NCR CORP
Form 10-Q
November 03, 2006

Table of Contents

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 September 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 incorporation or organization)	**(I.R.S. Employer 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 October 31, 2006, was approximately 178.2 million.

Table of Contents

TABLE OF CONTENTS

PART I. Financial Information

PART II. Other Information

Table of Contents

Part I. Financial Information

Item 1. Financial Statements

Condensed Consolidated Statements of Operations (Unaudited)

In millions, except per share amounts	Three Months Ended September 30 2006	Three Months Ended September 30 2005	Nine Months Ended September 30 2006	Nine Months Ended September 30 2005
Product revenue	$ 795	$ 806	$ 2,237	$ 2,246
Service revenue	722	692	2,094	2,065
Total revenue	1,517	1,498	4,331	4,311
Cost of products	512	512	1,448	1,445
Cost of services	565	550	1,666	1,663
Selling, general and administrative expenses	267	267	776	790
Research and development expenses	55	57	173	174
Total operating expenses	1,399	1,386	4,063	4,072
Income from operations	118	112	268	239
Interest expense	6	5	18	17
Other income, net	(8)	(3)	(22)	(7)
Income before income taxes	120	110	272	229
Income tax expense (benefit)	31	(112)	64	(150)
Net income	$ 89	$ 222	$ 208	$ 379
Net income per common share				
Basic	$ 0.50	$ 1.20	$ 1.15	$ 2.04
Diluted	$ 0.49	$ 1.18	$ 1.13	$ 1.99
Weighted average common shares outstanding				
Basic	178.7	184.9	180.5	185.8
Diluted	181.4	188.7	183.5	190.1

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

Condensed Consolidated Balance Sheets (Unaudited)

In millions, except per share amounts	September 30, 2006	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	$ 761	$ 810
Accounts receivable, net	1,306	1,305
Inventories, net	708	595
Other current assets	265	217
Total current assets	3,040	2,927
Property, plant and equipment, net	376	378
Goodwill	150	129
Prepaid pension cost	1,324	976
Deferred income taxes	391	522
Other assets	380	355
Total assets	$ 5,661	$ 5,287
Liabilities and stockholders equity		
Current liabilities		
Short-term borrowings	$ 5	$ 2
Accounts payable	514	490
Payroll and benefits liabilities	282	292
Deferred service revenue and customer deposits	468	444
Other current liabilities	438	417
Total current liabilities	1,707	1,645
Long-term debt	306	305
Pension and indemnity plan liabilities	497	557
Postretirement and postemployment benefits liabilities	264	259
Deferred income taxes	134	140
Income tax accruals	199	167
Other liabilities	141	158
Minority interests	20	21
Total liabilities	3,268	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 September 30, 2006 and December 31, 2005 respectively		
Common stock: par value $0.01 per share, 500.0 shares authorized, 177.8 and 181.7 shares issued and outstanding at September 30, 2006 and December 31, 2005 respectively	2	2
Paid-in capital	625	794
Retained earnings	1,725	1,518
Accumulated other comprehensive income (loss)	41	(279)
Total stockholders equity	2,393	2,035

Total liabilities and stockholders equity	$ 5,661	$ 5,287

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

Condensed Consolidated Statements of Cash Flows (Unaudited)

In millions	Nine Months Ended September 30 2006	2005
Operating activities		
Net Income	$ 208	$ 379
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	118	127
Stock-based compensation expense	22	3
Excess tax benefit from stock-based compensation	(13)	
Deferred income taxes	40	24
Non-cash income tax adjustment		(201)
Other adjustments to income, net	(5)	(2)
Changes in assets and liabilities:		
Receivables	1	39
Inventories	(114)	(43)
Current payables and accrued expenses	17	(44)
Deferred service revenue and customer deposits	23	23
Employee severance and pension	44	46
Other assets and liabilities	(53)	(48)
Net cash provided by operating activities	288	303
Investing activities		
Expenditures for property, plant and equipment	(65)	(51)
Proceeds from sales of property, plant and equipment	13	7
Additions to capitalized software	(69)	(57)
Other investing activities, business acquisitions and divestitures, net	(24)	2
Net cash used in investing activities	(145)	(99)
Financing activities		
Purchases of Company common stock	(280)	(320)
Excess tax benefit from stock-based compensation	13	
Short-term borrowings, additions	3	
Long-term debt, additions	1	
Proceeds from employee stock plans	68	117
Other financing activities, net	(3)	
Net cash used in financing activities	(198)	(203)
Effect of exchange rate changes on cash and cash equivalents	6	(11)
Decrease in cash and cash equivalents	(49)	(10)
Cash and cash equivalents at beginning of period	810	750
Cash and cash equivalents at end of period	$ 761	$ 740

See Notes to Condensed Consolidated Financial Statements.

