense based on the fair value of stock options grants and employee stock purchases under the ESPP, net income and net income per diluted share for the three months and six months ended June 30, 2005, on a pro forma basis, would have been as follows:

In millions, except per share amounts	**Three Months**	**Six Months**
	Ended June 30, 2005	**Ended June 30, 2005**
Net income	$ 127	$ 157
Stock-based employee compensation expense included in reported net income (net of tax)	1	2
Total stock-based employee compensation expense determined under fair value-based method for awards (pre-tax)	6	12
Tax benefit of stock-based employee compensation determined under fair value-based method for awards	(1)	(2)
Subtotal: Deduct from net income	5	10
Pro forma net income	$ 123	$ 149
Basic net income per share:		
As reported:	$ 0.68	$ 0.84
Pro forma:	$ 0.66	$ 0.80
Diluted net income per share:		
As reported:	$ 0.67	$ 0.82
Pro forma:	$ 0.65	$ 0.78

The 2005 pro forma net income and net income per diluted share for all periods presented was computed using the fair value of options as calculated using the Black-Scholes option-pricing model. The weighted average fair value of grants during the three months ended June 30, 2005 was $13.09 and for the six months ended June 30, 2005 was $15.45, and was estimated based on the following weighted average assumptions:

	Three Months	**Six Months**
	Ended June 30, 2005	**Ended June 30, 2005**
Dividend yield		
Risk-free interest rate	**3.91%**	**4.00%**
Expected volatility	**35.5%**	**35.5%**
Expected holding period (years)	**5.5**	**5.5**

Stock Option Plan

Prior to approval by the Company s stockholders on April 26, 2006 of the NCR 2006 Stock Incentive Plan (SIP), the NCR Management Stock Plan (MSP) was the principal vehicle through which equity grants were made to our employees and directors. The MSP provided for the grant of several different forms of stock-based benefits, including stock options to purchase shares of NCR common stock. Stock options under the MSP were generally granted at the fair market value of the common stock at the date of grant, had a ten-year term and vested within four years of the grant date. Grants that were issued before 1998 generally had a four-year vesting period, grants from 1998 through 2003 had a three-year vesting period, and grants issued in 2004 and after generally had a four-year vesting period. As a result of approval of the SIP by the Company s stockholders, NCR discontinued the MSP, except that awards previously granted and outstanding under the MSP remain outstanding.

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The SIP provides for the grant of several different forms of stock-based compensation, including stock options to purchase shares of NCR common stock. The Compensation and Human Resource Committee of the Board of Directors has discretion to determine the material terms and conditions of option awards under the SIP, provided that (i) the exercise price must be no less than the fair market value of NCR common stock on the date of grant, (ii) the term must be no longer than ten years, and (iii) in no event shall the normal vesting schedule provide for vesting in less than one year. Other terms and conditions of an award of stock options will be determined by the Compensation and Human Resource Committee of the Board of Directors as set forth in the agreement relating to that award. The Compensation and Human Resource Committee has authority to administer the SIP, except that the Committee on Directors and Governance will administer the SIP with respect to non-employee members of the Board of Directors.

Compensation expense in the first six months of 2006 was computed using the fair value of options as calculated using the Black-Scholes option-pricing model. The weighted average fair value of grants during the three months ended June 30, 2006 was $16.70 and for the six months ended June 30, 2006 was $15.75, and was estimated based on the following weighted average assumptions:

	Three Months	**Six Months**
	Ended June 30, 2006	**Ended June 30, 2006**
Dividend yield		
Risk-free interest rate	**4.96%**	**4.61%**
Expected volatility	**35.3%**	**35.7%**
Expected holding period (years)	**5.3**	**5.3**

Expected volatility incorporates a blend of both historical volatility of the Company s stock over a period equal to the expected term of the options and implied volatility from traded options on the Company s stock, as management believes this is more representative of prospective trends. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The expected holding period represents the period of time that options are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the five-year U.S. Treasury yield curve in effect at the time of grant.

