GENERAL DYNAMICS CORP
Form 10-Q
August 01, 2007
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 1, 2007

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 þ No ¨

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

Large Accelerated Filer þ Accelerated Filer ¨ Non-Accelerated Filer ¨

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

405,707,840 shares of the registrant s common stock, $1 par value per share, were outstanding at July 27, 2007.

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PART I FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEET

(Dollars in millions)	(Unaudited) July 1 2007	December 31 2006
ASSETS		
Current Assets:		
Cash and equivalents	$ 1,794	$ 1,604
Accounts receivable	2,539	2,341
Contracts in process	4,233	3,988
Inventories	1,595	1,484
Other current assets	390	463
Total Current Assets	10,551	9,880
Noncurrent Assets:		
Property, plant and equipment, net	2,233	2,168
Intangible assets, net	1,093	1,184
Goodwill	8,838	8,541
Other assets	692	603
Total Noncurrent Assets	12,856	12,496
	$ 23,407	$ 22,376
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Short-term debt and current portion of long-term debt	$ 506	$ 7
Accounts payable	1,819	1,956
Customer advances and deposits	3,048	2,949
Other current liabilities	2,765	2,912
Total Current Liabilities	8,138	7,824
Noncurrent Liabilities:		
Long-term debt	2,283	2,774
Other liabilities	2,364	1,951
Commitments and contingencies (See Note K)		
Total Noncurrent Liabilities	4,647	4,725
Shareholders Equity:		
Common stock	482	482
Surplus	1,009	880
Retained earnings	10,488	9,769
Treasury stock	(1,594)	(1,455)
Accumulated other comprehensive income	237	151
Total Shareholders Equity	10,622	9,827
	$ 23,407	$ 22,376

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

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CONSOLIDATED STATEMENT OF EARNINGS

(UNAUDITED)

(Dollars in millions, except per share amounts)	Three Months Ended July 1 2007	July 2 2006
Net Sales:		
Products	$ 4,509	$ 4,240
Services	2,082	1,694
	6,591	5,934
Operating Costs and Expenses:		
Products	3,965	3,773
Services	1,866	1,512
	5,831	5,285
Operating Earnings	760	649
Interest, net	(21)	(23)
Other, net	1	2
Earnings from Continuing Operations before Income Taxes	740	628
Provision for income taxes, net	222	208
Earnings from Continuing Operations	518	420
Discontinued operations, net of tax	(5)	216
Net Earnings	$ 513	$ 636
Earnings per Share		
Basic:		
Continuing operations	$ 1.28	$ 1.04
Discontinued operations	(0.01)	0.54
Net earnings	$ 1.27	$ 1.58
Diluted:		
Continuing operations	$ 1.27	$ 1.03
Discontinued operations	(0.01)	0.53
Net earnings	$ 1.26	$ 1.56
Supplemental Information:		
General and administrative expenses included in operating costs and expenses	$ 417	$ 385
Dividends Per Share	$ 0.29	$ 0.23

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

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CONSOLIDATED STATEMENT OF EARNINGS

(UNAUDITED)

(Dollars in millions, except per share amounts)	Six Months Ended July 1 2007	Six Months Ended July 2 2006
Net Sales:		
Products	$ 8,858	$ 8,299
Services	4,033	3,181
	12,891	11,480
Operating Costs and Expenses:		
Products	7,816	7,407
Services	3,634	2,828
	11,450	10,235
Operating Earnings	1,441	1,245
Interest, net	(47)	(40)
Other, net	2	2
Earnings from Continuing Operations before Income Taxes	1,396	1,207
Provision for income taxes, net	438	400
Earnings from Continuing Operations	958	807
Discontinued operations, net of tax	(11)	203
Net Earnings	$ 947	$ 1,010
Earnings per Share		
Basic:		
Continuing operations	$ 2.36	$ 2.01
Discontinued operations	(0.03)	0.50
Net earnings	$ 2.33	$ 2.51
Diluted:		
Continuing operations	$ 2.34	$ 1.99
Discontinued operations	(0.03)	0.50
Net earnings	$ 2.31	$ 2.49
Supplemental Information:		
General and administrative expenses included in operating costs and expenses	$ 810	$ 748
Dividends Per Share	$ 0.58	$ 0.46

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

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CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

(Dollars in millions)	Six Months Ended July 1 2007	Six Months Ended July 2 2006
Cash Flows from Operating Activities:		
Net earnings	$ 947	$ 1,010
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation of property, plant and equipment	132	120
Amortization of intangible assets	75	57
Stock-based compensation expense	41	32
Excess tax benefit from stock-based compensation	(26)	(26)
Deferred income tax provision	53	11
Discontinued operations, net of tax	11	(203)
(Increase) decrease in assets, net of effects of business acquisitions		
Accounts receivable	(186)	197
Contracts in process	(188)	(286)
Inventories	(100)	(214)
Other current assets	(38)	(23)
Increase (decrease) in liabilities, net of effects of business acquisitions		
Accounts payable	(159)	(26)
Customer advances and deposits	417	78
Other current liabilities	(54)	4
Other, net	2	81
Net Cash Provided by Operating Activities from Continuing Operations	927	812
Net Cash Used by Discontinued Operations-Operating Activities	(8)	(19)
Net Cash Provided by Operating Activities	919	793
Cash Flows from Investing Activities:		
Business acquisitions, net of cash acquired	(299)	(2,154)
Capital expenditures	(166)	(117)
Proceeds from sale of assets, net	93	
Other, net	(6)	(8)
Discontinued operations	(1)	287
Net Cash Used by Investing Activities	(379)	(1,992)
Cash Flows from Financing Activities:		
Dividends paid	(210)	(173)
Purchases of common stock	(153)	(85)
Proceeds from option exercises	102	137
Excess tax benefit from stock-based compensation	26	26
Net proceeds from commercial paper		862
Repayment of fixed-rate notes		(500)
Other, net	(115)	
Net Cash (Used) Provided by Financing Activities	(350)	267
Net Increase (Decrease) in Cash and Equivalents	190	(932)
Cash and Equivalents at Beginning of Period	1,604	2,331
Cash and Equivalents at End of Period	$ 1,794	$ 1,399
Supplemental Cash Flow Information:		
Cash payments for:		
Income taxes	$ 365	$ 307
Interest	$ 64	$ 73

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

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

A. Basis of Preparation

The Company

The term company or General Dynamics used in this document refers to General Dynamics Corporation and all of its wholly owned and majority-owned subsidiaries.

