

GENERAL DYNAMICS CORP
Form 10-Q
April 29, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended April 5, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-3671

GENERAL DYNAMICS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 13-1673581
State or other jurisdiction of I.R.S. employer identification no.
incorporation or organization

2941 Fairview Park Drive, Suite 100 22042-4513
Falls Church, Virginia
Address of principal executive offices Zip code
(703) 876-3000

Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

328,732,777 shares of the registrant's common stock, \$1 par value per share, were outstanding on April 5, 2015.

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PART I – FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)

| (Dollars in millions, except per-share amounts) | Three Months Ended | | |
|---|--------------------|----------------|---|
| | April 5, 2015 | March 30, 2014 | |
| Revenues: | | | |
| Products | \$4,932 | \$4,438 | |
| Services | 2,852 | 2,827 | |
| | 7,784 | 7,265 | |
| Operating costs and expenses: | | | |
| Products | 3,819 | 3,464 | |
| Services | 2,435 | 2,436 | |
| General and administrative (G&A) | 503 | 491 | |
| | 6,757 | 6,391 | |
| Operating earnings | 1,027 | 874 | |
| Interest, net | (21 |) (22 |) |
| Other, net | 3 | 1 | |
| Earnings from continuing operations before income tax | 1,009 | 853 | |
| Provision for income tax, net | 293 | 257 | |
| Earnings from continuing operations | 716 | 596 | |
| Discontinued operations, net of tax of (\$1) in 2014 | — | (1 |) |
| Net earnings | \$716 | \$595 | |
| Earnings per share | | | |
| Basic: | | | |
| Continuing operations | \$2.18 | \$1.74 | |
| Discontinued operations | — | — | |
| Net earnings | \$2.18 | \$1.74 | |
| Diluted: | | | |
| Continuing operations | \$2.14 | \$1.71 | |
| Discontinued operations | — | — | |
| Net earnings | \$2.14 | \$1.71 | |

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

| (Dollars in millions) | Three Months Ended | | |
|---|--------------------|----------------|---|
| | April 5, 2015 | March 30, 2014 | |
| Net earnings | \$716 | \$595 | |
| (Losses) gains on cash flow hedges | (383 |) 4 | |
| Unrealized gains on securities | 2 | 3 | |
| Foreign currency translation adjustments | (104 |) (65 |) |
| Change in retirement plans' funded status | 97 | 61 | |
| Other comprehensive (loss) income, pretax | (388 |) 3 | |
| (Benefit) provision for income tax, net | (104 |) 21 | |
| Other comprehensive loss, net of tax | (284 |) (18 |) |
| Comprehensive income | \$432 | \$577 | |

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

CONSOLIDATED BALANCE SHEETS

| (Dollars in millions) | (Unaudited) April 5, 2015 | December 31, 2014 |
|---|------------------------------|-------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and equivalents | \$4,412 | \$4,388 |
| Accounts receivable | 3,661 | 4,050 |
| Contracts in process | 4,444 | 4,591 |
| Inventories | 3,397 | 3,221 |
| Other current assets | 438 | 1,157 |
| Total current assets | 16,352 | 17,407 |
| Noncurrent assets: | | |
| Property, plant and equipment, net | 3,323 | 3,329 |
| Intangible assets, net | 893 | 912 |
| Goodwill | 11,699 | 11,731 |
| Other assets | 2,118 | 1,976 |
| Total noncurrent assets | 18,033 | 17,948 |
| Total assets | \$34,385 | \$35,355 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Short-term debt and current portion of long-term debt | \$1 | \$501 |
| Accounts payable | 2,266 | 2,057 |
| Customer advances and deposits | 6,487 | 7,335 |
| Other current liabilities | 4,358 | 3,858 |
| Total current liabilities | 13,112 | 13,751 |
| Noncurrent liabilities: | | |
| Long-term debt | 3,410 | 3,410 |
| Other liabilities | 6,343 | 6,365 |
| Commitments and contingencies (See Note L) | | |
| Total noncurrent liabilities | 9,753 | 9,775 |
| Shareholders' equity: | | |
| Common stock | 482 | 482 |
| Surplus | 2,588 | 2,548 |
| Retained earnings | 21,615 | 21,127 |
| Treasury stock | (9,949) | (9,396) |
| Accumulated other comprehensive loss | (3,216) | (2,932) |
| Total shareholders' equity | 11,520 | 11,829 |
| Total liabilities and shareholders' equity | \$34,385 | \$35,355 |

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| (Dollars in millions) | Three Months Ended | |
|---|--------------------|----------------|
| | April 5, 2015 | March 30, 2014 |
| Cash flows from operating activities - continuing operations: | | |
| Net earnings | \$716 | \$595 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation of property, plant and equipment | 94 | 95 |
| Amortization of intangible assets | 30 | 30 |
| Stock-based compensation expense | 40 | 27 |
| Excess tax benefit from stock-based compensation | (30) | (32) |
| Deferred income tax provision | (8) | 36 |
| Discontinued operations, net of tax | — | 1 |
| (Increase) decrease in assets, net of effects of business acquisitions: | | |
| Accounts receivable | 388 | 119 |
| Contracts in process | 152 | (94) |
| Inventories | (183) | (21) |
| Increase (decrease) in liabilities, net of effects of business acquisitions: | | |
| Accounts payable | 210 | (29) |
| Customer advances and deposits | (871) | (165) |
| Income taxes payable | 251 | 150 |
| Other current liabilities | (38) | (173) |
| Other, net | (6) | (117) |
| Net cash provided by operating activities | 745 | 422 |
| Cash flows from investing activities - continuing operations: | | |
| Maturities of held-to-maturity securities | 500 | — |
| Capital expenditures | (98) | (87) |
| Other, net | 94 | 10 |
| Net cash provided (used) by investing activities | 496 | (77) |
| Cash flows from financing activities - continuing operations: | | |
| Purchases of common stock | (620) | (1,430) |
| Repayment of fixed-rate notes | (500) | — |
| Dividends paid | (206) | (198) |
| Proceeds from option exercises | 87 | 249 |
| Other, net | 30 | 32 |
| Net cash used by financing activities | (1,209) | (1,347) |
| Net cash used by discontinued operations | (8) | (3) |
| Net increase (decrease) in cash and equivalents | 24 | (1,005) |
| Cash and equivalents at beginning of period | 4,388 | 5,301 |
| Cash and equivalents at end of period | \$4,412 | \$4,296 |
| Supplemental cash flow information: | | |
| Cash payments for: | | |
| Income taxes | \$53 | \$67 |
| Interest | \$19 | \$19 |

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)

| (Dollars in millions) | Common Stock | | Retained | Treasury | Accumulated Other Comprehensive | Total Shareholders' |
|----------------------------|--------------|---------|----------|-----------|---------------------------------------|------------------------|
| | Par | Surplus | Earnings | Stock | Loss | Equity |
| Balance, December 31, 2014 | \$482 | \$2,548 | \$21,127 | \$(9,396) | \$(2,932) | \$11,829 |
| Net earnings | — | — | 716 | — | — | 716 |
| Cash dividends declared | — | — | (228) | — | — | (228) |
| Stock-based awards | — | 40 | — | 81 | — | 121 |
| Shares purchased | — | — | — | (634) | — | (634) |
| Other comprehensive loss | — | — | — | — | (284) | (284) |
| Balance, April 5, 2015 | \$482 | \$2,588 | \$21,615 | \$(9,949) | \$(3,216) | \$11,520 |
| Balance, December 31, 2013 | \$482 | \$2,226 | \$19,428 | \$(6,450) | \$(1,185) | \$14,501 |
| Net earnings | — | — | 595 | — | — | 595 |
| Cash dividends declared | — | — | (214) | — | — | (214) |
| Stock-based awards | — | 99 | — | 205 | — | 304 |
| Shares purchased | — | — | — | (1,478) | — | (1,478) |
| Other comprehensive loss | — | — | — | — | (18) | (18) |
| Balance, March 30, 2014 | \$482 | \$2,325 | \$19,809 | \$(7,723) | \$(1,203) | \$13,690 |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per-share amounts or unless otherwise noted)

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation and Classification. The unaudited Consolidated Financial Statements include the accounts of General Dynamics Corporation and our wholly owned and majority-owned subsidiaries. We eliminate all inter-company balances and transactions in the unaudited Consolidated Financial Statements.

Consistent with defense industry practice, we classify assets and liabilities related to long-term production contracts as current, even though some of these amounts may not be realized within one year. In addition, some prior-year amounts have been reclassified among financial statement accounts to conform to the current-year presentation.

Interim Financial Statements. The unaudited Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. These rules and regulations permit some of the information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) to be condensed or omitted.

Our fiscal quarters are 13 weeks in length. Because our fiscal year ends on December 31, the number of days in our first and fourth quarters varies slightly from year to year. Operating results for the three-month period ended April 5, 2015, are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

The unaudited Consolidated Financial Statements contain all adjustments that are of a normal recurring nature necessary for a fair presentation of our results of operations and financial condition for the three-month periods ended April 5, 2015, and March 30, 2014.

These unaudited Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014.

Revenue Recognition. We account for revenues and earnings using the percentage-of-completion method. Under this method, contract costs and revenues are recognized as the work progresses, either as the products are produced or as services are rendered. We estimate the profit on a contract as the difference between the total estimated revenue and costs to complete a contract and recognize that profit over the life of the contract. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, we recognize the loss in the quarter it is identified. We review and update our contract-related estimates regularly. We recognize changes in estimated profit on contracts under the reallocation method. Under the reallocation method, the impact of a revision in estimate is recognized prospectively over the remaining contract term. The net increase in our operating earnings (and on a per-share basis) from the impact of revisions in contract estimates totaled favorable changes of \$63 (\$0.12) and \$38 (\$0.07) for the three-month periods ended April 5, 2015, and March 30, 2014, respectively. No revisions on any one contract were material to our unaudited Consolidated Financial Statements in the first quarter of 2015 or 2014.

