

General Dynamics Corp. (GD)

\$149.19 (As of 08/05/20)

Price Target (6-12 Months): **\$158.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/11/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: A

Growth: B

Momentum: F

Summary

General Dynamics ended the second quarter of 2020 on a solid note, with both earnings and revenues surpassing the Zacks Consensus Estimate. It boasts a strong position in the U.S. defense space, and continues to witness strong order growth from both Pentagon and overseas clients. Impressive backlog trends indicate solid demand for its products, thereby bolstering the revenue generation prospects significantly. In a year's time, shares have outperformed the industry. However, the slashing of shipbuilding investments by \$4 billion, per the recently proposed fiscal 2021 defense budget, could deal a heavy blow to the shipbuilding giant, once approved. Moreover, it anticipates the COVID-19 pandemic to continue affecting its businesses during the remainder of 2020. A deteriorating debt capital ratio might hurt investor confidence in the stock.

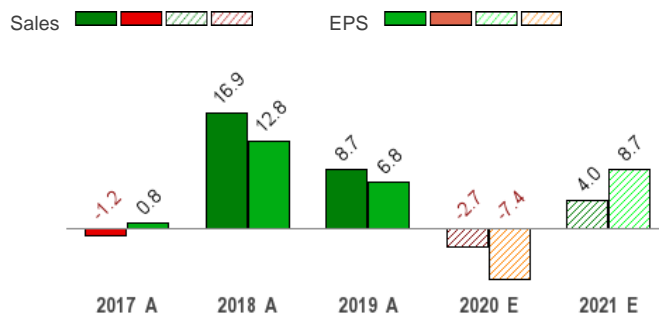
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$193.76 - \$100.55
20 Day Average Volume (sh)	1,260,167
Market Cap	\$42.8 B
YTD Price Change	-15.4%
Beta	1.02
Dividend / Div Yld	\$4.40 / 2.9%
Industry	Aerospace - Defense
Zacks Industry Rank	Bottom 13% (219 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.9%
Last Sales Surprise	1.7%
EPS F1 Est- 4 week change	-0.6%
Expected Report Date	10/28/2020
Earnings ESP	-0.3%
P/E TTM	13.3
P/E F1	13.5
PEG F1	1.5
P/S TTM	1.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	9,204 E	9,569 E	9,999 E	11,202 E	39,814 E
2020	8,749 A	9,264 A	9,659 E	10,758 E	38,298 E
2019	9,261 A	9,555 A	9,761 A	10,773 A	39,350 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.54 E	\$2.76 E	\$3.17 E	\$3.67 E	\$12.05 E
2020	\$2.43 A	\$2.18 A	\$2.91 E	\$3.54 E	\$11.09 E
2019	\$2.56 A	\$2.77 A	\$3.14 A	\$3.51 A	\$11.98 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/05/2020. The reports text is as of 08/06/2020.

Overview

Headquartered in Falls Church, VA, **General Dynamics Corporation** engages in mission-critical information systems and technologies; land and expeditionary combat vehicles, armaments and munitions; shipbuilding and marine systems; and business aviation. The company was incorporated in February 1952.

Following CSRA acquisition, the company's Information Systems & Technology (IS&T) segment has been reorganized into Information Technology and Mission Systems segments. The company currently operates through five segments: **Aerospace, Combat Systems, Marine Systems, Mission Systems and Information Technology.**

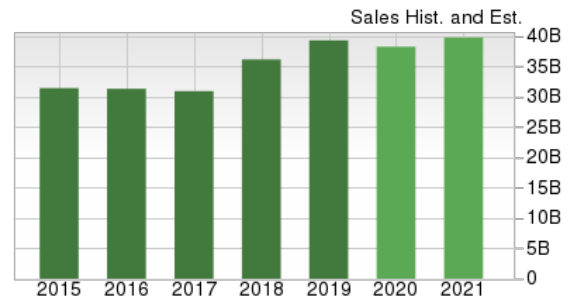
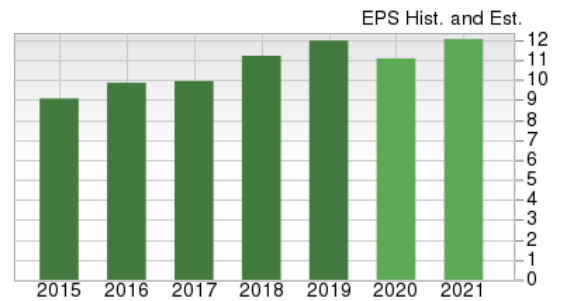
The **Aerospace** segment consists of Gulfstream Aerospace, which manufactures business jets, and Jet Aviation, which provides aircraft maintenance and spare parts. Segment revenues in 2019 summed \$9,801 million, representing 24.9% of the company's total revenues.

