

GENERAL DYNAMICS

Aerospace & Defense Industry

Table of Contents

Company Background	2
Reason for Purchase	3
Current Conditions and Developments Since Purchase	6
Investment Drivers	7
Investment Risks	8
Capital Asset Pricing Model	9
Relative Stock Valuation	10
Technical Analysis	16
Assessment of Stock & Recommendations	19
References	21
Appendix A	
Income Statement	22
Balance Sheet	23
Cash Flow Statement	25
Appendix B	
US Government Defense Spending	25
Appendix C	
Competitive Matrix	26

GENERAL DYNAMICS

Aerospace & Defense Industry

St. John's University Graduate Student Investment Fund

Ticker: GD

Current Price: \$73.79

December 13th, 2006

Recommendation: Sell

Dems Return to Power May End "Rummy Rally"

- Company Background
- Reason for Purchase
- Current Conditions and Developments Since Purchase
- Investment Drivers
- CAPM
- Investment Risks
- Relative Valuation of Stock
- Technical Analysis
- Assessment of Stock & Recommendations

Company Background

General Dynamics Corporation (NYSE:GD), formed in 1952 through the combination of Electric Boat Company and Consolidated Vultee (CONVAIR). The company is headquartered in Falls Church, Virginia.

- Beginning in 1995, the company expanded its business by purchasing other shipyards and combat vehicle-related businesses. Followed in 1997, it acquired companies with expertise in information technology products and services.

Today, General Dynamics Corporation is comprised of four primary business groups – Information Systems and Technology, Combat Systems, Marine Systems and Aerospace – and a smaller Resources group:

- The Information Systems and Technology group provides systems integration expertise, hardware and software products and support services.
- The Combat Systems group is a supplier of land and expeditionary combat systems around the world, providing tracked and wheeled armored combat vehicles, armament systems and ammunition to the U.S. military and its allies.
- The Marine Systems group designs, builds and supports submarines and a variety of ships for the Navy and commercial customers.
- The Aerospace group designs, develops, manufactures and services a comprehensive fleet of advanced business-jet aircraft.

GENERAL DYNAMICS

Aerospace & Defense Industry

- The Resources group comprises a coal mining business and an aggregates operation that mines sand, stone and gravel for construction use.

Reason for Purchase

Based on market conditions, political events, and growth prospects in 2002, General Dynamics had the winning attributes necessary for purchase in the Graduate Student Managed Investment Fund.

Market Peak & Industry, Company Growth

- In 2002, defense shares had peaked in June after a three-year run. However, by the fourth quarter, the Philadelphia Stock Exchange Defense Index had fallen 27 per cent, leaving shares in the sector below January levels, and as it turned out, a superior buy point.¹

- Companies were seeking to identify the hardware that could achieve greater scale and cost efficiencies through mergers, leaving them more opportunity to diversify their core business. Defense experts pointed to helicopters,



armored vehicles, satellites, solid-fuel rocket motors and rocket launch capabilities as areas ripe for such consolidation. In armor, General Dynamics, maker of the M-1 Abrams tank, would need to get bigger to diversify technologically, analysts at the time said.² In line with this industry assessment from analysts, General Dynamics had purchased more than 25 companies from the fall of 1995 until the fall of 2002, at a combined cost of \$ 10.1 billion, with about half of the cost coming out of cash and most of the rest from stock swaps.³

¹ Bowe, Christopher

² Ibid, Bowe.

³ Hamilton, Robert A.

GENERAL DYNAMICS

Aerospace & Defense Industry

- In many cases, serial acquirers often destroy shareholder value. However, in this case, General Dynamics appeared to be the exception. In the previous five years ending 2001, General Dynamics revenues had increased at a rate of 28 percent a year, and its earnings per share had been up 17 percent annually. Chairman Nicholas D. Chabraja, speaking at the 12th Annual Morgan Stanley Aerospace & Defense and Multi-Industry Conference in New York in September 2002, said “if General Dynamics did not buy make a major acquisition, it was on track to pay off all its debt by the middle of 2004, thanks to a balance sheet that was one of the strongest in the industry.”⁴
- While General Dynamics' newest divisions were showing some of the company's strongest results, Chabraja said, “The future also looks strong for its shipbuilding subsidiaries, which include Electric Boat in Groton. Growth in the other defense programs, which make up about two-thirds of General Dynamics' business, should help the company continue a history of growth.”⁵
- Specific products companies, like General Dynamics, in the defense industry, can benefit from greater efficiencies over time as the learning curve flattens and they smooth the production process. This can lead to double-digit profit margins, often not seen in large system projects.⁶

Key Divisions & Product Developments

- At Bath Iron Works in Maine, which had just won a contract for six new guided-missile destroyers, the backlog had grown to 13 ships, and at the National Steel and Shipbuilding work began that year on two double-hulled tankers, which represented a new line of commercial business for the company, and in 2003 it starts work on a new class of dry cargo ship for the Navy, a 12-ship, \$ 4 billion program.⁷
- Combat Systems, another long-time General Dynamics' core business, had moved away from main battle tanks and towards smaller, lighter and more lethal vehicles such as the Army's Stryker, a light armored vehicle, and the Marine Corps' Advanced Amphibious Assault Vehicle. Its backlog grew from \$ 1.5 billion in 2000 to \$ 5 billion in 2001, and stands to increase more as the new

⁴ Ibid, Hamilton.

⁵ Ibid, Hamilton.

⁶ Ibid, Bowe.

⁷ Ibid, Hamilton.