Interim Financial Statements

The unaudited Consolidated Financial Statements included in this Form 10-Q 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.

Operating results for the three- and six-month periods ended July 1, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

In management s opinion, the unaudited Consolidated Financial Statements contain all adjustments, that are of a normal recurring nature, necessary for a fair statement of the company s results for the three- and six-month periods ended July 1, 2007, and July 2, 2006.

These unaudited Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in the company s Annual Report on Form 10-K for the year ended December 31, 2006.

Classification

Consistent with defense industry practice, the company classifies 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.

B. Acquisitions, Intangible Assets and Goodwill

In the first half of 2007, General Dynamics acquired two businesses for an aggregate of approximately $300 in cash.

Aerospace

WECO Aerospace Systems, Inc. (WECO), of Lincoln, California, on March 8. WECO is an aviation-component overhaul company specializing in electronic accessories and flight instrument services.

Combat Systems

SNC Technologies Inc. (SNC TEC), a wholly owned subsidiary of SNC-Lavalin Group Inc. of Montreal, Quebec, on January 8. SNC TEC is an ammunition system integrator that supplies small-, medium- and large-caliber ammunition and related products to the Canadian Forces, U.S. and other national defense customers, and law enforcement agencies around the world.

In 2006, General Dynamics acquired three businesses for an aggregate of approximately $2.3 billion in cash.

Combat Systems

Chamberlain Manufacturing Corporation s Scranton, Pennsylvania, operation (Scranton Operation) on July 7. The Scranton Operation is a supplier of large-caliber projectile metal parts to the U.S. government.

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Information Systems and Technology

Anteon International Corporation (Anteon) of Fairfax, Virginia, on June 8. Anteon is a leading systems integration company that provides mission, operational and information technology (IT) enterprise support to the U.S. government. As a condition of the acquisition, the company divested several of Anteon s program management and engineering services contracts. The company received approximately $150 in after-tax proceeds from the sale of these contracts, resulting in a net purchase price of approximately $2.1 billion.

FC Business Systems, Inc. (FCBS), of Fairfax, Virginia, on January 17. FCBS provides a broad spectrum of engineering and IT services to government customers.

General Dynamics funded the above acquisitions using commercial paper borrowings and cash on hand. The operating results of these businesses have been included with the company s results as of 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. Some of the estimates related to the SNC TEC acquisition were still preliminary at July 1, 2007. The company is in the process of identifying and valuing intangible and other assets acquired. The completion of this analysis could result in an increase or decrease to the preliminary value assigned to these acquired assets, as well as to future periods amortization expense. The company expects the analysis to be completed during the third quarter of 2007 without any material adjustments.

Intangible assets consisted of the following:

	July 1 2007			December 31 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Contract and program intangible assets	$ 1,376	$ (448)	$ 928	$ 1,369	$ (390)	$ 979
Other intangible assets	358	(193)	165	383	(178)	205
Total intangible assets	$ 1,734	$ (641)	$ 1,093	$ 1,752	$ (568)	$ 1,184

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Contract and program intangible assets represent primarily acquired backlog and probable follow-on work and related customer relationships. The company amortizes these assets over 7 to 40 years. The weighted-average amortization life of these assets as of July 1, 2007, was 17 years. Other intangible assets consist primarily of aircraft product design and customer lists, amortized over 9 and 21 years, respectively, and software and licenses, amortized over 5 to 11 years.

Amortization expense was $36 and $75 for the three- and six-month periods ended July 1, 2007, and $30 and $57 for the three- and six-month periods ended July 2, 2006. The company expects to record annual amortization expense over the next five years as follows:

2008	$ 135
2009	$ 134
2010	$ 130
2011	$ 121
2012	$ 118

The changes in the carrying amount of goodwill by business group for the six months ended July 1, 2007, were as follows:

	Aerospace	Combat Systems	Marine Systems	Information Systems and Technology	Total Goodwill
December 31, 2006	$ 343	$ 2,069	$ 185	$ 5,944	$ 8,541
Acquisitions [(a)]	6	79		106	191
Other [(b)]		85		21	106
July 1, 2007	$ 349	$ 2,233	$ 185	$ 6,071	$ 8,838

(a) Includes adjustments to preliminary assignment of fair value to net assets acquired.
(b) Consists primarily of adjustments for foreign currency translation.

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C. Discontinued Operations

The company sold its aggregates business in the second quarter of 2006. The company received proceeds of approximately $300 in the second quarter of 2006 and recognized an after-tax gain of approximately $220. Also in 2006, the company began a process to sell its coal mining operation. Efforts to complete the sale are ongoing, and the company expects to close the sale of this business in 2007. The financial statements for all periods have been restated to remove the revenues and expenses of these businesses from the company s consolidated results of operations and present the results of their operations in discontinued operations. The results of operations and assets and liabilities of these businesses were not material to the Consolidated Financial Statements as of or for the three- and six-month periods ended July 1, 2007, and July 2, 2006.