The following table summarizes the Company s stock option activity for the six months ended June 30, 2006:

	Shares Under Option	**Weighted-Average Exercise Price per Share**	**Weighted-Average Remaining Contractual Term (in years)**	**Aggregate Intrinsic Value**
				(in millions)
Shares in thousands				
Outstanding at January 1, 2006	11,140	$ 21.53		
Granted	1,165	$ 38.97		
Exercised	(2,863)	$ 18.52		
Canceled	(149)	$ 30.39		
Forfeited	(9)	$ 27.28		
Outstanding at June 30, 2006	9,284	$ 24.53	6.43	$ 118
Fully vested and expected to vest at June 30, 2006	8,922	$ 24.50	6.40	$ 113
Exercisable at June 30, 2006	5,968	$ 19.97	5.14	$ 94

The total intrinsic value of options exercised was $59 million during the first six months of 2006 and $81 million during the first six months of 2005. Cash received from option exercises under all share-based payment arrangements for the six months ended June 30 was $61 million in 2006 and $102 million in 2005. The tax benefit realized from these exercises for the first six months was $18 million in 2006 and $25 million in 2005.

As of June 30, 2006 there was $38 million of total unrecognized compensation cost related to unvested stock option grants. That cost is expected to be recognized over a weighted-average period of 2.5 years.

Restricted Stock and Restricted Stock Units

The MSP provided for the issuance of restricted stock to certain employees as a form of long-term compensation, retention, promotion or other special circumstances. The Company s restricted stock grants under the MSP can be categorized as either service-based or performance-based vesting. The service-based shares typically vest over a three- to four-year period beginning on the date of grant. These grants are not subject to future performance measures. The cost of these awards, determined to be the fair market value of the shares at the date of grant, is expensed ratably over the period the restrictions lapse. For substantially all restricted stock grants, at the date of grant, the recipient has all rights of a stockholder, subject to certain restrictions on transferability and a risk of forfeiture. Performance-based grants are subject to future performance measurements, which included NCR s achievement of Cumulative Net Operating Profit (as defined in the Plan) over a three-year period and return on capital over a three-year period. All performance-based shares will become vested at the end of three years provided that the employee is continuously employed by NCR and the applicable performance measures are met. Performance-based grants must be earned, based on performance, before the actual number of shares to be vested is known. The Company considers the likelihood of meeting the performance criteria based upon management s estimates and analysis of future earnings. As a result of approval of the SIP by the Company s stockholders, NCR discontinued the MSP, except that awards previously granted and outstanding under the MSP remain outstanding.

The SIP also provides for the issuance of restricted stock, as well as restricted stock units. Performance goals may be established by the Compensation and Human Resource Committee in connection with the grant of restricted stock or restricted stock units. Any grant of restricted stock or restricted stock units will be subject to a vesting period of at least three years, except that a one-year term of service may be required if vesting is conditioned upon achievement of performance goals. At the date of grant, a recipient of restricted stock has all the rights of a stockholder subject to certain restrictions on transferability and a risk of forfeiture. A recipient of restricted stock units does not have the rights of a stockholder but is subject to restrictions on transferability and risk of forfeiture. Other terms and conditions applicable to any award of restricted stock or restricted stock units will be determined by the Compensation and Human Resource Committee and set forth in the agreement relating to that award.

The following table reports restricted stock activity during the six month period ended June 30, 2006:

	Number of Shares	Weighted-Average Grant-Date Fair Value per Share
Shares in thousands		
Unvested shares at January 1, 2006	867	$ 26.82
Shares granted	530	$ 38.77
Shares vested and distributed	(204)	$ 17.09
Shares forfeited	(39)	$ 33.73
Unvested shares at June 30, 2006	1,154	$ 33.79

The total intrinsic value of shares vested and distributed during the first six months of 2006 was $8 million and during the first six months of 2005 was $2 million. As of June 30, 2006, there was $29 million of unrecognized compensation cost related to unvested restricted stock grants. The unrecognized compensation cost is expected to be recognized over a remaining weighted-average period of 2.1 years.