GENERAL DYNAMICS

Aerospace & Defense Industry

programs mature, Chabraja said. Companies in its two newest divisions had generated much of the company's growth, Chabraja said.⁸

- Information Systems, which consists of nine businesses purchased over the last few years, had been organized into three divisions, and was the fastest-growing segment of the business, as well as General Dynamics' revenue leader.⁹
- Aerospace, started with the purchase of Gulfstream, had been strengthened by the September 2002 rollout of three new products, bringing the total to seven, covering business jets from \$ 10 million to \$ 45 million. Though Gulfstream had been hard hit by the national economic slowdown, Chabraja said, it had also embarked on a program to service aircraft, which now accounts for \$ 400 million a year in revenues, which combined with the broader product line will make it more resistant to economic turmoil.¹⁰
- EB's submarine programs -- the next-generation Virginia-class, the conversion of four old Trident-class submarines to fire large numbers of conventional missiles, and the reconfiguration of the last Seawolf-class boat as a special operations submarine -- are all considered "transformational" by the military, he said.¹¹

Republicans Win Back Senate

Finally, the surprising Republican victories in Congress provided the base for continued focus on big new technology projects, while, at the time, the potential for war in Iraq would give free advertising to the industry's wares.¹² Furthermore, the Republican victory created a sense that there would be quicker resolution on homeland security, and more congressional support for a bigger Pentagon budget and programs such as missile defense. The Standard & Poor's Aerospace and Defense Index rose more than 11 points, or 6.1 percent, from Tuesday to Friday of election week, November 2002.¹³ To some analysts, the early surge in defense stocks came as no surprise, given the strong support defense funding traditionally has received from Republicans. "A GOP House and Senate is likely to make it easier for [President] Bush to push through higher defense spending," Banc of America Securities defense analyst Nick Fothergill said in a written recap of a conference call held after the election. "Pet projects like missile defense

⁸ Ibid, Hamilton.

⁹ Ibid, Hamilton

¹⁰ Ibid, Hamilton.

¹¹ Ibid, Hamilton.

¹² Ibid, Bowe.

¹³ Lemke, Tim.

GENERAL DYNAMICS

Aerospace & Defense Industry

should get an easier ride." Mr. Bush signed a \$ 355.1 billion defense bill in October 2002, which included the largest defense spending increase since 1982. He was expected to ask for as much as \$ 400 billion for the 2004 budget. Based on the defense spending exhibits, Mr. Bush came though on that request.

Current Conditions and Developments Since Purchase

Democrats in Power

- In contrast with the reason for purchase, the convincing Democrat victory in Congress suggests a change in U.S. public opinion toward the War on Terror. In January 2007, the Democrats will maintain a majority, however slim, in the United States Senate and House of Representatives for the first time since 1994. It is questionable whether or not the defense budget will receive the same focus as it had under the Republican-controlled Congress. What's more, throughout the Bush Administration, Democrats have criticized the amount of defense spending the administration has approved. Thus, it would be appropriate to anticipate cuts in defense spending by the newly elected Democratic House of Representatives and Senate¹⁴.

"Rummy Rally"

- Secretary of Defense, Donald Rumsfeld, was a major proponent for military transformation, including modernizing warfare and intelligence capabilities. As such, most of the recent defense spending has been directed towards technological research and development, a primary driver of growth for General Dynamics.
- With the aforementioned Democrat election victory, Rumsfeld has resigned and with him has gone possibly much of the movement toward military modernization. On the other hand, some political analysts anticipate that defense spending might actually increase, with funds being redirected from modernization efforts, to outfitting the troops in combat.¹⁵ This could be positive for growth as General Dynamics is a primary producer of military armored vehicles. It might also create competitive price pressures not previously encountered as more defense contractors move to his area of development.

¹⁴ Morton, Peter.

¹⁵ Associated Press,

GENERAL DYNAMICS

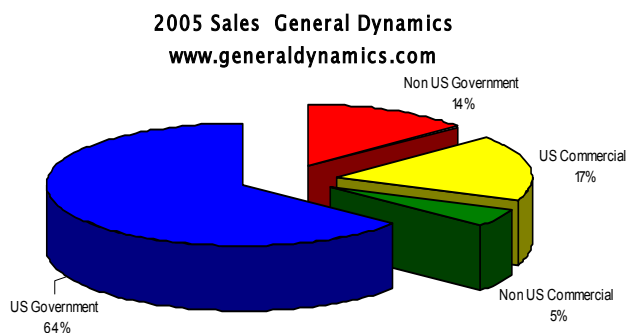
Aerospace & Defense Industry

General Dynamics has seen steady growth since our purchase in 2001 largely attributable to 9-11, the fear of our nation's safety, and the precedence to war there after. As the war in Iraq begins slows down, we feel that our portfolio may suffer greatly considering that 16% percent is invested in General Dynamics. Furthermore, with over 80% institutional ownership in GD, we fear that if one institution sets the trend to sell, others will soon follow suit.

Investment Drivers

Defense Spending Encourages Growth

- General Dynamics is a firm that has presented strong financials for the past five years mainly due to the steady increase in defense spending by the federal government. The firm's primary customer is the US government, and more specifically, the department of defense. Approximately two thirds of its revenue or 67% of its sales come from defense spending allocated by the US federal government¹⁶. This over-reliance on one customer renders General Dynamics extremely susceptible to changes in fiscal policy.
- Former Secretary of Defense, Donald Rumsfeld, was a proponent of military transformation which aimed at modernizing warfare and intelligence capabilities. Much of the recent defense spending contracts were directed towards technical research and development which is an area which General Dynamics concentrates on. Many political analysts are anticipating that defense spending will not be cut as much as originally feared, rather, the spending will be redirected to other areas of defense such as from high technological equipment to outfitting the troops¹⁷.
- There is some evidence to argue that the major military suppliers have been awarded significant contracts with the US government to support their business



