

General Dynamics Corp. (GD)

\$179.51 (As of 01/10/20)

Price Target (6-12 Months): **\$190.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/21/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: B

Growth: C

Momentum: D

Summary

General Dynamics boasts a strong position in the U.S. defense space and overseas, and continues to witness strong order growth, securing some pivotal contracts from the U.S. government and its overseas clients. The recent budgetary amendments under the current U.S. administration tend to strongly favor the company's business line. Product innovations can be expected to enhance this shipbuilder's footprint in the business jet market. However, rising interest expenses can be a potential headwind for its bottom-line growth going ahead. Moreover, delayed payments related to one of its large international vehicle programs in Canada are hurting its cash flow reserve. A comparative analysis of its historical EV/EBITDA ratio reflects a gloomy picture. Also, in the past year, shares of General Dynamics underperformed the industry.

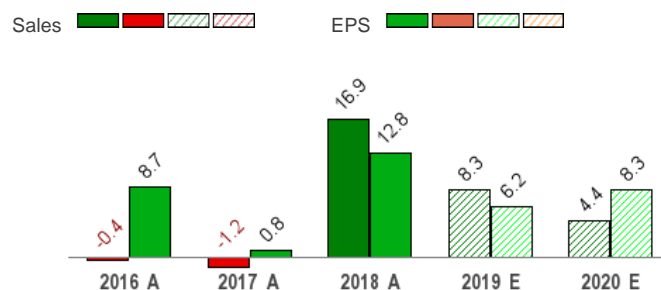
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$193.76 - \$160.21
20 Day Average Volume (sh)	1,051,728
Market Cap	\$51.9 B
YTD Price Change	1.8%
Beta	1.14
Dividend / Div Yld	\$4.08 / 2.3%
Industry	Aerospace - Defense
Zacks Industry Rank	Top 13% (34 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.6%
Last Sales Surprise	0.8%
EPS F1 Est- 4 week change	-0.2%
Expected Report Date	01/29/2020
Earnings ESP	0.7%
P/E TTM	15.6
P/E F1	13.9
PEG F1	1.6
P/S TTM	1.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	9,848 E	9,991 E	9,973 E	10,239 E	40,916 E
2019	9,261 A	9,555 A	9,761 A	10,602 E	39,190 E
2018	7,535 A	9,186 A	9,094 A	10,378 A	36,193 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$3.04 E	\$3.19 E	\$3.25 E	\$3.35 E	\$12.90 E
2019	\$2.56 A	\$2.77 A	\$3.14 A	\$3.45 E	\$11.91 E
2018	\$2.65 A	\$2.82 A	\$2.89 A	\$3.07 A	\$11.22 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 01/10/2020. The reports text is as of 01/13/2020.

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.**

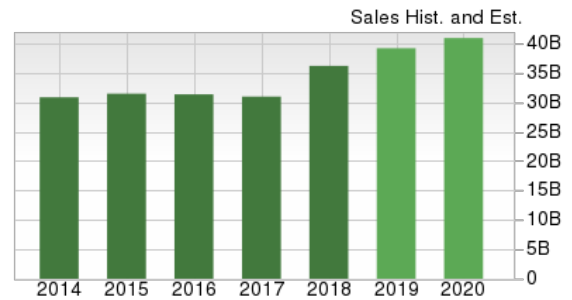
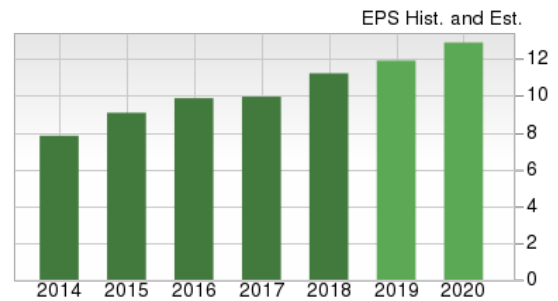
The **Aerospace** segment consists of Gulfstream Aerospace, which manufactures business jets, and Jet Aviation, which provides aircraft maintenance and spare parts. Segment revenues in 2018 summed \$8,455 million, representing 23.4% of the company's total revenues.

Combat Systems manufactures combat vehicles, medium-caliber guns, ammunition and ammunition handling systems. Revenues during 2018 came in at \$6,241 million, contributing 17.2% to the company's total revenues.

Mission Systems segment provides command, control and intelligence systems solutions. Revenues during 2018 came in at \$4,726 million, contributing 13% to the company's total revenues.

Marine Systems makes nuclear submarines, surface combatants and auxiliary ships. In 2018, revenues amounted to \$8,502 million, comprising 23.5% of the company's total revenues.