5

Table of Contents

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 Balance Sheet as of December 31, 2005 and the unaudited Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2005 have been retrospectively adjusted for the accounting change described below. 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 concluded that the impact of the change in accounting was not material to previously reported results, and, accordingly, treated the change in method of accounting for reworkable service parts as a change in accounting principle in accordance with Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* (SFAS 154). SFAS 154 requires that such accounting changes be made on a retrospective basis and that the unaudited 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 included in inventories in the accompanying unaudited Condensed Consolidated Balance Sheet as 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 for the nine months ended September 30, 2005 of $65 million, which was part of investing activities, is now reflected in the accompanying unaudited Condensed Consolidated Statement of Cash Flows as a component of operating activities. The impact of the accounting change on previously reported income from operations, net income and earnings per share of each prior period was not material. Accordingly, the cumulative effect of the change in accounting method of approximately $0.2 million was recorded as a decrease in cost of services in the accompanying unaudited Condensed Consolidated Statements of Operations for the nine months ended September 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.

Table of Contents

2. SUPPLEMENTAL FINANCIAL INFORMATION

In millions	Three Months Ended September 30 2006	2005	Nine Months Ended September 30 2006	2005
Comprehensive Income				
Net income	$ 89	$ 222	$ 208	$ 379
Other comprehensive income, net of tax:				
Unrealized (loss) gain on securities	(1)	3	(2)	2
Unrealized gain (loss) on derivatives	3		(1)	19
Additional minimum pension liability	247		247	
Currency translation adjustments	13		74	(57)
Other adjustments	(1)		2	
Total comprehensive income	$ 350	$ 225	$ 528	$ 343

In millions	September 30, 2006	December 31, 2005
Inventories		
Work in process and raw materials	$ 119	$ 96
Finished goods	249	205
Service parts	340	294
Total inventories, net	$ 708	$ 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.

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.

Emerging Issues Task Force (EITF) Issue No. 06-3 In June 2006, the EITF ratified the consensus on EITF Issue No. 06-3 (EITF 06-03), *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation).* EITF 06-03 concluded that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer, such as sales, use, value added and certain excise taxes is an accounting policy decision that should be disclosed in a company s financial statements. In addition, companies that record such taxes on a gross basis should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. EITF 06-03 is effective for interim and annual reporting periods beginning after December 15, 2006. The Company is currently evaluating the impact of adopting EITF 06-03 on our consolidated financial statements.

Statement of Financial Accounting Standards No. 157 In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). This statement defines fair value, establishes a framework for

measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 157 on our financial condition and results of operations.

Statement of Financial Accounting Standards No. 158 In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132R* (SFAS 158). This statement requires employers to recognize, on a prospective basis, the funded status of their defined benefit pension and other postretirement plans on their consolidated balance sheet and recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit costs. SFAS 158 also requires additional disclosures in the notes to financial statements. SFAS 158 is effective for fiscal years ending after December 15, 2006. The Company is currently assessing the impact of adopting SFAS 158 on our consolidated financial statements. However, based on our unfunded obligation as of December 31, 2005, the adoption of SFAS 158 would decrease total assets by approximately $650 million, increase total liabilities by approximately $240 million and reduce total stockholders equity by approximately $890 million. The adoption of SFAS 158 will not affect the Company s results of operations. The ultimate amounts recorded are dependent on a number of assumptions, including the discount rate in effect at December 31, 2006, the actual rate of return on pension assets for 2006 and the tax effects of the adjustment upon adoption. Changes in those assumptions since the last measurement date could increase or decrease the expected impact of implementing SFAS 158 on the Company s consolidated financial statements at December 31, 2006. Further, as the Company records additional benefit liabilities and establishes the related deferred tax assets, management will also assess the recoverability of the deferred tax assets by jurisdiction. Valuation allowances may be established if it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Staff Accounting Bulletin No. 108 In September 2006, the SEC released Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides guidance on how the effects of prior-year uncorrected financial statement misstatements should be considered in quantifying a current year misstatement. SAB 108 requires registrants to quantify misstatements using both an income statement (rollover) and balance sheet (iron curtain) approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior year errors that had been previously considered immaterial are now considered material based on either approach, no restatement is required as long as management properly applied its previous approach and all relevant facts and circumstances were considered. If prior years are not restated, the cumulative effect adjustment is recorded in opening retained earnings as of the beginning of the fiscal year of adoption. SAB 108 is effective for fiscal years ending on or after November 15, 2006. The Company does not expect the adoption of SAB 108 to have an impact on our financial condition or results of operations.