D. Earnings per Share and Comprehensive Income

Earnings Per Share

General Dynamics computes basic earnings per share using net earnings for the respective period and the weighted average number of common shares outstanding during the period. Diluted earnings per share incorporates the incremental shares issuable upon the assumed exercise of stock options and issuance of restricted shares.

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

	Three Months Ended		***Six Months Ended***	
	July 1 2007	**July 2 2006**	**July 1 2007**	**July 2 2006**
Basic weighted average shares outstanding	405,150	403,518	405,373	402,494
Dilutive effect of stock options and restricted stock	3,750	3,440	3,795	3,236
Diluted weighted average shares outstanding	408,900	406,958	409,168	405,730

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Comprehensive Income

The company s comprehensive income was $590 and $1,033 for the three- and six-month periods ended July 1, 2007, respectively, and $719 and $988 for the three- and six-month periods ended July 2, 2006, respectively. The primary components of the company s comprehensive income are net earnings and foreign currency translation adjustment.

E. Stock-based Compensation

On January 1, 2006, the company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense in the financial statements based on their fair value at the grant date. The following table details the components of stock-based compensation expense recognized in earnings in the three- and six-month periods ended July 1, 2007, and July 2, 2006:

	Three Months Ended		***Six Months Ended***	
	July 1 2007	**July 2 2006**	**July 1 2007**	**July 2 2006**
Stock options	$ 11	$ 8	$ 20	$ 17
Restricted stock	4	2	7	4
Total stock-based compensation expense included in earnings, net of tax	$ 15	$ 10	$ 27	$ 21

The company includes stock-based compensation expense in general and administrative expenses. Compensation expense for stock options is reported as a Corporate expense for segment reporting purposes (see Note M).

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F. Contracts in Process

Contracts in process represent recoverable costs and, where applicable, accrued profit related to government contracts and consisted of the following:

	July 1 2007	December 31 2006
Contract costs and estimated profits	$ 17,840	$ 16,100
Other contract costs	1,197	1,297
	19,037	17,397
Less advances and progress payments	14,804	13,409
Total contracts in process	$ 4,233	$ 3,988

Contract costs consist primarily of labor and material costs and related overhead and G&A expenses. Contract costs also include contract recoveries for matters such as contract changes, negotiated settlements and claims for unanticipated contract costs, which totaled approximately $10 as of July 1, 2007, and approximately $350 as of December 31, 2006. The company has resolved substantially all of its outstanding claims, including its request for equitable adjustment related to its T-AKE combat logistics ship contract. The company records revenue associated with these matters only when recovery can be estimated reliably and realization is probable.

Other contract costs represent amounts recorded under GAAP that are not currently allocable to contracts, such as a portion of the company s estimated workers compensation, other insurance-related assessments, pension and other post-retirement benefits, and environmental expenses. These costs will become allocable to contracts generally when they are paid. The company expects to recover these costs through ongoing business, including existing backlog and probable follow-on contracts. This business base includes numerous contracts for which the company is the sole source or is one of two suppliers on long-term defense programs. However, if the backlog in the future does not support the continued deferral of these costs, the profitability of the company s remaining contracts could be adversely affected. The decrease in other contract costs since year-end 2006 relates primarily to a reduction in deferred workers compensation and pension costs. The company expects to bill substantially all of its July 1, 2007, contracts-in-process balance, with the exception of these other contract costs, during the next 12 months.

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G. Inventories

Inventories represent primarily commercial aircraft components and consisted of the following:

	July 1 2007	December 31 2006
Raw materials	$ 801	$ 711
Work in process	725	715
Pre-owned aircraft	47	44
Other	22	14
Total inventories	$ 1,595	$ 1,484

H. Debt

Debt consisted of the following:

	Interest Rates	July 1 2007	December 31 2006
Fixed-rate notes			
Notes due in May 2008	3.000%	$ 499	$ 499
Notes due in August 2010	4.500%	699	699
Notes due in May 2013	4.250%	999	999
Notes due in August 2015	5.375%	400	400
Senior notes due in 2008	6.320%	150	150
Term debt due in 2008	7.500%	25	25
Other	Various	17	9
Total debt		2,789	2,781
Less current portion		506	7
Long-term debt		$ 2,283	$ 2,774

As of July 1, 2007, General Dynamics had outstanding $2.6 billion aggregate principal amount of fixed-rate notes. The sale of the fixed-rate notes was registered under the Securities Act of 1933, as amended (the Securities Act). The notes are fully and unconditionally guaranteed by several of the company s 100-percent-owned subsidiaries. The company has the option to redeem the notes prior to their maturity in whole or in part at 100 percent of the outstanding principal plus any accrued but unpaid

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interest and any applicable make-whole amounts. See Note N for condensed consolidating financial statements.

The senior notes are privately placed U.S. dollar-denominated notes issued by one of the company s Canadian subsidiaries. Interest is payable semiannually at an annual rate of 6.32 percent until maturity in September 2008. The subsidiary has a currency swap that fixes both the interest payments and principal at maturity of these notes. As of July 1, 2007, the fair value of this currency swap was a $58 liability, which offset the effect of changes in the currency exchange rate on the related debt. The senior notes are backed by a parent company guarantee.

The company assumed the term debt in connection with the acquisition of Primex Technologies, Inc., in 2001. A final annual sinking fund payment of $5 is required in December of 2007, with the remaining $20 payable in December 2008. Interest is payable in June and December at a rate of 7.5 percent annually.

As of July 1, 2007, other debt consisted primarily of a capital lease arrangement and $10 of non-interest-bearing debt assumed in connection with the company s acquisition of SNC TEC in January 2007.

