INTUIT INC
Form 10-Q
May 28, 2010

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

FORM 10-Q

þ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended April 30, 2010

OR

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______ to ______.

Commission File Number 0-21180

INTUIT INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0034661**
(State of incorporation)	*(IRS employer identification no.)*

2700 Coast Avenue, Mountain View, CA 94043

(Address of principal executive offices)

(650) 944-6000

(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 (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. 314,117,010 shares of Common Stock, $0.01 par value, were outstanding at May 24, 2010.

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PART I
ITEM 1
FINANCIAL STATEMENTS

INTUIT INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In millions, except per share amounts)	**Three Months Ended April 30, 2010**	**April 30, 2009**	**Nine Months Ended April 30, 2010**	**April 30, 2009**
Net revenue:				
Product	$ 564	$ 534	$ 1,191	$ 1,185
Service and other	1,043	883	1,727	1,467
Total net revenue	1,607	1,417	2,918	2,652
Costs and expenses:				
Cost of revenue:				
Cost of product revenue	34	34	117	122
Cost of service and other revenue	118	115	341	315
Amortization of purchased intangible assets	5	15	43	44
Selling and marketing	309	274	766	725
Research and development	141	130	426	404
General and administrative	102	74	267	208
Acquisition-related charges	10	10	31	33
Total costs and expenses	719	652	1,991	1,851
Operating income from continuing operations	888	765	927	801
Interest expense	(15)	(12)	(46)	(36)
Interest and other income, net	5	6	12	11
Income from continuing operations before income taxes	878	759	893	776
Income tax provision	302	274	306	257
Net income from continuing operations	576	485	587	519
Net income (loss) from discontinued operations			35	(1)
Net income	$ 576	$ 485	$ 622	$ 518
Basic net income per share from continuing operations	$ 1.83	$ 1.51	$ 1.86	$ 1.61
Basic net income (loss) per share from discontinued operations			0.11	
Basic net income per share	$ 1.83	$ 1.51	$ 1.97	$ 1.61

Shares used in basic per share calculations	314	322	316	322
Diluted net income per share from continuing operations	$ 1.78	$ 1.47	$ 1.80	$ 1.57
Diluted net income (loss) per share from discontinued operations			0.11	
Diluted net income per share	$ 1.78	$ 1.47	$ 1.91	$ 1.57
Shares used in diluted per share calculations	323	329	325	329

See accompanying notes.

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INTUIT INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In millions)	**April 30, 2010**	**July 31, 2009**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 430	$ 679
Investments	1,499	668
Accounts receivable, net	204	135
Income taxes receivable	1	67
Deferred income taxes	108	92
Prepaid expenses and other current assets	60	43
Current assets of discontinued operations		12
Current assets before funds held for customers	2,302	1,696
Funds held for customers	275	272
Total current assets	2,577	1,968
Long-term investments	92	97
Property and equipment, net	518	527
Goodwill	1,853	1,754
Purchased intangible assets, net	252	291
Long-term deferred income taxes	44	36
Other assets	91	77
Long-term assets of discontinued operations		76
Total assets	$ 5,427	$ 4,826
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 166	$ 103
Accrued compensation and related liabilities	186	171
Deferred revenue	310	360
Income taxes payable	283	
Other current liabilities	187	153
Current liabilities of discontinued operations		25
Current liabilities before customer fund deposits	1,132	812
Customer fund deposits	275	272
Total current liabilities	1,407	1,084
Long-term debt	998	998
Other long-term obligations	164	187

Total liabilities	2,569	2,269
Commitments and contingencies		
Stockholders equity:		
Preferred stock		
Common stock and additional paid-in capital	2,668	2,547
Treasury stock, at cost	(3,266)	(2,846)
Accumulated other comprehensive income	11	7
Retained earnings	3,445	2,849
Total stockholders equity	2,858	2,557
Total liabilities and stockholders equity	$ 5,427	$ 4,826

See accompanying notes.

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INTUIT INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(Unaudited)

(In millions, except shares in thousands)	**Shares of Common Stock**	**Common Stock and Additional Paid-In Capital**	**Treasury Stock**	**Accumulated Other Comprehensive Income**	**Retained Earnings**	**Total Stockholders Equity**
Balance at July 31, 2009	**322,766**	**$ 2,547**	**$ (2,846)**	**$ 7**	**$ 2,849**	**$ 2,557**
Components of comprehensive net income:						
Net income (loss)					622	622
Other comprehensive income (loss), net of tax				4		4
Comprehensive net income (loss)						626
Issuance of common stock under employee stock plans	13,808	26	302		(2)	326
Restricted stock units released, net of taxes	1,517	(24)	28		(24)	(20)
Stock repurchases under stock repurchase programs	(24,624)		(750)			(750)
Tax benefit from employee stock option transactions		23				23
Share-based compensation		99				99
Other		(3)				(3)
Balance at April 30, 2010	**313,467**	**$ 2,668**	**$ (3,266)**	**$ 11**	**$ 3,445**	**$ 2,858**

