

Initiating Coverage

General Dynamics

If War is Omnipresent, then Defense is Defensive

Key Take-away: General Dynamics is set for significant growth with the FAA certification of its Gulfstream G700 business jet, meeting strong market demand and bolstering its aerospace segment. Additionally, substantial contracts for Striker combat vehicles and Columbia- class submarines ensure steady revenue streams and long-term growth in the Combat Systems and Marine Systems Segments. Furthermore, the company is expanding its cybersecurity and IT solutions in the Technologies segment, addressing the increasing demand for secure digital infrastructure and driving overall performance.

Financial Developments: General Dynamics reported several significant developments in its second quarter of 2024, including strong financial results with operating earnings increasing 20.2% year-over-year to \$1.2 billion, and diluted earnings rising 20.7% to \$3.26. Defense contracts rising?

Bolstered by Europe’s Re-armament: The Ukraine war being well into its third year and a remilitarizing Europe may not be well-viewed in regard to global peace, but General Dynamics will play a key role in assisting a Europe looking to rejuvenate its armed forces. Many of its classes of armored-fighting vehicles are being purchased or retrofitted, either to be lent to Ukraine or for countries’ own defense. However, most of the focus remains on land-based armor as Russia fails to be a poignant threat via the seas, so GD’s naval segment is still only as valuable as the US Navy’s desires.

Healthy Pipelines: As should be with any military contractor these days, General Dynamics sports strong order backlogs in each of its segments. Notable is the Combat Systems Division, which received \$3.4b in orders last quarter, as the US Army sets its target for 100k shells produced per month. Marine Systems have seen a shrinking pipeline with fewer orders, although it can also be noted that a lessened pipeline is due to less congestion in the manufacturing and supply chain process.

Valuation: We initiate coverage with a \$300 PT.



Consortium Equity Research
Industrials | Defense
August 12th, 2024

Stock Rating: Equal Weight

Price Target: USD \$300.00

Price: \$292.38

Potential Upside/Downside: 2.7%

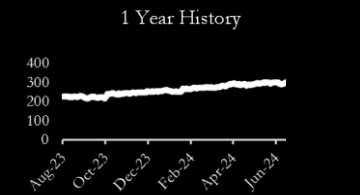
Ticker(s): \$GD

Market Cap: \$80.7b

Shares Outstanding: 274.7mm

Free Float (%): 93.42%

Dividend Yield: 1.92%



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Peer Comparisons

Comparable Companies

\$mm

Ticker	Mkt Cap	EV	P/E	Revenue LF	EBITDA LF
Northrop Grumman Corporation (NYSE:NOC)	\$ 72,295	\$ 86,858	32.3x	\$ 40,764	\$ 4,304.00
Lockheed Martin Corporation (NYSE:LMT)	\$ 131,474	\$ 148,208	20.0x	\$ 71,069	\$ 10,167.00
RTX Corporation (NYSE:RTX)	\$ 154,256	\$ 193,507	66.7x	\$ 72,417	\$ 9,217.00
L3Harris Technologies, Inc. (NYSE:LHX)	\$ 43,315	\$ 56,084	36.6x	\$ 20,765	\$ 3,686.00
General Dynamics (NYSE:GD)	\$ 80,507	\$ 86,402	22.9x	\$ 44,946	\$ 5,131.00

Ticker	LTM EV/EBITDA	Gross Margin	EBIT Margin	EBITDA Margin	1 Yr Rev Growth Rate LF
Northrop Grumman Corporation (NYSE:NOC)	20.2x	16.8%	7.3%	10.6%	7.6%
Lockheed Martin Corporation (NYSE:LMT)	14.6x	12.2%	12.6%	14.3%	5.5%
RTX Corporation (NYSE:RTX)	21.0x	16.4%	6.8%	12.7%	2.6%
L3Harris Technologies, Inc. (NYSE:LHX)	15.2x	26.3%	11.5%	17.8%	15.4%
General Dynamics (NYSE:GD)	16.8x	15.7%	9.5%	11.4%	10.0%

High	20.99x	26.3%	12.6%	17.8%	15.4%
75th Percentile	20.18x	16.8%	11.5%	14.3%	10.0%
Average	17.56x	17.5%	9.5%	13.4%	8.2%
Median	16.84x	16.4%	9.5%	12.7%	7.6%
25th Percentile	15.22x	15.7%	7.3%	11.4%	5.5%
Low	14.58x	12.2%	6.8%	10.6%	2.6%

Source: S&P NetAdvantage

Industry Overview

Boon of Government Spending: Government spending significantly benefits General Dynamics, with revenue from defense contracts accounting for over 70% of its total revenue. In 2023, GD's revenue from government contracts was approximately \$29.6 billion, providing financial stability and long-term growth through multi-year contracts and government-funded R&D projects.