As of July 1, 2007, and December 31, 2006, the company had no commercial paper outstanding but maintains the ability to access the market. The company has approximately $2 billion in bank credit facilities that provide backup liquidity to its commercial paper program. These credit facilities consist of a $1 billion multiyear facility expiring in July 2009 and a $975 multiyear facility expiring in December 2011. The company s commercial paper issuances and the bank credit facilities are guaranteed by several of the company s 100-percent-owned subsidiaries. Additionally, a number of the company s international subsidiaries have available local bank credit facilities aggregating approximately $810.

The company s financing arrangements contain a number of customary covenants and restrictions. The company was in compliance with all material covenants as of July 1, 2007.

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I. Liabilities

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

	July 1 2007	December 31 2006
Retirement benefits	$ 760	$ 739
Salaries and wages	559	457
Workers compensation	508	546
Other [(a)]	938	1,170
Other current liabilities	$ 2,765	$ 2,912
Deferred U.S. federal income taxes	$ 835	$ 854
Retirement benefits	559	386
Customer deposits on commercial contracts	523	308
Other [(b)]	447	403
Other liabilities	$ 2,364	$ 1,951

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

(b) *Consists primarily of liabilities for warranty reserves and workers compensation.*

J. Income Taxes

The company had a net deferred tax liability of $753 at July 1, 2007, and $722 at December 31, 2006. The current portion of the net deferred taxes was an asset of $104 at July 1, 2007, and $139 at December 31, 2006, and is included in other current assets on the Consolidated Balance Sheet.

On November 27, 2001, the company filed a refund suit in the U.S. Court of Federal Claims, titled *General Dynamics v. United States*, for the years 1991 to 1993. The company added the years 1994 to 1998 to the litigation on June 23, 2004. The suit seeks recovery of refund claims that were disallowed by the Internal Revenue Service (IRS) at the administrative level. On December 30, 2005, the court issued its opinion regarding one of the issues in the case. The court held that the company could not treat the A-12 contract as complete for federal income tax purposes in 1991, the year the contract was terminated. (See Note K for more information regarding the A-12 contract.) The company is considering whether to appeal this decision. With respect to the other issues in the suit, the company has reached a basis for settlement with the Department of Justice. However, the settlement is pending final approval by

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the Department of Justice and the Joint Committee on Taxation of the Congress. If the settlement is approved, the company expects the refund to be approximately $36, including after-tax interest. The company has recognized no benefit from this matter.

In the second quarter of 2007, the company and the IRS reached agreement on the examination of the company s federal income tax returns for 2003 and 2004, with the exception of one open immaterial issue. As a result of resolution of the 2003-2004 audit, the company reassessed its tax contingencies during the quarter and recognized a benefit of approximately $18, or $0.05 per share.

The IRS has examined all of the company s consolidated federal income tax returns through 2004. The company has recorded liabilities for tax uncertainties for all years that remain open to review. The company does not expect the resolution of tax matters for these years to have a material impact on its results of operations, financial condition or cash flows.

The company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109*, (FIN 48) on January 1, 2007. FIN 48 clarifies the accounting for income tax uncertainties. The company has developed and implemented a process based on the guidelines of FIN 48 to ensure that uncertain tax positions are identified, analyzed and properly reported in the company s financial statements in accordance with SFAS 109, *Accounting for Income Taxes*. Based on all known facts and circumstances and current tax law, the company believes that the total amount of unrecognized tax benefits as of July 1, 2007, is not material to its results of operations, financial condition or cash flows. The company also believes that the total amount of unrecognized tax benefits as of July 1, 2007 (with the exception of the refund suit discussed above), if recognized, would not have a material impact on its effective tax rate. The company further believes that, other than the potential resolution of the tax litigation discussed above, 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 the company s results of operations, financial condition or cash flows.

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K. Commitments and Contingencies

Litigation

Termination of A-12 Program. In January 1991, the U.S. Navy terminated the company s 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. Both the company and McDonnell Douglas, now owned by The Boeing Company, (the contractors) were parties to the contract with the Navy. 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 decision by the U.S. Court of Federal Claims (the trial court) on the contractors challenge to the termination for default, or a negotiated settlement.

On December 19, 1995, the trial court issued an order converting the termination for default to a termination for convenience. On March 31, 1998, a final judgment was entered in favor of the contractors for $1.2 billion plus interest.

On July 1, 1999, the U.S. Court of Appeals for the Federal Circuit (the appeals court) remanded the case to the trial court for determination of whether the government s default termination was justified. On August 31, 2001, following the trial on remand, the trial court upheld the default termination of the A-12 contract. In its opinion, the trial court rejected all of the government s arguments to sustain the default termination except for the government s schedule arguments, as to which the trial court held that the schedule the government unilaterally imposed was reasonable and enforceable, and that the government had not waived that schedule. On the sole ground that the contractors were not going to deliver the first aircraft on the date provided in the unilateral schedule, the trial court upheld the default termination and entered judgment for the government.

On January 9, 2003, the company s appeal was argued before a three-judge panel of the appeals court. On March 17, 2003, the appeals court vacated the trial court s judgment and remanded the case to the trial court for further proceedings. The appeals court found that the trial court had misapplied the

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controlling legal standard in concluding the termination for default could be sustained solely on the basis of the contractors inability to complete the first flight of the first test aircraft by December 1991. Rather, the appeals court held that to uphold a termination for default, the trial court would have to determine that there was no reasonable likelihood that the contractors could perform the entire contract effort within the time remaining for performance.

On May 3, 2007, the trial court issued a decision upholding the government s default termination. The company believes that the trial court failed to follow the appeals court ruling and continues to believe that the evidence supports a determination that the government s default termination was not justified. On May 30, 2007, the company filed a notice of appeal.