In the second quarter of 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. ASU 2014-09 prescribes a single, common revenue standard that replaces most existing revenue recognition guidance in GAAP. The standard outlines a five-step model, whereby revenue is recognized as performance obligations within a contract are satisfied. The standard also requires new, expanded disclosures regarding revenue recognition.

For public companies, ASU 2014-09 is effective in the first quarter of 2017. On April 1, 2015, the FASB proposed a one-year deferral of the standard's effective date, while permitting entities to still adopt one year earlier on the original effective date. A final determination will be made after a public comment period. The standard permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition date or method nor have we determined the effect of the standard on our consolidated financial statements as the standard continues to undergo changes.

The required adoption of the ASU will preclude our use of the reallocation method of recognizing revisions in estimated profit on contracts discussed above. As changes in estimated profit will be recognized in the period they are identified (cumulative catch-up method), rather than prospectively over the remaining contract term, we expect that the impact of revisions of contract estimates may be larger and potentially more variable from period to period. Anticipated losses on contracts will continue to be recognized in the quarter they are identified.

Discontinued Operations. We completed the sale of our axle business in the Combat Systems group in January 2015. The financial statements have been restated to reflect the results of operations of this business in discontinued operations.

Subsequent Events. We have evaluated material events and transactions that have occurred after April 5, 2015, and concluded that none have occurred that require adjustment to or disclosure in the unaudited Consolidated Financial Statements.

B. ACQUISITIONS, INTANGIBLE ASSETS AND GOODWILL

We did not acquire any businesses in the first quarter of 2015. In 2014, our Information Systems and Technology group acquired a provider of IT support to U.S. special operations forces.

The operating results of this acquisition have been included with our reported results since the closing date. The purchase price of this acquisition has been allocated to the estimated fair value of net tangible and intangible assets acquired, with any excess purchase price recorded as goodwill.

The changes in the carrying amount of goodwill by reporting unit for the three months ended April 5, 2015, were as follows:

| | Aerospace | Combat Systems | Information Systems and Technology | Marine Systems | Total Goodwill | |
|-----------------------|-----------|-------------------|--|----------------|----------------|---|
| December 31, 2014 (a) | \$2,555 | \$2,750 | \$6,137 | \$289 | \$11,731 | |
| Other (b) | 58 | (74 |) (16 |) — | (32 |) |
| April 5, 2015 | \$2,613 | \$2,676 | \$6,121 | \$289 | \$11,699 | |

(a) Goodwill on December 31, 2014, in the Information Systems and Technology reporting unit is net of \$1,994 of accumulated impairment losses.

(b) Consists primarily of adjustments for foreign currency translation.

Intangible assets consisted of the following:

| | Gross Carrying Amount April 5, 2015 | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount December 31, 2014 | Accumulated Amortization | Net Carrying Amount |
|---|--|-----------------------------|------------------------|--|-----------------------------|------------------------|
| Contract and program intangible assets* | \$1,654 | \$(1,148 |)\$506 | \$1,652 | \$(1,123 |)\$529 |
| Trade names and trademarks | 471 | (115 |)356 | 462 | (113 |)349 |
| Technology and software | 129 | (98 |)31 | 130 | (97 |)33 |
| Other intangible assets | 154 | (154 |)— | 154 | (153 |)1 |
| Total intangible assets | \$2,408 | \$(1,515 |)\$893 | \$2,398 | \$(1,486 |)\$912 |

* Consists of acquired backlog and probable follow-on work and related customer relationships.

Amortization expense was \$30 for the three-month periods ended April 5, 2015, and March 30, 2014. We expect to record amortization expense of \$120 in 2015.

C. EARNINGS PER SHARE

We compute basic earnings per share (EPS) using net earnings for the period and the weighted average number of common shares outstanding during the period. Basic weighted average shares outstanding have decreased throughout 2015 and 2014 due to share repurchases. See Note J for additional details of our share repurchases. Diluted EPS incorporates the additional shares issuable upon the assumed exercise of stock options and the release of restricted shares and restricted stock units (RSUs).

Basic and diluted weighted average shares outstanding were as follows (in thousands):

| Three Months Ended | April 5, 2015 | March 30, 2014 |
|---|---------------|----------------|
| Basic weighted average shares outstanding | 329,154 | 342,232 |
| Dilutive effect of stock options and restricted stock/RSUs* | 5,528 | 5,016 |
| Diluted weighted average shares outstanding | 334,682 | 347,248 |

* Excludes the following outstanding options to purchase shares of common stock because these options had exercise prices in excess of the average market price of our common stock during the period and therefore the effect of including these options would be antidilutive: 2015 - 722 and 2014 - 4,790.

D. FAIR VALUE

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between marketplace participants. Various valuation approaches can be used to determine fair value, each requiring different valuation inputs. The following hierarchy classifies the inputs used to determine fair value into three levels:

Level 1 – quoted prices in active markets for identical assets or liabilities;

Level 2 – inputs, other than quoted prices, observable by a marketplace participant either directly or indirectly; and

Level 3 – unobservable inputs significant to the fair value measurement.

We did not have any significant non-financial assets or liabilities measured at fair value on April 5, 2015, or December 31, 2014, except for the assets of our axle business that were classified as held for sale on December 31, 2014, and were measured at fair value using Level 3 inputs.

Our financial instruments include cash and equivalents, marketable securities and other investments; accounts receivable and accounts payable; short- and long-term debt; and derivative financial instruments. The carrying values of cash and equivalents, accounts receivable and payable and short-term debt on the Consolidated Balance Sheets approximate their fair value. The following tables present the fair values of our other financial assets and liabilities on April 5, 2015, and December 31, 2014, and the basis for determining their fair values:

| | Carrying Value | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) (a) |
|---|-------------------|------------|--|---|
| Financial assets (liabilities) (b) | April 5, 2015 | | | |
| Available-for-sale securities | \$188 | \$188 | \$120 | \$68 |
| Derivatives | (673) | (673) | — | (673) |
| Long-term debt, including current portion | (3,411) | (3,433) | — | (3,433) |
| | December 31, 2014 | | | |
| Held-to-maturity marketable securities | \$500 | \$500 | \$10 | \$490 |
| Available-for-sale securities | 188 | 188 | 123 | 65 |
| Derivatives | (276) | (276) | — | (276) |
| Long-term debt, including current portion | (3,911) | (3,911) | — | (3,911) |

(a) Determined under a market approach using valuation models that incorporate observable inputs such as interest rates, bond yields and quoted prices for similar assets and liabilities.

(b) We had no Level 3 financial instruments on April 5, 2015, or December 31, 2014.

E. INCOME TAXES

Net Deferred Tax Assets. Our net deferred tax asset was included on the Consolidated Balance Sheets in other assets and liabilities as follows:

| | April 5, 2015 | December 31, 2014 |
|-----------------------------------|---------------|-------------------|
| Current deferred tax asset | \$15 | \$16 |
| Current deferred tax liability | (739) | (729) |
| Noncurrent deferred tax asset | 1,559 | 1,439 |
| Noncurrent deferred tax liability | (85) | (82) |
| Net deferred tax asset | \$750 | \$644 |

Tax Uncertainties. For all periods open to examination by tax authorities, we periodically assess our liabilities and contingencies based on the latest available information. Where we believe there is more

than a 50 percent chance that our tax position will not be sustained, we record our best estimate of the resulting tax liability, including interest, in the Consolidated Financial Statements. We include any interest or penalties incurred in connection with income taxes as part of income tax expense.

We participate in the Internal Revenue Service (IRS) Compliance Assurance Process, a real-time audit of our consolidated federal corporate income tax return. The IRS has examined our consolidated federal income tax returns through 2013. We do not expect the resolution of tax matters for open years to have a material impact on our results of operations, financial condition, cash flows or effective tax rate.

Based on all known facts and circumstances and current tax law, we believe the total amount of any unrecognized tax benefits on April 5, 2015, is not material to our results of operations, financial condition or cash flows, and if recognized, would not have a material impact on our effective tax rate. In addition, there are no tax positions for which it is reasonably possible that the unrecognized tax benefits will significantly vary over the next 12 months, producing, individually or in the aggregate, a material effect on our results of operations, financial condition or cash flows.

F. CONTRACTS IN PROCESS

Contracts in process represent recoverable costs and, where applicable, accrued profit related to long-term contracts that have been inventoried until the customer is billed, and consisted of the following:

| | April 5, 2015 | December 31, 2014 |
|--------------------------------------|---------------|-------------------|
| Contract costs and estimated profits | \$7,390 | \$7,494 |
| Other contract costs | 1,061 | 1,064 |
| | 8,451 | 8,558 |
| Advances and progress payments | (4,007 |) (3,967 |
| Total contracts in process | \$4,444 | \$4,591 |

Contract costs consist primarily of labor, material, overhead and G&A expenses. Other contract costs represent amounts that are not currently allocable to government contracts, such as a portion of our estimated workers' compensation obligations, other insurance-related assessments, pension and other post-retirement benefits and environmental expenses. These costs will become allocable to contracts generally after they are paid. We expect to recover these costs through ongoing business, including existing backlog and probable follow-on contracts. If the backlog in the future does not support the continued deferral of these costs, the profitability of our remaining contracts could be adversely affected.

G. INVENTORIES

Our inventories represent primarily business-jet components and are stated at the lower of cost or net realizable value. Work-in-process represents largely labor, material and overhead costs associated with aircraft in the manufacturing process and is based primarily on the estimated average unit cost of the units in a production lot. Raw materials are valued primarily on the first-in, first-out method. We record pre-owned aircraft acquired in connection with the sale of new aircraft at the lower of the trade-in value or the estimated net realizable value.