Omnipresence of Geopolitical Threat: Persistent geopolitical threats ensure steady demand for GD's products. The global defense budget increased by 7% in 2023, driving high demand for GD's advanced combat systems and cybersecurity solutions. GD's international sales, comprising around 20% of total revenue, are poised for growth due to increasing foreign military sales.

Secular Growth of UHNI & C-Suite Privileges: The rise in Ultra-High-Net-Worth Individuals (UHNI) supports GD's Aerospace segment, with Gulfstream business jets seeing a 10% year-over-year increase in demand in 2023. Additionally, competitive compensation packages for C-Suite executives attract top talent, fostering innovation and leadership within the company.

Company Overview

Company Description: GD divides their business into four segments: Aerospace, Combat Systems, Marine Systems, and Technologies.

Aerospace: The Aerospace segment includes Gulfstream business jets, which saw a 10% increase in revenue in 2023, totaling \$8.3 billion. The demand for business jets is driven by the growing UHNI population and the need for corporate executives to travel efficiently and securely.

Combat Systems: The Combat Systems segment focuses on land combat vehicles, advanced weaponry, and munitions. In 2023, this segment generated \$6.4 billion in revenue, with a projected growth rate of 8% for 2024, driven by continuous modernization programs and stable government contracts.

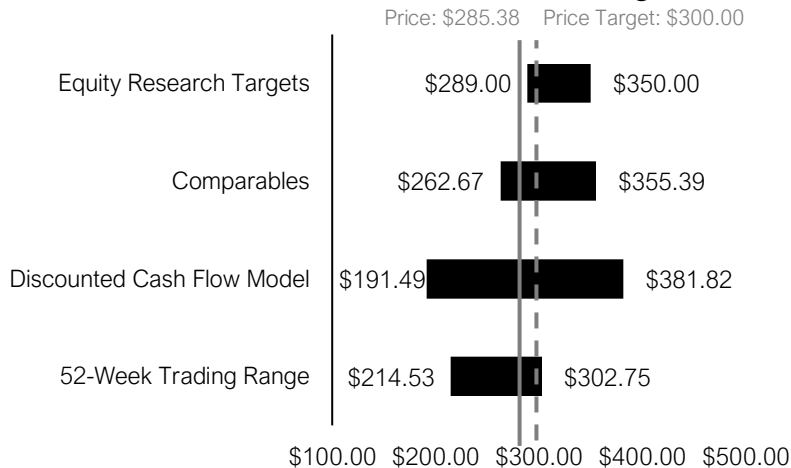
Marine Systems: Marine Systems designs and constructs nuclear-powered submarines and surface ships, primarily for the U.S. Navy. In 2023, this segment generated \$7.8 billion in revenue, with significant contracts such as the Columbia-class submarine program ensuring future growth.

Technologies: The Technologies segment provides IT services, mission-critical information systems, and command and control solutions. In 2023, this segment contributed \$19.8 billion in revenue.

Investment Thesis & Valuation

Our analysis gives GD a price target of \$300.00 and an equal weight rating.

Football Field Valuation Range



Potential Downsides to Our Rating

Political Nature of Defense Spending: Historically speaking, defense investors have been wary of the politicians holding the keys to the war chest that keep the industry funded. While perhaps that was somewhat validated in the Obama era, it seems all but baked in that US political party is willing to keep military spending on its path to approaching \$1 trillion per year due to the political unpopularity of appearing “weak” against any US adversary.

It should also be noted that third-time Presidential candidate Donald Trump has pledged to end the Ukrainian War immediately if he is elected, with little clarity on the details. While an absence of war in Ukraine would hurt General Dynamics’ business, the rash decision making of another Trump term and his aloof attitude towards NATO would likely boost European spending.

Gulfstream Risk Factors: While GD’s stock has a 5Y Monthly Beta of 0.60, the Aerospace segment with Gulfstream very exposed in the event of a prolonged downturn. Business jets are the ultimate luxury, and despite what occurred following the Great Recession, executive pay-packages and benefits would come under more scrutiny if there were another prolonged downturn

Our Price Target: **\$300.00**

Our PT is based on a healthy, continuing growth for private jets as UNHIs value their time, and sustained purchasing of weaponry, as submarines and artillery pieces maintain their value in the eyes of the Pentagon and allies.

