

General Dynamics

Sweet spot between aero and defense

Reiterate Rating: BUY | PO: 315.00 USD | Price: 264.78 USD

Benefit from tailwinds in both aero and defense end mkts

General Dynamics (NYSE: GD) continues to occupy the sweet spot between aerospace and defense. On one hand, GD possesses the best-in-class aerospace company with Gulfstream, which continues to see strong demand in the post-COVID environment. On the other hand, GD's Combat, Marine, and Technologies segments provide the company with well-rounded exposure to ramping (e.g., Columbia-class) and legacy programs (e.g., 155mm ammunition), both of which are likely to remain well-funded through the outyears. We reiterate our Buy rating and raise PO to \$315 from \$295 as we roll our DCF model one year forward.

Aero orders defy worries of slowing bizjet demand

Aerospace closed out the year with a strong book-to-bill of 1.2x for both 4Q23 and 2023. Backlog closed out the year up 2.8% Y/Y at \$20.5bn. While these metrics are strong, they are even more impressive given that 2023 saw two separate half-month order intake pauses due to the failures of SVB and First Republic Bank as well as the recent Gaza conflict. This robust demand profile defies prior concerns that business jet demand was waning in the wake of the COVID-19 pandemic and the return of commercial travel. However, FAA delays in certification and the push back of G700 entry into service motivate us to remain conservative regarding the pace at which GD can deliver. Despite its 50 G700 delivery target, we anticipate Gulfstream will only deliver half that amount.

Combat Systems growth to be driven by munitions orders

Combat Systems (CS) continues to outperform with sales up 8.5% Y/Y, largely driven by OTS (artillery and propellant volumes) and European Land Systems (higher Piranha, Eagle, and bridge volumes + international tanks). Demand also remains robust, with CS boasting a 1.1x BTB for 2023 on international demand for Abrams MBTs and munitions, especially in Europe. We think management remains conservative in its outlook (CS grew 13% in 2023 despite flat outlook). We expect the segment to exceed expectations with 5.4% growth (vs. 2.8% outlook), largely on robust munitions volumes.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	12.19	12.02	14.45	16.30	18.25
EPS Change (YoY)	5.5%	-1.4%	20.2%	12.8%	12.0%
Consensus EPS (Bloomberg)			14.73	16.34	17.78
DPS	5.04	5.28	5.72	6.16	6.64
Valuation (Dec)					
P/E	21.7x	22.0x	18.3x	16.2x	14.5x
Dividend Yield	1.9%	2.0%	2.2%	2.3%	2.5%
EV / EBITDA*	16.9x	16.9x	14.6x	13.4x	12.4x
Free Cash Flow Yield*	4.8%	5.3%	5.5%	6.2%	6.7%

* For full definitions of *iQmethod*SM measures, see page 6.

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Timestamp: 30 January 2024 03:00AM EST

30 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	295.00	315.00
2024E DPS	5.88	5.72

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Stock Data

Price	264.78 USD
Price Objective	315.00 USD
Date Established	30-Jan-2024
Investment Opinion	B-1-7
52-Week Range	202.35 USD - 267.97 USD
Mkt Val (mn) / Shares Out (mn)	72,258 USD / 272.9
Free Float	87.7%
Average Daily Value (mn)	323.03 USD
BofA Ticker / Exchange	GD / NYS
Bloomberg / Reuters	GD US / GD.N
ROE (2024E)	18.0%
Net Dbt to Eqty (Dec-2023A)	34.5%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

OTS – Ordnance & Tactical Systems

BTB – book-to-bill

iQprofileSM General Dynamics

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	9.5%	9.2%	10.6%	11.5%	12.6%
Return on Equity	18.7%	16.6%	18.0%	18.7%	19.3%
Operating Margin	10.7%	10.0%	10.9%	11.5%	12.0%
Free Cash Flow	3,465	3,806	3,984	4,509	4,838