The **Information Technology** segment integrates secure communication systems and networks. Segment revenues in 2018 summed \$8,269 million, representing 22.9% of the company's total revenues.



Reasons To Buy:

▲ General Dynamics boasts a strong position in the U.S. defense space and overseas. The recent budgetary amendments under the current U.S. administration tend to strongly favor the company's business line. Notably, the proposed fiscal 2020 defense budget includes a spending provision of \$205.6 billion for the U.S. Navy, approximately 6% higher than the previous fiscal budget allotment. It includes the procurement for purchasing 11 new ships, including four submarines. General Dynamics, being one of the two contractors in the world equipped to build nuclear-powered submarines and one of the prime U.S. shipbuilders, should certainly benefit from this increased budget proposal, if approved.

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

▲ During the third quarter of 2019, General Dynamics witnessed strong order growth, which was in line with its usual trend. This, in turn, boosted its backlog that amounted to \$67.4 billion at the end of the reported quarter. The estimated potential contract value, at the end of third quarter, came in at \$35.64 billion, up 2.7% year over year. As a result, the company's Aerospace unit reflected a book-to-bill ratio of 1-to-1, while the Combat Systems unit enhanced its backlog this quarter with a book-to-bill of 1.3. Such impressive book-to-bill ratio indicates solid demand for the company's products, thereby bolstering its revenue generation prospects significantly.

▲ With respect to product development, General Dynamics' G600 aircraft received both type and production certification from the U.S. Federal Aviation Administration (FAA) toward the end of June 2019. The company commenced deliveries during the third quarter and expects to approach double digit total this year. As result of G600 jets' deliveries, General Dynamics anticipates its revenues and earnings to get a boost during the second half of 2019. In October, General Dynamics introduced its flagship aircraft in the business-jet industry, the Gulfstream G700. The first flight of this jet is currently expected to take place this December. Such product innovation is projected to fortify this shipbuilder's footing in the business jet market.

Reasons To Sell:

- ▼ General Dynamics' interest expenses increased a solid 43.4% year over year to \$350 million during the first nine months of 2019. Interestingly, the company has been witnessing an upward trend in its interest expenses over the past few years. On a year-over-year basis, interest expenses witnessed a massive surge of 245.6% at the end of 2018 and a rise of 13.2% at the end of 2017. General Dynamics expects to incur interest expenses of \$460 million in 2019, an increase of 29.2% from 2018's level, reflecting a full year of financing for the CSRA acquisition and additional commercial paper issuances. Such rising expenses can be a potential headwind for the company's bottom-line growth, going ahead. This might have discouraged investors' interest in this stock. Evidently, General Dynamics' share price has only gained 11.6% in the past year compared to the industry's rise of 19.1%.

Delayed payments from a large program is hurting General Dynamics' cash flow. Rising interest expenses are likely to hurt the company's growth prospects.
 - ▼ A comparative analysis of its historical Enterprise Value/Sales (EV/Sales F12M) ratio reflects a relatively gloomy picture that might be a cause for investors' concern. General Dynamics currently has a forward 12-month EV/Sales ratio of 1.58. This level compares unfavorably with what the stock witnessed in a year's time. Moreover, the company's EV/Sales ratio is higher than that of its industry's ratio of 1.51, indicating the stock is an overvalued one.
 - ▼ General Dynamics is carrying more commercial paper than anticipated due to delayed payments related to one of its large international vehicle programs in Canada that has been outstanding since the fourth quarter of the last year. Such payment delays affected the company's cash flow from operations. Evidently, the company witnessed a cash inflow of only \$587 million as of Sep 29 compared to the cash inflow of \$1,081 million in the year-ago period. If such payment delays persist, the General Dynamics' cash flow balance may consistently remain under pressure. This, in turn, might reduce the company's ability to reward its shareholders through dividend hikes and share repurchase programs.
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Last Earnings Report

General Dynamics' Q3 Earnings Beat, Revenues Up Y/Y

General Dynamics Corporation reported third-quarter 2019 earnings from continuing operations of \$3.14 per share, which beat the Zacks Consensus Estimate of \$3.06 by 2.6%. The bottom line also improved 10.2% from the prior-year quarter's \$2.85 per share.

Total Revenues

General Dynamics' third-quarter revenues of \$9,761 million surpassed the Zacks Consensus Estimate of \$9,682 million by 0.82%. Further, revenues increased 7.3% from \$9,094 million in the year-ago quarter. The year-over-year increase can be attributed to sales growth in the company's Aerospace, Combat and Marine Systems segments.

Backlog

General Dynamics' total backlog at the end of third-quarter 2019 was \$67.4 billion. Estimated potential contract value, representing management's estimate of value in unfunded indefinite delivery, indefinite quantity (IDIQ) contracts and unexercised options, was \$35.6 billion. Total estimated contract value, the sum of all backlog components, was \$103 billion.