Inventories consisted of the following:

| | April 5, 2015 | December 31, 2014 |
|--------------------|---------------|-------------------|
| Work in process | \$1,980 | \$1,828 |
| Raw materials | 1,327 | 1,290 |
| Finished goods | 23 | 28 |
| Pre-owned aircraft | 67 | 75 |
| Total inventories | \$3,397 | \$3,221 |

H. DEBT

Debt consisted of the following:

| | Interest Rate | April 5, 2015 | December 31, 2014 |
|-----------------------|---------------|---------------|-------------------|
| Fixed-rate notes due: | | | |
| January 2015 | 1.375% | \$— | \$500 |
| July 2016 | 2.250% | 500 | 500 |
| November 2017 | 1.000% | 897 | 897 |
| July 2021 | 3.875% | 499 | 499 |
| November 2022 | 2.250% | 992 | 992 |
| November 2042 | 3.600% | 498 | 498 |
| Other | Various | 25 | 25 |
| Total debt | | 3,411 | 3,911 |
| Less current portion | | 1 | 501 |
| Long-term debt | | \$3,410 | \$3,410 |

Our fixed-rate notes are fully and unconditionally guaranteed by several of our 100-percent-owned subsidiaries (see Note O for condensed consolidating financial statements). We have the option to redeem the notes prior to their maturity in whole or part for the principal plus any accrued but unpaid interest and applicable make-whole amounts. In January 2015, we repaid \$500 of fixed-rate notes on their scheduled maturity date.

On April 5, 2015, we had no commercial paper outstanding, but we maintain the ability to access the commercial paper market in the future. We have \$2 billion in committed bank credit facilities that provide backup liquidity to our commercial paper program. These credit facilities include a \$1 billion multi-year facility expiring in July 2016 and a \$1 billion multi-year facility expiring in July 2018. These facilities are required by rating agencies to support our commercial paper issuances. We may renew or replace, in whole or part, these credit facilities at or prior to their expiration dates. Our bank credit facilities are guaranteed by several of our 100-percent-owned subsidiaries. In addition, we have approximately \$115 in committed bank credit facilities to provide backup liquidity to our European businesses.

Our financing arrangements contain a number of customary covenants and restrictions. We were in compliance with all covenants on April 5, 2015.

I. OTHER LIABILITIES

A summary of significant other liabilities by balance sheet caption follows:

| | April 5, 2015 | December 31, 2014 |
|---|---------------|-------------------|
| Deferred income taxes | \$739 | \$729 |
| Fair value of cash flow hedges | 722 | 292 |
| Salaries and wages | 601 | 718 |
| Workers' compensation | 417 | 420 |
| Retirement benefits | 306 | 309 |
| Other (a) | 1,573 | 1,390 |
| Total other current liabilities | \$4,358 | \$3,858 |
| Retirement benefits | \$4,595 | \$4,596 |
| Customer deposits on commercial contracts | 594 | 617 |
| Deferred income taxes | 85 | 82 |
| Other (b) | 1,069 | 1,070 |
| Total other liabilities | \$6,343 | \$6,365 |

(a) Consists primarily of dividends payable, taxes payable, environmental remediation reserves, warranty reserves, liabilities of discontinued operations and insurance-related costs.

(b) Consists primarily of liabilities for warranty reserves and workers' compensation and liabilities of discontinued operations.

The increase in the fair value of our cash flow hedge liabilities from December 31, 2014, to April 5, 2015, largely corresponds to the unrecognized losses on cash flow hedges deferred in accumulated other comprehensive loss (AOCL). These losses will be deferred in AOCL until the underlying transaction is reflected in earnings, at which time we believe the losses will be offset by corresponding gains in the remeasurement of the underlying transactions being hedged.

J. SHAREHOLDERS' EQUITY

Share Repurchases. In the first three months of 2015, we repurchased approximately 4.7 million of our outstanding shares for \$634. On February 9, 2015, with shares from the prior authorization largely exhausted, the board of directors authorized management to repurchase 10 million additional shares of common stock on the open market. On April 5, 2015, 7.7 million shares remained authorized by our board of directors for repurchase, approximately 2 percent of our total shares outstanding. We repurchased 29 million shares for a total of approximately \$3.4 billion in 2014, including 14 million shares in the first three months of 2014.

Dividends per Share. Dividends declared per share were \$0.69 and \$0.62 and for the three-month periods ended April 5, 2015, and March 30, 2014, respectively. Cash dividends paid were \$206 and \$198 for the three-month periods ended April 5, 2015 and March 30, 2014, respectively.

Accumulated Other Comprehensive Loss. The changes, pretax and net of tax, in each component of AOCL consisted of the following:

| | Losses on Cash Flow Hedges | Unrealized Gains on Securities | Foreign Currency Translation Adjustments | Changes in Retirement Plans' Funded Status | AOCL |
|--------------------------------------|----------------------------------|--------------------------------------|---|--|-------------|
| Balance, December 31, 2014 | \$(173 |)\$22 | \$541 | \$(3,322 |)\$(2,932) |
| Other comprehensive loss, pretax | (383 |)2 | (104 |)97 | (388) |
| Benefit for income tax, net | (135 |)2 | (5 |)34 | (104) |
| Other comprehensive loss, net of tax | (248 |)— | (99 |)63 | (284) |
| Balance, April 5, 2015 | \$(421 |)\$22 | \$442 | \$(3,259 |)\$(3,216) |

| | Gains on Cash Flow Hedges | Unrealized Gains on Securities | Foreign Currency Translation Adjustments | Changes in Retirement Plans' Funded Status | AOCL |
|--------------------------------------|---------------------------------|--------------------------------------|---|--|-------------|
| Balance, December 31, 2013 | \$9 | \$15 | \$974 | \$(2,183 |)\$(1,185) |
| Other comprehensive income, pretax | 4 | 3 | (65 |)61 | 3 |
| Provision for income tax, net | 1 | 1 | (1 |)20 | 21 |
| Other comprehensive loss, net of tax | 3 | 2 | (64 |)41 | (18) |
| Balance, March 30, 2014 | \$12 | \$17 | \$910 | \$(2,142 |)\$(1,203) |

Amounts reclassified out of AOCL related primarily to changes in retirement plans' funded status and consisted of pretax recognized net actuarial losses of \$112 and \$76 for the three-month periods ended April 5, 2015, and March 30, 2014, respectively. This was partially offset by pretax amortization of prior service credit of \$18 and \$17 for the three-month periods ended April 5, 2015, and March 30, 2014, respectively. These AOCL components are included in our net periodic pension and other post-retirement benefit cost. See Note M for additional details.

K. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We are exposed to market risk, primarily from foreign currency exchange rates, interest rates, commodity prices and investments. We may use derivative financial instruments to hedge some of these risks as described below. We do not use derivatives for trading or speculative purposes.

Foreign Currency Risk and Hedging Activities. Our foreign currency exchange rate risk relates to receipts from customers, payments to suppliers and inter-company transactions denominated in foreign currencies. To the extent possible, we include terms in our contracts that are designed to protect us from this risk. Otherwise, we enter into derivative financial instruments, principally foreign currency forward purchase and sale contracts, designed to offset and minimize our risk. The two-year average maturity of these instruments matches the duration of the activities that are at risk.

We had \$9 billion in notional forward exchange contracts outstanding on April 5, 2015, and \$9.1 billion on December 31, 2014. We recognize derivative financial instruments on the Consolidated Balance Sheets at fair value (see Note D).

We record changes in the fair value of derivative financial instruments in operating costs and expenses in the Consolidated Statements of Earnings or in other comprehensive loss (OCL) within the

Consolidated Statements of Comprehensive Income depending on whether the derivative is designated and qualifies for hedge accounting. Gains and losses related to derivatives that qualify as cash flow hedges are deferred in OCL until the underlying transaction is reflected in earnings. We adjust derivative financial instruments not designated as cash flow hedges to market value each period and record the gain or loss in the Consolidated Statements of Earnings. The gains and losses on these instruments generally offset losses and gains on the assets, liabilities and other transactions being hedged. Gains and losses resulting from hedge ineffectiveness are recognized in the Consolidated Statements of Earnings for all derivative financial instruments, regardless of designation.

Net gains and losses recognized in earnings, including gains and losses related to hedge ineffectiveness, were not material to our results of operations for the three-month periods ended April 5, 2015, and March 30, 2014. Net gains and losses reclassified to earnings from OCL were not material to our results of operations for the three-month periods ended April 5, 2015, and March 30, 2014, and we do not expect the amount of these gains and losses that will be reclassified to earnings during the next 12 months to be material.

We had no material derivative financial instruments designated as fair value or net investment hedges on April 5, 2015, or December 31, 2014.

Interest Rate Risk. Our financial instruments subject to interest rate risk include fixed-rate long-term debt obligations and variable-rate commercial paper. However, the risk associated with these instruments is not material.

Commodity Price Risk. We are subject to risk of rising labor and commodity prices, primarily on long-term fixed-price contracts. To the extent possible, we include terms in our contracts that are designed to protect us from this risk. Some of the protective terms included in our contracts are considered derivatives but are not accounted for separately because they are clearly and closely related to the host contract. We have not entered into any material commodity hedging contracts but may do so as circumstances warrant. We do not believe that changes in labor or commodity prices will have a material impact on our results of operations or cash flows.

Investment Risk. Our investment policy allows for purchases of fixed-income securities with an investment-grade rating and a maximum maturity of up to five years. On April 5, 2015, we held \$4.4 billion in cash and equivalents, but held no marketable securities.

Foreign Currency Financial Statement Translation. We translate foreign currency balance sheets from our international businesses' functional currency (generally the respective local currency) to U.S. dollars at the end-of-period exchange rates, and statements of earnings at the average exchange rates for each period. The resulting foreign currency translation adjustments are a component of OCL.

We do not hedge the fluctuation in reported revenues and earnings resulting from the translation of these international operations' results into U.S. dollars. The impact of translating our non-U.S. operations' revenues and earnings into U.S. dollars was not material to our results of operations for the three-month periods ended April 5, 2015, or March 30, 2014. In addition, the effect of changes in foreign exchange rates on non-U.S. cash balances was not material in the first three months of either 2015 or 2014.

L. COMMITMENTS AND CONTINGENCIES

Litigation

Various claims and other legal proceedings incidental to the normal course of business are pending or threatened against us. These matters relate to such issues as government investigations and claims, the protection of the environment, asbestos-related claims and employee-related matters. The nature of litigation is such that we cannot predict the outcome of these matters. However, based on information currently available, we believe any potential liabilities in these proceedings, individually or in the aggregate, will not have a material impact on our results of operations, financial condition or cash flows.