If, contrary to the company s expectations, the default termination is ultimately sustained, 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 $1.3 billion at July 1, 2007. This would result in a liability for the company of approximately $1.3 billion pretax. The company s after-tax charge would be approximately $750, or $1.83 per share, to be recorded in discontinued operations. The company s after-tax cash cost would be approximately $675. The company believes it has sufficient resources to satisfy its obligation if required.

Other. Various claims and other legal proceedings incidental to the normal course of business are pending or threatened against the company. While it cannot predict the outcome of these matters, the company believes any potential liabilities in these proceedings, individually or in the aggregate, will not have a material impact on its results of operations, financial condition or cash flows.

Environmental

General Dynamics is subject to and affected by a variety of federal, state, local and foreign environmental laws and regulations. The company is directly or indirectly involved in environmental investigations or remediation at some of its current and former facilities, and at third-party sites not owned by the company but where it has been designated a Potentially Responsible Party (PRP) by the U.S. Environmental Protection Agency or a state environmental agency. Based on historical experience, the company expects 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, the company provides financial assurance for certain sites undergoing or subject to investigation or remediation. Where applicable, the company seeks insurance recovery for costs related to environmental liability. The company does 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 costs, the company does not believe that its liability at any individual site, or in the aggregate, arising from such environmental conditions, will be material to its results of operations, financial condition or cash flows. The company also does not believe that the range of reasonably possible additional loss beyond what has been recorded would be material to its results of operations, financial condition or cash flows.

Other

In the ordinary course of business, General Dynamics has entered into letters of credit and other similar arrangements with financial institutions and insurance carriers totaling approximately $1.5 billion at July 1, 2007.

The company, from time to time in the ordinary course of business, guarantees the payment or performance obligations of its subsidiaries arising under certain contracts. The company is aware of no event of default that would require it to satisfy these guarantees.

As a government contractor, the company is occasionally subject to U.S. government audits and investigations relating to its operations, including claims for fines, penalties, and compensatory and treble damages. Based on currently available information, the company believes the outcome of such ongoing government disputes and investigations will not have a material impact on its results of operations, financial condition or cash flows.

In the ordinary course of business, the company s Aerospace group offers customers trade-in options, which may or may not be exercised by the customers, in connection with new-aircraft sales transactions. If these options are exercised, the company will accept trade-in aircraft (Gulfstream and

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competitor aircraft) at a predetermined minimum trade-in price as partial consideration in the new aircraft transactions. Any excess of the trade-in price above the fair market value is treated as a reduction of revenue upon recording of the new aircraft sales transaction. As of July 1, 2007, these option commitments were not material.

The company provides product warranties to its customers associated with certain product sales, particularly business-jet aircraft. The company records estimated warranty costs in the period in which the related products are delivered. The warranty liability recorded at each balance sheet date is based on the estimated number of months of warranty coverage remaining for products delivered and the average historical monthly warranty payments, and is included in other current liabilities and other liabilities on the Consolidated Balance Sheet.

The changes in the carrying amount of warranty liabilities for the six-month periods ended July 1, 2007, and July 2, 2006, were as follows:

Six Months Ended	**July 1 2007**	**July 2 2006**
Beginning balance	$ 219	$ 202
Warranty expense	32	42
Payments	(25)	(27)
Adjustments [(a)]		1
Ending balance [(b)]	$ 226	$ 218

(a) *Includes warranty liabilities assumed in connection with acquisitions and foreign exchange translation adjustments.*

(b) *Warranty obligations incurred in connection with long-term production contracts are accounted for within the contract estimates at completion (EACs) and are excluded from the above amounts.*

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L. Retirement Plans

The company provides defined-benefit pension and other post-retirement benefits to eligible employees.

Net periodic pension and other post-retirement benefit costs for the three- and six-month periods ended July 1, 2007, and July 2, 2006, consisted of the following:

			Other	
	Pension Benefits		***Post-retirement Benefits***	
Three Months Ended	**July 1 2007**	**July 2 2006**	**July 1 2007**	**July 2 2006**
Service cost	$ 53	$ 67	$ 4	$ 5
Interest cost	104	106	16	17
Expected return on plan assets	(139)	(136)	(6)	(6)
Recognized net actuarial loss	3	7	1	2
Amortization of prior service cost	(11)	(3)		
Net periodic cost	$ 10	$ 41	$ 15	$ 18

			Other	
	Pension Benefits		***Post-retirement Benefits***	
Six Months Ended	**July 1 2007**	**July 2 2006**	**July 1 2007**	**July 2 2006**
Service cost	$ 106	$ 133	$ 8	$ 9
Interest cost	208	212	32	34
Expected return on plan assets	(277)	(272)	(13)	(13)
Recognized net actuarial loss	6	15	3	4
Amortization of prior service cost	(23)	(6)	1	1
Amortization of transition obligation			1	1
Net periodic cost	$ 20	$ 82	$ 32	$ 36

General Dynamics contractual arrangements with the U.S. government provide for the recovery of contributions to the company s pension plans covering employees working in its government contracting businesses. With respect to post-retirement benefit plans, the company s government contracts provide for the recovery of contributions to a Voluntary Employees Beneficiary Association trust and, for non-funded plans, recovery of claims paid. The cumulative pension and post-retirement benefit cost for some of these plans exceeds the company s cost currently allocable to contracts. To the extent recovery of the cost is considered probable based on the company s backlog, the company defers the excess in contracts in process on the Consolidated Balance Sheet until the cost is paid, charged to contracts and included in net sales. For other plans, the amount contributed to the plans, charged to contracts and included in net sales has exceeded the plans cumulative benefit cost. The company has deferred recognition of these excess earnings to provide a better matching of revenues and expenses. These deferrals have been classified against the prepaid benefit cost related to these plans. (See Note F for discussion of the company s deferred contract costs.)

