

GENERAL DYNAMICS CORP
Form 10-Q
May 03, 2011
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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 3, 2011

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
*State or other jurisdiction of
incorporation or organization*

13-1673581
*I.R.S. employer
identification no.*

2941 Fairview Park Drive, Suite 100

Falls Church, Virginia
Address of principal executive offices

22042-4513
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

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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

372,000,435 shares of the registrant's common stock, \$1 par value per share, were outstanding on April 3, 2011.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS****CONSOLIDATED BALANCE SHEET**

(Dollars in millions)	December 31 2010	(Unaudited) April 3 2011
ASSETS		
Current assets:		
Cash and equivalents	\$ 2,613	\$ 2,484
Accounts receivable	3,848	4,237
Contracts in process	4,873	4,896
Inventories	2,158	2,273
Other current assets	694	905
Total current assets	14,186	14,795
Noncurrent assets:		
Property, plant and equipment, net	2,971	2,993
Intangible assets, net	1,992	1,943
Goodwill	12,649	12,723
Other assets	747	650
Total noncurrent assets	18,359	18,309
Total assets	\$ 32,545	\$ 33,104
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Short-term debt and current portion of long-term debt	\$ 773	\$ 792
Accounts payable	2,736	2,510
Customer advances and deposits	4,465	4,731
Other current liabilities	3,203	3,219
Total current liabilities	11,177	11,252
Noncurrent liabilities:		
Long-term debt	2,430	2,411
Other liabilities	5,622	5,564
Commitments and contingencies (See Note K)		
Total noncurrent liabilities	8,052	7,975
Shareholders equity:		
Common stock	482	482
Surplus	1,729	1,781
Retained earnings	17,076	17,518
Treasury stock	(4,535)	(4,647)
Accumulated other comprehensive loss	(1,436)	(1,257)
Total shareholders equity	13,316	13,877
Total liabilities and shareholders equity	\$ 32,545	\$ 33,104

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of this statement.

Table of Contents**CONSOLIDATED STATEMENT OF EARNINGS****(UNAUDITED)**

	Three Months Ended	
	April 4	April 3
	2010	2011
(Dollars in millions, except per share amounts)		
Revenues:		
Products	\$ 5,162	\$ 5,061
Services	2,588	2,737
	7,750	7,798
Operating costs and expenses:		
Products	4,144	4,009
Services	2,202	2,351
General and administrative	486	509
	6,832	6,869
Operating earnings	918	929
Interest, net	(44)	(34)
Other, net		1
Earnings from continuing operations before income taxes	874	896
Provision for income taxes, net	275	278
Earnings from continuing operations	599	618
Discontinued operations, net of tax		(2)
Net earnings	\$ 597	\$ 618
Earnings per share		
Basic:		
Continuing operations	\$ 1.56	\$ 1.66
Discontinued operations	(0.01)	
Net earnings	\$ 1.55	\$ 1.66
Diluted:		
Continuing operations	\$ 1.54	\$ 1.64
Discontinued operations	(0.01)	
Net earnings	\$ 1.53	\$ 1.64

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of this statement.

Table of Contents**CONSOLIDATED STATEMENT OF CASH FLOWS****(UNAUDITED)**

(Dollars in millions)	Three Months Ended	
	April 4	April 3
	2010	2011
Cash flows from operating activities:		
Net earnings	\$ 597	\$ 618
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation of property, plant and equipment	86	85
Amortization of intangible assets	57	58
Stock-based compensation expense	29	32
Excess tax benefit from stock-based compensation	(17)	(15)
Deferred income tax provision	10	19
Discontinued operations, net of tax	2	
(Increase) decrease in assets, net of effects of business acquisitions		
Accounts receivable	(51)	(389)
Contracts in process	(241)	(14)
Inventories	143	(154)
Increase (decrease) in liabilities, net of effects of business acquisitions		
Accounts payable	(114)	(226)
Customer advances and deposits	(230)	198
Income taxes payable	234	215
Other current liabilities	(374)	(121)
Other, net	79	21
Net cash provided by operating activities	210	327
Cash flows from investing activities:		
Purchases of available-for-sale securities	(31)	(174)
Maturities of held-to-maturity securities	2	116
Purchases of held-to-maturity securities	(247)	(78)
Capital expenditures	(60)	(61)
Other, net	54	59
Net cash used by investing activities	(282)	(138)
Cash flows from financing activities:		
Purchases of common stock	(200)	(314)
Dividends paid	(147)	(157)
Proceeds from option exercises	168	138
Other, net	16	15
Net cash used by financing activities	(163)	(318)
Net cash used by discontinued operations	(3)	
Net decrease in cash and equivalents	(238)	(129)
Cash and equivalents at beginning of period	2,263	2,613
Cash and equivalents at end of period	\$ 2,025	\$ 2,484
Supplemental cash flow information:		
Cash payments for:		
Income taxes	\$ 35	\$ 55
Interest	\$ 62	\$ 44

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of this statement.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

A. BASIS OF PREPARATION

Basis of Consolidation and Classification

The unaudited Consolidated Financial Statements included in this Form 10-Q 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 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 are not expected to 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 3, 2011, are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

In our opinion, 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 4, 2010, and April 3, 2011.

We have evaluated material events and transactions that have occurred after the balance sheet date and concluded that no subsequent events have occurred that require adjustment to or disclosure in this Form 10-Q.

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, 2010.

Table of Contents**B. ACQUISITIONS, INTANGIBLE ASSETS AND GOODWILL**

We did not acquire any businesses in the first three months of 2011. In 2010, we acquired three businesses for an aggregate of \$233 in cash:

Combat Systems

A business that demilitarizes, incinerates and disposes of munitions, explosives and explosive wastes in an environmentally safe and efficient manner (on May 12).

Information Systems and Technology

A provider of software for military mission planning and execution (on January 8).

A U.K. based-company that designs and manufactures sensor and optical surveillance systems for military and security applications (on June 22).

We funded these acquisitions using cash on hand. The operating results of these businesses have been included with our reported results since the respective closing dates of the acquisitions. The purchase prices of these businesses have been allocated to the estimated fair value of net tangible and intangible assets acquired, with any excess purchase price recorded as goodwill.

Intangible assets consisted of the following:

	December 31 2010			April 3 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Contract and program intangible assets*	\$ 2,421	\$ (949)	\$ 1,472	\$ 2,426	\$ (1,000)	\$ 1,426
Trade names and trademarks	483	(58)	425	488	(62)	426
Technology and software	176	(94)	82	176	(97)	79
Other intangible assets	207	(194)	13	207	(195)	12
Total intangible assets	\$ 3,287	\$ (1,295)	\$ 1,992	\$ 3,297	\$ (1,354)	\$ 1,943

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

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The amortization lives (in years) of our intangible assets on April 3, 2011, were as follows:

	Range of Amortization Life	Weighted Average Amortization Life
Contract and program intangible assets	7-30	17
Trade names and trademarks	30	30
Technology and software	7-13	10
Other intangible assets	7-15	11
Total intangible assets		19

We amortize intangible assets on a straight-line basis unless the pattern of usage of the benefits indicates an alternate method is more representative of the usage of the asset. Amortization expense was \$57 for the three-month period ended April 4, 2010, and \$58 for the three-month period ended April 3, 2011. We expect to record 2011 full-year amortization expense of \$226 and annual amortization expense over the next five years as follows:

2012	\$ 219
2013	181
2014	155
2015	150
2016	125

The changes in the carrying amount of goodwill by reporting unit for the three months ended April 3, 2011, were as follows:

	Aerospace	Combat Systems	Marine Systems	Information Systems and Technology	Total Goodwill
December 31, 2010	\$ 2,650	\$ 2,828	\$ 198	\$ 6,973	\$ 12,649
Acquisitions					
Other*	17	45		12	74
April 3, 2011	\$ 2,667	\$ 2,873	\$ 198	\$ 6,985	\$ 12,723

* Consists primarily of adjustments for foreign currency translation.