¹⁶ www.generaldynamics.com

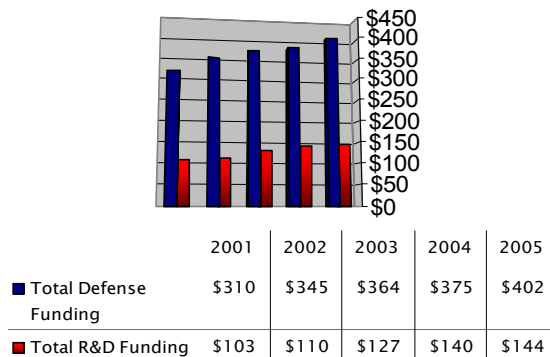
¹⁷ Sevastopoulos, Dimitri

GENERAL DYNAMICS

Aerospace & Defense Industry

for the next fiscal year. On November 7 alone, two of the major developers of military technology, General Dynamics and Northrop Grumman, both received military contracts totaling over \$200 million¹⁸. It will be noteworthy for those who chose to retain their ownership in General Dynamics to stay apprised of the number, size, and frequency of the military contracts awarded in the up coming year.

US Defense Spending 2001–2005
www.generaldynamics.com



- Of their four production units, only the aerospace segment produces for non military clients who offer a fleet of business-jet aircraft for Corporations, private individuals, and government users. With the speculation of

possible cuts in military spending, it would be advisable for General Dynamics to redirect concentration towards the development of the company's non-military client base.

- In 2005 alone, General Dynamics was awarded \$4,800 million in US military contracts¹⁹. The St. John's Student Managed Investment Fund feels strongly that the military contracts for 2006 will not amount to a comparable sum which will inevitably cause a decline in revenues for General Dynamics.

Investment Risks

One Customer: Uncle Sam

- The company's primary customer is the U.S. government, particularly the Department of Defense. In 2005, 67% of the company's net sales were to the U.S. government; 17% were to U.S. commercial customers; 11% were directly to international defense customers; and the remaining 5% were to international commercial customers.

¹⁸ www.generaldynamics.com , www.northrupgrumman.com

¹⁹ www.generaldynamics.com

GENERAL DYNAMICS

Aerospace & Defense Industry

- Such a large percentage given to a single customer is a serious threat to profitability, especially with a changing political climate in Washington.

Positive Trends, Reversal Likely

- The current Administration's desire to modernize U.S. military forces coupled with the U.S. military's engagement in the Global War on Terrorism has driven steady Department of Defense funding increases since 2001.
- For fiscal year 2006, the Congress appropriated \$411 billion for the Department of Defense, a 33% increase in funding since 2001. Furthermore, internationally, many foreign governments remain committed to funding weapons and equipment modernization in the pursuit of interoperability with U.S. and allied forces and flexible capabilities for peacekeeping and regional operations.
- Looking ahead, the defense budget top line is expected to continue to grow, while at a somewhat moderate rate. In the business-aviation market, it continued to strengthen in 2005, reflecting an improved global economy and higher U.S. corporate earnings. With this growing demand of business-aviation, a positive look is given to this industry.
- However, Democrats have indicated a desire to pay down the budget deficit, which could mean cuts in Defense. Indeed, a decrease in defense contract funding could seriously hinder the ability of GD to maintain its current growth level.

CAPM

- The Capital Asset Pricing Model, or simply CAPM, is a model that describes the relationship between risk and expected return and that is used in the pricing of risky securities.

- The general idea behind CAPM is that investors need to be compensated in two ways: time value of money and risk. The time value of money is represented by the risk-free (r_f) rate in the formula and compensates the investors for placing money in any investment over a period of time. The

$$r_a = r_f + \beta_a (r_m - r_f)$$

Where
 r_f = Risk Free Rate
 β_a = Beta of General Dynamics Stock
 r_m = Expected Market Return

GENERAL DYNAMICS

Aerospace & Defense Industry

other half of the formula represents risk and calculates the amount of compensation the investor needs for taking on additional risk. This is calculated by taking a risk measure (beta) that compares the returns of the asset to the market over a period of time and to the market premium ($R_m - r_f$).

- The CAPM says that the expected return of a security or a portfolio equals the rate on a risk-free security plus a risk premium. If this expected return does not meet or beat the required return, then the investment should not be undertaken. The security market line plots the results of the CAPM for all different risks (betas).
- Using the CAPM model and the following assumptions, we can compute the expected return of General Dynamics:
 - ✦ if the risk-free rate is 4.92%²⁰,
 - ✦ the beta (risk measure) of the stock is .588 and
 - ✦ the expected market return over the period is 8.48%²¹,
 - ✦ Therefore, stock is expected to return 7.01% ($4.92\% + .588(8.48\% - 4.92\%)$).
- Note that according to the Capital Asset Pricing Model, General Dynamics expected return is less than the long-term average of the S&P 500.
- It is true that the Beta of GD is less than 1, so the expected return should be less than the overall market. However, we use the CAPM as part of our valuation, not the entirety of our valuation. Such qualitative factors such as American public opinion, Democratic control of Congress, and a scale down in military operations in the Middle East must also be considered.

Relative Valuation of Stock

Positive Factors Effecting GD

Valuation:

- The TTM (Trailing Twelve Month) Price/Earnings (P/E) ratio is 17.28. This ratio is lower than the average P/E for this Industry Group (Aerospace), which is 21.87. The P/E of the S&P 500 is 18.32.