4. BUSINESS COMBINATIONS, DIVESTITURES AND EQUITY INVESTMENTS

The Company completed four acquisitions and purchased the remaining 5% minority interest in one of our subsidiaries during the first nine months of 2006 for total consideration of approximately $34 million, which was paid in cash. Goodwill recognized in these transactions amounted to $20 million, and the amount is expected to be fully deductible for tax purposes. Goodwill of $8 million was assigned to the Data Warehousing segment, $9 million was assigned to the Financial Self Service segment and $3 million was assigned to Retail Store Automation. 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.

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 price of these businesses, reported under Other Investing Activities in the unaudited Consolidated Statements of Cash Flows, has been allocated to the estimated fair value of net tangible and intangible assets acquired, with any excess recorded as goodwill.

Table of Contents

In the third quarter of 2006, the Company sold the U.S. forms and laser documents part of its Systemedia business consumables portfolio. The sale did not have a material impact on our consolidated results of operations, financial position or cash flows.

5. IDENTIFIABLE INTANGIBLE ASSETS

NCR s identifiable intangible assets, reported under Other Assets in the unaudited 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:

	September 30, 2006		December 31, 2005	
In millions	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**	**(19)**	48	(12)
Total identifiable intangible assets	**$ 64**	**$ (20)**	$ 67	$ (25)

The increase in 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:

	Nine months ended September 30,	For the year ended (estimated)				
In millions	2006	2006	2007	2008	2009	2010
Amortization expense	$ 9	$ 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 nine months ended September 30, 2006 and for the three and nine months ended September 30, 2005 (pro forma).

Table of Contents

As of September 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, the components of which are further described below for the periods ended September 30, 2006 and 2005 as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
In millions	**2006**	**2005**	**2006**	**2005**
Stock options	**$ 5**	$	**$ 13**	$
Restricted stock	**3**	1	**9**	3
Total stock-based compensation (pre-tax)	**8**	1	**22**	3
Tax benefit	**(2)**	(1)	**(6)**	(1)
Total stock-based compensation, net of tax	**$ 6**	$	**$ 16**	$ 2

As a result of adopting SFAS 123R, the Company recognized $5 million ($3 million after-tax) of expense related to stock options in the third quarter of 2006, which had a $0.02 impact on basic and diluted earnings per share, and for the nine months ended September 30, 2006, the Company recognized $13 million ($9 million after-tax) of expense related to stock options, which had a $0.05 impact on basic and diluted earnings per share. Overall, total stock-based compensation expense, which includes expense related to stock options and restricted stock, increased $7 million ($6 million after-tax) for the third quarter of 2006 and $19 million ($14 million after-tax) for the nine months ended September 30, 2006 as compared to the same period in 2005. Compensation cost capitalized as part of inventory and fixed assets as of September 30, 2006 was immaterial.

Stock-based compensation expense for the first nine 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 September 30, 2006 was $13.59 and for the nine months ended September 30, 2006 was $15.64, and was estimated based on the following weighted average assumptions:

	Three Months Ended September 30,	Nine Months Ended September 30,
	2006	**2006**
Dividend yield		
Risk-free interest rate	**4.76%**	**4.62%**
Expected volatility	**34.7%**	**35.6%**
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 interest 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.