Table of Contents**C. EARNINGS PER SHARE, DIVIDENDS AND COMPREHENSIVE INCOME***Earnings per Share*

We compute basic earnings per share using net earnings for the period and the weighted average number of common shares outstanding during the period. Diluted earnings per share incorporates the additional shares issuable upon the assumed exercise of stock options and the release of restricted shares. Basic and diluted weighted average shares outstanding were as follows (in thousands):

<i>Three Months Ended</i>	April 4 2010	April 3 2011
Basic weighted average shares outstanding	384,823	372,680
Dilutive effect of stock options and restricted stock	4,161	3,683
Diluted weighted average shares outstanding	388,984	376,363

Dividends

Dividends declared per share were \$0.42 and \$0.47 for the three-month periods ended April 4, 2010, and April 3, 2011, respectively.

Comprehensive Income

Our comprehensive income was \$535 and \$797 for the three-month periods ended April 4, 2010, and April 3, 2011, respectively. The primary components of our comprehensive income are net earnings and foreign currency translation adjustments of (\$57) and \$128 for the three-month periods ended April 4, 2010, and April 3, 2011, respectively.

D. FAIR VALUE OF FINANCIAL INSTRUMENTS

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. We did not have any significant non-financial assets or liabilities measured at fair value on December 31, 2010, or April 3, 2011.

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.

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The carrying values of cash and equivalents, accounts receivable and payable, and short-term debt (commercial paper) on the Consolidated Balance Sheet approximate their fair value. The following tables present the fair values of our other financial assets and liabilities on December 31, 2010, and April 3, 2011, 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)			December 31, 2010	
Marketable securities:				
Available-for-sale	\$ 47	\$ 47	\$ 47	\$
Held-to-maturity	165	165		165
Other investments	113	113	55	58
Derivatives	130	130		130
Long-term debt, including current portion	(3,203)	(3,436)		(3,436)
			April 3, 2011	
Marketable securities:				
Available-for-sale	\$ 159	\$ 159	\$ 159	\$
Held-to-maturity	128	128		128
Other investments	118	118	60	58
Derivatives	189	189		189
Long-term debt, including current portion	(3,203)	(3,418)		(3,418)

(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 December 31, 2010, or April 3, 2011.

The increase from year-end 2010 in marketable securities and derivative instruments represents the majority of the increase in other current assets on the Consolidated Balance Sheet.

Table of Contents**E. 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:

	December 31 2010	April 3 2011
Contract costs and estimated profits	\$ 15,675	\$ 16,870
Other contract costs	909	932
	16,584	17,802
Advances and progress payments	(11,711)	(12,906)
Total contracts in process	\$ 4,873	\$ 4,896

Contract costs consist primarily of labor and material costs and related overhead and general and administrative (G&A) expenses. Contract costs also include estimated contract recoveries for matters such as contract changes, negotiated settlements and claims for unanticipated contract costs. We record revenue associated with these matters only when the amount of recovery can be estimated reliably and realization is probable. Assumed recoveries for these items were not material on December 31, 2010, or April 3, 2011.

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. This business base includes numerous contracts for which we are the sole source or are one of two suppliers on long-term U.S. defense programs. However, 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. We expect to bill substantially all of our April 3, 2011, contracts-in-process balance during the next 12 months, with the exception of these other contract costs.

F. 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 based 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:

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	December 31 2010	April 3 2011
Work in process	\$ 1,124	\$ 1,204
Raw materials	965	961
Finished goods	69	67
Pre-owned aircraft		41
Total inventories	\$ 2,158	\$ 2,273

G. DEBT

Debt consisted of the following:

	Interest Rate	December 31 2010	April 3 2011
Fixed-rate notes due:			
July 2011	1.800%	\$ 749	\$ 750
May 2013	4.250%	1,000	1,000
February 2014	5.250%	997	997
August 2015	5.375%	400	400
Other	Various	57	56
Total debt		3,203	3,203
Less current portion		773	792
Long-term debt		\$ 2,430	\$ 2,411

Fixed-rate Notes

On April 3, 2011, we had outstanding \$3.1 billion aggregate principal amount of fixed-rate notes. The fixed-rate notes are fully and unconditionally guaranteed by several of our 100-percent-owned subsidiaries. We have the option to redeem the notes prior to their maturity in whole or in part at 100 percent of the principal plus any accrued but unpaid interest and applicable make-whole amounts. The next material repayment of long-term debt is \$750 of fixed-rate notes scheduled to mature in July of 2011. As we approach the maturity date, we will determine whether to repay these notes with cash on hand or refinance the obligation. See Note N for condensed consolidating financial statements.

Commercial Paper

On April 3, 2011, we had no commercial paper outstanding, but we maintain the ability to access the market. We have approximately \$2 billion in bank credit facilities that provide backup liquidity to our commercial paper program. These credit facilities include a \$975 multi-year facility expiring in December 2011 and a \$1 billion multi-year facility expiring in July 2013. These facilities are required by rating agencies to support our commercial paper issuances. We may renew or replace, in whole or in part, these credit facilities prior to their expiration. Our commercial paper issuances and the bank credit facilities are guaranteed by several of our 100-percent-owned subsidiaries.

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Our financing arrangements contain a number of customary covenants and restrictions. We were in compliance with all material covenants on April 3, 2011.

H. OTHER LIABILITIES

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

	December 31 2010	April 3 2011
Salaries and wages	\$ 773	\$ 681
Workers compensation	537	541
Deferred income taxes	383	388
Retirement benefits	254	274
Other ^(a)	1,256	1,335
Total other current liabilities	\$ 3,203	\$ 3,219
Retirement benefits	\$ 3,596	\$ 3,631
Customer deposits on commercial contracts	1,039	971
Deferred income taxes	220	219
Other ^(b)	767	743
Total other liabilities	\$ 5,622	\$ 5,564

(a) Consists primarily of dividends 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.

I. INCOME TAXES*Deferred Tax Assets/(Liabilities)*

Our net deferred tax liability was included in the Consolidated Balance Sheet as follows:

	December 31 2010	April 3 2011
Current deferred tax asset	\$ 30	\$ 29
Current deferred tax liability	(383)	(388)
Noncurrent deferred tax asset	359	292
Noncurrent deferred tax liability	(220)	(219)
Net deferred tax liability	\$ (214)	\$ (286)

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Tax Uncertainties

We periodically assess our liabilities and contingencies for all periods open to examination by tax authorities 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 for financial reporting purposes.