On December 31, 2006, the company adopted SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*. SFAS 158 amended SFAS 87, *Employers Accounting for Pensions*, SFAS 106, *Employers Accounting for Postretirement Benefits*, and SFAS 132(R), *Employers Disclosures About Pension and Other Postretirement Benefits*. This statement requires balance sheet recognition of the overfunded or underfunded status of pension and post-retirement benefit plans. The difference between the asset or liability recognized under SFAS 87 or SFAS 106 and the funded status of these plans is recorded directly to accumulated other comprehensive income in shareholders equity on the Consolidated Balance Sheet. SFAS 158 does not change the measurement or reporting of periodic pension or post-retirement benefit cost.

M. Business Group Information

General Dynamics operates in four business groups: Aerospace, Combat Systems, Marine Systems, and Information Systems and Technology. The company organizes and measures its business groups in accordance with the nature of products and services offered. These business groups derive their revenues from business aviation; land and expeditionary combat vehicles, armaments and munitions; shipbuilding and marine systems; and mission-critical information systems and technologies, respectively. The company measures each group s profit based on operating earnings. As a result, the company does not allocate net interest, other income and expense items, and income taxes to its business groups.

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Summary financial information for each of the company s business groups follows:

	Net Sales		Operating Earnings	
Three Months Ended	July 1 2007	July 2 2006	July 1 2007	July 2 2006
Aerospace	$ 1,208	$ 1,067	$ 199	$ 166
Combat Systems	1,712	1,444	191	172
Marine Systems	1,272	1,266	112	92
Information Systems and Technology	2,399	2,157	269	232
Corporate *			(11)	(13)
	$ 6,591	$ 5,934	$ 760	$ 649

	Net Sales		Operating Earnings	
Six Months Ended	July 1 2007	July 2 2006	July 1 2007	July 2 2006
Aerospace	$ 2,302	$ 1,996	$ 372	$ 311
Combat Systems	3,280	2,813	365	319
Marine Systems	2,529	2,541	210	189
Information Systems and Technology	4,780	4,130	519	452
Corporate *			(25)	(26)
	$ 12,891	$ 11,480	$ 1,441	$ 1,245

	Identifiable Assets	
	July 1 2007	December 31 2006
Aerospace	$ 2,936	$ 2,755
Combat Systems	6,908	6,347
Marine Systems	2,399	2,347
Information Systems and Technology	9,406	9,323
Corporate *	1,758	1,604
	$ 23,407	$ 22,376

* *Corporate operating results include the company s stock option expense and a portion of the operating results of the company s commercial pension plans. Corporate identifiable assets include cash and equivalents from domestic operations, assets of discontinued operations and a portion of the net prepaid pension cost related to the company s commercial pension plans.*

N. 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 100-percent-owned subsidiaries of General Dynamics Corporation (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 as of July 1, 2007, and December 31,

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2006, for the balance sheet, as well as the statements of earnings and cash flows for the three- and six-month periods ended July 1, 2007, and July 2, 2006.

Condensed Consolidating Statement of Earnings

Three Months Ended July 1, 2007	**Parent**	**Guarantors on a Combined Basis**	**Other Subsidiaries on a Combined Basis**	**Consolidating Adjustments**	**Total Consolidated**
Net Sales	$	$ 5,727	$ 864	$	$ 6,591
Cost of sales	(6)	4,710	710		5,414
General and administrative expenses	17	349	51		417
Operating Earnings	(11)	668	103		760
Interest expense	29	1	4		34
Interest income	4		9		13
Other, net		1			1
Earnings from Continuing Operations before Income Taxes	(36)	668	108		740
Provision for income taxes	(35)	225	32		222
Discontinued operations, net of tax		(5)			(5)
Equity in net earnings of subsidiaries	514			(514)	
Net Earnings	$ 513	$ 438	$ 76	$ (514)	$ 513
Three Months Ended July 2, 2006					
Net Sales	$	$ 5,141	$ 793	$	$ 5,934
Cost of sales	1	4,237	662		4,900
General and administrative expenses	12	332	41		385
Operating Earnings	(13)	572	90		649
Interest expense	37	1	3		41
Interest income	10	1	7		18
Other, net		1	1		2
Earnings from Continuing Operations before Income Taxes	(40)	573	95		628
Provision for income taxes	(24)	197	35		208
Discontinued operations, net of tax		216			216
Equity in net earnings of subsidiaries	652			(652)	
Net Earnings	$ 636	$ 592	$ 60	$ (652)	$ 636

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Six Months Ended July 1, 2007	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
Net Sales	$	$ 11,230	$ 1,661	$	$ 12,891
Cost of sales	(5)	9,262	1,383		10,640
General and administrative expenses	30	680	100		810
Operating Earnings	(25)	1,288	178		1,441
Interest expense	57	2	7		66
Interest income	7		12		19
Other, net		1	1		2
Earnings from Continuing Operations before Income Taxes	(75)	1,287	184		1,396
Provision for income taxes	(60)	438	60		438
Discontinued operations, net of tax		(11)			(11)
Equity in net earnings of subsidiaries	962			(962)	
Net Earnings	$ 947	$ 838	$ 124	$ (962)	$ 947
Six Months Ended July 2, 2006					
Net Sales	$	$ 9,903	$ 1,577	$	$ 11,480
Cost of sales	1	8,173	1,313		9,487
General and administrative expenses	25	639	84		748
Operating Earnings	(26)	1,091	180		1,245
Interest expense	68	2	6		76
Interest income	22	1	13		36
Other, net		1	1		2
Earnings from Continuing Operations before Income Taxes	(72)	1,091	188		1,207
Provision for income taxes	(39)	373	66		400
Discontinued operations, net of tax		203			203
Equity in net earnings of subsidiaries	1,043			(1,043)	
Net Earnings	$ 1,010	$ 921	$ 122	$ (1,043)	$ 1,010

