

General Dynamics Corp (GD) is an aerospace and defense company. It offers a broad portfolio of products and services in business aviation, combat vehicles, weapons systems and munitions, ship design, construction and repair, and information systems and technology. It operates through the following segments: Aerospace, Combat Systems, Information Technology, Mission Systems and Marine Systems.

Business Segments

Aerospace – 25% of 2019 Revenues

- Designs and manufactures business-jet aircraft and provides a full range of services for business aircraft produced by Gulfstream and other manufacturers
- Gulfstream and Jet Aviation have powerful brand recognition and are renowned for being at the forefront of the industry
- 2019: Revenues \$9,801 million, operating earnings \$1,532 million

Combat Systems – 18% of 2019 Revenues

- Designs, manufactures, and sustains the world’s most lethal, mobile, and survivable land combat platforms and munitions for the U.S. and its international partners
- Three business units: Land Systems, European Land Systems, and Ordnance and Tactical Systems
- Products include Abrams main battle tank, the Stryker, and the Light Armored Vehicle (LAV) family of fighting vehicles
- Produces armaments and munitions that support nearly all kinetic military systems in the U.S. arsenal today
- 2019: Revenues \$7,007 million, operating earnings \$996 million

Information Technology – 21% of 2019 Revenues

- Employs 30,000 technologists and mission experts across the defense, intelligence, and federal civilian markets
- Uses its expertise to improve government services and modernize critical systems
- Uses the latest innovations in cloud, cyber, artificial intelligence, software development and data analytics to secure the nation’s most sensitive information to operate global supply chains and support our nation’s most critical missions.
- 2019: Revenue \$8,422 million, operating earnings \$628 million

Mission Systems – 13% of 2019 Revenues

- Provides mission-critical solutions. A technology integrator and original equipment manufacturer with deep expertise in ground, sea, air, space, and cyberspace
- Its Technology and products are built into platforms and integrated systems

- Has industry leading technologies and a unique combination of products and capabilities that are purpose built for high consequence of failure, C4ISR and cybersecurity applications
- 2019: Revenues \$4,937 million, operating earnings \$683 million

Marine Systems – 23% of 2019 Revenues

- Designs and builds nuclear-powered submarines, surface combatants and auxiliary ships for the U.S. Navy, as well as Jones Act ships for commercial customers
- It has shipyards on the East and West coasts of the US that provide repair services for nearly all classes of US Navy ships
- Invests in businesses to support the significant increase in the Navy's shipbuilding plans, particularly in the submarine fleet.
- 2019: Revenues \$9,183 million, operating earnings \$785 million

Investment Thesis

We believe the General Dynamics (GD) is well positioned to grow its revenues, earnings, and dividends over the next several years. The company has both a long-term catalyst and a short-to-medium term catalyst that should positively impact the stock.

Long-Term Catalyst: GD has significantly increased its capital expenditures over the last three years, with much of it going into its shipyards. Contracts to build Virginia Class attack submarines and Columbia Class ballistic missile submarines are the primary reasons for the investments. In 2019 the Navy awarded GD a \$22.2 billion contract to build 9 Virginia Class Block V submarines with 19 Virginia class submarines in backlog through 2029. GD also is the designer and builder for the 12 boat Columbia Class ballistic missile submarine program that replaces the Ohio-Class submarines currently in service. The Navy considers this program to be its top priority. GD is slated to begin construction on the lead boat in Q4 2020 and to deliver it to the Navy as Ohio-class submarine retirements begin in 2027. The company broke ground last year on a 200,000 square foot assembly building which the company considers the centerpiece of a \$1.7 billion expansion to support Columbia and Virginia class construction. We expect the end of the expansion program and other pre-construction expenditures combined with these long-term programs should provide the company with a source of future free cash flow growth.

Short/Intermediate-Term Catalyst: The short-to-intermediate term catalyst is a rebound in the Aerospace segment which generated almost 25% of GD's 2019 revenues. Third quarter demand for Gulfstream jets was remained hampered by concerns about the economy, an unsettled political climate, and a wide variety of travel restrictions. Less flying has also reduced demand for Jet Aviation's services. Any reduction in COVID restrictions and an improvement in the economic environment should positively impact this important segment of the company. We also believe that ongoing poor performance by the airline industry may make private jets more attractive (and justifiable) for corporations and ultra-high net worth individuals.

Positives

The Virginia and Columbia class submarine programs are top-priority programs (note that Columbia ballistic missile submarines are part of the nuclear defense triad of air, land and sea based nuclear weapons). These programs provide highly visible long-range cash flows for the company and should be protected from any reduction in defense spending.

The Information Technology segment appears to be gaining traction and expanding its footprint in areas such as cloud computing, cybersecurity, Artificial intelligence and digital modernization. Over 50% of its awards in the third quarter of 2020 were from competitive new business.

GD is experiencing broad based growth in its backlog. Total backlog at the end of the third quarter was \$81.5 billion, down \$1.1 billion sequentially but up significantly year over year.

GD believes in “reshaping” its business portfolio on an ongoing basis. The company continually sells businesses that are either underperforming or considered to be non-core while regularly making small (and sometimes large) acquisitions. We believe that this is a good practice that helps to optimize its business portfolio.

Risks

The U.S. government was the source for approximately 66% of GD’s 2019 revenues. The priorities of the government can change over time (and over administrations) leading to a reduction in defense spending.

Aerospace was GD’s highest margin segment in 2019 and generated approximately 25% of the year’s total revenue. The company’s revenues and profitability could be significantly impacted if Aerospace does not quickly recover from the impact of Covid-19.

GD is dependent on sub-contractors, most small or mid-sized business, for many of its products. The current economic slowdown combined with problems in the commercial aerospace industry has put pressure on many of these companies. The failure of one or more of its suppliers could prevent GD from delivering its products on time and on budget.

Government contractors operate in a highly regulated environment. Violations of any rule or regulation could result in fines and/or loss of business.

Valuation Summary

Valuation Measurement	Current	Trailing 5 Year High, Low & Average			Versus the Industry Average
		High	Low	Avg	
P/E (LTM)	13.9	24.1	8.4	17.1	0.6
P/E (NTM)	13.3	20.7	7.9	15.6	0.6
P/BV	3.0	6.0	2.1	4.4	0.7
P/CF	11.9	35.2	9.8	20.2	0.8
P/Sales	1.1	2.3	0.7	1.6	0.7
EV/EBITDA	12.1	16.5	10.0	12.8	0.6
EV/Sales	1.6	2.4	1.4	1.9	0.8
Div Yld	2.9	4.0	1.4	2.0	1.3

Note:

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