

# General Dynamics Corporation (GD)

Updated November 9<sup>th</sup>, 2020 by Prakash Kolli

## Key Metrics

<b>Current Price:</b>	\$139	<b>5 Year CAGR Estimate:</b>	11.0%	<b>Market Cap:</b>	\$39.89B
<b>Fair Value Price:</b>	\$155	<b>5 Year Growth Estimate:</b>	6.0%	<b>Ex-Dividend Date:</b>	10/08/20
<b>% Fair Value:</b>	90%	<b>5 Year Valuation Multiple Estimate:</b>	2.1%	<b>Dividend Payment Date:</b>	11/13/20
<b>Dividend Yield:</b>	3.2%	<b>5 Year Price Target</b>	\$207	<b>Years Of Dividend Growth:</b>	28
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase:</b>	10.3%

## Overview & Current Events

General Dynamics is an U.S. aerospace & defense company that operates five business segments: Aerospace (23% of sales), Combat Systems (17%), Marine Systems (23%), Information Technology (23%), and Mission Systems (13%). The company's Aerospace segment is focused on business jets and services while the remainder of the company is defense. The company makes the well-known M1 Abrams tank, Stryker vehicle, *Virginia*-class submarine, *Columbia*-class submarine, and Gulfstream business jets. Based on revenue, General Dynamics is the third largest defense company. General Dynamics had revenue of approximately \$39.4B in 2019.

General Dynamics reported decent Q3 2020 results on October 28, 2020. Companywide revenue declined (3.4%) to \$9,431M from \$9,761M and diluted GAAP earnings per share decreased (7.6%) to \$2.90 from \$3.14 on a year-over-year basis. The declines again resulted from weakness in Aerospace, Information Technology, and Mission Systems segments. Aerospace revenue fell (20.8%) to \$1,975M from \$2,495M in the prior year and margins fell 150 bps to 14.3%. But revenue and margins seem to be stabilizing on a sequential basis. The backlog is declining and is now \$11,964M. New orders have strengthened, and the book-to-bill ratio rose to 0.92X but are still running behind 2019.

Combat Systems increased revenue 3.5% to \$1,801M from \$1,740M driven by the ELS and North America. Orders were up \$1.0B+ in comparable periods. Revenue for Marine Systems increased 7.6% to \$2,405M from \$2,235M due to growth in work for the *Virginia*-class Block V and *Columbia*-class submarines. Information Technology revenue decreased (2.0%) to \$2,029M from \$2,071M due to impact of COVID-19 travel restrictions and limited site access. Operating margins recovered 280 bps to 7.2%. Revenue for Mission Systems was flat at \$1,221M from \$1,220M.

The companywide backlog remains very healthy at \$81.5B, and the unfunded backlog is ~\$50.4B. That said, the backlog is declining for three segments and growing for IT and Combat Systems, which seems to have turned the corner. The company is aggressively submitting bids for IT and the backlog in the segment should grow with some wins.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$6.82	\$6.94	\$6.48	\$7.03	\$7.83	\$9.08	\$9.87	\$9.95	\$11.22	\$11.98	<b>\$11.05</b>	<b>\$14.79</b>
<b>DPS</b>	\$1.68	\$1.88	\$2.04	\$2.24	\$2.48	\$2.76	\$3.04	\$3.36	\$3.76	\$3.99	<b>\$4.40</b>	<b>\$6.47</b>
<b>Shares<sup>1</sup></b>	372	356	354	353	332	311	302	297	289	290	<b>287</b>	<b>273</b>

General Dynamics top and bottom lines are growing due to increasing U.S. defense spending and international sales. The business jet market is being negatively impacted in the near-term due to COVID-19 and travel restrictions. General Dynamics has established naval and ground platforms that support maintenance and modernization contracts as well as future prime contract wins. COVID-19 will likely cause earnings to drop in 2020, but after that we forecast on average 6% annual earnings per share growth out to 2025. Operating margin expansion and a reduction of share count will support earnings per share growth. We expect dividend growth to be about 8% going forward. General Dynamics is a Dividend Aristocrat and the current payout ratio is relatively low supporting future dividend increases.

<sup>1</sup> Share count in millions.

Disclosure: This analyst is long GD

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## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	9.9	9.9	10.4	11.3	15.2	15.5	14.8	20.5	17.7	14.7	12.6	14.0
Avg. Yld.	2.5%	2.7%	3.0%	2.8%	2.1%	2.0%	2.1%	1.7%	1.9%	2.3%	3.2%	3.1%

General Dynamics' stock price has dropped since our last report and is trading below our fair value estimate. The dividend yield is higher than the average yield over the past decade. We have maintained our earnings estimate at the mid-point of current guidance. Our current fair value estimate is now \$155. Our 5-year price target is now \$207.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	25%	27%	31%	32%	32%	30%	31%	36%	34%	34%	40%	44%