Combat Systems manufactures combat vehicles, medium-caliber guns, ammunition and ammunition handling systems. Revenues during 2019 came in at \$7,007 million, contributing 17.8% to the company's total revenues.

Mission Systems segment provides command, control and intelligence systems solutions. Revenues during 2019 came in at \$4,737 million, contributing 12.6% to the company's total revenues.

Marine Systems makes nuclear submarines, surface combatants and auxiliary ships. In 2019, revenues amounted to \$9,183 million, comprising 23.3% of the company's total revenues.

The **Information Technology** segment integrates secure communication systems and networks. Segment revenues in 2019 summed \$8,422 million, representing 21.4% of the company's total revenues.



Reasons To Buy:

- ▲ During the second quarter of 2020, General Dynamics witnessed strong order growth, which was in line with its usual trend. This, in turn, boosted its backlog, which grew 22% year over year to \$82.7 billion owing to higher orders received by the Marine System segment. The estimated contract value, which combines total backlog with estimated potential contract value, was \$132.2 billion at the end of the second quarter, approximately 30% more than the year-ago quarter. The company's Information Technology segment's funded backlog increased to \$5.46 billion during the second quarter, the highest ever. Notably, significant order intakes, particularly in the Combat and Information Technology segments, position the company well for 2020 and beyond. Such impressive backlog trends indicate solid demand for the company's products, thereby bolstering its revenue generation prospects significantly. Notably, the company outperformed the industry in terms of share price performance. General Dynamics' share price fell only 17.5% in the past year compared with the industry's decline of 28.5%.

General Dynamics' focus on product innovations should help maintain a steady growth momentum and drive results in the quarters ahead. Positive budgetary amendments also boost growth
 - ▲ In the fourth quarter of 2019, General Dynamics' Gulfstream G500 received certification approval from the European Aviation Safety Agency, clearing the way for European Union registrations and customer deliveries. As a result, the company successfully delivered its Gulfstream G500 to its first European customer in Georgia. In October 2019, General Dynamics introduced its flagship aircraft in the business jet industry, the Gulfstream G700, which completed its first flight in February 2020, demonstrating the program's maturity and officially launching its official flight-test program. This ultra-long-range jet is expected to commence service in 2022. Notably, such product innovation along with major certification approvals is projected to enhance this shipbuilder's footprint in the business jet market, going ahead.
 - ▲ General Dynamics has been making investments in its business to promote operating efficiency, innovation and affordability for its customers. This is evident as capital expenditures made in 2019 were \$987 million compared with \$690 million made during 2018. This increase reflects ongoing investments to support growth at its shipyards. In the Aerospace segment, the company continues to invest in the development of new aircraft products and technologies to support the Aerospace segment's long-term growth.
-

Reasons To Sell:

- ▼ It is already a known fact that General Dynamics boasts a strong position in the U.S. defense space and overseas. However, the fiscal 2021 defense budget proposes to slash its shipbuilding investments by \$4 billion, as the U.S. Navy plans on securing fewer ships and submarines and direct more funding toward operations and research. The proposed spending provision includes eight ships, including three submarines, compared to the procurement for purchasing 11 new ships, including four submarines, in the previous year's budget. If approved, this might hamper growth of the company's shipbuilding business in the near term.
- ▼ Although the COVID-19 pandemic did not have a material impact on General Dynamic's operating results or business in the first quarter of 2020, its ongoing and prolonged impacts may be a cause of concern and might dent its second-quarter performance. This could be because the pandemic might have an adverse impact on the company's existing and planned operations, distribution systems and thus, increase overall expenses. Within the company's Aerospace segment, quarantine and travel restrictions in connection with the outbreak have already delayed aircraft deliveries and impacted some supply chain providers. Since the pandemic is unlikely to die out anytime soon, it might turn out to be a major growth inhibitor for this stock, going ahead.
- ▼ The company's long-term debt stands at \$10.47 billion as of Jun 30, higher than \$9.01 billion as of Mar 31. Meanwhile, the company's cash and cash equivalents were \$2.3 billion at the end of the second quarter, which is lower than its current debt of \$4.12 billion. This indicates a weak solvency position for the company.

Further, the company's debt-to-capital ratio at the end of the first quarter stood at 0.51, which increased sequentially from 0.47. The company's interest coverage came in at 9.4 as of Jun 30, down sequentially from 10.1. Together these unfavorable financial ratios indicate that General Dynamic might face difficulties and struggle to meet debt obligations in the near future. At a time when every entity is looking forward to preserving liquidity amid uncertainties concerning the COVID-19 outbreak, deteriorating times interest earned and debt capital ratio might hurt investors' confidence in the stock.