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The following table represents the composition of restricted stock grants in the first six months of 2006:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Shares in thousands		
Service-based shares	86	$ 39.05
Performance-based shares	444	$ 38.83
Total stock grants	530	$ 38.77

Other Share-based plans

The ESPP enables eligible employees to purchase NCR s common stock at a discount to the average market price at the end of the last trading day of each month. In 2006, the ESPP discount was reduced from 15% to 5% of the average market price. As a result, this plan is considered non-compensatory in accordance with SFAS 123R. Employees may authorize payroll deductions of up to 10% of eligible compensation for common stock purchases. Employees purchased approximately 0.2 million shares in the first six months of 2006 and 0.4 million shares in the first six months of 2005 of NCR common stock for approximately $8 million in 2006 and $11 million in 2005. As of June 30, 2006, approximately 16 million shares were authorized and 1.8 million shares were available for purchase under this plan. On April 26, 2006, NCR s stockholders approved a new Employee Stock Purchase Plan, which will become effective on January 1, 2007.

7. EMPLOYEE BENEFIT PLANS

Components of net periodic benefit expense for the three months ended June 30 are as follows:

In millions	U.S. Pension Benefits		International Pension Benefits		Total Pension Benefits	
	2006	**2005**	**2006**	**2005**	**2006**	**2005**
Net service cost	**$ 11**	$ 12	**$ 12**	$ 11	**$ 23**	$ 23
Interest cost	**45**	44	**21**	22	**66**	66
Expected return on plan assets	**(60)**	(56)	**(31)**	(33)	**(91)**	(89)
Settlement charge			**(1)**		**(1)**	
Special Termination Benefit		19				19
Amortization of:						
Transition asset		(1)				(1)
Prior service cost			**2**	1	**2**	1
Actuarial loss	**13**	15	**23**	18	**36**	33
Net benefit cost	**$ 9**	$ 33	**$ 26**	$ 19	**$ 35**	$ 52

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Components of net periodic benefit expense for the six months ended June 30 are as follows:

In millions	U.S. Pension Benefits		International Pension Benefits		Total Pension Benefits	
	2006	**2005**	**2006**	**2005**	**2006**	**2005**
Net service cost	**$ 23**	$ 23	**$ 22**	$ 23	**$ 45**	$ 46
Interest cost	**90**	89	**41**	43	**131**	132
Expected return on plan assets	**(120)**	(112)	**(60)**	(66)	**(180)**	(178)
Special Termination Benefit	**9**	19			**9**	19
Amortization of:						
Transition asset		(1)				(1)
Prior service cost			**3**	3	**3**	3
Actuarial loss	**26**	30	**45**	35	**71**	65
Net benefit cost	**$ 28**	$ 48	**$ 51**	$ 38	**$ 79**	$ 86

The net periodic benefit cost of the postretirement plan for the three months and six months ended June 30 were:

In millions	Three Months Ended June 30		Six Months Ended June 30	
	2006	**2005**	**2006**	**2005**
Interest cost	**$ 2**	$ 2	**$ 4**	$ 4
Amortization of:				
Prior service cost (benefit)	**(4)**	(3)	**(7)**	(6)
Actuarial loss	**2**	1	**4**	3
Net benefit cost	**$**	$	**$ 1**	$ 1

Employer Contributions

Pension For the three months ended June 30, 2006, NCR contributed approximately $20 million to its international pension plans and $2 million to its executive pension plan. For the six months ended June 30, 2006, NCR contributed approximately $41 million to its international pension plans and $4 million to its executive pension plan. NCR anticipates contributing an additional $79 million to its international pension plans and $6 million to its executive pension plan in 2006 for a total of $120 million and $10 million, respectively. NCR does not anticipate making cash contributions to its U.S. qualified pension plan in 2006.