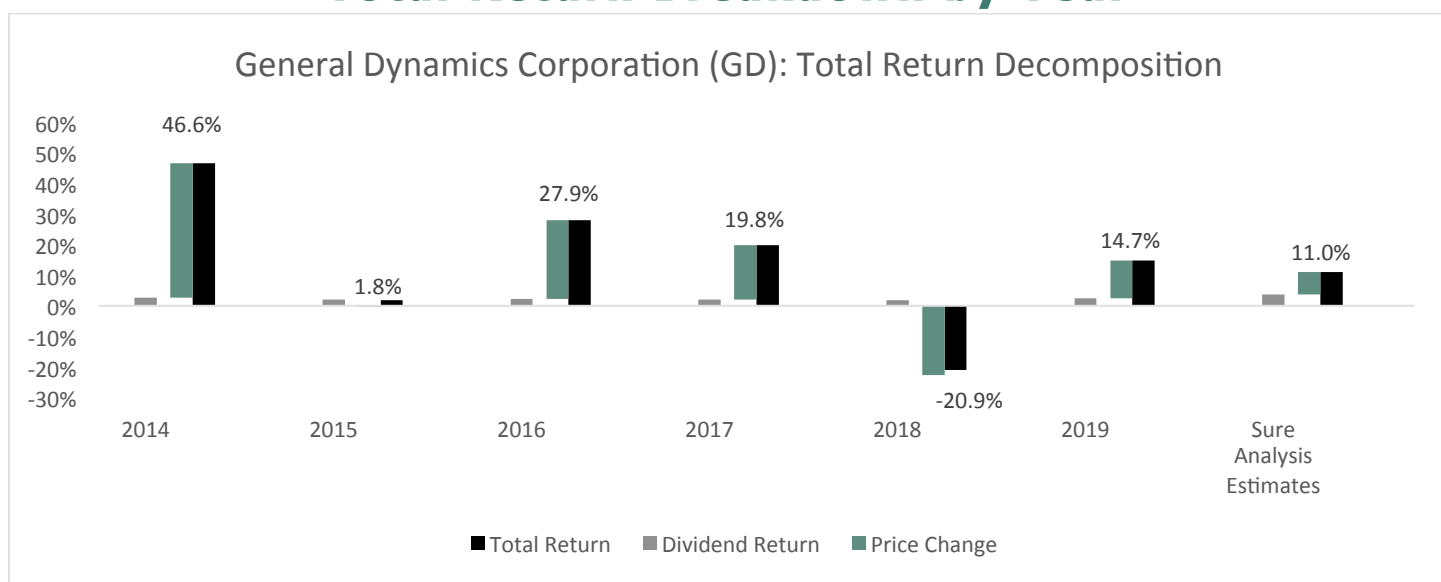
General Dynamics is an entrenched military prime contractor. It has ground and marine platforms that serve as the backbone for the U.S. Army, U.S. Navy and militaries around the world. This leads to a competitive advantage as these platforms have decades long life cycles and General Dynamics has expertise and experience to perform sustainment and modernization. These characteristics lead to a good degree of recession resistance. However, the company faces risks in program cuts, reduction in federal spending, and cyclical nature of the business jet market. General Dynamics is increasing its exposure to information technology and cybersecurity. These are competitive fields with lower margins.

General Dynamics' debt increased for the CRSA acquisition. Short-term debt is \$3,394M and long-term debt is \$9,978M offset by only \$1,469M in cash. Interest coverage is healthy at about 10X and the leverage ratio is about 2.3X.

## Final Thoughts & Recommendation

At present we are forecasting a 11.0% annual total return through 2025. General Dynamics' stock price has been pressured due to exposure to the weak business jet market. In addition, defense stocks have been trending down during the election. That said, the stock is well off its 52-week high, the yield is greater the past decade's average, and the backlog is near a record high. Investors should consider this stock. We rate this stock a buy at the current price.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	32466	32677	30992	30930	30852	31781	30561	30973	36193	39350
Gross Profit	5909	5856	4980	5728	5873	6232	5665	6242	6715	7059
Gross Margin	18.2%	17.9%	16.1%	18.5%	19.0%	19.6%	18.5%	20.2%	18.6%	17.9%
SG&A Exp.	1964	2030	2221	2039	1984	1937	1921	2006	2258	2411
D&A Exp.	569	592	590	525	496	481	453	441	763	829
Operating Profit	3945	3826	2759	3689	3889	4295	3744	4236	4457	4648
Op. Margin	12.2%	11.7%	8.9%	11.9%	12.6%	13.5%	12.3%	13.7%	12.3%	11.8%
Net Profit	2624	2526	-332	2357	2533	3036	2572	2912	3345	3484
Net Margin	8.1%	7.7%	-1.1%	7.6%	8.2%	9.6%	8.4%	9.4%	9.2%	8.9%
Free Cash Flow	2616	2780	2170	2675	3307	2038	1771	3448	2458	1994
Income Tax	1162	1166	854	1125	1129	1183	977	1165	727	718

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	32545	34883	34309	35494	35337	31997	33172	35046	45408	48841
Cash & Equivalents	2613	2649	3296	5301	4388	2785	2334	2983	963	902
Acc. Receivable	3848	4429	4204	4370	4050	3446	3399	3617	3759	3544
Inventories	2158	7478	7740	7670	7812	7723	5118	5303	5977	6306
Goodwill & Int.	14641	15389	13431	12976	12643	12206	12123	12616	22179	21992
Total Liabilities	19229	21651	22919	20993	23508	21259	22871	23611	33676	35264
Accounts Payable	2736	2895	2469	2216	2057	1964	2538	3207	3179	3162
Long-Term Debt	3203	3907	3908	3909	3893	3399	3888	3982	12417	11930
Total Equity	13316	13232	11390	14501	11829	10738	10301	11435	11732	13577
D/E Ratio	0.24	0.30	0.34	0.27	0.33	0.32	0.38	0.35	1.06	0.88

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	8.2%	7.5%	-1.0%	6.8%	7.2%	9.0%	7.9%	8.5%	8.3%	7.4%
Return on Equity	20.4%	19.0%	-2.7%	18.2%	19.2%	26.9%	24.4%	26.8%	28.9%	27.5%
ROIC	16.0%	15.0%	-2.0%	14.0%	14.8%	20.3%	18.2%	19.7%	16.9%	14.0%
Shares Out.	372	356	354	353	332	311	302	297	289	290
Revenue/Share	84.28	88.91	87.71	87.50	90.39	97.29	98.46	101.67	120.98	135.3
FCF/Share	6.79	7.56	6.14	7.57	9.69	6.24	5.71	11.32	8.22	6.86

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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