Our Upside Case: **\$380.00**

Our upside case makes a best effort to view GD’s valuation should a war break out that sees a full scale mobilization of the American industrial sector towards a war. This remains unlikely, but with the secular trends of wars costing more in dollars than bodies, GD would stand to make unprecedented profit.

Our Downside Case: **\$190.00**

Our downside case sees significant stagnation in the civil aerospace market, either from a standard cyclical downturn, or a targeted political attack on UHNIs and their lifestyles. Additionally, it factors in an area of relatively low military conflict.

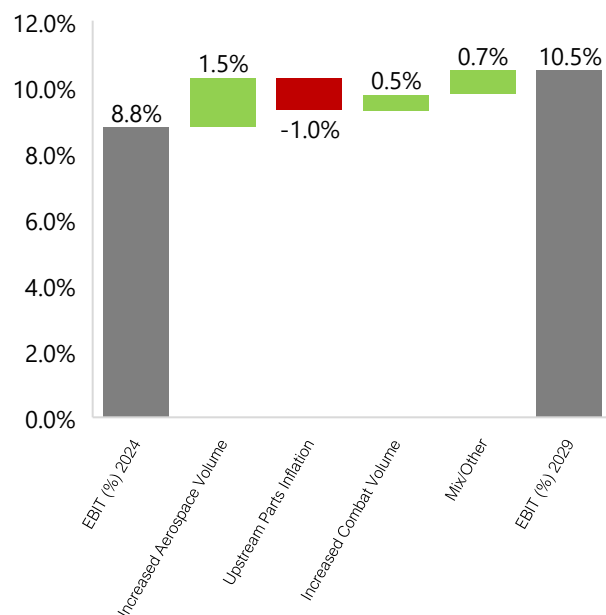
DCF Case Values



The Future of Warfare is Unpredictable: Warfare is always changing, and there is no guarantee that the next major war will involve and engage all General Dynamics' business segments. While Consortium is bullish on the use of submarine warfare, it was considered a surprise the extent to which artillery has thus far played a role in the Ukraine conflict. The future of warfare could very well be much more digital, which could engage an entirely new set of companies than the legacy defense contractors.

Projections

EBIT Waterfall Chart



Income Statement (\$mm)	2023A	2024E	2025E	2026E	2027E	CAGR%
Revenue	42,272	48,000	51,549	54,729	57,375	7.9%
EBITDA	4,376	5,360	6,100	6,841	7,554	14.6%
EBIT	3,707	4,560	5,000	5,418	5,795	11.8%
EBIAT	3,839	3,641	3,765	3,955	3,038	-5.7%

Margin & Growth Data	2023A	2024E	2025E	2026E	2027E	AVG%
EBITDA Margin	10.4%	11.2%	11.8%	12.5%	13.2%	11.8%
EBIT Margin	8.8%	9.5%	9.7%	9.9%	10.1%	9.6%
Revenue Growth	7.3%	13.6%	7.4%	6.2%	4.8%	7.8%
EBIT Growth	-19.4%	23.0%	9.7%	8.4%	7.0%	5.7%

Valuation Metrics	2023A	2024E	2025E	2026E	2027E	AVG%
P/FCF	30.7x	21.8x	30.3x	16.0x	15.2x	22.8x
EV/Sales	2.0x	1.8x	1.6x	1.5x	1.5x	1.7x
EV/EBITDA	19.3x	15.7x	13.8x	12.3x	11.2x	14.5x
FCF Yield	3.3%	4.6%	3.3%	6.2%	6.6%	4.8%

About \$GD

General Dynamics Corporation, headquartered in Reston, Virginia, is an American aerospace and defense company founded in 1952. It operates through four main business segments: Aerospace, Marine Systems, Combat Systems, and Technologies. The company produces military and civilian aircraft, combat vehicles, and engages in shipbuilding, serving both the U.S. government and international clients. General Dynamics is involved in various defense systems and technology development. The company remains a significant entity in the aerospace and defense industry through its diverse product and service offerings.

Disclosures & Ratings

Consortium Equity Research does not hold any professional relationships with any reported equities. **Overweight** means the analyst team believes the stock price will outperform the coverage industry (TMT, Healthcare, Industrial, Consumer, FIG) in the next 6-12 months. **Equal Weight** means the team expects performance in line with the industry. **Underweight** means the team expects underperformance relative to the industry.