Postretirement For the three months ended June 30, 2006, the Company made $4 million in contributions to its U.S. postretirement plan. For the six months ended June 30, 2006, the Company made $9 million in contributions to its U.S. postretirement plan. NCR anticipates contributing an additional $12 million to its U.S. postretirement plan for a total of $21 million in 2006.

8. COMMITMENTS AND CONTINGENCIES

In the normal course of business, NCR is subject to various regulations, proceedings, lawsuits, claims and other matters, including actions under laws and regulations related to the environment and health and safety, among others. NCR believes the amounts provided in its condensed consolidated financial statements, as prescribed by GAAP, are adequate in light of the probable and estimable liabilities. However, there can be no assurances that the actual amounts required to satisfy alleged liabilities from various lawsuits, claims, legal proceedings and other matters, including the Fox River environmental matter discussed below, and to comply with applicable laws and regulations, will not exceed the amounts reflected in NCR s condensed consolidated financial statements or will not have a material adverse effect on its consolidated results of operations, financial condition or cash flows. Any costs that may be incurred in excess of those amounts provided as of June 30, 2006 cannot currently be reasonably determined.

Environmental Matters NCR s facilities and operations are subject to a wide range of environmental protection laws, and NCR has investigatory and remedial activities underway at a number of facilities that it currently owns or operates, or formerly owned or operated, to comply, or to determine compliance, with such laws. Also, NCR has been identified, either by a government agency or by a private party seeking contribution to site clean-up costs, as a potentially responsible party (PRP) at a number of sites pursuant to various state and federal laws, including the Federal Water Pollution Control Act, the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), and comparable state statutes.

NCR is one of eight entities that have been formally notified by governmental and other entities (such as local Native American tribes) that they are PRPs for environmental claims under CERCLA and other statutes arising out of the presence of polychlorinated biphenyls (PCBs) in sediments in the lower Fox River and in the Bay of Green Bay, in Wisconsin. NCR was identified as a PRP because of alleged PCB discharges from two carbonless copy paper manufacturing facilities it previously owned, which are located along the Fox River. Some parties contend that NCR is also responsible for PCB discharges from paper mills owned by other companies because carbonless paper manufactured by NCR was purchased by those mills as a raw material for their paper making processes. NCR sold the facilities in 1978 to Appleton Papers Inc. (API), which has also been identified as a PRP. The other Fox River PRPs include P.H. Glatfelter Company, Fort James Operating Company (a subsidiary of Georgia-Pacific Corp., which was recently acquired by Koch Industries), WTM I Co. (formerly Wisconsin Tissue Mills, now owned by Chesapeake Corporation), Riverside Paper Corporation, Sonoco-U.S. Paper Mills, Inc. (owned by Sonoco Products Company), and Menasha Corporation.

The governmental and other entities making such claims against NCR and the other PRPs have been coordinating their actions, including the assertion of claims against the PRPs. Additionally, certain claimants have notified NCR and the other PRPs of their intent to commence a natural resource damage (NRD) lawsuit, but have not as yet instituted litigation; and one of the claimants, the U.S. Environmental Protection Agency (USEPA), formally proposed the Fox River site for inclusion on the CERCLA National Priorities List, but no action has yet been taken on this proposal.

In 2005, NCR revised the basis of its reserve for the Fox River matter. The factors considered in revising the reserve are discussed below. At March 31, 2006, and after taking into account receivables for certain probable insurance and indemnity recoveries, the reserve was $58 million. At June 30, 2006, the reserve was $72 million, after taking into account receivables for certain probable insurance and indemnity recoveries. The change between June 30, 2006 and March 31, 2006 was primarily due to the receipt of approximately $15 million of the $19 million in insurance receivables (also discussed below). NCR regularly re-evaluates the assumptions used in determining the appropriate reserve for the Fox River matter as additional information becomes available and, when warranted, makes appropriate adjustments.