²⁰ <http://research.stlouisfed.org/fred2/data/TB3MS.txt>

²¹ http://personal.fidelity.com/products/funds/mfl_frame.shtml?315912204

GENERAL DYNAMICS

Aerospace & Defense Industry

- The Price/TTM Sales ratio is 1.21. A stock with a low Price/Sales ratio indicates a stock is not overvalued. The Price/Sales ratio is significant since it is harder to manipulate sales than earnings. The Price/TTM Sales ratio for this Industry Group (Aerospace) is 1.59.

Profitability:

- The prior quarter Operating Margin of 11.15% is greater than the TTM Operating Margin of 10.80%, according to the most recent quarterly data available from Market Edge Research.
- The Return on Assets (ROA) is 10.23. A high ROA is a good profitability measure since it reflects the ability of management to produce profits from each dollar of company assets. The average ROA for this Industry Group (Aerospace) is 6.25.

Market Profile ²²	
52 Wk. Price Range	\$55.09 – 77.98
Average Daily Volume	1,364,630
Beta	0.588
Dividend Yield (Estimated)	1.308
Shares Outstanding	404,644,000
Market Capitalization	\$29,097,950,000
Institutional Holdings	79.10%
Insider Holdings	1.87%
Book Value per Share	\$23.42
Debt to Total Capital	\$0.20
Return on Equity	19.60%

- The Operating Cash Flow was positive in the last three years.
- The Return on Equity (ROE) is 20.87%. This ratio helps represent the future ability of a company to grow earnings. The average ROE for this Industry Group (Aerospace) is 14.18%.

Balance Sheet Strength

- The Current Ratio is 1.13 for the most recent quarter, according to Market Edge Research. Current ratios above 1 mean that a company's short-term debts are less than its assets. The higher the current ratio, the stronger the company's finances.
- The Long-Term Debt/Capital is 23.48% for the most recent quarter, according to Market Edge Research. This indication of financial leverage measures the extent of a firm's capital that is provided by lenders. Below 25% reflects well on a company's financial stability. The average LT Debt/Capital for this Industry Group (Aerospace) is 31.0.

²² MarketEdge Research

GENERAL DYNAMICS

Aerospace & Defense Industry

Growth Potential

- The prior quarter Earnings Per Share (EPS) of \$1.08 is greater than the EPS of the year over year quarter of \$0.92.
- The TTM EPS growth rate of 18.65% is greater than the TTM Sales Per Share (SPS) growth rate of 13.58%.
- The EPS growth rate of 13.36% is greater than the expected next year EPS growth rate for S&P 500 of 9.40%
- The earnings trend is positive for the last three quarters on a year over year basis.

EARNINGS PER SHARE²³	2001	2002	2003	2004	2005
Primary – Excluding EI & DO	4.69	5.22	5.04	6.03	7.31
Primary – Including EI & DO	4.69	4.55	5.08	6.15	7.28
Fully Diluted – Excluding EI & DO	4.65	5.18	5.00	5.97	7.25
Fully Diluted – Including EI & DO	4.65	4.52	5.04	6.09	7.22

Analyst Consensus Forecast:

- The EPS forecast for the next two quarters is greater than the prior quarter EPS.
- The Revenue forecast for the next two quarters is greater than the prior quarter Revenue.

Negative Factors Effecting GD

Valuation:

- The Price/Book Value ratio is 3.12. The average Price/ Book for this Industry Group (Aerospace) is 2.89.
- The Price/Cash Flow ratio is 40.43. A low ratio shows a strong ability to generate cash and reflects well on a company's stock price and liquidity. The average Price/Cash Flow ratio for this Industry Group (Aerospace) is 22.50.

²³ MarketEdge Research

GENERAL DYNAMICS

Aerospace & Defense Industry

- The Market Edge PEG (Leading P/E Ratio / Earnings Growth Rate) ratio is 1.26. This ratio is the Leading P/E ratio divided by expected per-share earnings growth over the coming year. A PEG ratio greater than 1 indicates a stock may be overvalued or the market expects future EPS to be greater than the EPS consensus. The average Market Edge PEG ratio for this Industry Group (Aerospace) is 1.17.

Growth Potential:

- The prior quarter EPS growth rate of 17.39% is smaller than the TTM EPS growth rate of 18.65%.
- The TTM SPS growth rate of 13.58% is less than the three-year cumulative average SPS growth rate of 15.45%.

Stock Price Valuation:

General Dynamics' stock closed on November 17, 2006 at \$73.91. According to the results obtained from employing relative valuation techniques, GD's stock has an average value of \$62.99 making it significantly overvalued²⁴.

	2001	2002	2003	2004	2005	Avg	Estimated Growth Rate	Expected Price 2006
EPS	2.33	2.59	2.5	3.02	3.63	2.841	0.11	\$64.15
P/E	16.50	16.9	14.7	16.2	15.3	15.92		

The equation used in the above valuation is:

$$P/E * EPS * (1 + \text{Estimated EPS Growth Rate})$$

	2001	2002	2003	2004	2005	Avg	Estimated Growth Rate	Expected Price 2006
CFPS	3.03	3.14	3.22	3.83	4.52	3.548	0.1	\$62.75
P/CFPS	12.69	13.94	11.41	12.77	12.29	12.62		

The equation used for the above valuation is:

$$P/CFPS * CFPS * (1 + \text{Estimated Cash Flow Growth Rate})$$

²⁴ Value Line

GENERAL DYNAMICS

Aerospace & Defense Industry

	2001	2002	2003	2004	2005	Avg	Estimated Growth Rate	Expected Price 2006
SPS	30.29	34.4	41.97	48.73	53.06	41.69	0.07	\$62.09
P/SPS	1.27	1.272	0.876	1.004	1.047	1.094		

The equation used to complete the above valuation is:

$$P/S * SPS * (1 + \text{Estimated Sales Growth Rate})$$

PV of Share Price:

We consider several factors when evaluating the value of General Dynamics. While some quantitative fundamental statistics would appear to make GD an excellent investment (particularly in the Market Edge Research Summary), the numbers are largely based on past performance. This is not indicative of long-term growth potential.