Environmental

We are subject to and affected by a variety of federal, state, local and foreign environmental laws and regulations. We are directly or indirectly involved in environmental investigations or remediation at some of our current and former facilities and third-party sites that we do not own but where we have been designated a Potentially Responsible Party (PRP) by the U.S. Environmental Protection Agency or a state environmental agency. Based on historical experience, we expect that a significant percentage of the total remediation and compliance costs associated with these facilities will continue to be allowable contract costs and, therefore, recoverable under U.S. government contracts.

As required, we provide financial assurance for certain sites undergoing or subject to investigation or remediation. We accrue environmental costs when it is probable that a liability has been incurred and the amount can be reasonably estimated. Where applicable, we seek insurance recovery for costs related to environmental liabilities. We do not record insurance recoveries before collection is considered probable. Based on all known facts and analyses, we do not believe that our liability at any individual site, or in the aggregate, arising from such environmental conditions, will be material to our results of operations, financial condition or cash flows. We also do not believe that the range of reasonably possible additional loss beyond what has been recorded would be material to our results of operations, financial condition or cash flows.

Other

Government Contracts. As a government contractor, we are subject to U.S. government audits and investigations relating to our operations, including claims for fines, penalties, and compensatory and treble damages. We believe the outcome of such ongoing government audits and investigations will not have a material impact on our results of operations, financial condition or cash flows.

In the performance of our contracts, we routinely request contract modifications that require additional funding from the customer. Most often, these requests are due to customer-directed changes in the scope of work. While we are entitled to recovery of these costs under our contracts, the administrative process with our customer may be protracted. Based upon the circumstances, we periodically file requests for equitable adjustment (REAs) that are sometimes converted into claims. In some cases, these requests are disputed by our customer. We believe our outstanding modifications and other claims will be resolved without material impact to our results of operations, financial condition or cash flows.

Letters of Credit and Guarantees. In the ordinary course of business, we have entered into letters of credit, bank guarantees, surety bonds and other similar arrangements with financial institutions and insurance carriers totaling approximately \$972 on April 5, 2015. In addition, from time to time and in the ordinary course of business, we contractually guarantee the payment or performance obligations of our subsidiaries arising under certain contracts.

Aircraft Trade-ins. In connection with orders for new aircraft in funded contract backlog, our Aerospace group has outstanding options with some customers to trade in aircraft as partial consideration in their new-aircraft transaction. These trade-in commitments are structured to establish the fair market

value of the trade-in aircraft at a date generally 120 or fewer days preceding delivery of the new aircraft to the customer. At that time, the customer is required to either exercise the option or allow its expiration. Any excess of the pre-established trade-in price above the fair market value at the time the new outfitted aircraft is delivered is treated as a reduction of revenue in the new-aircraft sales transaction.

Product Warranties. We provide warranties to our customers associated with certain product sales. We record estimated warranty costs in the period in which the related products are delivered. The warranty liability recorded at each balance sheet date is generally based on the number of months of warranty coverage remaining for products delivered and the average historical monthly warranty payments. Warranty obligations incurred in connection with long-term production contracts are accounted for within the contract estimates at completion. Our other warranty obligations, primarily for business-jet aircraft, are included in other current and noncurrent liabilities on the Consolidated Balance Sheets.

The changes in the carrying amount of warranty liabilities for the three-month periods ended April 5, 2015, and March 30, 2014, were as follows:

| Three Months Ended | April 5, 2015 | March 30, 2014 |
|--------------------|---------------|----------------|
| Beginning balance | \$428 | \$354 |
| Warranty expense | 31 | 33 |
| Payments | (29 |) (14 |
| Ending balance | \$430 | \$373 |

M. RETIREMENT PLANS

We provide defined-contribution benefits, as well as some remaining defined-benefit pension and other post-retirement benefits.

Net periodic cost associated with our defined-benefit pension and other post-retirement benefit plans for the three-month periods ended April 5, 2015, and March 30, 2014, consisted of the following:

| Three Months Ended | Pension Benefits | | Other Post-retirement Benefits | |
|--------------------------------------|------------------|----------------|--------------------------------|----------------|
| | April 5, 2015 | March 30, 2014 | April 5, 2015 | March 30, 2014 |
| Service cost | \$57 | \$48 | \$3 | \$3 |
| Interest cost | 133 | 133 | 11 | 13 |
| Expected return on plan assets | (174 |) (164 |) (8 |) (8 |
| Recognized net actuarial loss | 110 | 74 | 2 | 2 |
| Amortization of prior service credit | (17 |) (17 |) (1 |) — |
| Net periodic cost | \$109 | \$74 | \$7 | \$10 |

Our contractual arrangements with the U.S. government provide for the recovery of contributions to our pension and other post-retirement benefit plans covering employees working in our defense business groups. For non-funded plans, our government contracts allow us to recover claims paid. Following payment, these recoverable amounts are allocated to contracts and billed to the customer in accordance with the Cost Accounting Standards (CAS) and specific contractual terms. For some of these plans, the cumulative pension and post-retirement benefit cost exceeds the amount currently allocable to contracts. To the extent recovery of the cost is considered probable based on our backlog and probable follow-on contracts, we defer the excess in contracts in process on the Consolidated Balance Sheets until the cost is allocable to contracts. See Note F for discussion of our deferred contract costs. For other plans, the amount

allocated to contracts and included in revenues has exceeded the plans' cumulative benefit cost. We have deferred recognition of these excess earnings to provide a better matching of revenues and expenses. These deferrals have been classified against the plan assets on the Consolidated Balance Sheets.

N. BUSINESS GROUP INFORMATION

We operate in four business groups: Aerospace, Combat Systems, Information Systems and Technology and Marine Systems. We organize our business groups in accordance with the nature of products and services offered. These business groups derive their revenues from business aviation; combat vehicles, weapons systems and munitions; communication and information technology systems and solutions; and military and commercial shipbuilding and services, respectively. We measure each group's profit based on operating earnings. As a result, we do not allocate net interest, other income and expense items, and income taxes to our business groups.

Summary financial information for each of our business groups follows:

| Three Months Ended | Revenues | | Operating Earnings | |
|------------------------------------|---------------|----------------|--------------------|----------------|
| | April 5, 2015 | March 30, 2014 | April 5, 2015 | March 30, 2014 |
| Aerospace | \$2,108 | \$2,125 | \$431 | \$404 |
| Combat Systems | 1,363 | 1,258 | 204 | 139 |
| Information Systems and Technology | 2,370 | 2,281 | 217 | 183 |
| Marine Systems | 1,943 | 1,601 | 188 | 166 |
| Corporate* | — | — | (13 |)(18 |
| | \$7,784 | \$7,265 | \$1,027 | \$874 |

*Corporate operating results consist primarily of stock option expense.

O. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

The fixed-rate notes described in Note H are fully and unconditionally guaranteed on an unsecured, joint and several basis by certain of our 100-percent-owned subsidiaries (the guarantors). The following condensed consolidating financial statements illustrate the composition of the parent, the guarantors on a combined basis (each guarantor together with its majority-owned subsidiaries) and all other subsidiaries on a combined basis.

CONDENSED CONSOLIDATING STATEMENTS OF EARNINGS (UNAUDITED)

| Three Months Ended April 5, 2015 | Parent | Guarantors on a Combined Basis | Other Subsidiaries on a Combined Basis | Consolidating Adjustments | Total Consolidated |
|--|--------|---|--|------------------------------|-----------------------|
| Revenues | \$— | \$6,768 | \$1,016 | \$— | \$7,784 |
| Cost of sales | 1 | 5,462 | 791 | — | 6,254 |
| G&A | 12 | 416 | 75 | — | 503 |
| Operating earnings | (13 |)890 | 150 | — | 1,027 |
| Interest, net | (23 |)1 | 1 | — | (21 |
| Other, net | 1 | 2 | — | — | 3 |
| Earnings before income tax | (35 |)893 | 151 | — | 1,009 |
| Provision for income tax, net | (25 |)290 | 28 | — | 293 |
| Equity in net earnings of subsidiaries | 726 | — | — | (726 |)— |
| Net earnings | \$716 | \$603 | \$123 | \$(726 |)\$716 |
| Comprehensive income | \$432 | \$606 | \$(224 |)\$(382 |)\$432 |
| Three Months Ended March 30, 2014 | Parent | Guarantors on a Combined Basis | Other Subsidiaries on a Combined Basis | Consolidating Adjustments | Total Consolidated |
| Revenues | \$— | \$6,393 | \$872 | \$— | \$7,265 |
| Cost of sales | 6 | 5,198 | 696 | — | 5,900 |
| G&A | 14 | 368 | 109 | — | 491 |
| Operating earnings | (20 |)827 | 67 | — | 874 |
| Interest, net | (22 |)— | — | — | (22 |
| Other, net | — | — | 1 | — | 1 |
| Earnings before income tax | (42 |)827 | 68 | — | 853 |
| Provision for income tax, net | (9 |)249 | 17 | — | 257 |
| Discontinued operations, net of tax | (1 |)— | — | — | (1 |
| Equity in net earnings of subsidiaries | 629 | — | — | (629 |)— |
| Net earnings | \$595 | \$578 | \$51 | \$(629 |)\$595 |
| Comprehensive income | \$577 | \$572 | \$4 | \$(576 |)\$577 |