In July 2003, USEPA and Wisconsin Department of Natural Resources (WDNR) issued their final clean-up plan (known as a Record of Decision, or ROD) for the largest portion of the Fox River. The ROD addressed the lower part of the Fox River and portions of Green Bay, where USEPA and WDNR (the Governments) estimate the bulk of the sediments that need to be remediated are located. In two portions of the lower part of the Fox River covered by the ROD Operable Units (OUs) 3 and 4 the Governments selected large-scale dredging as the clean-up approach. In the ROD document, the Governments estimated that approximately 6.5 million cubic yards of sediment would be removed from these portions at an estimated cost of approximately $284 million. The Governments also identified capping the river bed with appropriate materials as a contingent remedy to be evaluated during the remedial design process. For Green Bay, or OU-5, the Governments selected monitored natural attenuation as the clean-up approach at an estimated cost of approximately $40 million. The Governments also indicated that some limited dredging near the mouth of the river might be required, but this will be determined during the design stage of the project. Earlier, in January 2003, the Governments issued their ROD for the upper portions of the Fox River OUs 1 and 2. Combining the cost estimates from both RODs, it appeared that the Governments expected the selected remedies for all five OUs to cost approximately $400 million, exclusive of contingencies.

By letter dated September 30, 2003, the Governments notified NCR and seven other PRPs of their potential liability for remediation of the lower portions of the Fox River and requested that one or more of the PRPs enter into an agreement with the Governments to perform the engineering design work for the clean-up of OUs 2-5. In response, in 2004, NCR and Georgia-Pacific (G-P) entered into an Administrative Order on Consent (AOC) with the Governments to perform this design work, which is not expected to be completed until 2007. While there is ongoing debate within the scientific, regulatory, legal, public policy and legislative communities over how to properly manage large areas of contaminated sediments, NCR believes that the remedy to be implemented at the Fox River will address in excess of 7 million cubic yards of sediment.

The extent of NCR s potential liability remains subject to many uncertainties. NCR s eventual liability which is expected to be paid out over a period of at least ten to twenty years will depend on a number of factors. In general, the most significant factors include: (1) the total clean-up costs for the site; (2) the total natural resource damages for the site; (3) the share NCR and API will jointly bear of the total clean-up costs and natural resource damages as former and current owners of paper manufacturing facilities located along the Fox River; (4) the share NCR will bear of the joint NCR/API payments for clean-up costs and natural resource damages; and (5) NCR s transaction costs to defend itself in this matter. In setting the reserve, NCR attempts to estimate a range of reasonably possible outcomes for each of these factors, although each range is itself highly uncertain. NCR uses its best estimate within the range, if that is possible. Where there is a range of equally likely outcomes, and there is no amount within that range that appears to be a better estimate than any other amount, NCR uses the low end of the range. These factors are discussed below:

For the first factor described above, total clean-up costs for the site, NCR previously determined that there was a range of equally possible outcomes, and that no estimate within that range was better than the other estimates. Accordingly, NCR used the low end of that range, which was $480 million. This amount was derived by taking the Governments ROD estimate for total clean-up costs $400 million and increasing it by 20% to reflect NCR s analysis that the Governments own cost estimates were understated. As the engineering design work has progressed, some of the uncertainty surrounding clean-up costs has been reduced. While there is a range of reasonably possible outcomes for clean-up costs, based on information currently available, a best estimate within that range can now be made. That estimate is $551 million, which includes the expected costs of the clean-up work in OU 1 and OUs 2-5, plus a 20% contingency for both. The range of reasonably possible outcomes is now estimated to be between $459 million (assuming no contingencies) and $874 million (depending on how the remedy is implemented). However, there can be no assurances that these amounts will not be significantly higher. For example, one consultant has expressed an opinion that total clean-up costs for the site could be approximately $1.1 billion.

Second, for total natural resource damages, NCR previously determined that there was a range of equally possible outcomes, and that no estimate within that range was better than the other estimates. Accordingly, NCR used the low end of that range, which was the lowest estimate in the Governments 2000 report on natural resource damages. That amount was $176 million. Based on confidential settlement discussions held in 2005, along with NCR s assessment of the trustees positions and prior NRD settlements, a best estimate of the remaining total NRD liability can now be made, and that amount is $131 million. There is still a range of reasonably possible outcomes, and that range is between $10 million and $176 million.