In terms of valuation ratios, investors are getting pickier. Many have abandoned the P/E ratio, not because it is worthless, but because they desire more information about a stock's potential. We've realized that the P/E doesn't tell us everything we need to know. Using the P/E along with current growth rates produces the more informative PEG ratio, a great indicator of a stock's potential value. In addition to the aerospace and defense industry PEG ratio being greater than 1 (a sign it is overvalued), GD's ratio is overvalued relative to the industry. We consider this extremely troubling, but consider the qualitative factors more indicative of the negative outlook for the defense industry in general.

The vital qualitative factor missing from standard fundamental valuations is that of American public opinion on national defense. Democrats historically have voted to cut defense spending, and current growth forecasts of Market Edge do not consider this, nor their recent victory in both the House and Senate. The U.S. government has awarded record-level defense contracts to companies like General Dynamics. Moving forward, particularly with the Report on Iraq currently released, it seems that the U.S. will gradually re-deploy troops from the Middle East. The necessities for armor, in particular, will likely decrease exponentially should the U.S. withdraw forces from the Middle East. What's more, General Dynamics generates over two thirds of its income from U.S. government defense spending. For these reasons, the long-term growth potential, and share price appreciation of General Dynamics, simply does not meet the standard of the Graduate Student Managed Investment Fund. Accordingly, after averaging the three expected stock prices for 2006, we come up with \$62.99 which is

GENERAL DYNAMICS

Aerospace & Defense Industry

significantly lower than the market price of \$73.91. We feel that this price level may actually under-estimate the potential for loss in investment when considering qualitative judgments.

In conclusion, it is clear that General Dynamics' stock is overvalued by the market which contributes more evidence to the claim that we are now faced with a good opportunity to sell.

GENERAL DYNAMICS

Aerospace & Defense Industry

Technical Analysis

"Technical analysis looks at actual trades where bulls and bears have put their money where their collective mouths are. There is no revision of data. There is no ambiguity. There is no mystical divining of the future. All market and stock selection is based on current, not past, price performance, the predictable behavior of market participants, and the dynamics between markets over time." Michael N. Kahn (Technical Analysis - Plain and Simple)

The following is a summary of the performance General Dynamics' stock is based on technical analysis of the charts below.

Chart 1 shows robust stock performance since the later part of 2003. A stock's support level is the level at which investors and traders believe prices will move higher after hitting the corresponding support mark. Judging from the chart below, the support mark for GD is around \$66. A horizontal support row of three O's at \$66 can clearly be seen. The pattern is starting to take on a shape of a right sided triangle. If this consolidation continues it may facilitate either a trend reversal or an uptrend. Considering outside factors such as political trends; the probability of a subsequent reversal trend is significant.



GENERAL DYNAMICS

Aerospace & Defense Industry

Chart 2 shows that the long trend of the GD stock has been recently interrupted by a well-defined triangle consolidation pattern. We anticipate that a breakout from the pattern may happen soon. The yellow highlight shows a small down flag that could be followed by a push toward new highs or lows. Again due to outside factors it is probable that the support level mentioned earlier may be tested.



GENERAL DYNAMICS

Aerospace & Defense Industry

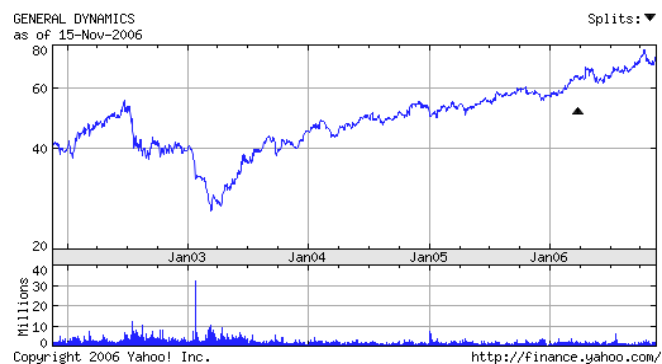
In Chart 3 volume is shown to have significantly increased in the current month. This may yield a clue to a pending up or down action. If that is the case, this single period data more than likely indicates that a breakout is about to occur.



In conclusion, the recent reversal pattern, though small, may be an indication that the past trend is in jeopardy. This could be the first event in the transition from an upward trend to a downward one. The current consolidation may remain intact, support may hold, but outside factors namely, politics, may cause the bulls on the stock to lose their desire and allow those bearish on the stock to take over. What ever the catalyst may be, the probability is increasing that there may be a shift from the bulls to the bears.

Assessment of Stock & Recommendations

General Dynamics has provided St. John's University's portfolio with growth of over \$23,000 over the past two and half years. As shown in the graph below, its stock had a 2 for 1 split in March of 2006.



General Dynamics makes up 16% of the investment portfolio mainly due to its accumulated gains through out our ownership due to not only our initial purchasing of the stock but also due to the stock splinting in 2006.

Currently, General Dynamics Corporation has a market capitalization of \$30.32 billion, which is an increase of over 14 billion since our first purchase of the stock.

Over the last few weeks General Dynamic has been awarded variety of defense contracts such as the recently awarded \$7 Million Pact to Support White House Communications Agency, the Army's \$380 million with GD for the Abrams M1A2 System. Additionally, GD recently appointed Mr. Mike Mulligan as V.P. of Armament and Technical Products division. Mulligan ensured stock holders that GD will "stay plugged into customer needs" regardless of the new Democratic majority in Congress. While the awarding of new Government grants seems



promising for GD, their stock hitting record highs only a month ago of \$77.98 per share. Goldman Sacs has recently downgraded the stock and over the last five days we have seen the stock drop nearly two and a half-dollars. This further emphasizes our need to sell

this stock and sell it quickly in order to get our greatest possible value for the stock before GD draws too much attention and we start to see the stock price drop and institutions sell.