CONDENSED CONSOLIDATING BALANCE SHEETS (UNAUDITED)

| April 5, 2015 | Parent | Guarantors on a Combined Basis | Other Subsidiaries on a Combined Basis | Consolidating Adjustments | Total Consolidated |
|---|----------|---|--|------------------------------|-----------------------|
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and equivalents | \$2,599 | \$— | \$1,813 | \$— | \$4,412 |
| Accounts receivable | — | 1,310 | 2,351 | — | 3,661 |
| Contracts in process | 546 | 2,787 | 1,111 | — | 4,444 |
| Inventories | | | | | |
| Work in process | — | 1,969 | 11 | — | 1,980 |
| Raw materials | — | 1,293 | 34 | — | 1,327 |
| Finished goods | — | 18 | 5 | — | 23 |
| Pre-owned aircraft | — | 67 | — | — | 67 |
| Other current assets | 81 | 207 | 150 | — | 438 |
| Total current assets | 3,226 | 7,651 | 5,475 | — | 16,352 |
| Noncurrent assets: | | | | | |
| Property, plant and equipment | 150 | 6,119 | 1,095 | — | 7,364 |
| Accumulated depreciation of PP&E | (54) | (3,312) | (675) | — | (4,041) |
| Intangible assets | — | 1,482 | 926 | — | 2,408 |
| Accumulated amortization of intangible assets | — | (1,065) | (450) | — | (1,515) |
| Goodwill | — | 8,122 | 3,577 | — | 11,699 |
| Other assets | 1,611 | 249 | 258 | — | 2,118 |
| Investment in subsidiaries | 38,078 | — | — | (38,078) | — |
| Total noncurrent assets | 39,785 | 11,595 | 4,731 | (38,078) | 18,033 |
| Total assets | \$43,011 | \$19,246 | \$10,206 | \$(38,078) | \$34,385 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
| Current liabilities: | | | | | |
| Short-term debt | \$— | \$1 | \$— | \$— | \$1 |
| Customer advances and deposits | — | 3,373 | 3,114 | — | 6,487 |
| Other current liabilities | 1,444 | 3,424 | 1,756 | — | 6,624 |
| Total current liabilities | 1,444 | 6,798 | 4,870 | — | 13,112 |
| Noncurrent liabilities: | | | | | |
| Long-term debt | 3,387 | 23 | — | — | 3,410 |
| Other liabilities | 3,487 | 2,369 | 487 | — | 6,343 |
| Total noncurrent liabilities | 6,874 | 2,392 | 487 | — | 9,753 |
| Intercompany | 23,173 | (22,580) | (593) | — | — |
| Shareholders' equity: | | | | | |
| Common stock | 482 | 6 | 2,043 | (2,049) | 482 |
| Other shareholders' equity | 11,038 | 32,630 | 3,399 | (36,029) | 11,038 |
| Total shareholders' equity | 11,520 | 32,636 | 5,442 | (38,078) | 11,520 |
| Total liabilities and shareholders' equity | \$43,011 | \$19,246 | \$10,206 | \$(38,078) | \$34,385 |

CONDENSED CONSOLIDATING BALANCE SHEETS

| December 31, 2014 | Parent | Guarantors on a Combined Basis | Other Subsidiaries on a Combined Basis | Consolidating Adjustments | Total Consolidated |
|---|----------|---|--|------------------------------|-----------------------|
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and equivalents | \$2,536 | \$— | \$1,852 | \$— | \$4,388 |
| Accounts receivable | — | 1,379 | 2,671 | — | 4,050 |
| Contracts in process | 542 | 2,966 | 1,083 | — | 4,591 |
| Inventories | | | | | |
| Work in process | — | 1,818 | 10 | — | 1,828 |
| Raw materials | — | 1,260 | 30 | — | 1,290 |
| Finished goods | — | 20 | 8 | — | 28 |
| Pre-owned aircraft | — | 75 | — | — | 75 |
| Other current assets | 781 | 215 | 161 | — | 1,157 |
| Total current assets | 3,859 | 7,733 | 5,815 | — | 17,407 |
| Noncurrent assets: | | | | | |
| Property, plant and equipment | 148 | 6,035 | 1,109 | — | 7,292 |
| Accumulated depreciation of PP&E | (52) | (3,246) | (665) | — | (3,963) |
| Intangible assets | — | 1,484 | 914 | — | 2,398 |
| Accumulated amortization of intangible assets | — | (1,042) | (444) | — | (1,486) |
| Goodwill | — | 8,095 | 3,636 | — | 11,731 |
| Other assets | 1,479 | 213 | 284 | — | 1,976 |
| Investment in subsidiaries | 37,449 | — | — | (37,449) | — |
| Total noncurrent assets | 39,024 | 11,539 | 4,834 | (37,449) | 17,948 |
| Total assets | \$42,883 | \$19,272 | \$10,649 | \$(37,449) | \$35,355 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
| Current liabilities: | | | | | |
| Short-term debt | \$500 | \$1 | \$— | \$— | \$501 |
| Customer advances and deposits | — | 3,529 | 3,806 | — | 7,335 |
| Other current liabilities | 1,298 | 3,511 | 1,106 | — | 5,915 |
| Total current liabilities | 1,798 | 7,041 | 4,912 | — | 13,751 |
| Noncurrent liabilities: | | | | | |
| Long-term debt | 3,386 | 24 | — | — | 3,410 |
| Other liabilities | 3,514 | 2,369 | 482 | — | 6,365 |
| Total noncurrent liabilities | 6,900 | 2,393 | 482 | — | 9,775 |
| Intercompany | 22,356 | (22,557) | 201 | — | — |
| Shareholders' equity: | | | | | |
| Common stock | 482 | 6 | 2,043 | (2,049) | 482 |
| Other shareholders' equity | 11,347 | 32,389 | 3,011 | (35,400) | 11,347 |
| Total shareholders' equity | 11,829 | 32,395 | 5,054 | (37,449) | 11,829 |
| Total liabilities and shareholders' equity | \$42,883 | \$19,272 | \$10,649 | \$(37,449) | \$35,355 |

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS (UNAUDITED)

| Three Months Ended April 5, 2015 | Parent | Guarantors on a Combined Basis | Other Subsidiaries on a Combined Basis | Consolidating Adjustments | Total Consolidated |
|---|---------|---|--|------------------------------|-----------------------|
| Net cash provided by operating activities * | \$(101 |)\$760 | \$86 | \$— | \$745 |
| Cash flows from investing activities: | | | | | |
| Maturities of held-to-maturity securities | 500 | — | — | — | 500 |
| Capital expenditures | (2 |)(89 |)(7 |)— | (98 |
| Other, net | 1 | 93 | — | — | 94 |
| Net cash provided by investing activities | 499 | 4 | (7 |)— | 496 |
| Cash flows from financing activities: | | | | | |
| Purchases of common stock | (620 |)— | — | — | (620 |
| Repayment of fixed-rate notes | (500 |)— | — | — | (500 |
| Dividends paid | (206 |)— | — | — | (206 |
| Proceeds from option exercises | 87 | — | — | — | 87 |
| Other, net | 30 | — | — | — | 30 |
| Net cash used by financing activities | (1,209 |)— | — | — | (1,209 |
| Net cash used by discontinued operations | (8 |)— | — | — | (8 |
| Cash sweep/funding by parent | 882 | (764 |)(118 |)— | — |
| Net increase in cash and equivalents | 63 | — | (39 |)— | 24 |
| Cash and equivalents at beginning of period | 2,536 | — | 1,852 | — | 4,388 |
| Cash and equivalents at end of period | \$2,599 | \$— | \$1,813 | \$— | \$4,412 |
| Three Months Ended March 30, 2014 | | | | | |
| Net cash provided by operating activities * | \$(65 |)\$669 | \$(182 |)\$— | \$422 |
| Net cash used by investing activities | — | (68 |)(9 |)— | (77 |
| Cash flows from financing activities: | | | | | |
| Purchases of common stock | (1,430 |)— | — | — | (1,430 |
| Other, net | 83 | — | — | — | 83 |
| Net cash used by financing activities | (1,347 |)— | — | — | (1,347 |
| Net cash used by discontinued operations | (3 |)— | — | — | (3 |
| Cash sweep/funding by parent | 609 | (601 |)(8 |)— | — |
| Net increase in cash and equivalents | (806 |)— | (199 |)— | (1,005 |
| Cash and equivalents at beginning of period | 4,180 | — | 1,121 | — | 5,301 |
| Cash and equivalents at end of period | \$3,374 | \$— | \$922 | \$— | \$4,296 |

* Continuing operations only

(Dollars in millions, except per-share amounts or unless otherwise noted)

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

BUSINESS OVERVIEW

General Dynamics is an aerospace and defense company that offers a broad portfolio of products and services in business aviation; combat vehicles, weapons systems and munitions; communications and information technology systems and solutions; and shipbuilding. We operate globally through four business groups: Aerospace, Combat Systems, Information Systems and Technology, and Marine Systems. Our primary customer is the U.S. government, including the Department of Defense, other U.S. government customers and the intelligence community. We also do significant business with non-U.S. governments and a diverse base of corporate and individual buyers of business aircraft. The following discussion should be read in conjunction with our 2014 Annual Report on Form 10-K and with the unaudited Consolidated Financial Statements included in this Form 10-Q. The unaudited Consolidated Financial Statements have been restated to reflect the results of operations of our axle business in discontinued operations (for further discussion, see Note A to the unaudited Consolidated Financial Statements).

RESULTS OF OPERATIONS

INTRODUCTION

An understanding of our accounting practices is important to evaluate our operating results. We recognize the majority of our revenues using the percentage-of-completion method of accounting. The following paragraphs explain how this method is applied in recognizing revenues and operating costs in our business groups.

In the Aerospace group, contracts for new aircraft have two major phases: the manufacture of the "green" aircraft and the aircraft's outfitting, which includes exterior painting and installation of customer-selected interiors. We record revenues on these contracts at the completion of these two phases: when green aircraft are delivered to and accepted by the customer, and when the customer accepts final delivery of the outfitted aircraft. We do not recognize revenue at green delivery unless (1) a contract has been executed with the customer and (2) the customer can be expected to satisfy its obligations under the contract, as evidenced by the receipt of significant deposits from the customer and other factors. Revenues associated with the group's completions of other original equipment manufacturers' (OEMs) aircraft and the group's services businesses are recognized as work progresses or upon delivery of services.

Fluctuations in revenues from period to period result from the number and mix of new aircraft deliveries (green and outfitted), progress on aircraft completions and the level of aircraft service activity during the period.