Third, for the NCR/API share of clean-up costs and natural resource damages, NCR has examined amounts developed by several independent, nationally-recognized engineering and paper-industry experts, along with those set forth in draft government reports. NCR has determined that there is a range of equally possible outcomes, and that no estimate within that range is better than the other estimates. Accordingly, NCR uses the low end of that range, which is based primarily on an estimate of the joint NCR/API percentage of direct discharges of PCBs to the river. There are other estimates that are significantly higher; however, NCR believes there is such uncertainty surrounding these estimates that it cannot quantify the high end of the range, although NCR does not believe the joint NCR/API percentage of direct discharges is near 100%.

Fourth, for the NCR share of the joint NCR/API payments, NCR previously estimated that it would pay 45 percent of all costs attributable to the joint NCR/API share. NCR and API are parties to a sharing agreement that requires NCR to pay 45 percent of the first $75 million in total costs attributable to the joint NCR/API share, and provides for an arbitration to determine shares for amounts in excess of $75 million. The arbitration was held in 2005, and the arbitrators determined that NCR will pay 40 percent of costs in excess of $75 million. NCR s estimate has been revised to be consistent with the arbitration award. NCR s analysis of this factor assumes that API is able to pay its share of the NCR/API joint share.

Finally, NCR estimated the transaction costs it is likely to incur to defend this matter through 2013, the time period the Governments projected in the RODs it will take to design and implement the remedy for the river. This estimate is based on an analysis of NCR s costs since this matter first arose in 1995 and estimates of what NCR s defense and transaction costs will be in the future. NCR expects that the bulk of these transaction costs will be incurred in the earlier years of this time period, when the remedy will be designed and the initial clean-up activities will begin. NCR believes that once clean-up is underway, its transaction costs may decrease significantly on an annual basis.

Given the ongoing remedial design work being conducted by NCR and G-P (see above), it is possible there could be some additional changes to some elements of the reserve during 2006, although that is difficult to predict.

In 2001, NCR and API entered into an interim settlement with the Governments that limited NCR/API s joint cash payouts to $10 million per year over a four-year period beginning at the time of such interim settlement. Any portion of an annual $10 million installment not paid out in a given year was rolled over and made available for payment during subsequent years up until December 2005. In exchange for these payments, the Governments agreed not to take any enforcement actions against NCR and API during the term of the settlement. These payments were shared by NCR and API under the terms of the sharing agreement discussed above and were to be credited against NCR s long-term exposure for this matter. NCR s share of these payments was taken into account in determining its reserve to the extent that NCR can relate specific payments to clean-up work that was considered in estimating NCR s long-term liability. NCR and API used $7 million of the amounts paid under the interim settlement to fund part of the design work NCR and G-P are performing under the AOC discussed above. The parties to the interim settlement NCR, API and the Governments recently reached an agreement to extend the settlement for another year, but to limit the extension to just NRD matters.

NCR and Sonoco-U.S. Paper Mills have entered into a consent decree with the Governments to undertake a removal action involving an area of elevated PCBs downriver of the De Pere Dam in 2007. The consent decree was lodged with the federal court in Wisconsin in April 2006 and is awaiting approval and entry by the court. The estimated costs of this project are included in the $551 million estimate discussed in the first factor above.

AT&T Inc. and Lucent Technologies, Inc. are jointly responsible for indemnifying NCR for a portion of amounts incurred by NCR for the Fox River matter over a certain threshold. NCR s estimate of what AT&T and Lucent will pay under the indemnity is recorded as a long-term receivable of $8 million and is deducted in determining the net amount discussed above. In 2005, AT&T Corp. merged with SBC Communications Corp., and the resulting entity is named AT&T Inc. NCR does not expect that the AT&T and SBC merger will have an impact on AT&T s indemnification obligation to NCR.