The IRS began its examination of our 2007 to 2009 tax returns in the fourth quarter of 2009, and we expect this examination to conclude in 2011. The IRS selected General Dynamics to participate in its Compliance Assurance Process, a real-time audit, for 2010 and future years. We have recorded liabilities for tax uncertainties for all years that remain open to review. We do not expect the resolution of tax matters for these 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 unrecognized tax benefits on April 3, 2011, is not material to our results of operations, financial condition or cash flows. We also believe that the total amount of unrecognized tax benefits on April 3, 2011, if recognized, would not have a material impact on our effective tax rate. We further believe that there are no tax positions for which it is reasonably possible that the unrecognized tax benefits will significantly increase or decrease over the next 12 months producing, individually or in the aggregate, a material effect on our results of operations, financial condition or cash flows.

J. 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

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. We periodically enter into derivative financial instruments, principally foreign currency forward purchase and sale contracts with terms of less than three years. These instruments are designed to minimize our risk by fixing, or limiting the adverse impact on, the amount of firmly committed and forecasted foreign currency-denominated payments, receipts and inter-company transactions related to our business and operational financing activities.

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.

Table of Contents*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 two years. On April 3, 2011, we held \$2.8 billion in cash and equivalents and marketable securities. Our marketable securities have an average duration of three months and an average credit rating of AA. Historically, we have not experienced material gains or losses on these instruments due to changes in interest rates or market values.

Hedging Activities

We had \$4.2 billion in notional forward foreign exchange contracts outstanding on December 31, 2010, and \$4.6 billion on April 3, 2011. We recognize derivative financial instruments on the Consolidated Balance Sheet at fair value (see Note D). The fair value of these derivative contracts consisted of the following:

	December 31 2010	April 3 2011
Other current assets:		
Designated as cash flow hedges	\$ 128	\$ 188
Not designated as cash flow hedges	35	37
Other current liabilities:		
Designated as cash flow hedges	(16)	(19)
Not designated as cash flow hedges	(17)	(17)
Total	\$ 130	\$ 189

We had no material derivative financial instruments designated as fair value or net investment hedges on December 31, 2010, or April 3, 2011.

We record changes in the fair value of derivative financial instruments in operating costs and expenses in the Consolidated Statement of Earnings or in accumulated other comprehensive income (AOCI) within shareholders' equity on the Consolidated Balance Sheet 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 AOCI 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 Statement of Earnings. The gains and losses on these instruments generally offset losses and gains on the assets, liabilities and other transactions.

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being hedged. Gains and losses resulting from hedge ineffectiveness are recognized in the Consolidated Statement of Earnings for all derivative financial instruments, regardless of designation.

Net gains and losses recognized in earnings and AOCI, including gains and losses related to hedge ineffectiveness, were not material for the three-month periods ended April 4, 2010, and April 3, 2011. We do not expect the amount of gains and losses in AOCI that will be reclassified to earnings during the next 12 months to be material.

Foreign Currency Financial Statement Translation

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

We do not hedge the fluctuation in reported revenues and earnings resulting from the translation of these international operations' income statements into U.S. dollars. The impact of translating our international operations' revenues and earnings into U.S. dollars was not material to our results of operations for the three-month periods ended April 4, 2010, or April 3, 2011. 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 2010 or 2011.

K. COMMITMENTS AND CONTINGENCIES

Litigation

Termination of A-12 Program. In January 1991, the U.S. Navy terminated the A-12 aircraft contract for default. The A-12 contract was a fixed-price incentive contract for the full-scale development and initial production of the Navy's carrier-based Advanced Tactical Aircraft. We and McDonnell Douglas, the contractors, were parties to the contract with the Navy. (McDonnell Douglas is now owned by The Boeing Company.) Both contractors had full responsibility to the Navy for performance under the contract, and both are jointly and severally liable for potential liabilities arising from the termination. As a consequence of the termination for default, the Navy demanded the contractors repay \$1.4 billion in unliquidated progress payments. The Navy agreed to defer collection of that amount pending a resolution by the court or a negotiated settlement.

Over 20 years of litigation, the trial court (the U.S. Court of Federal Claims) and appeals court (the Court of Appeals for the Federal Circuit) have issued multiple rulings, some in favor of the government and others in favor of the contractors. On May 3, 2007, the trial court issued a decision upholding the default termination. The court did not, however, award any money judgment to the government. On June 2, 2009, a three-judge panel of the appeals court affirmed the trial court's decision, and on November 24, 2009, the appeals court denied the contractors' petitions for rehearing. On September 28, 2010, the U.S. Supreme Court granted the contractors' petition for review as to one issue—whether the government can maintain its default claim against the contractors while invoking the state-secrets privilege to deny the contractors a defense to that claim. Oral arguments were presented on January 18, 2011. The contractors contend that the government should not be permitted to pursue its default claim after stripping the contractors of their superior knowledge defense to that claim by invoking the state-secrets privilege. Additionally, apart from the state-secrets issue, and even if the Supreme Court ultimately were to rule in the government's favor on that issue, we continue to believe

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that there are significant legal obstacles to the government's ability to collect any amount from the contractors given that no court has ever entered a money judgment in favor of the government. Based on the reasons stated above, we have not recorded an accrual for this matter.

If, contrary to our expectations, the default termination is ultimately sustained and the government prevails on its recovery theories, the contractors could collectively be required to repay the government as much as \$1.4 billion for progress payments received for the A-12 contract, plus interest, which was approximately \$1.5 billion on April 3, 2011. This would result in a liability to us of half of the total, or approximately \$1.4 billion pretax. Our after-tax charge would be approximately \$820, or \$2.18 per share, to be recorded in discontinued operations. Our after-tax cash cost would be approximately \$730. We believe we have sufficient resources to satisfy our obligation if required.

Other. 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 U.S. 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 at 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, reimbursed by the U.S. government.

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 liability. We do not record insurance recoveries before collection is considered probable. Based on all known facts and analyses, as well as current U.S. government policies relating to allowable contract costs, 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

Letters of Credit. In the ordinary course of business, we have entered into letters of credit and other similar arrangements with financial institutions and insurance carriers totaling approximately \$1.7 billion on April 3, 2011. These include letters of credit for our international subsidiaries, which are backed by available local bank credit facilities aggregating approximately \$1 billion. From time to time in the ordinary course of business, we guarantee the payment or performance obligations of our

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subsidiaries arising under certain contracts. We are aware of no event of default that would require us to satisfy these guarantees.

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. Based on currently available information, we believe the outcome of such ongoing government disputes and investigations will not have a material impact on our results of operations, financial condition or cash flows.

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 aircraft is delivered is treated as a reduction of revenue in the new-aircraft sales transaction.

Product Warranties. We provide product 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 (EACs). Our other warranty obligations, primarily for business-jet aircraft, are included in other current liabilities and other liabilities on the Consolidated Balance Sheet.

The changes in the carrying amount of warranty liabilities for the three-month periods ended April 4, 2010, and April 3, 2011, were as follows:

<i>Three Months Ended</i>	April 4 2010	April 3 2011
Beginning balance	\$ 239	\$ 260
Warranty expense	18	12
Payments	(13)	(13)
Adjustments*	(2)	(1)
Ending balance	\$ 242	\$ 258

* Includes warranty liabilities assumed in connection with acquisitions, foreign exchange translation adjustments and reclassifications.

L. RETIREMENT PLANS

We provide defined-benefit pension and other post-retirement benefits, as well as defined-contribution benefits, to eligible employees.