Table of Contents

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 Employee Stock Purchase Plan (ESPP) in accordance with APB No. 25. If NCR had recognized stock option-based compensation expense based on the fair value of stock option grants and employee stock purchases under the ESPP, net income and net income per diluted share for the three and nine months ended September 30, 2005, on a pro forma basis, would have been as follows:

In millions, except per share amounts	**Three Months Ended September 30, 2005**	**Nine Months Ended September 30, 2005**
Net income	$ 222	$ 379
Stock-based employee compensation expense included in reported net income (pre-tax)	1	3
Tax benefit of stock-based employee compensation included in reported net income	(1)	(1)
Subtotal: Add to net income		2
Total stock-based employee compensation expense determined under fair value-based method for awards (pre-tax)	7	19
Tax benefit of stock-based employee compensation determined under fair value-based method for awards	(2)	(4)
Subtotal: Deduct from net income	5	15
Pro forma net income	$ 217	$ 366
Basic net income per share:		
As reported:	$ 1.20	$ 2.04
Pro forma:	$ 1.17	$ 1.97
Diluted net income per share:		
As reported:	$ 1.18	$ 1.99
Pro forma:	$ 1.15	$ 1.93

The 2005 pro forma net income and net income per diluted share for all periods presented were 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 September 30, 2005 was $13.75 and for the nine months ended September 30, 2005 was $15.40, and was estimated based on the following weighted average assumptions:

	Three Months Ended September 30, 2005	**Nine Months Ended September 30, 2005**
Dividend yield		
Risk-free interest rate	**4.19%**	**4.01%**
Expected volatility	**35.5%**	**35.5%**
Expected holding period (years)	**5.5**	**5.5**

Stock Options

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. The SIP is now the principle vehicle through which equity grants are made to our employees and directors.

Although no new awards can be made under the MSP, 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 SIP. New shares of the Company s common stock are issued as a result of stock option exercises.

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 (defined as the average of the high and low trading price) 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.

The following table summarizes the Company s stock option activity for the nine months ended September 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	1,230	$ 38.70		
Exercised	(3,091)	$ 18.44		
Canceled	(233)	$ 31.50		
Forfeited	(18)	$ 27.10		
Outstanding at September 30, 2006	9,028	$ 24.70	6.21	$ 131
Fully vested and expected to vest at September 30, 2006	8,676	$ 24.67	6.18	$ 127
Exercisable at September 30, 2006	6,145	$ 19.88	5.29	$ 119

The total intrinsic value of options exercised was $63 million during the first nine months of 2006 and $93 million during the first nine months of 2005. Cash received from option exercises under all share-based payment arrangements for the nine months ended September 30 was $68 million in 2006 and $117 million in 2005. The tax benefit realized from these exercises for the first nine months was $20 million in 2006 and $29 million in 2005. As of September 30, 2006 there was $33 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 were categorized as having 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

Table of Contents

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 MSP) 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 awarded 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 nine month period ended September 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	563	$ 38.16
Shares vested and distributed	(268)	$ 18.16
Shares forfeited	(73)	$ 30.49
Unvested shares at September 30, 2006	1,089	$ 34.54

The total intrinsic value of shares vested and distributed during the first nine months of 2006 was $10 million and during the first nine months of 2005 was $4 million. As of September 30, 2006, there was $27 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 2.0 years.

Table of Contents

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

Shares in thousands	Number of Shares	Weighted-Average Grant-Date Fair Value
Service-based shares	109	$ 36.57
Performance-based shares	454	$ 38.71
Total stock grants	563	$ 38.16

Other Share-based plans

The ESPP enables eligible employees to purchase NCR s common stock at a discount to the average of the highest and lowest sale prices on 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 0.3 million shares of NCR Common Stock in the first nine months of 2006 for approximately $12 million, compared to 0.5 million shares purchased in the comparable 2005 period for $16 million. As of September 30, 2006, approximately 16 million shares were authorized and 1.7 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 September 30 are as follows:

	U.S. Pension Benefits		International Pension Benefits		Total Pension Benefits	
In millions	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Net service cost	**$ 9**	$ 9	**$ 11**	$ 10	**$ 20**	$ 19
Interest cost	**46**	43	**20**	21	**66**	64
Expected return on plan assets	**(59)**	(55)	**(31)**	(32)	**(90)**	(87)
Settlement charge			**1**	3	**1**	3
Amortization of:						
Prior service cost			**2**	1	**2**	1
Actuarial loss	**10**	13	**24**	18	**34**	31