Segmental Performance

Aerospace: The segment reported revenues of \$2,495 million, up 22.8% year over year. However, operating earnings of \$393 million increased 4.5% from the prior-year quarter's \$376 million.

Combat Systems: Segment revenues rose 14.2% from the prior-year quarter to \$1,740 million. Moreover, operating earnings were up 9.5% from the year-ago quarter to \$264 million.

Information Systems and Technology: The segment reported revenues of \$2,071 million, which declined 10.2% year over year. Operating earnings also dropped 7% from the prior-year period to \$146 million.

Marine Systems: The segment's revenues of \$2,235 million were up 11.6% from the year-ago quarter's \$2,003 million. Operating earnings also improved 23.7% from the year-ago level to \$209 million.

Mission Systems: The segment's revenues of \$1,220 million declined 0.8% from the year-ago quarter's \$1,230 million. Operating earnings of \$185 million also increased 3.4% from the year-ago quarter's \$179 million.

Operational Highlights

Company-wide operating margin remained in line with the year ago quarter's operating margin of 12.5%.

In the quarter under review, General Dynamics' operating costs and expenses rose 7.4% from the year-ago period to \$8,545 million.

Interest expenses in the reported quarter amounted to \$114 million, in line with the year ago quarter's number.

Financial Condition

As of Sep 29, 2019, General Dynamics' cash and cash equivalents were \$974 million compared with \$963 million on Dec 31, 2018.

Long-term debt as of Sep 29, 2019 was \$8,989 million, which massively declined from the 2018-end level of \$11,444 million.

In the first nine months of 2019, the company's cash provided by operating activities was \$587 million compared with \$1,081 million cash provided by operating activities in the comparable year-ago period.

Quarter Ending 09/2019

Report Date	Oct 23, 2019
Sales Surprise	0.82%
EPS Surprise	2.61%
Quarterly EPS	3.14
Annual EPS (TTM)	11.54

Recent News

On **Jan 3, 2020**, General Dynamics Corp.'s business subsidiary, National Steel and Shipbuilding Co. (NASSCO), secured a \$98-million contract to execute docking phased maintenance availability for fiscal 2020. The deal was awarded by the Naval Sea Systems Command, Washington, DC.

Per the terms, General Dynamics' NASSCO unit will maintain, modernize and repair USS Harpers Ferry (LSD 49) and also provide the required facilities and human resources for the completion of the work. Work related to the deal is expected to get completed by December 2020 and will be performed in San Diego, CA.

On **Dec 3, 2019**, General Dynamics Corp.'s Electric Boat division recently secured a \$22.2-billion multi-year modification contract for manufacturing nine Virginia-class submarines, of which eight would include the Virginia Payload Module (VPM). The deal has been awarded by the Naval Sea Systems Command, Washington, D.C.

On **Oct 14, 2019**, General Dynamics Corp.'s Electric Boat division secured a contract to offer lead yard support, development studies and design efforts related to Virginia class submarines. The deal has been awarded by The Naval Sea Systems Command, Washington, DC.

Valued at \$434.4 million, the deal is expected to be completed by September 2020. Through this contract, Electric Boat will also provide all engineering and related lead yard support necessary for direct maintenance and support of Virginia class ship specifications.

On **Aug 23, 2019**, General Dynamics' business subsidiary, National Steel and Shipbuilding Co. (NASSCO), clinched a \$1.08-billion contract for the construction of Expeditionary Sea Base (ESB) 6 and 7 ships. The deal was awarded by the Naval Sea Systems Command, Washington, DC.

Work related to the deal is expected to get completed by January 2025, while the majority of the task will be performed in San Diego, CA.

On **Jul 11, 2019**, General Dynamics' Electric Boat division secured a \$173.8-million contract for providing engineering, technical, design agent and planning yard support for attack submarines. The deal has been awarded by the Naval Sea Systems Command, Washington, D.C. Work related to the deal is scheduled to get completed by September 2023. Majority of this work will be performed in Groton, CT.

Valuation

General Dynamics' shares are down 3.1% in the past six months period and up 11.65% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are up 2.1% and 5.9% in the past six months period, respectively. Over the past year, the Zacks sub-industry is up 19.1% whereas the sector is up 26%.

The S&P 500 index is up 10% in the past six months period but went up 28.4% in the past year.

The stock is currently trading at 13.88X forward 12-month earnings, which compares to 17.93X for the Zacks sub-industry, 17.91X for the Zacks sector and 18.88X for the S&P 500 index.