Net periodic cost associated with our defined-benefit pension and other post-retirement benefit plans for the three-month periods ended April 4, 2010, and April 3, 2011, consisted of the following:

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<i>Three Months Ended</i>	<i>Other</i>			
	<i>Pension Benefits</i>		<i>Post-retirement Benefits</i>	
	<i>April 4 2010</i>	<i>April 3 2011</i>	<i>April 4 2010</i>	<i>April 3 2011</i>
Service cost	\$ 54	\$ 64	\$ 3	\$ 4
Interest cost	127	129	15	15
Expected return on plan assets	(150)	(150)	(8)	(8)
Recognized net actuarial loss (gain)	17	40	(1)	1
Amortization of prior service credit	(11)	(11)		1
Net periodic cost	\$ 37	\$ 72	\$ 9	\$ 13

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 government contracting businesses. 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 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, we defer the excess in contracts in process on the Consolidated Balance Sheet until the cost is allocable to contracts. 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 Sheet. (See Note E for discussion of our deferred contract costs.)

M. BUSINESS GROUP INFORMATION

We operate in four business groups: Aerospace, Combat Systems, Marine Systems and Information Systems and Technology. We organize and measure 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; military and commercial shipbuilding; and communications and information technology, 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:

<i>Three Months Ended</i>	<i>Revenues</i>		<i>Operating Earnings</i>	
	<i>April 4 2010</i>	<i>April 3 2011</i>	<i>April 4 2010</i>	<i>April 3 2011</i>
	Aerospace	\$ 1,357	\$ 1,353	\$ 218
Combat Systems	2,002	1,955	269	277
Marine Systems	1,639	1,676	161	167
Information Systems and Technology	2,752	2,814	290	276
Corporate*			(20)	(21)
	\$ 7,750	\$ 7,798	\$ 918	\$ 929

* Corporate operating results include our stock option expense and a portion of the operating results of our commercial pension plans.

Table of Contents**N. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS**

The fixed-rate notes described in Note G 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 Statement of Earnings

	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
<i>Three Months Ended April 4, 2010</i>					
Revenues	\$	\$ 6,432	\$ 1,318	\$	\$ 7,750
Cost of sales	(3)	5,252	1,097		6,346
General and administrative expenses	20	372	94		486
Operating earnings	(17)	808	127		918
Interest expense	(47)				(47)
Interest income	2		1		3
Other, net		(1)	1		
Earnings from continuing operations before income taxes	(62)	807	129		874
Provision for income taxes	(21)	270	26		275
Discontinued operations, net of tax			(2)		(2)
Equity in net earnings of subsidiaries	638			(638)	
Net earnings	\$ 597	\$ 537	\$ 101	\$ (638)	\$ 597
<i>Three Months Ended April 3, 2011</i>					
Revenues	\$	\$ 6,383	\$ 1,415	\$	\$ 7,798
Cost of sales	(3)	5,192	1,171		6,360
General and administrative expenses	22	375	112		509
Operating earnings	(19)	816	132		929
Interest expense	(36)				(36)
Interest income	2				2
Other, net	1	(1)	1		1
Earnings from continuing operations before income taxes	(52)	815	133		896
Provision for income taxes	(15)	259	34		278
Equity in net earnings of subsidiaries	655			(655)	
Net earnings	\$ 618	\$ 556	\$ 99	\$ (655)	\$ 618

Table of Contents**Condensed Consolidating Balance Sheet**

<i>December 31, 2010</i>	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
ASSETS					
Current assets:					
Cash and equivalents	\$ 1,608	\$	\$ 1,005	\$	\$ 2,613
Accounts receivable		1,538	2,310		3,848
Contracts in process	263	3,205	1,405		4,873
Inventories					
Work in process		1,090	34		1,124
Raw materials		808	157		965
Finished goods		36	33		69
Other current assets	143	147	404		694
Total current assets	2,014	6,824	5,348		14,186
Noncurrent assets:					
Property, plant and equipment	147	4,687	1,125		5,959
Accumulated depreciation of PP&E	(42)	(2,448)	(498)		(2,988)
Intangible assets		1,664	1,623		3,287
Accumulated amortization of intangible assets		(920)	(375)		(1,295)
Goodwill		8,322	4,327		12,649
Other assets	183	172	392		747
Investment in subsidiaries	30,580			(30,580)	
Total noncurrent assets	30,868	11,477	6,594	(30,580)	18,359
Total assets	\$ 32,882	\$ 18,301	\$ 11,942	\$ (30,580)	\$ 32,545
LIABILITIES AND SHAREHOLDERS EQUITY					
Current liabilities:					
Short-term debt	\$ 749	\$ 21	\$ 3	\$	\$ 773
Customer advances and deposits		2,182	2,283		4,465
Other current liabilities	596	3,397	1,946		5,939
Total current liabilities	1,345	5,600	4,232		11,177
Noncurrent liabilities:					
Long-term debt	2,396	29	5		2,430
Other liabilities	2,774	2,242	606		5,622
Total noncurrent liabilities	5,170	2,271	611		8,052
Intercompany	13,051	(13,626)	575		
Shareholders equity:					
Common stock, including surplus	2,211	6,786	2,360	(9,146)	2,211
Retained earnings	17,076	18,175	3,097	(21,272)	17,076
Treasury stock	(4,535)				(4,535)
Accumulated other comprehensive loss	(1,436)	(905)	1,067	(162)	(1,436)
Total shareholders equity	13,316	24,056	6,524	(30,580)	13,316
Total liabilities and shareholders equity	\$ 32,882	\$ 18,301	\$ 11,942	\$ (30,580)	\$ 32,545

Table of Contents**Condensed Consolidating Balance Sheet**

<i>April 3, 2011</i>	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
ASSETS					
Current assets:					
Cash and equivalents	\$ 1,513	\$	\$ 971	\$	\$ 2,484
Accounts receivable		1,536	2,701		4,237
Contracts in process	272	3,056	1,568		4,896
Inventories					
Work in process		1,163	41		1,204
Raw materials		804	157		961
Finished goods		25	42		67
Pre-owned aircraft		41			41
Other current assets	338	198	369		905
Total current assets	2,123	6,823	5,849		14,795
Noncurrent assets:					
Property, plant and equipment	148	4,743	1,169		6,060
Accumulated depreciation of PP&E	(43)	(2,490)	(534)		(3,067)
Intangible assets		1,664	1,633		3,297
Accumulated amortization of intangible assets		(951)	(403)		(1,354)
Goodwill		8,323	4,400		12,723
Other assets	117	164	369		650
Investment in subsidiaries	31,687			(31,687)	
Total noncurrent assets	31,909	11,453	6,634	(31,687)	18,309
Total assets	\$ 34,032	\$ 18,276	\$ 12,483	\$ (31,687)	\$ 33,104
LIABILITIES AND SHAREHOLDERS EQUITY					
Current liabilities:					
Short-term debt	\$ 750	\$ 39	\$ 3	\$	\$ 792
Customer advances and deposits		2,076	2,655		4,731
Other current liabilities	759	3,232	1,738		5,729
Total current liabilities	1,509	5,347	4,396		11,252
Noncurrent liabilities:					
Long-term debt	2,397	9	5		2,411
Other liabilities	2,779	2,157	628		5,564
Total noncurrent liabilities	5,176	2,166	633		7,975
Intercompany	13,470	(14,141)	671		
Shareholders equity:					
Common stock, including surplus	2,263	6,853	1,869	(8,722)	2,263
Retained earnings	17,518	18,918	3,680	(22,598)	17,518
Treasury stock	(4,647)				(4,647)
Accumulated other comprehensive income	(1,257)	(867)	1,234	(367)	(1,257)
Total shareholders equity	13,877	24,904	6,783	(31,687)	13,877
Total liabilities and shareholders equity	\$ 34,032	\$ 18,276	\$ 12,483	\$ (31,687)	\$ 33,104