GENERAL DYNAMICS

Aerospace & Defense Industry

Any number of events can occur, such as the continuation of war in Iraq or America going to war with North Korea, or an act of terrorism which would ultimately help General Dynamics to grow. However, we feel that an increase in stock price of nearly \$36 a share has been extremely beneficial to our portfolio. However, we feel that 16% of our portfolio will be better invested in another industry at this time.

References

Bowe, Christopher. "Big Names in Defence Face Tough Choices: Companies Search for Keys to Unlock Long-Term Growth." *Financial Times* November 2002.

Hamilton, Robert A. "General Dynamics Boasts Revenue Growth, Strong Shipbuilding Subsidiaries." *Knight Ridder/Tribune Business News*. September 2002.

Lemke, Tim. "Defense Stocks Rise on Republican Election Wins." *Knight Ridder/Tribune Business News* November 2002.

Morton, Peter. "Business Braces for Democrats: Hostility to key U.S. industries expected after election result." *National Post*. November 2006.

Associated Press, "Military Contractors Fall on News of Rumsfeld Resignation After Holding Steady on Midterm News." November 8, 2006.

Sevastopoulos, Dimiti, Personal Interview, "Post Rumsfeld Defense Spending" American Public Media. November 9, 2006.

Value Line Publishing, Inc. September 2006.

www.generaldynamics.com

www.marketedge.com

www.northrupgrumman.com

www.standardandpoors.com

GENERAL DYNAMICS

Aerospace & Defense Industry

Appendix A: Financial Statements²⁵

Income Statement

INCOME STATEMENT	2001	2002	2003	2004	2005
Sales (Net)	12,163.00	13,829.00	16,617.00	19,178.00	21,244.00
Cost of Goods Sold	10,407.00	12,034.00	14,873.00	16,911.00	18,705.00
Gross Profit	1,756.00	1,795.00	1,744.00	2,267.00	2,539.00
Selling, General, & Admin Expenses	C	C	C	C	C
Operating Income Before Depreciation	1,756.00	1,795.00	1,744.00	2,267.00	2,539.00
Depreciation, Depletion, & Amortiz	271	213	277	326	342
Operating Income After Depreciation	1,485.00	1,582.00	1,467.00	1,941.00	2,197.00
Interest Expense	68	55	108	157	154
Non-Operating Income/Expense	7	21	13	1	57
Special Items	0	36	0	0	0
Pretax Income	1,424.00	1,584.00	1,372.00	1,785.00	2,100.00
Income Taxes - Total	481	533	375	582	632
Minority Interest	C	C	C	C	C
Income Before Extraordinary Items & Discontinued Operations (EI&DO)	943	1,051.00	997	1,203.00	1,468.00
Extraordinary Items	0	0	0	0	0
Discontinued Operations	0	-134	7	24	-7
Net Income (Loss)	943	917	1,004.00	1,227.00	1,461.00
	=====	=====	=====	=====	=====
Income Before EI&DO	943	1,051.00	997	1,203.00	1,468.00
Preferred Dividends	0	0	0	0	0
Available for Common Before EI&DO	943	1,051.00	997	1,203.00	1,468.00
Common Stk Equivalents - Savings	0	0	0	0	0
Adjusted Available for Common	943	917	1,004.00	1,227.00	1,461.00
	=====	=====	=====	=====	=====
EARNINGS PER SHARE:	2001	2002	2003	2004	2005
Primary - Excluding EI&DO	4.69	5.22	5.04	6.03	7.31
Primary - Including EI&DO	4.69	4.55	5.08	6.15	7.28
Fully Diluted - Excluding EI&DO EI&DO	4.65	5.18	5	5.97	7.25
Fully Diluted - Including EI&DO	4.65	4.52	5.04	6.09	7.22
COMMON SHARES:					
for Primary EPS Calculation	201.14	201.36	197.79	199.56	200.82
for Fully Diluted EPS Calculation	202.91	202.85	199.15	201.47	202.42
Outstanding at Fiscal Year End	200.75	200.99	197.97	201.03	200.18