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In millions, except shares in thousands)	**Shares of Common Stock**	**Common Stock and Additional Paid-In Capital**	**Treasury Stock**	**Accumulated Other Comprehensive Income (Loss)**	**Retained Earnings**	**Total Stockholders Equity**
Balance at July 31, 2008	**322,600**	**$ 2,415**	**$ (2,787)**	**$ 8**	**$ 2,444**	**$ 2,080**

Components of comprehensive net income:						
Net income (loss)					518	518
Other comprehensive income (loss), net of tax				(5)		(5)
Comprehensive net income (loss)						513
Issuance of common stock under employee stock plans	6,495		141		(15)	126
Restricted stock units released, net of taxes	950	(15)	21		(21)	(15)
Stock repurchases under stock repurchase programs	(7,383)		(200)			(200)
Tax benefit from employee stock option transactions		8				8
Share-based compensation		94				94
Other		(6)				(6)
Balance at April 30, 2009	**322,662**	**$ 2,496**	**$ (2,825)**	**$ 3**	**$ 2,926**	**$ 2,600**

See accompanying notes.

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INTUIT INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In millions)	Three Months Ended April 30, 2010	Three Months Ended April 30, 2009	Nine Months Ended April 30, 2010	Nine Months Ended April 30, 2009
Cash flows from operating activities:				
Net income	$ 576	$ 485	$ 622	$ 518
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation	36	36	111	105
Amortization of intangible assets	19	27	87	84
Share-based compensation	34	37	99	94
Pre-tax gain on sale of IRES (1)			(58)	
Deferred income taxes	(39)	1	(61)	45
Tax benefit from share-based compensation plans	13	2	23	8
Excess tax benefit from share-based compensation plans	(6)	(1)	(11)	(7)
Other	5	3	15	10
Total adjustments	62	105	205	339
Changes in operating assets and liabilities:				
Accounts receivable	264	170	(67)	(146)
Prepaid expenses, income taxes receivable and other assets	48	154	43	40
Accounts payable	7	25	63	40
Accrued compensation and related liabilities	51	22	13	(76)
Deferred revenue	(201)	(174)	(45)	(52)
Income taxes payable	280	150	282	137
Other liabilities	(43)	(2)	33	78
Total changes in operating assets and liabilities	406	345	322	21
Net cash provided by operating activities (1)	**1,044**	**935**	**1,149**	**878**
Cash flows from investing activities:				
Purchases of available-for-sale debt securities	(1,169)	(71)	(1,719)	(138)
Sales of available-for-sale debt securities	205	28	623	292
Maturities of available-for-sale debt securities	69	3	112	27
Net change in funds held for customers money market funds and other cash equivalents	39	(50)	146	267
Purchases of property and equipment	(34)	(31)	(100)	(148)
Net change in customer fund deposits	(38)	50	3	(267)

Acquisitions of businesses, net of cash acquired		(8)	(141)	(8)
Proceeds from divestiture of business			122	
Other	(6)	(3)	(12)	
Net cash provided by (used in) investing activities	**(934)**	**(82)**	**(966)**	**25**
Cash flows from financing activities:				
Net proceeds from issuance of common stock under stock plans	176	31	326	126
Tax payments related to issuance of restricted stock units			(20)	(15)
Purchase of treasury stock	(200)		(750)	(200)
Excess tax benefit from share-based compensation plans	6	1	11	7
Other	(1)	(2)	(2)	(2)
Net cash provided by (used in) financing activities	**(19)**	**30**	**(435)**	**(84)**

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Other comprehensive income (loss) before tax	41	119	(45)	122
Provision for income tax, net	36	20	69	41
Other comprehensive income (loss), net of tax	5	99	(114)	81
Comprehensive income	$ 645	$ 640	$1,097	$1,217

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

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CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in millions)	December 31, 2013	June 29, 2014
ASSETS		
Current assets:		
Cash and equivalents	$5,301	$3,841
Accounts receivable	4,370	4,474
Contracts in process	4,780	4,934
Inventories	2,890	3,158
Other current assets	821	776
Total current assets	18,162	17,183
Noncurrent assets:		
Property, plant and equipment, net	3,359	3,327
Intangible assets, net	1,044	983
Goodwill	11,932	11,927
Other assets	997	912
Total noncurrent assets	17,332	17,149
Total assets	$35,494	$34,332
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term debt and current portion of long-term debt	$1	$501
Accounts payable	2,216	2,486
Customer advances and deposits	6,584	6,694
Other current liabilities	3,458	3,541
Total current liabilities	12,259	13,222
Noncurrent liabilities:		
Long-term debt	3,908	3,409
Other liabilities	4,826	4,582
Commitments and contingencies (See Note L)		
Total noncurrent liabilities	8,734	7,991
Shareholders' equity:		
Common stock	482	482
Surplus	2,226	2,415
Retained earnings	19,428	20,142
Treasury stock	(6,450)	(8,816)
Accumulated other comprehensive loss	(1,185)	(1,104)
Total shareholders' equity	14,501	13,119
Total liabilities and shareholders' equity	$35,494	$34,332