Table of Contents**Condensed Consolidating Statement of Cash Flows**

	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
<i>Three Months Ended April 4, 2010</i>					
Net cash provided by operating activities	\$ (54)	\$ 273	\$ (9)	\$	\$ 210
Cash flows from investing activities:					
Purchases of held-to-maturity securities	(125)		(122)		(247)
Business acquisitions, net of cash acquired		(48)			(48)
Other, net	22	8	(17)		13
Net cash used by investing activities	(103)	(40)	(139)		(282)
Cash flows from financing activities:					
Purchases of common stock	(200)				(200)
Proceeds from option exercises	168				168
Dividends paid	(147)				(147)
Other, net	17		(1)		16
Net cash used by financing activities	(162)		(1)		(163)
Net cash used by discontinued operations			(3)		(3)
Cash sweep/funding by parent	385	(233)	(152)		
Net decrease in cash and equivalents	66		(304)		(238)
Cash and equivalents at beginning of period	1,406		857		2,263
Cash and equivalents at end of period	\$ 1,472	\$	\$ 553	\$	\$ 2,025
<i>Three Months Ended April 3, 2011</i>					
Net cash provided by operating activities	\$ (72)	\$ 636	\$ (237)	\$	\$ 327
Cash flows from investing activities:					
Purchases of available-for-sale securities	(142)	(32)			(174)
Maturities of held-to-maturity securities	9		107		116
Other, net	(50)	(17)	(13)		(80)
Net cash used by investing activities	(183)	(49)	94		(138)
Cash flows from financing activities:					
Purchases of common stock	(314)				(314)
Dividends paid	(157)				(157)
Proceeds from option exercises	138				138
Other, net	15				15
Net cash used by financing activities	(318)				(318)
Cash sweep/funding by parent	478	(587)	109		
Net decrease in cash and equivalents	(95)		(34)		(129)
Cash and equivalents at beginning of period	1,608		1,005		2,613
Cash and equivalents at end of period	\$ 1,513	\$	\$ 971	\$	\$ 2,484

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS****OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

BUSINESS OVERVIEW

General Dynamics offers a broad portfolio of products and services in business aviation; combat vehicles, weapons systems and munitions; military and commercial shipbuilding; and communications and information technology. We operate through four business groups: Aerospace, Combat Systems, Marine Systems and Information Systems and Technology. Our primary customers are the U.S. military, other U.S. government organizations, the armed forces of other nations, and a diverse base of corporate and individual buyers of business aircraft. We operate in two primary markets: defense and national security, and business aviation. The majority of our revenues derive from contracts with the U.S. government. The following discussion should be read in conjunction with our 2010 Annual Report on Form 10-K, filed with the Securities and Exchange Commission, and with the unaudited Consolidated Financial Statements included in this Form 10-Q.

RESULTS OF OPERATIONS*Consolidated Overview*

<i>Three Months Ended</i>	April 4 2010	April 3 2011	Variance	
Revenues	\$ 7,750	\$ 7,798	\$ 48	0.6%
Operating earnings	918	929	11	1.2%
Operating margin	11.8%	11.9%		
Net cash provided by operating activities	210	327	117	55.7%

General Dynamics' revenues increased in the first quarter of 2011 compared with 2010. Our defense revenues were up slightly while aerospace revenues remained steady year over year. The increase in defense revenues was driven by growth in several U.S. Navy programs in the Marine Systems group and information technology (IT) services in the Information Systems and Technology group. Combat Systems revenues were down from 2010 due to reduced volume on U.S. military vehicle programs. In the Aerospace group, higher aircraft manufacturing and services revenues offset reductions in other original equipment manufacturer (OEM) aircraft outfitting work and pre-owned aircraft activity.

Higher operating earnings in the first quarter of 2011 compared with the same period in 2010 resulted in a 10 basis-point increase in overall operating margins in the first quarter. Margins expanded in the Aerospace, Combat Systems and Marine Systems groups. Our Aerospace group continued to benefit from excellent operational performance in the quarter. Our defense businesses retained their focus on program execution, particularly in light of an increasingly challenging defense environment caused by the prolonged resolution of the 2011 U.S. defense budget.

Net cash provided by operating activities was \$327 in the first three months of 2011, over 50 percent of net earnings, compared with \$210, approximately 35 percent of net earnings, in the same period in 2010. We deployed this cash to fund capital expenditures, repurchase our common stock and pay dividends.

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Our net debt—debt less cash and equivalents and marketable securities—was \$432 at the end of the first quarter of 2011, down from \$1.3 billion at the end of the first quarter of 2010. This decrease in net debt came after the following capital deployments in the past 12 months: \$1.3 billion of share repurchases, \$641 of dividends paid, \$476 of company-sponsored research and development, \$371 of capital expenditures, more than \$300 of contributions to our retirement plans and \$185 spent on acquisitions.

Net interest expense in the first three months of 2011 was \$34 compared with \$44 in the same period in 2010. The decrease was due largely to the repayment of \$700 of fixed-rate notes in the third quarter of 2010. We expect full-year 2011 net interest expense to be approximately \$130, subject to capital deployment activities during the year.

Our effective tax rate for the first three months of 2011 was 31 percent compared with 31.5 percent in the same period in 2010. We anticipate a full-year 2011 effective tax rate of approximately 31 percent, compared with 30.7 percent in 2010. For additional discussion of tax matters, see Note I to the unaudited Consolidated Financial Statements.

Aerospace

<i>Three Months Ended</i>	April 4 2010	April 3 2011	Variance	
Revenues	\$ 1,357	\$ 1,353	\$ (4)	(0.3)%
Operating earnings	218	230	12	5.5%
Operating margin	16.1%	17.0%		
Gulfstream aircraft deliveries (in units):				
Green	28	24	(4)	(14.3)%
Outfitted	17	24	7	41.2%

The Aerospace group's revenues were steady year over year. Higher volume in aircraft manufacturing operations and continued growth in aircraft services activity were offset by a reduction in aircraft outfitting work for other OEMs and pre-owned aircraft sales.

The group delivered fewer green Gulfstream aircraft in the first quarter of 2011 compared with the first three months of 2010. Manufacturing revenues were stable despite the reduced deliveries as a result of a more favorable mix of aircraft deliveries, which included fewer mid-cabin aircraft. The group's five-week aircraft manufacturing furlough in mid-2009 resulted in a temporary decline in outfitted deliveries in the first quarter of 2010. Outfitted deliveries have since increased, resulting in higher revenues in the first quarter of 2011. Decreased OEM production across the broader business-jet market and production delays on narrow- and wide-body commercial aircraft resulted in a decline in completions work at Jet Aviation.

Growth in aircraft services activity throughout 2010 continued into the first quarter of 2011, with both Gulfstream and Jet Aviation maintenance and repair work, fixed-base operations and aircraft management services increasing in the first quarter of 2011. This increase reflects the growing installed base of business-jet aircraft and increased aircraft utilization.