The majority of the Aerospace group's operating costs relates to new aircraft production for firm orders and consists of labor, material, subcontractor and overhead costs. The costs are accumulated in production lots and recognized as operating costs at green aircraft delivery based on the estimated average unit cost in a production lot. While changes in the estimated average unit cost for a production lot impact the level of operating costs, the amount of operating costs reported in a given period is based largely on the number and type of aircraft delivered. Operating costs in the Aerospace group's completions and services businesses are generally recognized as incurred.

For new aircraft, operating earnings and margins are a function of the prices of our aircraft, our operational efficiency in manufacturing and outfitting the aircraft, and the mix of aircraft deliveries between the higher-margin large-cabin and lower-margin mid-cabin aircraft. Additional factors affecting the group's

earnings and margins include the volume, mix and profitability of completions and services work performed, the market for pre-owned aircraft, and the level of general and administrative (G&A) and net research and development (R&D) costs incurred by the group.

In the defense groups, revenue on long-term government contracts is recognized as work progresses, either as products are produced or services are rendered. As a result, variations in revenues are discussed generally in terms of volume, typically measured by the level of activity on individual contracts or programs. Year-over-year variances attributed to volume are due to changes in production or service levels and delivery schedules.

Operating costs for the defense groups consist of labor, material, subcontractor, overhead and G&A costs and are recognized generally as incurred. Variances in costs recognized from period to period primarily reflect increases and decreases in production or activity levels on individual contracts and, therefore, result largely from the same factors that drive variances in revenues.

Operating earnings and margins in the defense groups are driven by changes in volume, performance or contract mix. Performance refers to changes in profitability based on revisions to estimates at completion on individual contracts. These revisions result from increases or decreases to the estimated value of the contract, the estimated costs to complete or both. Therefore, changes in costs incurred in the period compared with prior periods do not necessarily impact profitability. It is only when total estimated costs at completion on a given contract change without a corresponding change in the contract value that the profitability of that contract may be impacted. Contract mix refers to changes in the volume of higher- vs. lower-margin work. Additionally, higher or lower margins can be inherent in the contract type (e.g., fixed-price/cost-reimbursable) or type of work (e.g., development/production).

CONSOLIDATED OVERVIEW

| Three Months Ended | April 5, 2015 | March 30, 2014 | Variance | | |
|------------------------------|---------------|----------------|----------|-------|----|
| Revenues | \$7,784 | \$7,265 | \$519 | 7.1 | % |
| Operating costs and expenses | 6,757 | 6,391 | (366) | (5.7) |)% |
| Operating earnings | 1,027 | 874 | 153 | 17.5 | % |
| Operating margins | 13.2 | % 12.0 | | | % |

Our revenues increased in the first quarter of 2015 compared with the prior-year period. Revenues were up in all of our defense business groups for the first time in over four years. The largest increase was in the Marine Systems group where higher ship construction, engineering and repair activity led to 21 percent year-over-year growth. Revenues were essentially flat in our Aerospace group.

Operating costs and expenses increased less than revenues, resulting in higher operating earnings and margins. The 120 basis point increase in operating margins was largely due to improved performance in the Combat Systems and Information Systems and Technology groups.

REVIEW OF BUSINESS GROUPS

Following is a discussion of operating results and outlook for each of our business groups. For the Aerospace group, results are analyzed for specific lines of products and services, consistent with how the group is managed. For the defense groups, the discussion is based on the types of products and services each group offers with a supplemental discussion of specific contracts and programs when significant to the group's results. Information regarding our business groups also can be found in Note N to the unaudited Consolidated Financial Statements.

AEROSPACE

| Three Months Ended | April 5, 2015 | March 30, 2014 | Variance | | |
|--------------------|---------------|----------------|----------|--------|----|
| Revenues | \$2,108 | \$2,125 | \$(17 |) (0.8 |)% |
| Operating earnings | 431 | 404 | 27 | 6.7 | % |
| Operating margin | 20.4 | % 19.0 | % | | |

Gulfstream aircraft deliveries (in units):

| | | | | | |
|-----------|----|----|----|---------|----|
| Green | 34 | 35 | (1 |) (2.9 |)% |
| Outfitted | 32 | 39 | (7 |) (17.9 |)% |

Operating Results

The change in the Aerospace group's revenues in the first quarter of 2015 consisted of the following:

| | | |
|--|-------|---|
| Aircraft manufacturing, outfitting and completions | \$(26 |) |
| Pre-owned aircraft | 8 | |
| Aircraft services | 1 | |
| Total decrease | \$(17 |) |

Aircraft manufacturing, outfitting and completions revenues declined slightly in the first quarter of 2015 primarily due to fewer deliveries of outfitted large-cabin aircraft.

The increase in the group's operating earnings in the first quarter of 2015 consisted of the following:

| | | |
|--|------|---|
| Aircraft manufacturing, outfitting and completions | \$38 | |
| Pre-owned aircraft | (1 |) |
| Aircraft services | 5 | |
| G&A/other expenses | (15 |) |
| Total increase | \$27 | |

Aircraft manufacturing, outfitting and completions earnings were up from operating improvements and a favorable supplier settlement associated with aircraft component design and delivery delays. In addition, the group's services performance was very strong in the quarter due to a favorable mix of work. Absent these factors, the group's margins would have been lower, primarily driven by the timing of G&A expenses.

Outlook

As noted in our 2014 Form 10-K, we expect an increase of approximately 8 percent in the group's full-year revenues in 2015 compared with 2014 as a result of Gulfstream aircraft deliveries. Operating margins are expected to be around 18 percent, down somewhat from 2014 primarily due to higher net R&D expenses, aircraft manufacturing mix and more pre-owned aircraft sales.

COMBAT SYSTEMS

| Three Months Ended | April 5, 2015 | March 30, 2014 | Variance | | |
|--------------------|---------------|----------------|----------|------|---|
| Revenues | \$1,363 | \$1,258 | \$105 | 8.3 | % |
| Operating earnings | 204 | 139 | 65 | 46.8 | % |
| Operating margins | 15.0 | % 11.0 | % | | |

Operating Results

The change in the Combat Systems group's revenues in the first quarter of 2015 consisted of the following:

| | | | |
|---------------------------------|-------|---|--|
| International military vehicles | \$127 | | |
| U.S. military vehicles | (21) |) | |
| Weapon systems and munitions | (1) |) | |
| Total increase | \$105 | | |

Revenues from international military vehicles were up in the first quarter of 2015 as work ramped up on a contract with the Government of Canada's Canadian Commercial Corporation for a Middle Eastern customer and another with the British Army for Specialist Vehicle (SV) platforms. U.S. military vehicle revenues were down slightly due to the completion of the Ground Combat Vehicle (GCV) design and development program.

The Combat Systems group's operating margins increased 400 basis points in the first quarter of 2015. Operating margins were up across the group, largely as a result of reduced overhead costs following restructuring activities completed in 2014 and strong operating performance. Operating results in the first quarter of 2014 included \$29 of restructuring charges in our European military vehicles business, primarily for employee severance.

Outlook

As noted in our 2014 Form 10-K, we expect the Combat Systems group's revenues and operating margins in 2015 to be consistent with 2014 as growth on our international military vehicle contracts offsets some scheduled reductions in spending on several U.S. military production programs.

INFORMATION SYSTEMS AND TECHNOLOGY

| Three Months Ended | April 5, 2015 | March 30, 2014 | Variance | | |
|--------------------|---------------|----------------|----------|------|---|
| Revenues | \$2,370 | \$2,281 | \$89 | 3.9 | % |
| Operating earnings | 217 | 183 | 34 | 18.6 | % |
| Operating margins | 9.2 | % 8.0 | % | | |

Operating Results

The change in the Information Systems and Technology group's revenues in the first quarter of 2015 consisted of the following:

| | | |
|--------------------------------------|------|--|
| C4ISR solutions* | \$46 | |
| Information technology (IT) services | 43 | |
| Total increase | \$89 | |

* Command, control, communications, computing (C4), intelligence, surveillance and reconnaissance (ISR) solutions

Revenues increased in the first quarter of 2015 in the C4ISR solutions business primarily as a result of higher volume on the Common Hardware Systems-4 (CHS-4) program and increased demand for encryption products. Revenues increased in the first three months of 2015 in our IT services business due to increased contact-center services work for the Centers for Medicare & Medicaid Services and the late 2014 acquisition of a provider of IT support to U.S. special operations forces.

The group's operating margins increased 120 basis points in the first quarter of 2015, the result of improved operating performance, favorable contract mix and ongoing cost-reduction efforts, including the consolidation of two businesses in the group effective in January of 2015.

Outlook

As noted in our 2014 Form 10-K, we expect 2015 full-year revenues in the Information Systems and Technology group to decrease approximately 5.5 percent from 2014. Operating margins are expected to improve to slightly more than 9 percent.

MARINE SYSTEMS

| Three Months Ended | April 5, 2015 | March 30, 2014 | Variance | | |
|--------------------|---------------|----------------|----------|------|---|
| Revenues | \$1,943 | \$1,601 | \$342 | 21.4 | % |
| Operating earnings | 188 | 166 | 22 | 13.3 | % |
| Operating margins | 9.7 | % 10.4 | % | | |

Operating Results

The change in the Marine Systems group's revenues in the first quarter of 2015 consisted of the following:

| | |
|--|-------|
| Navy ship construction | \$186 |
| Navy ship engineering, repair and other services | 69 |
| Commercial ship construction | 87 |
| Total increase | \$342 |

The increase in Navy ship construction revenues in 2015 is primarily due to higher volume on the Virginia-class program, including long-lead materials for the Block IV contract awarded in the second quarter of 2014. Revenues for Navy ship engineering, repair and other services increased in the first quarter of 2015 because of development work on the next-generation ballistic-missile submarine and surface-ship repair operations. Commercial ship construction revenues increased in the first quarter of 2015 as work ramped up on the group's construction of Jones Act ships. Operating margins decreased somewhat in the first quarter of 2015 primarily due to a shift in contract mix to the Block IV Virginia-class and commercial ship contracts and continued construction on the DDG-1000 program and two of the DDG-51 ships in the Navy's restart of the program.