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.4x	1.4x	1.2x	1.2x	1.2x
Asset Replacement Ratio	1.3x	1.0x	1.1x	1.1x	1.1x
Tax Rate	16.0%	16.8%	17.5%	17.5%	17.5%
Net Debt-to-Equity Ratio	49.8%	34.5%	25.9%	18.8%	12.4%
Interest Cover	11.6x	12.4x	15.8x	20.0x	24.1x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	39,407	42,272	46,394	48,465	50,855
% Change	2.4%	7.3%	9.8%	4.5%	4.9%
Gross Profit	6,622	7,103	7,796	8,144	8,546
% Change	3.3%	7.3%	9.8%	4.5%	4.9%
EBITDA	5,095	5,108	5,922	6,427	6,973
% Change	0.8%	0.3%	15.9%	8.5%	8.5%
Net Interest & Other Income	(175)	(261)	(238)	(188)	(164)
Net Income (Adjusted)	3,391	3,314	3,976	4,425	4,881
% Change	4.1%	-2.3%	20.0%	11.3%	10.3%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	3,390	3,315	3,976	4,424	4,882
Depreciation & Amortization	884	863	865	877	891
Change in Working Capital	318	528	31	112	(7)
Deferred Taxation Charge	(178)	(177)	(177)	(177)	(177)
Other Adjustments, Net	165	181	217	242	267
Capital Expenditure	(1,114)	(904)	(928)	(969)	(1,017)
Free Cash Flow	3,465	3,806	3,984	4,509	4,838
% Change	2.4%	9.8%	4.7%	13.2%	7.3%
Share / Issue Repurchase	(1,229)	(434)	(1,000)	(1,500)	(1,700)
Cost of Dividends Paid	(1,369)	(1,428)	(1,574)	(1,672)	(1,776)
Change in Debt	(1,000)	(1,250)	(500)	(1,500)	(1,000)

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	1,242	1,913	2,823	2,660	3,023
Trade Receivables	3,008	3,004	3,331	3,480	3,652
Other Current Assets	16,813	18,698	20,139	20,501	21,060
Property, Plant & Equipment	5,900	6,198	6,500	6,824	7,177
Other Non-Current Assets	24,622	24,997	24,758	24,526	24,299
Total Assets	51,585	54,810	57,551	57,991	59,210
Short-Term Debt	1,253	507	507	507	507
Other Current Liabilities	14,088	15,925	17,747	18,393	19,140
Long-Term Debt	9,243	8,754	8,254	6,754	5,754
Other Non-Current Liabilities	8,433	8,325	8,125	7,925	7,725
Total Liabilities	33,017	33,511	34,633	33,579	33,126
Total Equity	18,568	21,299	22,918	24,412	26,084
Total Equity & Liabilities	51,585	54,810	57,551	57,991	59,210

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Defense Electronics

Company Description

General Dynamics Corporation (GD) is engaged in business aviation, land and expeditionary combat vehicles and systems, armaments, munitions, shipbuilding and marine systems, and information systems and technologies. Major products include Virginia-class nuclear-powered submarine and Ohio class replacement, Arleigh Burke-class, Aegis, Abrams tank, Stryker 8-wheeled assault vehicle, medium-caliber munitions and gun systems, tactical and strategic mission systems. GD is based in Reston, VA.

Investment Rationale

Defense remains defensive and a strong balance sheet and cash flow generation should ensure continued incremental M&A in defense and commercial markets, as well as sustain dividend growth and share repurchases.

Stock Data

Average Daily Volume 1,219,978

Quarterly Earnings Estimates

	2023	2024
Q1	2.64A	2.92E
Q2	2.70A	3.16E
Q3	3.04A	3.82E
Q4	3.64A	4.55E

Aero: rising above supply chain and regulatory challenges

The Aerospace segment faced challenges due to the delayed certification of the G700, impacting 15 deliveries in 4Q23. These are anticipated to be completed in 1Q24 if the company receives the FAA's certification, which seems possible. Despite this, the segment demonstrated resilience with a 1.2x BTB and a \$20.5bn backlog (+5% Y/Y). Revenue of \$2.7bn also increased 12% Y/Y but was below BofAe of \$2.9bn, mainly driven by delivery delays which deprived the company of slightly over \$1bn of revenue. Supply chain issues also affected production increases of in-service aircraft. Operating margins of 16.4% came 100bps below our expectations.

Looking ahead, we expect supply chain challenges and regulatory hurdles to remain a persistent issue. Consequently, we anticipate G700 deliveries will fall short of management's expectations (25 BofAe vs. target 50 in 2024). GD anticipates \$12.0bn of revenue (vs. BofAe \$11.8bn) and an operating margin increase to 15% (in line with BofAe). The company expects to reach 160 aircraft deliveries in the next year, with fewer G280s as a result of the Gaza conflict's impact on an Israel-based supplier. Nevertheless, our outlook remains positive as GD still possesses a robust backlog of \$20.5bn and the best-in-class aerospace business.

Combat: strength at munitions and Euro Land Systems

Combat Systems exhibited strong performance, with 4Q23 revenue of \$2.4bn, up 8.5% Y/Y and above BofAe of \$2.0bn. Despite a 14.8% margin, which was 146bps below our estimate, the segment demonstrated growth in OTS and European Land Systems. We continue to expect CS sales to outpace management expectations, as was the case in 2023. We anticipate revenue of \$8.7bn vs. \$8.5bn outlook. Our 14.4% operating margin is in line with GD outlook as we anticipate impact from the initial costs of ramping production. The segment remains well-positioned to capitalize on continued demand both domestically and abroad given deteriorating geopolitical dynamics.