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended	
(Dollars in millions)	June 30, 2013	June 29, 2014
Cash flows from operating activities - continuing operations:		
Net earnings	$1,211	$1,136
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation of property, plant and equipment	186	191
Amortization of intangible assets	79	61
Stock-based compensation expense	61	64
Excess tax benefit from stock-based compensation	(16)	(54)
Deferred income tax provision	47	64
Discontinued operations, net of taxes	(1)	106
Increase in assets, net of effects of business acquisitions:		
Accounts receivable	(102)	(104)
Contracts in process	(125)	(130)
Inventories	(161)	(278)
Increase (decrease) in liabilities, net of effects of business acquisitions:		
Accounts payable	(10)	270
Customer advances and deposits	(54)	25
Income taxes payable	50	188
Other current liabilities	(149)	(81)
Other, net	71	(164)
Net cash provided by operating activities	1,087	1,294
Cash flows from investing activities - continuing operations:		
Capital expenditures	(165)	(162)
Other, net	4	17
Net cash used by investing activities	(161)	(145)
Cash flows from financing activities - continuing operations:		
Purchases of common stock	(485)	(2,691)
Proceeds from option exercises	212	415
Dividends paid	(198)	(411)
Excess tax benefit from stock-based compensation	16	54
Net cash used by financing activities	(455)	(2,633)
Net cash (used) provided by discontinued operations	(10)	24
Net increase (decrease) in cash and equivalents	461	(1,460)
Cash and equivalents at beginning of period	3,296	5,301
Cash and equivalents at end of period	$3,757	$3,841
Supplemental cash flow information:		
Cash payments for:		
Income taxes	$468	$281
Interest	$46	$44

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)

	Common Stock		Retained	Treasury	Accumulated Other Comprehensive	Total Shareholders'
(Dollars in millions)	Par	Surplus	Earnings	Stock	Loss	Equity
Balance, December 31, 2012	$482	$1,988	$17,860	$(6,165)	$(2,775)	$11,390
Net earnings	—	—	1,211	—	—	1,211
Cash dividends declared	—	—	(394)	—	—	(394)
Stock-based awards	—	55	—	193	—	248
Shares purchased	—	—	—	(585)	—	(585)
Other comprehensive loss	—	—	—	—	(114)	(114)
Balance, June 30, 2013	$482	$2,043	$18,677	$(6,557)	$(2,889)	$11,756
Balance, December 31, 2013	$482	$2,226	$19,428	$(6,450)	$(1,185)	$14,501
Net earnings	—	—	1,136	—	—	1,136
Cash dividends declared	—	—	(422)	—	—	(422)
Stock-based awards	—	189	—	325	—	514
Shares purchased	—	—	—	(2,691)	—	(2,691)
Other comprehensive income	—	—	—	—	81	81
Balance, June 29, 2014	$482	$2,415	$20,142	$(8,816)	$(1,104)	$13,119

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

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per-share amounts or unless otherwise noted)
A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
Basis of Consolidation and Classification. The unaudited Consolidated Financial Statements include the accounts of General Dynamics Corporation and our wholly owned and majority-owned subsidiaries. We eliminate all inter-company balances and transactions in the unaudited Consolidated Financial Statements.
Consistent with defense industry practice, we classify assets and liabilities related to long-term production contracts as current, even though some of these amounts may not be realized within one year.
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- and six-month periods ended June 29, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.
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- and six-month periods ended June 30, 2013, and June 29, 2014.
These unaudited Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013.
The unaudited Consolidated Financial Statements have been restated to reflect the results of operations of our axle business in discontinued operations (see further discussion below).
Revenue Recognition. We account for revenues and earnings using the percentage-of-completion method. Under this method, contract costs and revenues are recognized as the work progresses, either as the products are produced or as services are rendered. We estimate the profit on a contract as the difference between the total estimated revenue and costs to complete a contract and recognize that profit over the life of the contract. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, we recognize the loss in the quarter it is identified.
We review and update our contract estimates regularly. We recognize changes in estimated profit on contracts under the reallocation method. Under the reallocation method, the impact of a revision in estimate is recognized prospectively over the remaining contract term. The net increase in our operating earnings (and on a per-share basis) from the favorable impact of revisions in contract estimates totaled $83 ($0.15) and $191 ($0.35) for the three- and six-month periods ended June 30, 2013, and $62 ($0.12) and $100 ($0.19) for the three- and six-month periods ended June 29, 2014, respectively. While no revisions on any one contract were material to our unaudited Consolidated Financial Statements in the second quarter and first six months of 2014, the amount decreased compared with the prior-year periods as 2013 included higher favorable revisions in contract estimates on several programs nearing completion in the Combat Systems and Information Systems and Technology groups.

In the second quarter of 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. ASU 2014-9 prescribes a single, common revenue standard that replaces most existing revenue recognition guidance in GAAP. The standard outlines a five-step model, whereby revenue is recognized as performance obligations within a contract are satisfied. The standard also requires new, expanded disclosures regarding revenue recognition. ASU 2014-9 is effective in the first quarter of 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition method nor have we determined the effect of the standard on our consolidated financial statements.

The required adoption of the ASU in 2017 will preclude our use of the reallocation method of recognizing revisions in estimated profit on contracts discussed above. Because changes in estimated profit will be recognized in the period they are identified (cumulative catch-up method), rather than prospectively over the remaining contract term, we expect that the impact of revisions of contract estimates may be larger and potentially more variable from period to period. Anticipated losses on contracts will continue to be recognized in the quarter they are identified.