NCR has reached settlement agreements with two of its principal insurance carriers for settlements in a combined total of approximately $29 million. Of this, $1 million was paid in 2005, and $19 million was recorded as a receivable at the end of 2005 ($15 million was paid in the second quarter of 2006 as discussed above). The other $9 million is subject to competing claims by another party. NCR and the other party have agreed that these funds will be used for Fox River costs and will be shared on an agreed upon basis (subject to reallocation at a later date). NCR s agreed upon share of the $9 million is expected to be $4 million.

It is difficult to estimate the future financial impact of environmental laws, including potential liabilities. NCR records environmental provisions when it is probable that a liability has been incurred and the amount or range of

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the liability is reasonably estimable. Provisions for estimated losses from environmental restoration and remediation are, depending on the site, based primarily on internal and third-party environmental studies (except for the Fox River site, where the estimated clean-up costs and natural resource damages are estimated as described above), estimates as to the number and participation level of any other PRPs, the extent of the contamination, and the nature of required clean-up and restoration actions. Reserves are adjusted as further information develops or circumstances change. Management expects that the amounts reserved from time to time will be paid out over the period of investigation, negotiation, remediation and restoration for the applicable sites. The amounts provided for environmental matters in NCR s consolidated financial statements are the estimated gross undiscounted amounts of such liabilities, without deductions for insurance or third-party indemnity claims. Except for the sharing agreement with API described above with respect to the Fox River site, in those cases where insurance carriers or third-party indemnitors have agreed to pay any amounts and management believes that collectibility of such amounts is probable, the amounts would be reflected as receivables in the consolidated financial statements. For the Fox River site, an asset relating to the AT&T and Lucent indemnity and certain insurance recoveries have been recognized, since payment is deemed probable.

Guarantees and Product Warranties Guarantees associated with NCR s business activities are reviewed for appropriateness and impact to the Company s financial statements. Periodically, NCR s customers enter into various leasing arrangements coordinated by NCR with a leasing partner. In some instances, NCR guarantees the leasing partner a minimum value at the end of the lease term on the leased equipment or guarantees lease payments between the customer and the leasing partner. As of June 30, 2006, the maximum future payment obligation of this guaranteed value and the associated liability balance was $8 million.

NCR has an equity investment in a certain affiliate in which the Company has issued debt guarantees originally five years in length for the affiliate to third-party lending institutions. These guarantees expire at various dates in 2007. If default occurs, NCR s maximum amount of future payment obligation on these guarantees, as of June 30, 2006, would be $1 million. The Company has not recorded a liability in connection with these guarantees as the likelihood of default is low.

NCR provides its customers a standard manufacturer s warranty and records, at the time of the sale, a corresponding estimated liability for potential warranty costs. Estimated future obligations due to warranty claims are based upon historic factors such as labor rates, average repair time, travel time, number of service calls per machine and cost of replacement parts. Each business unit consummating a sale recognizes the total customer revenue and records the associated warranty liability using pre-established warranty percentages for that product class. From time to time, product design or quality corrections are accomplished through modification programs. When identified, associated costs of labor and parts for such programs are estimated and accrued as part of the warranty reserve.

The following table identifies the activity relating to the warranty reserve:

In millions	Six Months Ended June 30	
	2006	**2005**
Warranty reserve liability		
Beginning balance at January 1	**$ 19**	$ 21
Accruals for warranties issued	**21**	20
Settlements (in cash or in kind)	**(23)**	(23)
Ending balance at June 30	**$ 17**	$ 18

NCR also offers extended warranties to its customers as maintenance contracts. NCR accounts for these contracts by deferring the related maintenance revenue over the extended warranty period. Amounts associated with these maintenance contracts are not included in the table above.