Outlook

As noted in our 2014 Form 10-K, we expect the Marine Systems group's 2015 full-year revenues to increase approximately 2 to 2.5 percent from 2014, primarily due to higher revenues on the Virginia-class program. Operating margins are expected to remain in the mid-9 percent range.

CORPORATE

Corporate results consist primarily of compensation expense for stock options. Corporate costs totaled \$13 in the first quarter of 2015 compared with \$18 in the first quarter of 2014. We expect 2015 full-year Corporate costs of approximately \$65 to \$70.

OTHER INFORMATION

PRODUCT REVENUES AND OPERATING COSTS

| Three Months Ended | April 5, 2015 | March 30, 2014 | Variance | | |
|--------------------|---------------|----------------|----------|------|---|
| Revenues | \$4,932 | \$4,438 | \$494 | 11.1 | % |
| Operating costs | 3,819 | 3,464 | 355 | 10.2 | % |

The change in product revenues in the first quarter of 2015 consisted of the following:

| | |
|-----------------------------|-------|
| Ship construction | \$270 |
| Military vehicle production | 166 |
| Other, net | 58 |
| Total increase | \$494 |

Ship construction revenues increased in the first quarter of 2015 due to higher volume on the Virginia-class submarine program and commercial Jones Act ships. Military vehicle production revenues increased as work ramped up on two large non-U.S. programs awarded in 2014.

Product operating costs were higher in the first quarter of 2015 primarily due to volume on the programs described above.

SERVICE REVENUES AND OPERATING COSTS

| Three Months Ended | April 5, 2015 | March 30, 2014 | Variance | | |
|--------------------|---------------|----------------|----------|-----|---|
| Revenues | \$2,852 | \$2,827 | \$25 | 0.9 | % |
| Operating costs | 2,435 | 2,436 | (1) | — | % |

The change in service revenues in the first quarter of 2015 consisted of the following:

| | |
|---|------|
| Navy engineering, repair and other services | \$72 |
| Military vehicle services | (58) |
| Other, net | 11 |
| Total increase | \$25 |

Navy engineering, repair and other services revenues increased in the first quarter of 2015 due to increased development work on the next-generation ballistic-missile submarine and higher surface-ship repair volume. Military vehicle services revenues decreased due to the completion of the Ground Combat Vehicle (GCV) design and development program.

Service operating costs were essentially flat in the first quarter of 2015 as there was little change in the overall volume of services.

OTHER INFORMATION

G&A Expenses

As a percentage of revenues, G&A expenses were 6.5 percent and 6.8 percent in the first three months of 2015 and 2014, respectively. G&A expenses in the first quarter of 2014 were negatively impacted by \$29 of severance-related charges in our European military vehicles business in the Combat systems group. We expect G&A expenses in 2015 to be approximately 6.5 percent of revenues.

Interest, Net

Net interest expense was \$21 in the first three months of 2015, compared with \$22 in the same period in 2014. We expect full-year 2015 net interest expense to be \$82, compared with \$86 in 2014.

Provision for Income Tax, Net

Our effective tax rate was 29 percent in the first three months of 2015, compared with 30.1 percent in the prior-year period. The effective tax rate in the first three months of 2015 was favorably impacted by approval received in the first quarter of a research and development tax credit refund request. We anticipate the full-year effective tax rate to be approximately 29.5 percent in 2015.

BACKLOG AND ESTIMATED POTENTIAL CONTRACT VALUE

Our total backlog, including funded and unfunded portions, was \$70.5 billion at the end of the first quarter of 2015, down 3 percent from \$72.4 billion on December 31, 2014. Our total estimated contract value, which combines total backlog with estimated potential contract value, was \$96.1 billion on April 5, 2015.

Estimated potential contract value includes work awarded on unfunded indefinite delivery, indefinite quantity (IDIQ) contracts or unexercised options associated with existing firm contracts. Contract options in our defense business represent agreements to perform additional work under existing contracts at the election of the customer. The actual amount of funding received in the future may be higher or lower than our estimate of potential contract value. We recognize options in backlog when the customer exercises the option and establishes a firm order. In the Aerospace group, estimated potential contract value primarily represents options to purchase new aircraft and long-term agreements with fleet customers.

The following table details the backlog and the estimated potential contract value of each business group at the end of the first quarter of 2015 and fourth quarter of 2014:

| | Funded | Unfunded | Total Backlog | Estimated Potential Contract Value | Total Estimated Contract Value |
|------------------------------------|-------------------|----------|---------------|------------------------------------|--------------------------------|
| | April 5, 2015 | | | | |
| Aerospace | \$12,947 | \$147 | \$13,094 | \$2,699 | \$15,793 |
| Combat Systems | 18,942 | 462 | 19,404 | 5,459 | 24,863 |
| Information Systems and Technology | 6,842 | 1,815 | 8,657 | 15,296 | 23,953 |
| Marine Systems | 17,248 | 12,138 | 29,386 | 2,143 | 31,529 |
| Total | \$55,979 | \$14,562 | \$70,541 | \$25,597 | \$96,138 |
| | December 31, 2014 | | | | |
| Aerospace | \$13,115 | \$117 | \$13,232 | \$2,734 | \$15,966 |
| Combat Systems | 19,292 | 506 | 19,798 | 5,522 | 25,320 |
| Information Systems and Technology | 7,070 | 1,539 | 8,609 | 16,115 | 24,724 |
| Marine Systems | 13,452 | 17,319 | 30,771 | 2,311 | 33,082 |
| Total | \$52,929 | \$19,481 | \$72,410 | \$26,682 | \$99,092 |

AEROSPACE

Aerospace funded backlog represents aircraft orders for which we have definitive purchase contracts and deposits from customers. Unfunded backlog consists of agreements to provide future aircraft maintenance and support services. The group ended the first quarter of 2015 with backlog of \$13.1 billion, compared with \$13.2 billion at year-end 2014. Orders for Gulfstream aircraft were up slightly compared to the first quarter of 2014 and reflected demand across our product portfolio. In addition, we received several orders for custom completions of narrow- and wide-body aircraft in our Jet Aviation business.

DEFENSE GROUPS

The total backlog in our defense groups represents the estimated remaining sales value of work to be performed under firm contracts. The funded portion of this backlog includes items that have been authorized and appropriated by the Congress and funded by the customer, as well as commitments by international customers that are similarly approved and funded by their governments. We have included in total backlog firm contracts at the amounts we believe we are likely to receive funding, but there is no guarantee that future budgets and appropriations will provide funding for a given program.

Total backlog in our defense groups was \$57.4 billion on April 5, 2015, compared with \$59.2 billion at year-end 2014. Estimated potential contract value was \$22.9 billion on April 5, 2015. Each of our defense groups received notable contract awards during the first quarter of 2015.

Combat Systems awards included the following:

• \$410 from the U.S. Army under the Stryker wheeled armored vehicle program for production of 107 double-V-hulled vehicles and for contractor logistics support.

\$220 from the Government of Canada for the integration of an enhanced surveillance suite onto Canadian LAV III vehicles.

An IDIQ contract from the Army to supply 155mm ammunition. The program has a maximum potential value of \$300 over five years.

Information Systems and Technology awards included the following:

\$175 from the National Geospatial-Intelligence Agency (NGA) to consolidate NGA's operations from six locations to one stand-alone location at New Campus East (NCE).

\$155 for combat and seaframe control systems on two Navy Littoral Combat Ships (LCS).

\$70 from the Army for ruggedized computing equipment under the CHS-4 program.

\$70 from the U.S. Department of State to provide supply chain management services.

An IDIQ contract to manage the Army's Live Training Transformation (LT2) live training systems, including nearly 300 training ranges worldwide. The program has a maximum potential value of \$415 over five years.

Marine Systems awards included the following:

\$180 from the U.S. Navy to provide engineering and technical support for nuclear submarines.

\$55 from the Navy for the design and development of moored training ship components.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

We ended the first quarter of 2015 with a cash balance of \$4.4 billion, up slightly from the end of 2014. Our net cash position, defined as cash and equivalents and marketable securities less debt, was \$1 billion at the end of the first quarter of 2015, up from \$977 at the end of 2014. The following is a discussion of our major operating, investing and financing activities, as classified on the unaudited Consolidated Statements of Cash Flows, in the first three months of 2015 and 2014.

OPERATING ACTIVITIES

We generated cash from operating activities of \$745 in the first three months of 2015, compared with \$422 in the same period in 2014. The primary driver of cash flows in both periods was net earnings. Deposits received in the second half of 2014 related to a large non-U.S. contract awarded in our Combat Systems group are being utilized to fund supplier commitments on the program, which is expected to negatively affect operating cash flows in 2015.

INVESTING ACTIVITIES

Cash provided by investing activities was \$496 in the first three months of 2015, compared with cash used for investing activities of \$77 in the same period in 2014. The primary use of cash for investing activities in both periods was capital expenditures. We expect capital expenditures of approximately 2 percent of revenues in 2015. Cash provided by investing activities in 2015 includes \$500 of proceeds from maturing marketable securities as well as proceeds from the sale of our axle business in the Combat Systems group.

FINANCING ACTIVITIES

Cash used for financing activities was \$1.2 billion in the first three months of 2015, compared with \$1.3 billion in the same period in 2014. Our primary financing activities include debt repayments, repurchases of common stock and payment of dividends. Net cash from financing activities also includes proceeds received from stock option exercises. In the first three months of 2015, we repurchased approximately 4.7 million of our outstanding shares for \$634. As some of these shares did not settle until the second quarter of 2015, an associated cash outflow of \$14 will be reported as a financing activity at that time. On February 9, 2015, with shares from the prior authorization largely exhausted, the board of directors authorized management to repurchase 10 million additional shares of common stock on the open market. On April 5, 2015, 7.7 million shares remained authorized by our board of directors for repurchase, approximately 2 percent of our total shares outstanding. We repurchased 29 million shares for a total of approximately \$3.4 billion in 2014, including 14 million shares in the first three months of 2014.

On March 4, 2015, our board of directors declared an increased quarterly dividend of \$0.69 per share, the 18th consecutive annual increase. The board had previously increased the quarterly dividend to \$0.62 per share in March 2014.