Discontinued Operations. In June 2014, we committed to a plan to sell our axle business in the Combat Systems group. Accordingly, the assets and liabilities of the business, including an allocation of goodwill, were reported as held for sale and included in other current assets and liabilities on the unaudited Consolidated Balance Sheets. When a business is held for sale, management is required to evaluate the net assets of the business for impairment based on its fair value less cost to sell. Based on this analysis, we recognized a $106 after-tax loss in the second quarter.

In late 2013, we settled our litigation with the U.S. Navy related to a terminated contract in the company’s former tactical military aircraft business. Under the terms of the settlement agreement, the Navy received a $198 credit that will be utilized over several years as the company renders design and construction services on the DDG-1000 program. This activity will be reported in net cash from discontinued operations on the Consolidated Statements of Cash Flows.

Subsequent Events. We have evaluated material events and transactions that have occurred after June 29, 2014, and concluded that no subsequent events have occurred that require adjustment to or disclosure in this Form 10-Q.

B. ACQUISITIONS, INTANGIBLE ASSETS AND GOODWILL

We did not acquire any businesses in 2013 or 2014.

The changes in the carrying amount of goodwill by reporting unit for the six months ended June 29, 2014, were as follows:

	Aerospace	Combat Systems	Marine Systems	Information Systems and Technology	Total Goodwill
December 31, 2013 (a)	$2,741	$2,849	$289	$6,053	$11,932
Other (b)	(2)	(5)	—	2	(5)
June 29, 2014	$2,739	$2,844	$289	$6,055	$11,927

(a)Goodwill on December 31, 2013, in the Information Systems and Technology reporting unit is net of $1,994 of accumulated impairment losses.

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

Intangible assets consisted of the following:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	December 31, 2013			June 29, 2014		
Contract and program intangible assets*	$1,790	$(1,189)	$601	$1,629	$(1,076)	$553
Trade names and trademarks	507	(103)	404	505	(111)	394
Technology and software	130	(92)	38	130	(95)	35
Other intangible assets	155	(154)	1	155	(154)	1
Total intangible assets	$2,582	$(1,538)	$1,044	$2,419	$(1,436)	$983

* Consists of acquired backlog and probable follow-on work and related customer relationships. The decrease in the gross carrying amount and accumulated amortization of contract and program intangible assets from December 31, 2013, to June 29, 2014, is primarily due to the write-off of fully amortized assets in the Information Systems and Technology group.

Amortization expense was $37 and $79 for the three- and six-month periods ended June 30, 2013, and $31 and $61 for the three- and six-month periods ended June 29, 2014, respectively. We expect to record amortization expense of $121 in 2014.

C. EARNINGS PER SHARE

Earnings per Share. We compute basic earnings per share (EPS) using net earnings for the period and the weighted average number of common shares outstanding during the period. Basic weighted average shares outstanding have decreased throughout 2013 and 2014 due to share repurchases. Diluted EPS incorporates the additional shares issuable upon the assumed exercise of stock options and the release of restricted shares and restricted stock units (RSUs). Diluted EPS also includes contingently issuable shares associated with the settlement of our accelerated share repurchase (ASR) program that expires later in 2014. See Note J for additional details of our share repurchases and the ASR.

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

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 29, 2014	June 30, 2013	June 29, 2014
Basic weighted average shares outstanding	351,110	336,692	351,492	339,462
Dilutive effect of other securities*	1,822	6,093	1,732	5,905
Diluted weighted average shares outstanding	352,932	342,785	353,224	345,367

* Excludes the following outstanding options to purchase shares of common stock and nonvested restricted stock/RSUs because the effect of including these securities would be antidilutive: 2013 - 16,484 and 2014 - 2,922.

D. FAIR VALUE

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

- Level 1 – quoted prices in active markets for identical assets or liabilities;
- Level 2 – inputs, other than quoted prices, observable by a marketplace participant either directly or indirectly; and
- Level 3 – unobservable inputs significant to the fair value measurement.

We did not have any significant non-financial assets or liabilities measured at fair value on December 31, 2013, or June 29, 2014, except for our assets held for sale (discussed in Note A) that were measured at fair value using Level 3 inputs. Our estimate of fair value considered the discounted projected cash flows of the underlying operations and an evaluation of market prices for similar assets.

Our financial instruments include cash and equivalents and other investments; accounts receivable and accounts payable; short- and long-term debt; and derivative financial instruments. The carrying values of cash and equivalents, accounts receivable and accounts payable on the Consolidated Balance Sheets approximate their fair value. The following tables present the fair values of our other financial assets and liabilities on December 31, 2013, and June 29, 2014, and the basis for determining their fair values:

	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2) (a)
Financial assets (liabilities) (b)	December 31, 2013			
Other investments	$183	$183	$134	$49
Derivatives	10	10	—	10
Long-term debt, including current portion	(3,909)	(3,758)	—	(3,758)
	June 29, 2014			
Other investments	$173	$173	$108	$65
Derivatives	9	9	—	9
Long-term debt, including current portion	(3,910)	(3,869)	—	(3,869)

(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, 2013, or June 29, 2014.