In addition, NCR provides its customers with certain indemnification rights. In general, NCR agrees to indemnify the customer if a third party asserts patent or other intellectual property infringement on the part of the customer for its use of the Company s products. From time to time, NCR also enters into agreements in connection with its acquisition and divestiture activities that include indemnification obligations by the Company. The fair value of these indemnification obligations is not readily determinable due to the conditional nature of the Company s potential obligations and the specific facts and circumstances involved with each particular agreement. The Company has not recorded a liability in connection with these indemnifications. Historically, payments made by the Company under these types of agreements have not had a material effect on the Company s consolidated financial condition, results of operations or cash flows.

9. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net income by the weighted average number of shares outstanding during the reported period. The calculation of diluted earnings per share is similar to basic earnings per share, except that the weighted average number of shares outstanding includes the dilution from potential shares added from stock options and unvested restricted stock awards. Please refer to Note 6 for share information on NCR s stock compensation plans.

The components of basic and diluted earnings per share are as follows:

	Three Months Ended June 30		**Six Months Ended June 30**	
In millions, except per share amounts				
	2006	**2005**	**2006**	**2005**
Net income available for common stockholders	**$ 78**	$ 127	**$ 119**	$ 157
Weighted average outstanding shares of common stock	**181.1**	186.2	**181.4**	186.3
Dilutive effect of employee stock options and restricted stock	**3.1**	4.1	**3.2**	4.5
Common stock and common stock equivalents	**184.2**	190.3	**184.6**	190.8
Earnings per share:				
Basic	**$ 0.43**	$ 0.68	**$ 0.66**	$ 0.84
Diluted	**$ 0.42**	$ 0.67	**$ 0.64**	$ 0.82

Options to purchase an additional 0.2 million shares of common stock for the second quarter of 2006 and 0.9 million for the second quarter of 2005 were outstanding but were not included in the computation of diluted earnings per share because the options exercise prices were greater than the average market price of the common shares and, therefore, the effect would have been anti-dilutive.

10. DEBT OBLIGATIONS

In March 2006, the Company replaced a $400 million, five-year unsecured revolving credit facility and a $200 million, five-year unsecured revolving credit facility, with a $500 million, five-year unsecured revolving credit facility. This replacement credit facility contains certain representations and warranties; conditions; affirmative, negative and financial covenants; and events of default customary for such facilities. Interest rates charged on borrowings outstanding under the credit facility are based on prevailing market rates. No amount was outstanding under the facility at June 30, 2006.

11. SEGMENT INFORMATION

NCR is managed through the following businesses, which are also the Company s operating segments: (1) Data Warehousing, (2) Financial Self Service, (3) Retail Store Automation, (4) Customer Services, (5) Systemedia and (6) Payment & Imaging and Other.

The following table presents data for revenue and operating income (loss) by segment:

In millions	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
Revenue by segment				
Data Warehousing				
Products	$ 210	$ 183	$ 373	$ 378
Professional and installation-related services	103	99	187	178
Total Data Warehousing solution	313	282	560	556
Data Warehousing support services	86	79	165	155
Total Data Warehousing revenue	399	361	725	711
Financial Self Service (ATMs)				
Products	277	258	488	475
Professional and installation-related services	66	65	114	120
Total Financial Self Service revenue	343	323	602	595
Retail Store Automation				
Products	167	158	298	280
Professional and installation-related services	54	53	95	106
Total Retail Store Automation revenue	221	211	393	386
Customer Services				
Customer Service Maintenance:				
Financial Self Service	167	153	322	301
Retail Store Automation	117	117	233	231
Payment & Imaging and Other	32	33	62	64
Third-Party Products and Exited Businesses	67	70	126	143
Total Customer Services Maintenance	383	373	743	739
Third-Party Product Sales	8	14	16	25
Professional and installation-related services	66	69	117	139
Total Customer Services revenue	457	456	876	903
Systemedia	120	122	221	236
Payment & Imaging and Other				
Products	23	27	46	46
Professional and installation-related services	14	14	30	28
Total Payment & Imaging and Other	37	41	76	74
Elimination of installation-related services revenue included in both the Customer Services segment and other segments	(46)	(44)	(79)	(92)
Total Revenue	$ 1,531	$ 1,470	$ 2,814	$ 2,813