In the first three months of 2015, we repaid \$500 of fixed-rate notes on their scheduled maturity date with the proceeds from maturing marketable securities discussed above. We have no further material repayments of long-term debt scheduled until mid-2016. See Note H to the unaudited Consolidated Financial Statements for additional information regarding our debt obligations, including scheduled debt maturities and interest rates.

We had no commercial paper outstanding on April 5, 2015. We have \$2 billion in bank credit facilities that remain available, including a \$1 billion facility expiring in July 2016 and a \$1 billion facility expiring in July 2018. These facilities provide backup liquidity to our commercial paper program. We also have an effective shelf registration on file with the Securities and Exchange Commission that allows us to access the debt markets.

NON-GAAP FINANCIAL MEASURES – FREE CASH FLOW

We define free cash flow from operations as net cash provided by operating activities less capital expenditures. We believe free cash flow from operations is a useful measure for investors, because it portrays our ability to generate cash from our businesses for purposes such as repaying maturing debt, funding business acquisitions, repurchasing our common stock and paying dividends. We use free cash flow from operations to assess the quality of our earnings and as a performance measure in evaluating management. The following table reconciles the free cash flow from operations with net cash provided by operating activities, as classified on the unaudited Consolidated Statements of Cash Flows:

| Three Months Ended | April 5, 2015 | March 30, 2014 |
|--|---------------|----------------|
| Net cash provided by operating activities | \$745 | \$422 |
| Capital expenditures | (98) | (87) |
| Free cash flow from operations | \$647 | \$335 |
| Cash flows as a percentage of earnings from continuing operations: | | |
| Net cash provided by operating activities | 104 | % 71 |
| Free cash flow from operations | 90 | % 56 |

We expect to continue to generate funds in excess of our short- and long-term liquidity needs. We believe we have adequate funds on hand and sufficient borrowing capacity to execute our financial and operating strategy.

ADDITIONAL FINANCIAL INFORMATION

ENVIRONMENTAL MATTERS AND OTHER CONTINGENCIES

For a discussion of environmental matters and other contingencies, see Note L to the unaudited Consolidated Financial Statements. We do not expect our aggregate liability with respect to these matters to have a material impact on our results of operations, financial condition or cash flows.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our unaudited Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). The preparation of financial statements in accordance with GAAP requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the period.

Accounting for long-term contracts and programs involves the use of various techniques to estimate total contract revenues and costs. Contract estimates are based on various assumptions to project the outcome of future events that often span several years. We review our performance monthly and update our contract estimates at least annually and often quarterly, as well as when required by specific events and circumstances. We recognize changes in estimated profit on contracts under the reallocation method. Under this method, the impact of revisions in estimates is recognized prospectively over the remaining contract term. The net increase in our operating earnings (and on a per-share basis) from the impact of revisions in contract estimates totaled favorable changes of \$63 (\$0.12) and \$38 (\$0.07) for the three-month periods ended April 5, 2015, and March 30, 2014, respectively. No revisions on any one contract were material to our unaudited Consolidated Financial Statements in the first quarter of 2015 or 2014. In the second quarter of 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. ASU 2014-09 prescribes a single, common revenue standard that replaces most existing revenue recognition guidance in GAAP. The standard outlines a five-step model, whereby revenue is recognized as performance obligations within a contract are satisfied. The standard also requires new, expanded disclosures regarding revenue recognition.

For public companies, ASU 2014-09 is effective in the first quarter of 2017. On April 1, 2015, the FASB proposed a one-year deferral of the standard's effective date, while permitting entities to still adopt one year earlier on the original effective date. A final determination will be made after a public comment period. The standard permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition date or method nor have we determined the effect of the standard on our consolidated financial statements as the standard continues to undergo changes.

The required adoption of the ASU will preclude our use of the reallocation method of recognizing revisions in estimated profit on contracts discussed above. Because changes in estimated profit will be recognized in the period they are identified (cumulative catch-up method), rather than prospectively over the remaining contract term, we expect that the impact of revisions of contract estimates may be larger and potentially more variable from period to period. Anticipated losses on contracts will continue to be recognized in the quarter they are identified.

Other significant estimates include those related to goodwill and other intangible assets, income taxes, pensions and other post-retirement benefits, workers' compensation, warranty obligations and litigation and other contingencies. We employ judgment in making our estimates but they are based on historical experience, currently available information and various other assumptions that we believe to be reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates.

We believe that our judgment is applied consistently and produces financial information that fairly depicts the results of operations for all periods presented. For a full discussion of our critical accounting policies, see our Annual Report on Form 10-K for the year ended December 31, 2014.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes with respect to this item from the disclosure included in our Annual Report on Form 10-K for the year ended December 31, 2014.

ITEM 4. CONTROLS AND PROCEDURES

Our management, under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, on April 5, 2015, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting that occurred during the quarter ended April 5, 2015, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements that are based on management's expectations, estimates, projections and assumptions. Words such as "expects," "anticipates," "plans," "believes," "scheduled," "outlook," "estimates," "should" and variations of these words and similar expressions are intended to identify forward-looking statements. Examples include projections of revenues, earnings, operating margins, segment performance, cash flows, contract awards, aircraft production, deliveries and backlog. In making these statements we rely on assumptions and analyses based on our experience and perception of historical trends, current conditions and expected future developments as well as other factors we consider appropriate under the circumstances. We believe our estimates and judgments are reasonable based on information available to us at the time. Forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as amended. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict. Therefore, actual future results and trends may differ materially from what is forecast in forward-looking statements due to a variety of factors, including the risk factors discussed in Item 1A of our Annual Report on Form 10-K. These factors include, without limitation:

- general U.S. and international political and economic conditions;
- decreases in U.S. government defense spending or changing priorities within the defense budget and the impacts of the Budget Control Act of 2011, including sequester;
- termination or restructuring of government contracts due to unilateral government action;

differences in anticipated and actual program performance, including the ability to perform under long-term fixed-price contracts within estimated costs, and performance issues with key suppliers and subcontractors; expected recovery on contract claims and requests for equitable adjustment; changing customer demand or preferences for business aircraft, including the effects of economic conditions on the business-aircraft market; potential for changing prices for energy and raw materials; and the status or outcome of legal and/or regulatory proceedings.

All forward-looking statements speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. All subsequent written and oral forward-looking statements attributable to the company or any person acting on the company's behalf are qualified by the cautionary statements in this section. We do not undertake any obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date of this report. These factors may be revised or supplemented in subsequent reports on SEC Forms 10-Q and 8-K.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For information relating to legal proceedings, see Note L to the unaudited Consolidated Financial Statements contained in Part I, Item 1.

ITEM 1A. RISK FACTORS

There have been no material changes with respect to this item from the disclosure included in our Annual Report on Form 10-K for the year ended December 31, 2014.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information about our first quarter repurchases of equity securities that are registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program (a) | Maximum Number of Shares that May Yet Be Purchased Under the Program (a) |
|-----------------------------------|----------------------------------|------------------------------|--|--|
| Pursuant to Share Buyback Program | | | | |
| 1/1/15-2/1/15 | 400,000 | \$ 133.91 | 400,000 | 1,994,152 |
| 2/2/15-3/1/15 | 2,301,517 | \$ 137.81 | 2,301,517 | 9,692,635 |
| 3/2/15-4/5/15 | 1,951,786 | \$ 134.78 | 1,951,786 | 7,740,849 |

Shares Delivered or Withheld Pursuant to Restricted Stock Vesting

(b)

| | | |
|---------------|-----------|-----------|
| 1/1/15-2/1/15 | 203,788 | \$ 138.11 |
| 2/2/15-3/1/15 | — | \$— |
| 3/2/15-4/5/15 | — | \$— |
| Total | 4,857,091 | \$— |

(a) On February 9, 2015, with shares from the prior authorization largely exhausted, the board of directors authorized management to repurchase 10 million additional shares of common stock.

(b) Represents shares withheld by, or delivered to, us pursuant to provisions in agreements with recipients of restricted stock granted under our equity compensation plans that allow us to withhold, or the recipient to deliver to us, the number of shares with a fair value equal to the minimum statutory tax withholding due upon vesting of the restricted shares.

We did not make any unregistered sales of equity in the first quarter.

ITEM 6. EXHIBITS

Indenture dated as of March 24, 2015, by and among General Dynamics Corporation, the Guarantors (as defined 4.1 therein) and The Bank of New York Mellon, as Trustee (incorporated herein by reference from the company's registration statement on Form S-3, filed with the Securities and Exchange Commission March 24, 2015)

- 10.1* Form of Non-Statutory Stock Option Agreement pursuant to the General Dynamics Corporation 2012 Equity Compensation Plan (for grants beginning March 4, 2015, and including, as indicated therein, provisions for certain executive officers who are subject to the General Dynamics Corporation Compensation Recoupment Policy)**
- 10.2* Form of Restricted Stock Award Agreement pursuant to the General Dynamics Corporation 2012 Equity Compensation Plan (for grants beginning March 4, 2015, and including, as indicated therein, provisions for certain executive officers who are subject to the General Dynamics Corporation Compensation Recoupment Policy)**
- 10.3* Form of Restricted Stock Unit Award Agreement pursuant to the General Dynamics Corporation 2012 Equity Compensation Plan (for grants beginning March 4, 2015)**
- 10.4* Form of Performance Restricted Stock Unit Award Agreement pursuant to the General Dynamics Corporation 2012 Equity Compensation Plan (for grants beginning March 4, 2015, and including, as indicated therein, provisions for certain executive officers who are subject to the General Dynamics Corporation Compensation Recoupment Policy)**
- 31.1 Certification by CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**
- 31.2 Certification by CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**
- 32.1 Certification by CEO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
- 32.2 Certification by CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
- 101 Interactive Data File**

* Indicates a management contract or compensatory plan or arrangement required to be filed pursuant to Item 15(b) of Form 10-K.

** Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

GENERAL DYNAMICS CORPORATION

by

Kimberly A. Kuryea
Vice President and Controller
(Authorized Officer and Chief Accounting Officer)

Dated: April 29, 2015