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Additionally, the group sold no pre-owned aircraft in the first quarter of 2011 compared with three in 2010. We took in two trade-in aircraft in the quarter, one of which was available for sale and one under contract at quarter end.

The group's operating earnings were up compared with the first quarter of 2010. The increase in the group's earnings consisted of the following:

Aircraft manufacturing and outfitting	\$ 15
Aircraft services	9
Pre-owned aircraft	
SG&A/other	(12)
Total increase in operating earnings	\$ 12

The group's aircraft manufacturing and outfitting earnings increased compared with 2010 due to the growth in aircraft manufacturing volume and improved pricing on large-cabin units delivered in 2011. First quarter 2011 earnings included revenue from liquidated damages associated with a fleet customer's determination not to purchase aircraft under a multi-year delivery contract. The liquidated damages recognized in connection with this single transaction contributed favorably to the group's margins in the quarter but were slightly less than the damages received in the year-ago quarter when the group experienced a number of customer defaults. Jet Aviation continues to take steps to improve its performance, although earnings from its completions business were down compared with the first quarter of 2010.

Consistent with the increased volume, aircraft services earnings continued to improve from the comparative 2010 period. Margins were up slightly compared with the first quarter of 2010 due to a favorable mix of service work.

The group's operating earnings in the first quarter of 2011 were also impacted by higher SG&A activities associated with selling and marketing expenses.

As a result of the factors discussed above, the group's overall operating margins increased 90 basis points in the quarter compared with the same prior-year period.

We expect full-year 2011 Aerospace revenues to increase approximately 15 to 16 percent over 2010 and full-year operating margins to be approximately 15.5 to 16 percent. This outlook assumes initial green deliveries of the group's new G650 aircraft later this year and sustained growth in aircraft services. On April 2, 2011, one of the five test aircraft used in flight testing for the ultra-large-cabin, ultra-high-speed G650 program crashed. We are cooperating fully with the National Transportation Safety Board (NTSB) in its investigation of the accident and working closely with the Federal Aviation Administration (FAA) on progressing toward G650 type certification. While we have temporarily suspended flight activity for the remaining four test aircraft, other certification activities and production work on the G650 program continue. The impact on the aircraft's certification and initial green delivery schedule is currently unknown.

Table of Contents*Combat Systems*

<i>Three Months Ended</i>	April 4 2010	April 3 2011	Variance	
Revenues	\$ 2,002	\$ 1,955	\$ (47)	(2.3)%
Operating earnings	269	277	8	3.0%
Operating margin	13.4%	14.2%		

The Combat Systems group's revenues were down in the first quarter of 2011 compared with the same period in 2010 due to reduced activity in the group's U.S. military vehicle business. The decrease in the group's revenues consisted of the following:

U.S. military vehicles	\$ (101)
Weapon systems and munitions	12
European military vehicles	42
Total decrease in revenues	\$ (47)

In the group's U.S. military vehicle business, volume was down on the Abrams main battle tank and Expeditionary Fighting Vehicle (EFV) programs. The reductions related primarily to less refurbishment and upgrade work for the Abrams tank, consistent with our expectations, and a decline in EFV activity as the system design and development contract concludes. Increased volume on the group's foreign military sales (FMS) contract to provide light armored vehicles to an international military customer partially offset the decline in revenues.

In the group's weapon systems and munitions businesses, revenues were up modestly in the first quarter compared with the same prior-year period. The growth resulted from increased sales of heavy-payload axles in both the military and commercial markets.

Revenues in the group's European military vehicle business increased in the first quarter of 2011 due largely to a higher volume of sales of Duro and EAGLE wheeled military vehicles to a variety of European customers and the start-up of the Specialist Vehicle (SV) program for the United Kingdom. The group is designing and co-producing seven prototype vehicles under the SV program in coordination with our U.K. business in the Information Systems and Technology group.

Despite the decrease in revenues, the Combat Systems group's operating earnings increased in the first quarter of 2011, resulting in an 80 basis-point margin improvement compared with the first quarter of 2010. Margins were up as a result of productivity improvements across the group and a favorable contract mix, including reduced engineering and development work.

We expect full-year 2011 Combat Systems revenues to be approximately \$9 billion, consistent with 2010, as growth in international vehicle contracts, particularly in the second half of the year, offsets a reduction in volume on some of the group's U.S. vehicle programs. We expect full-year operating margins for the group to be approximately 14 percent.

Table of Contents*Marine Systems*

<i>Three Months Ended</i>	April 4 2010	April 3 2011	Variance	
Revenues	\$ 1,639	\$ 1,676	\$ 37	2.3%
Operating earnings	161	167	6	3.7%
Operating margin	9.8%	10.0%		

The Marine Systems group's revenues increased in the first quarter of 2011 over the same prior-year period as growth in several U.S. Navy programs was partially offset by a decline in commercial ship construction. The increase in the group's revenues consisted of the following:

Multi-year Navy ship construction	\$ 5
Other Navy ship design, construction, engineering and repair	64
Commercial ship construction	(32)
Total increase in revenues	\$ 37

The group's multi-year Navy ship-construction programs include Virginia-class submarines, DDG-51 and DDG-1000 destroyers, and T-AKE combat-logistics ships. The group has been accelerating construction of Virginia-class submarines over the past several years to achieve a build rate of two boats per year in 2011. This resulted in moderately higher volume on the program in the first quarter of 2011. The group is completing the last three boats under the Block II contract and has begun the first three boats under the Block III contract. Deliveries of the remaining 11 boats under contract are scheduled through 2018. Subsequent to the end of the quarter, in connection with the passage of the 2011 U.S. defense budget we received funding for the second 2011 boat.

Destroyer program revenues decreased in the first quarter of 2011 due largely to the timing of contract awards and construction activities. Volume was down on the DDG-51 program as the current multi-ship contract nears completion. The remaining two DDG-51 destroyers under contract are scheduled for delivery in 2011 and 2012. Based on the Navy's plans to continue the DDG-51 program, the group expects to receive an award for an additional DDG-51 in 2011, following funding for long-lead material for this ship in 2010. Revenues were also down slightly on the DDG-1000 destroyer program. Delivery of the first DDG-1000 is scheduled for 2014. The group was awarded long-lead construction for the second ship and long-lead material for the third ship in 2010, with construction contracts for these ships expected in 2011. The group expects to complete contract negotiations with the U.S. Navy for the second and third ships in this class in the second quarter of 2011.

Activity on the group's T-AKE program was up in the first quarter of 2011 as the group continued construction on the remaining ships under contract. Deliveries of the remaining three ships are scheduled through 2012. Volume is also up on the Mobile Landing Platform program. Advanced design efforts continue in anticipation of a construction award this year following funding in the 2011 U.S. defense budget.

While the net impact of these ship-construction programs resulted in essentially steady revenues compared with 2010, volume was up on engineering and repair programs for the Navy. Revenues were

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up in the first quarter of 2011 on the group's engineering work associated with the next-generation ballistic-missile submarine under development for the Navy. Additionally, the group's repair work continued to increase in the first quarter of 2011 following significant growth in 2009 and 2010, particularly at our West Coast operation.

In 2010, the group completed construction of a five-ship commercial product-carrier program, resulting in a decrease in commercial shipbuilding revenues in 2011. Given the success of the program, the age of the fleet of Jones Act ships and environmental regulations that require double-hull tankers and impose emission control limits, we anticipate additional commercial program opportunities as the economy continues to recover.