²⁵ www.standardandpoors.com

GENERAL DYNAMICS

Aerospace & Defense Industry

Appendix A: cont

Balance Sheet

BALANCE SHEET	2001	2002	2003	2004	2005
ASSETS					
Cash & Equivalents	442	328	860	976	2,331.00
Receivables - Total (Net)	996	1,074.00	1,378.00	1,459.00	2,034.00
Inventories - Total	3,026.00	3,319.00	3,708.00	4,100.00	4,391.00
Prepaid Expenses	0	0	0	0	0
Current Assets - Other	429	377	448	752	417
Current Assets - Total	4,893.00	5,098.00	6,394.00	7,287.00	9,173.00
Plant, Property & Equip (Gross)	3,538.00	3,469.00	3,903.00	4,202.00	4,314.00
Accumulated Depreciation	1,770.00	1,613.00	1,818.00	2,033.00	2,189.00
Plant, Property & Equip (Net)	1,768.00	1,856.00	2,085.00	2,169.00	2,125.00
Investments at Equity	0	0	0	0	0
Investments and Advances - Other	0	0	0	0	0
Intangibles	3,758.00	4,070.00	7,113.00	7,405.00	7,585.00
Deferred Charges	0	0	0	0	0
Assets - Other	650	707	591	683	708
TOTAL ASSETS	11,069.00	11,731.00	16,183.00	17,544.00	19,591.00
	=====	=====	=====	=====	=====
LIABILITIES					
Accounts Payable	904	1,056.00	1,317.00	1,508.00	1,710.00
Notes Payable	0	0	0	0	0
Accrued Expenses	698	731	919	799	808
Taxes Payable	0	0	0	0	0
Debt (Long-Term) Due In One Year	1,211.00	732	747	6	510
Other Current Liabilities	1,766.00	2,063.00	2,633.00	3,061.00	3,879.00
Total Current Liabilities	4,579.00	4,582.00	5,616.00	5,374.00	6,907.00
Long Term Debt	724	718	3,296.00	3,291.00	2,781.00
Deferred Taxes (Balance Sheet)	215	197	351	644	756
Investment Tax Credit	0	0	0	0	0
Minority Interest	C	C	C	C	C
Liabilities - Other	1,023.00	1,035.00	999	1,046.00	1,002.00
TOTAL LIABILITIES	6,541.00	6,532.00	10,262.00	10,355.00	11,446.00
	-----	-----	-----	-----	-----
SHAREHOLDERS' EQUITY					
Preferred Stock	0	0	0	0	0
Common Stock	241	241	241	241	241
Capital Surplus	453	516	597	757	886
Retained Earnings (Net Other)	4,764.00	5,458.00	6,362.00	7,397.00	8,511.00
Less: Treasury Stock	930	1,016.00	1,279.00	1,206.00	1,493.00
TOTAL SHAREHOLDERS' EQUITY	4,528.00	5,199.00	5,921.00	7,189.00	8,145.00
TOTAL LIABILITIES & EQUITY	11,069.00	11,731.00	16,183.00	17,544.00	19,591.00

GENERAL DYNAMICS

Aerospace & Defense Industry

Appendix A: cont

Statement of Cash Flows

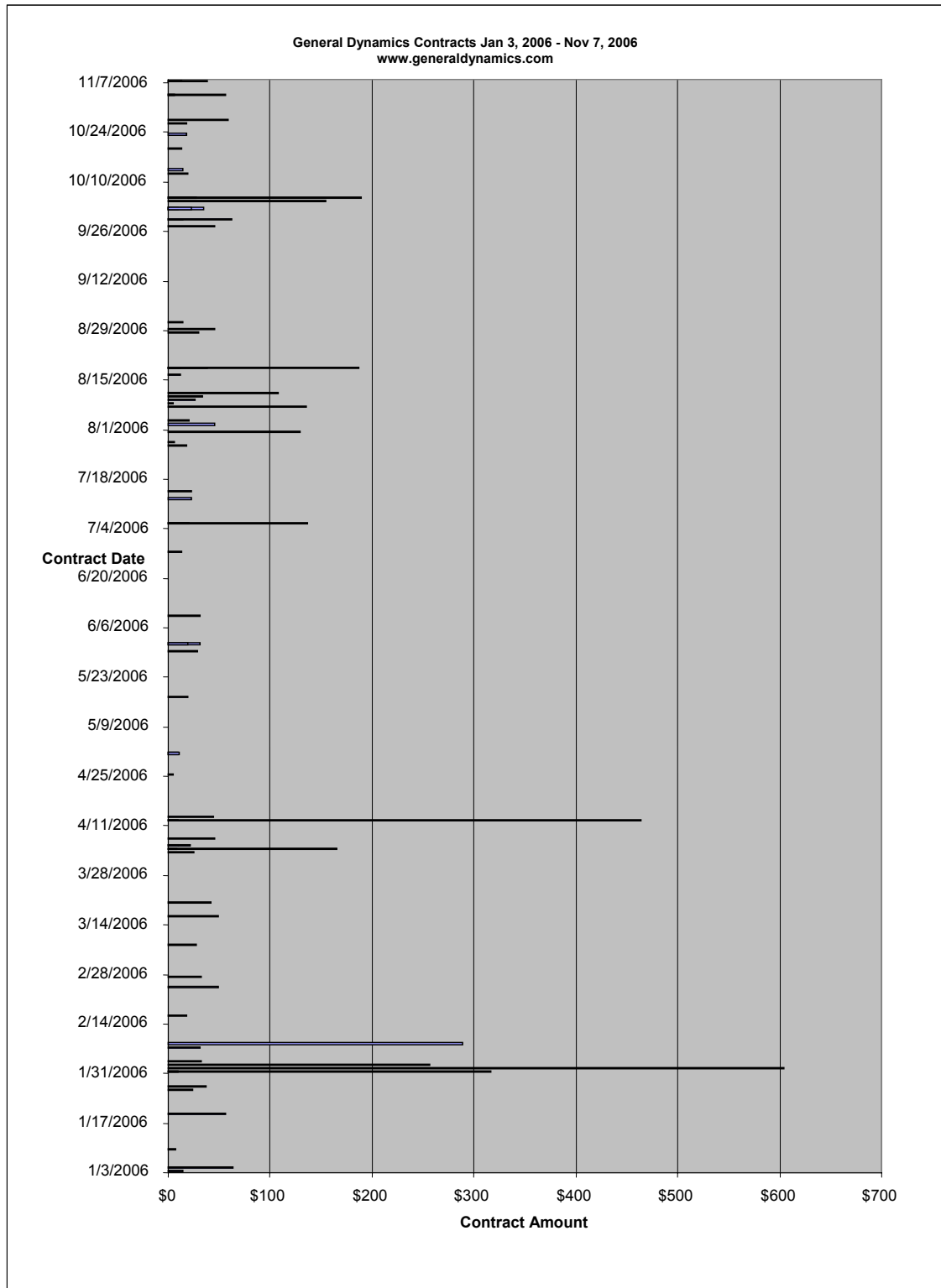
STATEMENT OF CASH FLOWS (Format Code (FC)=7)	2001	2002	2003	2004	2005
INDIRECT OPERATING ACTIVITIES					
Income Before Extraordinary Items	943	1,051.00	997	1,203.00	1,468.00
Depreciation and Amortizations	271	213	277	326	342
Extraordinary Items and Disc. Operations	0	-1	-9	25	-17
Deferred Taxes	117	179	134	279	144
Equity in Net Loss (Earnings)	0	0	0	0	0
Sale of PPEq and Investments - Loss (Gain)	0	0	0	0	0
Funds from Operations - Other	64	-70	-13	84	-15
Receivables - Decrease(Increase)	-38	-90	48	-66	-555
Inventory - Decrease (Increase)	-446	-343	-249	-337	-316
Accounts/P and Accrued Liabs - Inc(Dec)	C	137	58	168	190
Income Taxes - Accrued - Increase(Decrease)	C	-19	93	C	0
Other Assets and Liabilities - Net Change	192	68	387	120	815
Operating Activities - Net Cash Flow	1,103.00	1,125.00	1,723.00	1,802.00	2,056.00
	-	-	-	-	-
INVESTING ACTIVITIES					
Investments - Increase	45	41	30	46	10
Sale of Investments	42	39	31	37	18
Short term Investments - Change	C	C	C	C	C
Capital Expenditures	356	264	224	266	279
Sale of Property Plant and Equipment	C	C	C	C	C
Acquisitions	1,451.00	275	3,044.00	543	277
Investing Activities - Other	64	141	35	35	367
Investing Activities - Net Cash Flow	-1,746.00	-400	-3,232.00	-783	-181
	-	-	-	-	-
FINANCING ACTIVITIES					
Sale of Common and Preferred Stock	68	49	65	169	148
Purchase of Common and Preferred Stock	113	100	300	0	348
Cash Dividends	219	236	249	278	314
Long Term Debt - Issuance	1,325.00	0	3,094.00	C	C
Long Term Debt - Reduction	153	549	569	747	6
Current Debt - Changes	C	C	C	C	C
Financing Activities - Other	0	0	0	-48	0
Financing Activities - Net Cash Flow	908	-836	2,041.00	-904	-520
Exchange Rate Effect	0	0	0	0	0
Cash and Cash Equivalents - Change	265	-111	532	115	1,355.00
	=====	=====	=====	=====	=====
OTHER INFORMATION:					
Interest Paid - Net	70	55	79	149	142
Income Taxes Paid	326	377	268	302	529