E. INCOME TAXES

Deferred Taxes. Our net deferred tax asset (liability) was included on the Consolidated Balance Sheets in other assets and liabilities as follows:

	December 31, 2013	June 29, 2014
Current deferred tax asset	$35	$34
Current deferred tax liability	(300)	(321)
Noncurrent deferred tax asset	462	373
Noncurrent deferred tax liability	(135)	(91)
Net deferred tax asset (liability)	$62	$(5)

Tax Uncertainties. For all periods open to examination by tax authorities, we periodically assess our liabilities and contingencies based on the latest available information. Where we believe there is more than a 50 percent chance that our tax position will not be sustained, we record our best estimate of the resulting tax liability, including interest, in the Consolidated Financial Statements. We include any interest or penalties incurred in connection with income taxes as part of income tax expense.

We participate in the Internal Revenue Service (IRS) Compliance Assurance Process, a real-time audit of our consolidated corporate federal income tax return. The IRS has examined our consolidated federal income tax returns through 2012. We do not expect the resolution of tax matters for open years to have a material impact on our results of operations, financial condition, cash flows or effective tax rate.

Based on all known facts and circumstances and current tax law, we believe the total amount of unrecognized tax benefits on June 29, 2014, is not material to our results of operations, financial condition or cash flows, and if recognized, would not have a material impact on our effective tax rate. We further believe that there are no tax positions for which it is reasonably possible that the unrecognized tax benefits will significantly vary over the next 12 months, producing, individually or in the aggregate, a material effect on our results of operations, financial condition or cash flows.

F. CONTRACTS IN PROCESS

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

	December 31, 2013	June 29, 2014
Contract costs and estimated profits	$7,961	$8,013
Other contract costs	1,178	1,100
	9,139	9,113
Advances and progress payments	(4,359)	(4,179)
Total contracts in process	$4,780	$4,934

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

G. INVENTORIES

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

Inventories consisted of the following:

	December 31, 2013	June 29, 2014
Work in process	$1,633	$1,906
Raw materials	1,210	1,181
Finished goods	29	26
Pre-owned aircraft	18	45
Total inventories	$2,890	$3,158

H. DEBT

Debt consisted of the following:

		December 31, 2013	June 29, 2014
Fixed-rate notes due:	Interest Rate		
January 2015	1.375%	$500	$500
July 2016	2.250%	500	500
November 2017	1.000%	896	896
July 2021	3.875%	499	499
November 2022	2.250%	991	992
November 2042	3.600%	498	498
Other	Various	25	25
Total debt		3,909	3,910
Less current portion		1	501
Long-term debt		$3,908	$3,409

Our fixed-rate notes are fully and unconditionally guaranteed by several of our 100-percent-owned subsidiaries (see Note O for condensed consolidating financial statements). We have the option to redeem the notes prior to their maturity in whole or part for the principal plus any accrued but unpaid interest and applicable make-whole amounts. As we approach the maturity date of the fixed-rate notes due in January 2015, we will determine whether to repay these notes with cash on hand or refinance the obligation.

On June 29, 2014, we had no commercial paper outstanding, but we maintain the ability to access the commercial paper market in the future. We have $2 billion in committed bank credit facilities that provide backup liquidity to our commercial paper program. These credit facilities include a $1 billion multi-year facility expiring in July 2016 and a $1 billion multi-year facility expiring in July 2018. These facilities are required by rating agencies to support our commercial paper issuances. We may renew or replace, in whole or part, these credit facilities at or prior to their expiration dates. Our commercial paper issuances and the bank credit facilities are guaranteed by several of our 100-percent-owned subsidiaries. In addition, we have approximately $280 in committed bank credit facilities to provide backup liquidity to our European businesses.

Our financing arrangements contain a number of customary covenants and restrictions. We were in compliance with all material covenants on June 29, 2014.

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I. OTHER LIABILITIES
A summary of significant other liabilities by balance sheet caption follows:

	December 31, 2013	June 29, 2014
Salaries and wages	$801	$698
Workers' compensation	497	478
Retirement benefits	303	304
Deferred income taxes	300	321
Income taxes payable	36	173
Other (a)	1,521	1,567
Total other current liabilities	$3,458	$3,541
Retirement benefits	$3,064	$2,915
Customer deposits on commercial contracts	677	592
Deferred income taxes	135	91
Other (b)	950	984
Total other liabilities	$4,826	$4,582

(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 and liabilities of discontinued operations.

J. SHAREHOLDERS' EQUITY
Dividends per Share. Dividends declared per share were $0.56 and $1.12 for the three- and six-month periods ended June 30, 2013, and $0.62 and $1.24 for the three- and six-month periods ended June 29, 2014, respectively. Cash dividends paid were $198 for the six-month period ended June 30, 2013, and $213 and $411 for the three- and six-month periods ended June 29, 2014. In advance of possible tax increases, we accelerated our first quarter 2013 dividend payments to December 2012.
Share Repurchases. In the first six months of 2014, we repurchased approximately 25 million of our outstanding shares. Of this amount, 11.4 million shares were repurchased on January 24, 2014, for $1.2 billion under an ASR program facilitated through a financial institution. Our final cost of the ASR program will be determined based on the weighted-average daily market price of our stock during the term of the agreement, which expires later in 2014. On February 5, 2014, with shares from the prior authorization largely exhausted by the ASR program, the board of directors authorized management to repurchase 20 million additional shares of common stock on the open market. Subsequently, we repurchased an additional 13.6 million shares at an average price of $112 per share. On June 29, 2014, 6.4 million shares remain authorized by our board of directors for repurchase, approximately 2 percent of our total shares outstanding. We repurchased 7.6 million shares at an average price of $77 per share in the first six months of 2013.