Marine: margins suffer on supply chain woes

Marine Systems sustained robust growth in 4Q23, with revenue reaching \$3.4bn, a notable 15% Y/Y increase that exceeded our expectations of \$3.0bn sales. This growth was attributed to Columbia-class construction, engineering volumes, and service contracts. However, the segment experienced a 160bps reduction in operation margin, ending at 6.4%, 147bps below our estimate. The decline was primarily due to estimate at completion (EAC) rate decreases at Electric Boat. These EAC decreases resulted from delayed material deliveries and quality issues from various vendors, leading to additional out-of-station-work. This is not surprising given the widespread labor and material challenges across the naval supply chain. The company is actively working with the Navy to stabilize the supply chain through additional funding.

The segment concluded with 1.0x BTB, with a backlog of \$46bn, up 0.4% Y/Y. Moving into FY24, the company expects revenue at \$12.8bn with operating margins of 7.6%, both in line with our expectations. Despite near term headwinds related to labor and material supply, we expect these naval programs to remain well funded even in the event of budgetary delays and/or cuts.

Technologies: Mission Systems troubles in transition

Despite a 3% revenue decline Y/Y, Technologies revenue of \$3.2bn exceeded our expectations of \$2.9bn, driven by GDIT performance, particularly in defense, intel, and federal civilian applications. However, the operating margin experienced a 50bps contraction to 9.7%, 40bps below our estimate. This miss was primarily due to the revenue mix favoring faster-growing IT services over higher margin defense electronics at Mission Systems. In terms of order activity, GDIT received awards totaling \$13.5bn, surpassing the previous year-end record. Mission Systems also had a strong year demand-wise, with submitted bids nearly tripling 2022 levels. As we progress into FY24, the outlook looks nearly in line with our expectations with \$13bn revenue (up 0.9% Y/Y),



with GDIT expected to see low single digit growth and Mission Systems a slight decrease due to a transition from legacy systems and a slow ramp-up on new programs.

EPS pressured by lower margins at Marine & Tech

We are lowering our 2024e EPS to \$14.45 from \$14.75 as stronger than expected sales (\$46.4bn up from prior \$44.9bn) are more than offset by lower margins at Marine (7.6% vs. prior 8.5%) and Tech (9.4% vs. prior 9.7%) and higher tax rate (17.5% vs. prior 17.0%). In the outyears, we expect slightly stronger growth at 4.4% CAGR in 2024-2027 (vs. prior 4.3%). However, we expect Marine margins to remain pressured in the near term. We lower our EPS estimates to \$16.30 from \$16.75 in 2025e, \$18.25 from \$18.35 in 2026e, while raising 2027e to \$19.55 from \$19.45.

Raising PO to \$315 – rolling forward valuation

We are raising our PO to \$315 from \$295 as we roll our DCF model one year forward. We derive our PO of \$315 using a two-stage discounted cash flow (DCF) analysis, which assumes a 9.1% discount rate, 5.0% 2029-2033 growth rate, and 2.6% long-term growth rate (all assumptions unchanged).

In our view, GD's defense program exposure to land and sea priorities, coupled with Gulfstream could provide near-term and medium-term organic growth. Additionally, the company's strong balance sheet and solid cash generation could sustain dividend growth and share repurchases.

Price objective basis & risk

General Dynamics (GD)

We derive our PO of \$315 using a two-stage discounted cash flow (DCF) analysis, which assumes a 9.1% discount rate, 5.0% 2029-2033 growth rate, and 2.6% long-term growth rate. In our view, GD's defense program exposure to land and sea priorities, coupled with Gulfstream could provide near-term and medium-term organic growth. Additionally, the company's strong balance sheet and solid cash generation could sustain dividend growth and share repurchases.

Downside risks to our PO are 1) a downturn could occur in business jets, due to an exogenous factor, 2) given that business jets are priced in dollars, an unexpected devaluation in the dollar could significantly impact order activity, 3) poor execution on defense programs could adversely impact margins, 4) defense budget cuts could limit growth in the medium and long term.