Delayed aircraft deliveries due to the COVID-19 pandemic may hurt General Dynamics' top line. Intensified competition are likely to hurt the stock

Last Earnings Report

General Dynamics' Q2 Earnings Beat, Backlog Up Y/Y

General Dynamics Corporation reported second-quarter 2020 earnings from continuing operations of \$2.18 per share, which beat the Zacks Consensus Estimate of \$2.14 by 1.89%. Operating earnings, however, plunged 21.3% from \$2.77 per share in the year-ago quarter.

Total Revenues

General Dynamics' second-quarter revenues of \$9,264 million surpassed the Zacks Consensus Estimate of \$9,113 million by 1.7%. However, revenues declined 3% from \$9,555 million in the year-ago quarter.

Backlog

General Dynamics recorded a total backlog of \$82.7 billion, up 22% year over year. The year-over-year increase was owing to higher orders received by the Marine System segment. Funded backlog at the quarter-end was \$54.4 billion.

Segmental Performance

Aerospace: The segment reported revenues of \$1,974 million, down 7.6% year over year. However, operating earnings of \$159 million plunged 52% from the prior-year quarter's \$331 million.

Combat Systems: Segment revenues rose 5.7% from the prior-year quarter to \$1,754 million. However, operating earnings were down 1.2% from the year-ago quarter to \$239 million.

Information Systems and Technology: The segment reported revenues of \$1,884 million, which declined 12.7% year over year. Operating earnings also dropped 46.1% from the prior-year period to \$83 million.

Marine Systems: The segment's revenues of \$2,471 million were up 6.3% from the year-ago quarter's \$2,325 million. Operating earnings also improved 1.5% from the year-ago level to \$200 million.

Mission Systems: The segment's revenues of \$1,181 million declined 7.5% from the year-ago quarter's \$1,277 million. Operating earnings of \$164 million, however, increased 1.2% from the year-ago quarter's \$162 million.

Operational Highlights

Company-wide operating margin contracted 230 basis points (bps) to 9.1% from the year-ago quarter's 11.4%.

In the quarter under review, General Dynamics' operating costs and expenses declined 0.5% from the year-ago period to \$8,423 million.

Interest expenses in the reported quarter increased 10.9% year over year to \$132 million.

Financial Condition

As of Jun 28, 2020, General Dynamics' cash and cash equivalents were \$2,300 million compared with \$902 million on Dec 31, 2019.

Long-term debt as of Jun 28, 2020, was \$10,470 million, which escalated from the 2019-end level of \$9,010 million.

At the end of the first half of 2020, the company generated cash from operating activities of \$177 million against \$504 million used in the year-ago period.

Quarter Ending 06/2020

Report Date	Jul 29, 2020
Sales Surprise	1.66%
EPS Surprise	1.87%
Quarterly EPS	2.18
Annual EPS (TTM)	11.26

Recent News

On **June 11, 2020**, General Dynamics' business unit, Land Systems, recently secured a \$2.48-billion contract for the production of Stryker Double V-Hull A1 engineering vehicles along with an engineering change proposal configuration. The contract was awarded by the U.S. Army Contracting Command, Detroit Arsenal, MI. Work related to the deal is expected to get completed by Apr 30, 2027.

On **June 10, 2020**, General Dynamics' Mission Systems unit secured a \$104.2-million contract for the development, production and installation of Columbia (US01) and Dreadnought-class ballistic missile submarine. The contract was awarded by the Strategic Systems Programs, Washington, D.C.

Majority of the work related to the deal will be performed in Pittsfield, MA and is scheduled to be completed by November 2024.

Valuation

General Dynamics' shares are down 15.4% in the year-to-date period and 17.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 23.1% and 29.4% in the year to date period, respectively. Over the past year, the Zacks sub-industry is down 28.5% and the Zacks Aerospace sector witnessed a 28.8% decline.

The S&P 500 index is up 2.6% in the year to date period and 14.9% in the past year.

The stock is currently trading at 12.7X forward 12-month earnings, which compares to 21.3X for the Zacks sub-industry, 20.8X for the Zacks sector and 22.6X for the S&P 500 index.

Over the past five years, the stock has traded as high as 20.9X and as low as 8.3X, with a 5-year median of 15.1X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$158 price target reflects 13.5X earnings value.