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Accumulated Other Comprehensive Loss. The changes, before tax and net of tax, in each component of accumulated other comprehensive loss (AOCL) consisted of the following:

	Gains (losses) on Cash Flow Hedges	Unrealized Gains on Securities	Foreign Currency Translation Adjustments	Changes in Retirement Plans' Funded Status	AOCL
Balance, December 31, 2012	$6	$7	$1,092	$(3,880)	$(2,775)
Other comprehensive (loss) income before tax	(12)	7	(244)	204	(45)
Provision for income tax, net	4	(2)	3	(74)	(69)
Other comprehensive (loss) income net of tax	(8)	5	(241)	130	(114)
Balance, June 30, 2013	$(2)	$12	$851	$(3,750)	$(2,889)

	Gains (losses) on Cash Flow Hedges	Unrealized Gains on Securities	Foreign Currency Translation Adjustments	Changes in Retirement Plans' Funded Status	AOCL
Balance, December 31, 2013	$9	$15	$974	$(2,183)	$(1,185)
Other comprehensive (loss) income before tax	(9)	6	9	116	122
Provision for income tax, net	3	(2)	(1)	(41)	(41)
Other comprehensive (loss) income net of tax	(6)	4	8	75	81
Balance, June 29, 2014	$3	$19	$982	$(2,108)	$(1,104)

Amounts reclassified out of AOCL related primarily to changes in retirement plans' funded status and consisted of recognized net actuarial losses (before tax) of $224 and $153 for the six-month periods ended June 30, 2013, and June 29, 2014, respectively. This was partially offset by amortization of prior service credit (before tax) of $26 and $35 for the six-month periods ended June 30, 2013, and June 29, 2014, respectively. These AOCL components are included in our net periodic pension and other post-retirement benefit cost. See Note M for additional details.

K. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

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

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

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

Investment Risk. Our investment policy allows for purchases of fixed-income securities with an investment-grade rating and a maximum maturity of up to five years. On June 29, 2014, we held $3.8 billion in cash and equivalents, but held no marketable securities.

Hedging Activities. We had $1.7 billion in notional forward exchange contracts outstanding on December 31, 2013, and $1.4 billion on June 29, 2014. We recognize derivative financial instruments on the Consolidated Balance Sheets at fair value (see Note D).

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

Net gains and losses recognized in earnings and OCL, including gains and losses related to hedge ineffectiveness, were not material to our results of operations for the three- and six-month periods ended June 30, 2013, and June 29, 2014. We do not expect the amount of gains and losses in OCL that will be reclassified to earnings during the next 12 months to be material.

We had no material derivative financial instruments designated as fair value or net investment hedges on December 31, 2013, or June 29, 2014.

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

We do not hedge the fluctuation in reported revenues and earnings resulting from the translation of these international operations' results into U.S. dollars. The impact of translating our international operations' revenues and earnings into U.S. dollars was not material to our results of operations for the three- and six-month periods ended June 30, 2013, or June 29, 2014. In addition, the effect of changes in foreign exchange rates on non-U.S. cash balances was not material in the first six months of either 2013 or 2014.

L. COMMITMENTS AND CONTINGENCIES

Litigation

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

Environmental

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

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

Other

Portugal Program. In 2012, the Portuguese Ministry of National Defense notified our Combat Systems group's European Land Systems business that it was terminating the contract to provide 260 Pandur vehicles based on an alleged breach of contract. Subsequently, the customer drew $75 from bank guarantees for the contract. We have asserted that we are not in breach of the contract and that the termination of the contract was invalid, and we are currently in arbitration with the customer. As of June 29, 2014, we had approximately $145 outstanding under a bank guarantee for the program's offset requirements. The bank guarantee could be drawn upon by the customer through 2014.

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

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

Letters of Credit and Guarantees. In the ordinary course of business, we have entered into letters of credit, bank guarantees, surety bonds and other similar arrangements with financial institutions and insurance carriers totaling approximately $1.1 billion on June 29, 2014. In addition, from time to time and in the ordinary course of business, we contractually guarantee the payment or performance obligations of our subsidiaries arising under certain contracts.
Aircraft Trade-ins. In connection with orders for new aircraft in funded contract backlog, our Aerospace group has outstanding options with some customers to trade in aircraft as partial consideration in their new-aircraft transaction. These trade-in commitments are structured to establish the fair market value of the trade-in aircraft at a date generally 120 or fewer days preceding delivery of the new aircraft to the customer. At that time, the customer is required to either exercise the option or allow its expiration. Any excess of the pre-established trade-in price above the fair market value at the time the new aircraft is delivered is treated as a reduction of revenue in the new-aircraft sales transaction.
Product Warranties. We provide warranties to our customers associated with certain product sales. We record estimated warranty costs in the period in which the related products are delivered. The warranty liability recorded at each balance sheet date is generally based on the number of months of warranty coverage remaining for products delivered and the average historical monthly warranty payments. Warranty obligations incurred in connection with long-term production contracts are accounted for within the contract estimates at completion. Our other warranty obligations, primarily for business-jet aircraft, are included in other current and noncurrent liabilities on the Consolidated Balance Sheets.
The changes in the carrying amount of warranty liabilities for the six-month periods ended June 30, 2013, and June 29, 2014, were as follows:

Six Months Ended	June 30, 2013		June 29, 2014	
Beginning balance	$316		$354	
Warranty expense	52		62	
Payments	(29	)	(29	)
Ending balance	$339		$387	

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M. RETIREMENT PLANS

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

Net periodic cost associated with our defined-benefit pension and other post-retirement benefit plans for the three- and six-month periods ended June 30, 2013, and June 29, 2014, consisted of the following:

	Pension Benefits		Other Post-retirement Benefits	
Three Months Ended	June 30, 2013	June 29, 2014	June 30, 2013	June 29, 2014
Service cost	$80	$48	$4	$3
Interest cost	124	133	13	13
Expected return on plan assets	(148)	(164)	(7)	(8)
Recognized net actuarial loss	106	74	6	3
Amortization of prior service (credit) cost	(15)	(17)	2	(1)
Net periodic cost	$147	$74	$18	$10

	Pension Benefits		Other Post-retirement Benefits	
Six Months Ended	June 30, 2013	June 29, 2014	June 30, 2013	June 29, 2014
Service cost	$160	$96	$8	$6
Interest cost	248	266	26	26
Expected return on plan assets	(296)	(328)	(14)	(16)
Recognized net actuarial loss	212	148	12	5
Amortization of prior service (credit) cost	(30)	(34)	4	(1)
Net periodic cost	$294	$148	$36	$20

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

In 2011, changes were made to the CAS to harmonize the regulations with the Pension Protection Act of 2006 (PPA). For certain contracts awarded prior to February 27, 2012, we are entitled to recover additional pension costs from our customers resulting from the CAS harmonization with the PPA. We submitted REAs of approximately $165 for these contracts in 2012. These REAs remained outstanding on June 29, 2014, and are subject to negotiation with our customer, the U.S. Department of Defense.

N. BUSINESS GROUP INFORMATION

We operate in four business groups: Aerospace, Combat Systems, Marine Systems and Information Systems and Technology. We organize our business groups in accordance with the nature of products and services offered. These business groups derive their revenues from business aviation; combat vehicles, weapons systems and munitions; military and commercial shipbuilding and related services; and communication and information technology systems and solutions, 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:

	Revenues		Operating Earnings	
Three Months Ended	June 30, 2013	June 29, 2014	June 30, 2013	June 29, 2014
Aerospace	$2,053	$1,995	$389	$384
Combat Systems	1,472	1,465	219	220
Marine Systems	1,759	1,851	178	174
Information Systems and Technology	2,550	2,163	198	188
Corporate*	—	—	(23)	(17)
	$7,834	$7,474	$961	$949

	Revenues		Operating Earnings	
Six Months Ended	June 30, 2013	June 29, 2014	June 30, 2013	June 29, 2014
Aerospace	$3,831	$4,120	$699	$788
Combat Systems	2,935	2,723	430	359
Marine Systems	3,385	3,452	337	340
Information Systems and Technology	4,997	4,444	383	371
Corporate*	—	—	(45)	(35)
	$15,148	$14,739	$1,804	$1,823

*Corporate operating results consist primarily of stock option expense.

O. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

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

CONDENSED CONSOLIDATING STATEMENTS OF EARNINGS (UNAUDITED)

Three Months Ended June 30, 2013	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
Revenues	$—	$6,932	$902	$—	$7,834
Cost of sales	3	5,604	752	—	6,359
G&A	19	411	84	—	514
Operating earnings	(22)	917	66	—	961
Interest, net	(23)	5	—	—	(18)
Other, net	(1)	—	1	—	—
Earnings before income taxes	(46)	922	67	—	943
Provision for income taxes	(11)	283	31	—	303
Equity in net earnings of subsidiaries	675	—	—	(675)	—
Net earnings	$640	$639	$36	$(675)	$640
Comprehensive income	$645	$637	$(20)	$(617)	$645
Three Months Ended June 29, 2014					
Revenues	$—	$6,437	$1,037	$—	$7,474
Cost of sales	3	5,231	805	—	6,039
G&A	14	401	71	—	486
Operating earnings	(17)	805	161	—	949
Interest, net	(25)	—	1	—	(24)
Other, net	(2)	4	(2)	—	—
Earnings before income taxes	(44)	809	160	—	925
Provision for income taxes	(14)	270	23	—	279
Discontinued operations, net of taxes	(105)	—	—	—	(105)
Equity in net earnings of subsidiaries	676	—	—	(676)	—
Net earnings	$541	$539	$137	$(676)	$541
Comprehensive income	$640	$540	$200	$(740)	$640

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CONDENSED CONSOLIDATING STATEMENTS OF EARNINGS (UNAUDITED)