The group's 2011 operating earnings increased at a slightly higher rate than revenues, resulting in an increase in margins compared with the first quarter of 2010 despite a continuing shift in contract mix from the fixed-price DDG-51 program to the cost-reimbursable DDG-1000 contract and from the mature Block II Virginia-class contract to the Block III contract. Strong performance on the T-AKE contract contributed significantly to the margin increase.

We expect Marine Systems 2011 revenues to remain near 2010 revenues of approximately \$6.7 billion as increased Virginia-class production and submarine engineering activity are offset by lower DDG-51, T-AKE and commercial volume. For the year, we expect the group to achieve operating margins in the low-9 percent range, down from 2010. Margins are expected to decrease throughout the year due to the continued mix shift in ship-construction programs and the start-up of new production contracts.

Information Systems and Technology

<i>Three Months Ended</i>	April 4 2010	April 3 2011	Variance	
Revenues	\$ 2,752	\$ 2,814	\$ 62	2.3%
Operating earnings	290	276	(14)	(4.8)%
Operating margin	10.5%	9.8%		

The Information Systems and Technology group's revenues increased in the first quarter of 2011 over the same period in 2010. Increased revenues in the group's information technology (IT) services business were offset in part by a decline in revenue in the group's tactical communications and intelligence, surveillance and reconnaissance (ISR) businesses. The increase in the group's revenues consisted of the following:

Tactical communication systems	\$ (33)
IT services	124
ISR systems	(29)
Total increase in revenues	\$ 62

Revenues in the tactical communication systems business decreased in the first quarter of 2011 compared with 2010 due to lower volume on the Warfighter Information Network - Tactical (WIN-T) battlefield communications system and several programs at the group's Canadian operation, including

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the Canadian Maritime Helicopter Project (MHP). The group received an award in the first quarter of 2011 for low-rate initial production of equipment under the second increment of the WIN-T program, and we expect activity under this contract to increase starting in the second quarter. Revenues in the group's United Kingdom-based operation were steady, as lower volume on the BOWMAN contract, which is now in the maintenance and long-term support and enhancement phase of the program, was offset by higher volume on the demonstration phase of the U.K. Ministry of Defence Specialist Vehicle program.

In the group's IT services business, volume increased on IT support and modernization programs for the intelligence community, including the New Campus East (NCE) contract, as well as several programs associated with the Base Realignment and Closure (BRAC) facility changes, including the Walter Reed National Military Medical Center and Mark Center facilities. Revenue was also up on the group's Network-Centric Solutions (NETCENTS) program, which provides network support for federal agencies.

Revenue was down in the first quarter in the group's ISR business due largely to the sale of a satellite facility in the first quarter of 2010 and the completion of several signals intelligence programs in early 2011.

The Information Systems and Technology group's operating earnings and operating margins decreased in the first quarter of 2011 as a result of a shift in contract mix and an increasingly competitive and price-sensitive market for IT services. The significant sales growth in our IT services business in the quarter reduced the group's overall margin.

We expect full-year revenues in the Information Systems and Technology group to grow approximately 3 to 5 percent. We expect this growth to be spread among each of the group's businesses, particularly in the areas of tactical communication systems and IT services for intelligence and federal civilian customers. We expect the group's margins to remain above 10 percent for the year, with margins increasing throughout the year as higher-margin product sales increase.

Corporate

Corporate results consist primarily of compensation expense for stock options and a portion of the results from our commercial pension plans. Corporate operating expenses totaled approximately \$20 in the first quarter of both 2010 and 2011. We expect 2011 full-year Corporate operating expense of approximately \$90.

BACKLOG

Our total backlog was \$57.6 billion on April 3, 2011, down 3 percent from the fourth quarter of 2010. Our backlog does not include work awarded under unfunded indefinite delivery, indefinite quantity (IDIQ) contracts, unexercised options associated with existing firm contracts or options to purchase new aircraft, which we refer to collectively as estimated potential contract value. At the end of the first quarter of 2011, our estimate of this potential contract value was \$20.6 billion compared with \$21.8 billion at the end of 2010.

The following table details the backlog and the total estimated contract value of each business group at the end of the fourth quarter of 2010 and the first quarter of 2011:

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	Funded	Unfunded	Total Backlog	Estimated Potential Contract Value	Total Estimated Contract Value
<i>April 3, 2011</i>					
Aerospace	\$ 17,499	\$ 361	\$ 17,860	\$	\$ 17,860
Combat Systems	10,289	1,092	11,381	4,925	16,306
Marine Systems	8,113	10,540	18,653	549	19,202
Information Systems and Technology	7,958	1,724	9,682	15,119	24,801
Total	\$ 43,859	\$ 13,717	\$ 57,576	\$ 20,593	\$ 78,169

December 31, 2010

Aerospace	\$ 17,443	\$ 378	\$ 17,821	\$ 1,361	\$ 19,182
Combat Systems	10,908	892	11,800	4,645	16,445
Marine Systems	7,050	13,069	20,119	584	20,703
Information Systems and Technology	7,978	1,843	9,821	15,196	25,017
Total	\$ 43,379	\$ 16,182	\$ 59,561	\$ 21,786	\$ 81,347

Aerospace

Aerospace funded backlog represents orders for which we have definitive purchase contracts and deposits from the customer. Aerospace unfunded backlog consists of agreements to provide future aircraft maintenance and support services. Aerospace estimated potential contract value represents options to purchase new aircraft and long-term agreements with fleet customers. The group ended the first quarter of 2011 with \$17.9 billion of backlog, following its second consecutive quarterly increase. In the first quarter of 2011, a fleet customer informed us of its intent not to purchase 40 large-cabin aircraft, which were scheduled to be delivered over the next five years. We have, therefore, removed these aircraft from the group's estimated potential contract value. The impact to annual scheduled deliveries is not material.

Order activity in 2011 remains strong, with continued order interest from emerging markets, particularly the Asia-Pacific region. Additionally, we experienced the lowest amount of customer defaults in the backlog since the third quarter of 2008, an indication of the sustained improvement in the business-jet market. Backlog in the group's large-cabin segment remains well-positioned, with an 18- to 24-month period between customer order and delivery of in-service aircraft.

Defense Businesses

The total backlog for our defense businesses 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. While there is no guarantee that future budgets and appropriations will provide funding for a given program, we have included in the backlog only firm contracts we believe are likely to receive funding. Our backlog does not include work awarded under unfunded IDIQ contract awards or unexercised options. The estimated potential contract value represents our estimate of the potential value we will receive under these arrangements.

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Customers use IDIQ contracts for several reasons, including expanding the field of available contractors to maximize competition under a given program or when they have not defined the exact timing and quantity of deliveries that will be required at the time the contract is executed. These agreements, which set forth the majority of the contractual terms, including prices, are funded as delivery orders are placed. A significant portion of our estimated potential contract value is composed of multiple-award IDIQ contracts in which we are one of several companies competing for task orders. We include only our estimate of the value we will receive under these arrangements. The estimated contract value also includes IDIQ contracts for which we have been designated as the sole-source supplier to design, develop, produce and integrate complex products and systems over several years for the military or other government agencies. We believe the customers intend to fully implement these products and systems. Because the value of these arrangements is subject to the customer's future exercise of an indeterminate quantity of delivery orders, we recognize these contracts in backlog only when they are funded.