Analyst Certification

I, Ronald J. Epstein, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AerCap Holdings N.V.	AER	AER US	Ronald J. Epstein
	Air Lease Corporation	AL	AL US	Ronald J. Epstein
	Booz Allen Hamilton	BAH	BAH US	Mariana Perez Mora
	BWX Technologies, Inc.	BWXT	BWXT US	Ronald J. Epstein
	CACI International	CACI	CACI US	Mariana Perez Mora
	Cadre Holdings Inc	CDRE	CDRE US	Ronald J. Epstein
	Crane Co.	CR	CR US	Ronald J. Epstein
	Embraer	ERJ	ERJ US	Ronald J. Epstein
	General Dynamics	GD	GD US	Ronald J. Epstein
	HEICO Corporation	HEI	HEI US	Ronald J. Epstein
	Howmet Aerospace Inc.	HWM	HWM US	Ronald J. Epstein
	KBR	KBR	KBR US	Mariana Perez Mora
	Leidos Holdings	LDOS	LDOS US	Mariana Perez Mora
	Leonardo DRS, Inc.	DRS	DRS US	Ronald J. Epstein
	Northrop Grumman	NOC	NOC US	Ronald J. Epstein
	Palantir Technologies	PLTR	PLTR US	Mariana Perez Mora
	Parsons Corporation	PSN	PSN US	Mariana Perez Mora
	RBC Bearings Inc	RBC	RBC US	Ronald J. Epstein
	Rocket Lab	RKLB	RKLB US	Ronald J. Epstein
	Teledyne Technologies Inc	TDY	TDY US	Ronald J. Epstein
	TransDigm Group Inc.	TDG	TDG US	Ronald J. Epstein
	Triumph Group	TGI	TGI US	Ronald J. Epstein
NEUTRAL				
	Albany International	AIN	AIN US	Ronald J. Epstein
	Boeing	BA	BA US	Ronald J. Epstein
	Garmin	GRMN	GRMN US	Ronald J. Epstein
	Hexcel Corporation	HXL	HXL US	Ronald J. Epstein
	L3Harris	LHX	LHX US	Ronald J. Epstein
	Lockheed Martin	LMT	LMT US	Ronald J. Epstein
	RTX Corp	RTX	RTX US	Ronald J. Epstein
	Textron	TXT	TXT US	Ronald J. Epstein
UNDERPERFORM				
	Bombardier	BDRBF	BDRBF US	Ronald J. Epstein
	Bombardier Inc.	YBBD B	BBD/B CN	Ronald J. Epstein
	CAE Inc.	YCAE	CAE CN	Ronald J. Epstein



US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	CAE Inc.	CAE	CAE US	Ronald J. Epstein
	Huntington Ingalls Industries	HII	HII US	Ronald J. Epstein
	Mercury Systems	MRCY	MRCY US	Ronald J. Epstein
	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales
Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

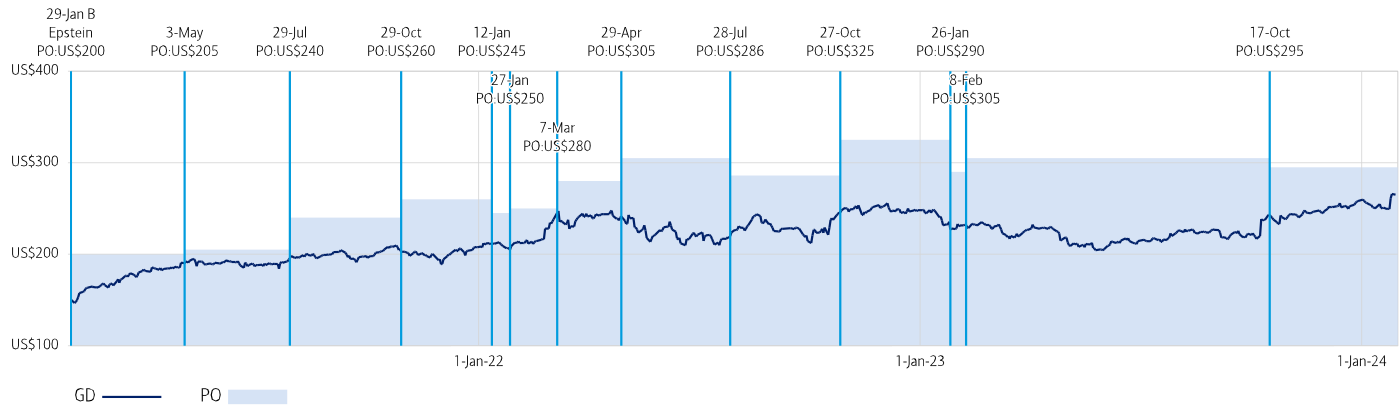
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Disclosures

Important Disclosures

General Dynamics (GD) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Aerospace/Defense Electronics Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	31	62.00%	Buy	23	74.19%
Hold	11	22.00%	Hold	9	81.82%
Sell	8	16.00%	Sell	6	75.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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