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Condensed Consolidating Balance Sheet

July 1, 2007	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
ASSETS					
Current Assets:					
Cash and equivalents	$ 835	$	$ 959	$	$ 1,794
Accounts receivable		1,585	954		2,539
Contracts in process	411	3,165	657		4,233
Inventories					
Raw materials		754	47		801
Work in process		714	11		725
Pre-owned aircraft		47			47
Other		16	6		22
Assets of discontinued operations		26			26
Other current assets	132	46	186		364
Total Current Assets	1,378	6,353	2,820		10,551
Noncurrent Assets:					
Property, plant and equipment	127	3,588	660		4,375
Accumulated depreciation and amortization of PP&E	(20)	(1,794)	(328)		(2,142)
Intangible assets and goodwill		8,781	1,791		10,572
Accumulated amortization of intangible assets		(533)	(108)		(641)
Other assets	184	473	35		692
Investment in subsidiaries	17,424			(17,424)	
Total Noncurrent Assets	17,715	10,515	2,050	(17,424)	12,856
	$ 19,093	$ 16,868	$ 4,870	$ (17,424)	$ 23,407
LIABILITIES AND SHAREHOLDERS EQUITY					
Current Liabilities:					
Short-term debt	$ 499	$ 6	$ 1	$	$ 506
Liabilities of discontinued operations		30			30
Other current liabilities	571	4,765	2,266		7,602
Total Current Liabilities	1,070	4,801	2,267		8,138
Noncurrent Liabilities:					
Long-term debt	2,098	22	163		2,283
Other liabilities	299	1,795	270		2,364
Total Noncurrent Liabilities	2,397	1,817	433		4,647
Shareholders Equity:					
Common stock, including surplus	1,494	6,072	1,580	(7,655)	1,491
Other shareholders equity	14,132	4,178	590	(9,769)	9,131
Total Shareholders Equity	15,626	10,250	2,170	(17,424)	10,622
	$ 19,093	$ 16,868	$ 4,870	$ (17,424)	$ 23,407

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Condensed Consolidating Balance Sheet

December 31, 2006	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
ASSETS					
Current Assets:					
Cash and equivalents	$ 594	$	$ 1,010	$	$ 1,604
Accounts receivable		1,389	952		2,341
Contracts in process	403	2,963	622		3,988
Inventories					
Work in process		714	1		715
Raw materials		678	33		711
Pre-owned aircraft		44			44
Other		12	2		14
Assets of discontinued operations		109			109
Other current assets	161	80	113		354
Total Current Assets	1,158	5,989	2,733		9,880
Noncurrent Assets:					
Property, plant and equipment	140	3,471	577		4,188
Accumulated depreciation and amortization of PP&E	(23)	(1,694)	(303)		(2,020)
Intangible assets and goodwill		8,798	1,495		10,293
Accumulated amortization of intangible assets		(476)	(92)		(568)
Other assets	187	382	34		603
Investment in subsidiaries	15,492			(15,492)	
Total Noncurrent Assets	15,796	10,481	1,711	(15,492)	12,496
	$ 16,954	$ 16,470	$ 4,444	$ (15,492)	$ 22,376
LIABILITIES AND SHAREHOLDERS EQUITY					
Current Liabilities:					
Short-term debt	$	$ 6	$ 1	$	$ 7
Liabilities of discontinued operations		228			228
Other current liabilities	586	4,691	2,312		7,589
Total Current Liabilities	586	4,925	2,313		7,824
Noncurrent Liabilities:					
Long-term debt	2,597	23	154		2,774
Other liabilities	234	1,548	169		1,951
Total Noncurrent Liabilities	2,831	1,571	323		4,725
Shareholders Equity:					
Common stock, including surplus	1,362	6,075	1,158	(7,233)	1,362
Other shareholders equity	12,175	3,899	650	(8,259)	8,465
Total Shareholders Equity	13,537	9,974	1,808	(15,492)	9,827
	$ 16,954	$ 16,470	$ 4,444	$ (15,492)	$ 22,376

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Condensed Consolidating Statement of Cash Flows

Six Months Ended July 1, 2007	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
Net Cash Provided by Operating Activities	$ (191)	$ 1,036	$ 74	$	$ 919
Cash Flows from Investing Activities:					
Business acquisitions, net of cash acquired		(18)	(281)		(299)
Other, net	37	(95)	(22)		(80)
Net Cash Used by Investing Activities	37	(113)	(303)		(379)
Cash Flows from Financing Activities:					
Dividends paid	(210)				(210)
Purchases of common stock	(153)				(153)
Other, net	128	(1)	(114)		13
Net Cash Used by Financing Activities	(235)	(1)	(114)		(350)
Cash sweep/funding by parent	630	(922)	292		
Net Increase in Cash and Equivalents	241		(51)		190
Cash and Equivalents at Beginning of Period	594		1,010		1,604
Cash and Equivalents at End of Period	$ 835	$	$ 959	$	$ 1,794
Six Months Ended July 2, 2006					
Net Cash Provided by Operating Activities	$ (326)	$ 714	$ 405	$	$ 793
Cash Flows from Investing Activities:					
Business acquisitions, net of cash acquired	(2)	(2,152)			(2,154)
Proceeds from sale of assets, net		299			299
Other, net	(1)	(118)	(18)		(137)
Net Cash Used by Investing Activities	(3)	(1,971)	(18)		(1,992)
Cash Flows from Financing Activities:					
Net proceeds from commercial paper	862				862
Repayment of fixed-rate notes	(500)				(500)
Other, net	(93)		(2)		(95)
Net Cash Provided by Financing Activities	269		(2)		267
Cash sweep/funding by parent	(1,203)	1,257	(54)		
Net Decrease in Cash and Equivalents	(1,263)		331		(932)
Cash and Equivalents at Beginning of Period	1,563		768		2,331
Cash and Equivalents at End of Period	$ 300	$	$ 1,099	$	$ 1,399