Contract options in our defense businesses represent agreements to perform additional work beyond the products and services associated with firm contracts, if the customer exercises the option. These options are negotiated in conjunction with a firm contract and provide the terms under which the customer may elect to procure additional units or services at a future date. We recognize contract options in backlog when the customer exercises the option and establishes a firm order.

Almost 75 percent of the decline in our defense business backlog from the fourth quarter of 2010 was in the Marine Systems group, which traditionally receives large, multi-year awards and works that backlog down in subsequent periods. Backlog was impacted in part by a delay in orders associated with the government's continuing resolution (CR), which funded the Pentagon at fiscal year 2010 funding levels throughout the first quarter of 2011. Despite the difficult business environment associated with budget pressures and delays, our defense businesses each experienced continued demand for their products and services during the first quarter of 2011, with several notable contract awards.

Combat Systems awards included the following:

\$325 from the Israeli Ministry of Defense for Merkava Armored Personnel Carrier (APC) hulls and material kit sets.

\$155 from the U.S. Marine Corps for ammunition for the Expeditionary Fire Support System. The contract has a maximum potential value of \$195 if all options are exercised.

\$45 from the U.S. Army for training ammunition.

\$35 from the Army for munitions demilitarization. The contract has a maximum potential value of \$165 over five years if all options are exercised.

Marine Systems awards included the following:

\$55 from the U.S. Navy for engineering, design and technical services for the DDG-1000 destroyer program, bringing the total value in backlog to approximately \$815.

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Information Systems and Technology awards included the following:

\$295 from the Army under the WIN-T program for low-rate initial production of equipment under the second increment of the program. The second increment adds on-the-move command-and-control capabilities to the tactical communication network.

\$100 from the Army for ruggedized computing equipment under the Common Hardware/Software III (CHS-3) program, bringing the total value in backlog to \$230.

\$90 from Austal USA for combat and seaframe control systems for the next Littoral Combat Ship (LCS). Options to provide these systems for eight additional ships will be recognized as orders as they are exercised over the next five years.

\$65 under the Mobile User Objective System (MUOS) program for development of the Navy's next-generation tactical satellite communication system.

\$55 for networking and computing products and support under the Network-Centric Solutions (NETCENTS) program, bringing the total value in backlog to \$215.

\$30 from the Army to operate its Supply Support Activity (SSA) in Kuwait. The contract has a maximum potential value of \$175 over five years if all options are exercised.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

We ended the first quarter of 2011 with a cash balance of \$2.5 billion, compared with \$2.6 billion at the end of 2010. Our net debt was \$432, essentially unchanged from the end of 2010. Following is a discussion of the major components of our operating, investing and financing activities, as classified on the Consolidated Statement of Cash Flows, in the first three months of 2010 and 2011.

Operating Activities

We generated cash from operating activities of \$327 in the first three months of 2011 compared with \$210 in the same period in 2010. The primary driver of cash flows in both periods was net earnings, offset by growth in operating working capital (OWC). The increase in OWC in the first three months of 2011 is due primarily to timing of contract payments, and we expect this growth to reverse over the remainder of the year.

As discussed further in Note K to the unaudited Consolidated Financial Statements, litigation on the A-12 contract termination has been ongoing since 1991. If, contrary to our expectations, the default termination ultimately is sustained and the government prevails on its recovery theories, we, along with The Boeing Company, could collectively be required to repay the U.S. government as much as \$1.4 billion for progress payments received for the A-12 contract, plus interest, which was approximately \$1.5 billion at April 3, 2011. If this were the outcome, we would owe half of the total, or approximately \$1.4 billion pretax. Our after-tax cash obligation would be approximately \$730. We believe we have sufficient resources, including access to capital markets, to pay such an obligation, if required.

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Investing Activities

We used \$138 for investing activities in the first three months of 2011 compared with \$282 in the same period in 2010. The primary uses of cash in investing activities were capital expenditures and purchases of marketable securities. Investing activities also include proceeds received from the sale of assets and marketable securities. We expect full-year capital expenditures to be less than 2 percent of revenues, up slightly from 2010 due largely to the seven-year facilities expansion project at the Aerospace group's Savannah campus announced in 2010. As a result of lower market interest rates, we have expanded our investments in available-for-sale and held-to-maturity securities in recent years to generate additional return. We had net purchases of \$77 in the first three months of 2011 and net purchases of \$229 in the first three months of 2010. We did not complete any acquisitions in the first quarter of 2011. We completed one acquisition for \$48 in the first three months of 2010. We used cash on hand to fund this acquisition. See Note B to the unaudited Consolidated Financial Statements for further discussion of acquisition activity.

Financing Activities

Net cash used for financing activities was \$318 in the three-month period ended April 3, 2011, compared with \$163 in the same period in 2010. Our financing activities include issuances and repayments of debt, payment of dividends and repurchases of common stock. Net cash from financing activities also includes proceeds received from stock option exercises.

We had no commercial paper outstanding at the end of the first quarter. We have approximately \$2 billion in bank credit facilities that have not been drawn upon. 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. The next material repayment of long-term debt is \$750 of fixed-rate notes scheduled to mature in July of 2011. As we approach the maturity date, we will determine whether to repay these notes with cash on hand or refinance the obligation.

On March 2, 2011, our board of directors declared an increased quarterly dividend of \$0.47 per share – the 14th consecutive annual increase. The board had previously increased the quarterly dividend to \$0.42 per share in March 2010.

In the first three months of 2011, we repurchased 3.1 million of our outstanding shares on the open market at an average price of \$75 per share. In the first three months of 2010, we repurchased 2.9 million shares at an average price of \$68 per share. On April 3, 2011, approximately 6.9 million shares remained authorized by our board of directors for repurchase – about 2 percent of our total shares outstanding. We expect to continue to repurchase shares as part of our capital deployment activities in the future.

Non-GAAP Management Metrics – Free Cash Flow

Our free cash flow from operations for the first three months of 2011 was \$266 compared with \$150 for the same period in 2010. 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 core 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 free cash flow from

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operations with net cash provided by operating activities, as classified on the unaudited Consolidated Statement of Cash Flows:

<i>Three Months Ended</i>	April 4 2010	April 3 2011
Net cash provided by operating activities	\$ 210	\$ 327
Capital expenditures	(60)	(61)
Free cash flow from operations	\$ 150	\$ 266
Cash flows as a percentage of earnings from continuing operations:		
Net cash provided by operating activities	35%	53%
Free cash flow from operations	25%	43%

Cash generation was strong across all areas of the business. We expect to continue to generate funds from operations in excess of our short- and long-term liquidity needs and 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 K 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 our 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 reporting period. On an ongoing basis, we evaluate our estimates, including those related to long-term contracts and programs, goodwill and other intangible assets, income taxes, pensions and other post-retirement benefits, workers' compensation, warranty obligations, pre-owned aircraft inventory, and contingencies and litigation. We base our estimates on historical experience and on various 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 under different assumptions or conditions. For a full discussion of our critical accounting policies, see our Annual Report on Form 10-K for the year ended December 31, 2010.

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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, 2010.

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) on April 3, 2011. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, on April 3, 2011, 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 3, 2011, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

FORWARD-LOOKING STATEMENTS