Over the past five years, the stock has traded as high as 20.91X and as low as 12.26X, with a 5-year median of 15.71X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$190 price target reflects 14.69X earnings value.

The table below shows summary valuation data for GD

Valuation Multiples - GD					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.88	17.93	17.91	18.88
	5-Year High	20.91	22.54	21.54	19.34
	5-Year Low	12.26	14.52	14.26	15.17
	5-Year Median	15.71	17.09	16.82	17.44
P/S F12M	Current	1.27	1.46	1.27	3.5
	5-Year High	2.05	1.64	1.39	3.5
	5-Year Low	1.12	0.95	0.8	2.54
	5-Year Median	1.45	1.25	1.06	3
P/B TTM	Current	3.84	12.4	9.14	4.46
	5-Year High	5.94	25.01	13.92	4.47
	5-Year Low	3.44	6.95	5.2	2.85
	5-Year Median	4.22	14.03	9.1	3.61

As of 01/10/2020

Industry Analysis Zacks Industry Rank: Top 13% (34 out of 254)



Top Peers

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

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	GD Neutral	X Industry	S&P 500	LDOS Outperform	LMT Neutral	NOC Neutral
VGM Score	C	-	-	A	B	B
Market Cap	51.93 B	12.69 B	24.03 B	14.30 B	116.73 B	63.10 B
# of Analysts	9	5.5	13	6	9	7
Dividend Yield	2.27%	0.87%	1.78%	1.35%	2.32%	1.41%
Value Score	B	-	-	B	C	C
Cash/Price	0.02	0.02	0.04	0.05	0.02	0.02
EV/EBITDA	11.52	14.25	14.04	16.65	16.54	15.11
PEG Ratio	1.57	2.32	2.02	2.47	2.41	1.25
Price/Book (P/B)	3.84	5.37	3.32	4.40	29.65	6.48
Price/Cash Flow (P/CF)	12.37	16.44	13.52	16.15	18.61	14.05
P/E (F1)	13.92	18.15	18.82	18.54	17.06	16.33
Price/Sales (P/S)	1.33	1.41	2.63	1.33	2.00	1.90
Earnings Yield	7.19%	5.42%	5.31%	5.39%	5.86%	6.12%
Debt/Equity	0.67	0.67	0.72	1.00	3.21	1.55
Cash Flow (\$/share)	14.51	5.28	6.94	6.26	22.24	26.65
Growth Score	C	-	-	A	A	B
Hist. EPS Growth (3-5 yrs)	7.41%	12.53%	10.56%	14.25%	14.78%	22.40%
Proj. EPS Growth (F1/F0)	8.24%	14.18%	7.49%	9.04%	12.19%	12.50%
Curr. Cash Flow Growth	20.42%	20.42%	14.83%	1.52%	24.70%	61.17%
Hist. Cash Flow Growth (3-5 yrs)	6.79%	7.81%	9.00%	37.15%	6.70%	14.12%
Current Ratio	1.11	1.16	1.23	1.16	1.28	1.29
Debt/Capital	39.95%	43.20%	42.99%	49.88%	76.27%	60.86%
Net Margin	8.66%	6.46%	11.08%	6.25%	10.26%	9.05%
Return on Equity	26.79%	19.00%	17.16%	21.12%	221.59%	39.12%
Sales/Assets	0.82	0.91	0.55	1.17	1.23	0.84
Proj. Sales Growth (F1/F0)	4.41%	5.32%	4.20%	6.47%	5.30%	5.34%
Momentum Score	D	-	-	D	F	C
Daily Price Chg	-1.16%	-0.43%	-0.33%	-0.06%	-0.27%	0.55%
1 Week Price Chg	1.52%	1.06%	-0.30%	1.27%	5.12%	8.25%
4 Week Price Chg	-0.53%	6.44%	1.71%	10.78%	7.75%	8.24%
12 Week Price Chg	1.56%	10.20%	6.05%	23.63%	9.75%	5.09%
52 Week Price Chg	10.52%	41.10%	22.39%	83.97%	49.13%	45.30%
20 Day Average Volume	1,051,728	493,325	1,580,816	815,814	1,064,750	921,187
(F1) EPS Est 1 week change	-0.13%	0.00%	0.00%	0.00%	0.00%	-0.33%
(F1) EPS Est 4 week change	-0.20%	0.00%	0.00%	1.18%	0.00%	0.06%
(F1) EPS Est 12 week change	-1.58%	-0.25%	-0.50%	3.19%	-4.26%	2.36%
(Q1) EPS Est Mthly Chg	0.33%	0.00%	0.00%	0.00%	0.00%	0.00%

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	B
Growth Score	C
Momentum Score	D
VGM Score	C

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.

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