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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 is a market leader in business aviation; land and expeditionary combat vehicles and systems, armaments, and munitions; shipbuilding and marine systems; and mission-critical information systems and technologies. The company operates through four business groups Aerospace, Combat Systems, Marine Systems, and Information Systems and Technology. General Dynamics 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. The company operates in two primary markets defense and business aviation. The majority of the company s revenues derive from contracts with the U.S. military. The following discussion should be read in conjunction with the company s 2006 Annual Report on Form 10-K, filed with the Securities and Exchange Commission, and with the unaudited Consolidated Financial Statements included herein.

Results of Operations

Consolidated Overview

Three Months Ended	**July 1 2007**	**July 2 2006**	**Variance**	
Net sales	$ 6,591	$ 5,934	$ 657	11.1%
Operating earnings	760	649	111	17.1%
Operating margin	11.5%	10.9%		

Six Months Ended	**July 1 2007**	**July 2 2006**	**Variance**	
Net sales	$ 12,891	$ 11,480	$ 1,411	12.3%
Operating earnings	1,441	1,245	196	15.7%
Operating margin	11.2%	10.8%		

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General Dynamics generated strong growth in net sales in the second quarter and first half of 2007 compared to the same periods in 2006. The sales growth was driven principally by higher new aircraft sales to meet continued demand in the Aerospace group and increased volume on combat vehicle programs in the Combat Systems group. Acquisitions in the Combat Systems and Information Systems and Technology groups also contributed to the increased sales in the second quarter and first six months of 2007. The Marine Systems group s sales were steady compared to 2006.

The company s second-quarter and first-half operating earnings and margins increased significantly in 2007 over the prior year periods. Each of the company s business groups experienced double-digit growth in operating earnings in the second quarter and first six months compared with 2006. The growth in operating earnings resulted from the increased volume in the Aerospace, Combat Systems and Information Systems and Technology groups, and from significantly improved margins in the Aerospace and Marine Systems groups. This led to overall margin expansion for the company of 60 basis points for the second quarter and 40 basis points for the first half of 2007. General and administrative (G&A) expenses as a percentage of net sales in the first six months of 2007 were 6.3 percent compared with 6.5 percent in the first half of 2006. The company expects G&A expenses as a percent of sales for the full-year 2007 to approximate the full-year 2006 rate of 6.2 percent.

General Dynamics earnings were backed by continued strong cash performance in the first half of 2007. Net cash provided by operating activities was $919, compared with $793 in the first six months of 2006 (96 percent and 98 percent of earnings from continuing operations, respectively). The company used cash to fund acquisitions and capital expenditures, repurchase its common stock and pay dividends. The company s net debt debt less cash and equivalents and short-term investments has decreased by $1.3 billion since the second quarter of 2006 despite almost $500 spent on acquisitions, over $150 of share repurchases and approximately $400 of dividends paid during the past 12 months.

The company s effective tax rate for the six-month period ended July 1, 2007, was 31.4 percent compared with 33.1 percent in the same period in 2006. The company s effective tax rate for the first half of 2007 was impacted favorably by the resolution of the company s 2003-2004 federal income tax audit during the second quarter. This settlement resulted in an $18, or approximately $0.05 per-share benefit, which reduced the company s effective tax rate for the first half of 2007 by 1.3 percent. The company anticipates an effective tax rate of approximately 32 to 33 percent for the full-year 2007, excluding the effect of the second-quarter IRS settlement and the potential resolution of other tax matters related to prior years or other discrete events that may occur in the future. For additional discussion of tax matters, see Note J to the unaudited Consolidated Financial Statements.

The company completed the sale of its aggregates operation in the second quarter of 2006. The company received approximately $300 in cash from the sale of this business and recognized an after-tax gain of $220 in discontinued operations. In addition, the company initiated a process in 2006 to sell its coal mining operation. With the sale of the aggregates business and the expected sale of the coal business in 2007, the operations previously reported as Resources have been reclassified to discontinued operations. The company s reported net sales exclude the revenues associated with these businesses, and their operating results for the first half of 2007 and 2006 have been included in discontinued operations, net of income taxes.

The company s total backlog was $44.6 billion as of July 1, 2007, up 2 percent from $43.6 billion at April 1, 2007. Funded backlog grew 3 percent during the second quarter to $35.4 billion. The total backlog in the Aerospace group increased 20 percent in the second quarter as the group continued to experience record-level order activity. The Aerospace group s total backlog reached a new high of $10.1 billion at July 1, 2007. The company s total backlog does not include work awarded under numerous indefinite delivery, indefinite quantity (IDIQ) contracts, unexercised options associated with existing firm contracts or options to purchase new aircraft. Management s estimate of the potential value to the company of these contracts, which may be realized over the next 15 years, was over $11 billion at the end of the second quarter of 2007.

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Aerospace

Three Months Ended	**July 1 2007**	**July 2 2006**	**Variance**	
Net sales	$ 1,208	$ 1,067	$ 141	13.2%
Operating earnings	199	166	33	19.9%
Operating margin	16.5%	15.6%		
Aircraft deliveries (in units):				
Green	36	29		
Completion	36	26		

Six Months Ended	**July 1 2007**	**July 2 2006**	**Variance**
Net sales	$ 2,302	$ 1,996	