The table below shows summary valuation data for GD

Valuation Multiples - GD					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	12.73	21.34	20.75	22.58
	5-Year High	20.91	22.54	20.94	22.58
	5-Year Low	8.25	14.52	14.17	15.25
	5-Year Median	15.06	17.75	17.24	17.55
P/S F12M	Current	1.08	1.26	1.13	3.61
	5-Year High	2.05	1.64	1.49	3.61
	5-Year Low	0.76	0.95	0.92	2.53
	5-Year Median	1.4	1.28	1.18	3.04
EV/EBITDA TTM	Current	10.66	19.31	11.29	12.8
	5-Year High	14.81	21.97	15	12.85
	5-Year Low	7.65	8.12	7.38	8.24
	5-Year Median	11.86	11.8	10.58	10.89

As of 08/05/2020

Industry Analysis Zacks Industry Rank: Bottom 13% (219 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Embraer Empresa Brasileira de Aeronautica (ERJ)	Neutral	3
Huntington Ingalls Industries, Inc. (HII)	Neutral	5
Leidos Holdings, Inc. (LDOS)	Neutral	3
L3Harris Technologies Inc (LHX)	Neutral	2
Lockheed Martin Corporation (LMT)	Neutral	3
Northrop Grumman Corporation (NOC)	Neutral	3
Textron Inc. (TXT)	Neutral	3
The Boeing Company (BA)	Underperform	5

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	GD	X Industry	S&P 500	LDOS	LMT	NOC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	A	A	A
Market Cap	42.81 B	11.08 B	22.93 B	12.76 B	107.20 B	54.97 B
# of Analysts	8	5.5	14	9	8	7
Dividend Yield	2.95%	0.11%	1.76%	1.52%	2.50%	1.76%
Value Score	A	-	-	A	A	A
Cash/Price	0.05	0.08	0.07	0.03	0.03	0.08
EV/EBITDA	9.28	11.02	13.16	13.66	12.83	16.21
PEG Ratio	1.51	2.45	2.99	1.58	2.30	NA
Price/Book (P/B)	3.08	3.26	3.20	3.60	28.32	5.66
Price/Cash Flow (P/CF)	10.02	10.22	12.45	12.77	14.58	11.95
P/E (F1)	13.40	15.90	21.78	16.87	15.90	14.71
Price/Sales (P/S)	1.11	1.10	2.47	1.10	1.70	1.58
Earnings Yield	7.43%	3.97%	4.33%	5.93%	6.29%	6.80%
Debt/Equity	0.75	0.87	0.77	1.32	3.22	1.61
Cash Flow (\$/share)	14.89	2.73	6.94	7.03	26.30	27.58
Growth Score	B	-	-	A	A	A
Hist. EPS Growth (3-5 yrs)	6.15%	14.53%	10.46%	14.53%	18.30%	23.60%
Proj. EPS Growth (F1/F0)	-7.45%	1.87%	-7.14%	2.88%	9.87%	5.69%
Curr. Cash Flow Growth	3.16%	11.64%	5.47%	6.19%	18.08%	2.21%
Hist. Cash Flow Growth (3-5 yrs)	6.36%	7.38%	8.55%	6.45%	9.70%	14.43%
Current Ratio	1.27	1.33	1.32	0.89	1.31	1.35
Debt/Capital	42.98%	49.63%	44.59%	56.87%	76.28%	61.62%
Net Margin	8.47%	5.85%	10.15%	5.26%	10.25%	6.91%
Return on Equity	24.10%	10.92%	14.46%	23.81%	182.05%	40.24%
Sales/Assets	0.76	0.79	0.51	1.11	1.29	0.82
Proj. Sales Growth (F1/F0)	-2.49%	0.00%	-1.68%	14.23%	8.29%	4.71%
Momentum Score	F	-	-	A	B	D
Daily Price Chg	1.32%	1.75%	0.59%	-2.75%	1.46%	1.45%
1 Week Price Chg	-2.27%	-1.88%	0.14%	4.49%	-1.87%	3.94%
4 Week Price Chg	3.68%	5.61%	5.31%	1.90%	9.50%	9.50%
12 Week Price Chg	13.45%	20.89%	19.84%	-6.05%	5.31%	2.89%
52 Week Price Chg	-17.51%	-17.56%	2.73%	11.37%	3.85%	-8.77%
20 Day Average Volume	1,260,167	685,361	2,098,555	1,048,418	1,376,023	1,028,184
(F1) EPS Est 1 week change	-0.28%	0.00%	0.00%	1.99%	0.00%	1.36%
(F1) EPS Est 4 week change	-0.58%	0.00%	1.10%	2.86%	2.01%	1.36%
(F1) EPS Est 12 week change	-1.22%	-2.22%	1.04%	3.36%	2.06%	1.43%
(Q1) EPS Est Mthly Chg	-1.37%	-1.23%	0.39%	-2.24%	-1.17%	-1.28%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	B
Momentum Score	F
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.