GENERAL DYNAMICS

Aerospace & Defense Industry

Appendix B:

General Dynamics US Government Contracts



GENERAL DYNAMICS

Aerospace & Defense Industry

Appendix C:

Competitive Matrix: Top Market Players in Aerospace/Defense Products and Services Industry²⁶

Name	General Dynamics Corp.	Goodrich Corp.	Lockheed Martin Corp.	Northrop Grumman Corp.	Rockwell Collins Inc.
Industry	Aerospace/ Defense-Prod/Svc	Aerospace/ Defense-Prod/Svc	Aerospace/ Defense-Prod/Svc	Aerospace/ Defense-Prod/Svc	Aerospace/ Defense-Prod/Svc
Current Share Price	73.85	45.67	88.54	68.07	59.85
Market Value	\$29,098 mil	\$5,642 mil	\$37,320 mil	\$22,984 mil	\$9,820 mil
Revenues	\$23,404 mil	\$5,741 mil	\$39,009 mil	\$30,078 mil	\$3,863 mil
Net Earnings	\$1,854 mil	\$453 mil	\$2,368 mil	\$1,421 mil	\$477 mil
5-yr. Sales Growth	0.1428	0.0658	0.1035	0.1964	0.0796
5-yr. Earnings Growth	0.1376	0.0162	NA	0.1248	0.155
Net Profit Margin	0.079	0.079	0.061	0.047	0.123
Short Interest	2.9	1.9	1.9	2.5	2.3
Est. EPS Growth Rate	0.104	0.14	0.113	0.123	0.145
Forward P/E	17.2	12.2	16.1	15.1	18.5
PEG	1.65	0.87	1.43	1.22	1.28
Price/Sales	1.3	1	1	0.8	2.7
Price/Cash Flow	13.1	7.4	11.7	11.1	15.7
Price/Book	3.1	2.7	4.6	1.3	8.1
ROE	0.187	0.245	0.3	0.085	0.427
ROA	0.079	0.066	0.083	0.042	0.147
Dividend	0.92	0.8	1.4	1.2	0.64
Dividend Yield	0.0128	0.0177	0.0159	0.018	0.0109
Payout Ratio	0.245	0.223	0.221	0.281	0.205
Total Return (12-mos.)	0.278	0.195	0.473	0.179	0.298
Total Return (3-yr.)	0.843	0.731	0.983	0.501	1.24
Beta	0.6	1.1	-0.3	0	0.7
% Off 52-wk. High	-0.053	-0.0375	-0.015	-0.0462	-0.0093
% Above 52-wk. Low	0.3405	0.2293	0.4759	0.211	0.3762
On Balance Volume Index	71	83	89	126	73
Consensus Analyst Recommendation	MODERATE BUY	MODERATE BUY	MODERATE BUY	HOLD	MODERATE BUY

²⁶<http://eresearch.fidelity.com/eresearch/goto/evaluate/snapshot.jhtml?symbols=GD&destination=%2Feresearch%2Fgoto%2Fevaluate%2Fsnapshot.jhtml>