Six Months Ended June 30, 2013	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
Revenues	$—	$13,320	$1,828	$—	$15,148
Cost of sales	6	10,830	1,499	—	12,335
G&A	39	816	154	—	1,009
Operating earnings	(45)	1,674	175	—	1,804
Interest, net	(46)	4	1	—	(41)
Other, net	(1)	1	—	—	—
Earnings before income taxes	(92)	1,679	176	—	1,763
Provision for income taxes	(20)	513	60	—	553
Discontinued operations, net of tax	1	—	—		1
Equity in net earnings of subsidiaries	1,282	—	—	(1,282)	—
Net earnings	$1,211	$1,166	$116	$(1,282)	$1,211
Comprehensive income	$1,097	$1,185	$(143)	$(1,042)	$1,097
Six Months Ended June 29, 2014					
Revenues	$—	$12,830	$1,909	$—	$14,739
Cost of sales	9	10,429	1,501	—	11,939
G&A	28	769	180	—	977
Operating earnings	(37)	1,632	228	—	1,823
Interest, net	(47)	—	1	—	(46)
Other, net	(2)	4	(1)	—	1
Earnings before income taxes	(86)	1,636	228	—	1,778
Provision for income taxes	(23)	520	39	—	536
Discontinued operations, net of taxes	(106)	—	—	—	(106)
Equity in net earnings of subsidiaries	1,305	—	—	(1,305)	—
Net earnings	$1,136	$1,116	$189	$(1,305)	$1,136
Comprehensive income	$1,217	$1,111	$205	$(1,316)	$1,217

CONDENSED CONSOLIDATING BALANCE SHEETS (UNAUDITED)

December 31, 2013	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
ASSETS					
Current assets:					
Cash and equivalents	$4,179	$—	$1,122	$—	$5,301
Accounts receivable	—	1,451	2,919	—	4,370
Contracts in process	571	3,124	1,085	—	4,780
Inventories					
Work in process	—	1,623	10	—	1,633
Raw materials	—	1,172	38	—	1,210
Finished goods	—	24	5	—	29
Pre-owned aircraft	—	18	—	—	18
Other current assets	424	203	194	—	821
Total current assets	5,174	7,615	5,373	—	18,162
Noncurrent assets:					
Property, plant and equipment	156	5,827	1,169	—	7,152
Accumulated depreciation of PP&E	(64)	(3,062)	(667)	—	(3,793)
Intangible assets	—	1,614	968	—	2,582
Accumulated amortization of intangible assets	—	(1,111)	(427)	—	(1,538)
Goodwill	—	8,041	3,891	—	11,932
Other assets	600	483	398	(484)	997
Investment in subsidiaries	35,071	—	—	(35,071)	—
Total noncurrent assets	35,763	11,792	5,332	(35,555)	17,332
Total assets	$40,937	$19,407	$10,705	$(35,555)	$35,494
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Customer advances and deposits	$—	$3,493	$3,091	$—	$6,584
Other current liabilities	868	3,644	1,163	—	5,675
Total current liabilities	868	7,137	4,254	—	12,259
Noncurrent liabilities:					
Long-term debt	3,883	25	—	—	3,908
Other liabilities	2,333	2,007	486	—	4,826
Total noncurrent liabilities	6,216	2,032	486	—	8,734
Intercompany	19,352	(19,697)	345	—	—
Shareholders' equity:					
Common stock	482	6	3,570	(3,576)	482
Other shareholders' equity	14,019	29,929	2,050	(31,979)	14,019
Total shareholders' equity	14,501	29,935	5,620	(35,555)	14,501
Total liabilities and shareholders' equity	$40,937	$19,407	$10,705	$(35,555)	$35,494

CONDENSED CONSOLIDATING BALANCE SHEETS (UNAUDITED)

June 29, 2014	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
ASSETS					
Current assets:					
Cash and equivalents	$2,882	$—	$959	$—	$3,841
Accounts receivable	—	1,340	3,134	—	4,474
Contracts in process	524	2,974	1,436	—	4,934
Inventories					
Work in process	—	1,895	11	—	1,906
Raw materials	—	1,148	33	—	1,181
Finished goods	—	17	9	—	26
Pre-owned aircraft	—	45	—	—	45
Other current assets	262	304	210	—	776
Total current assets	3,668	7,723	5,792	—	17,183
Noncurrent assets:					
Property, plant and equipment	155	5,944	1,184	—	7,283
Accumulated depreciation of PP&E	(67)	(3,196)	(693)	—	(3,956)
Intangible assets	—	1,451	968	—	2,419
Accumulated amortization of intangible assets	—	(995)	(441)	—	(1,436)
Goodwill	—	7,992	3,935	—	11,927
Other assets	533	400	330	(351)	912
Investment in subsidiaries	36,489	—	—	(36,489)	—
Total noncurrent assets	37,110	11,596	5,283	(36,840)	17,149
Total assets	$40,778	$19,319	$11,075	$(36,840)	$34,332
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Short-term debt	$500	$1	$—	$—	$501
Customer advances and deposits	—	3,503	3,191	—	6,694
Other current liabilities	1,090	3,559	1,378	—	6,027
Total current liabilities	1,590	7,063	4,569	—	13,222
Noncurrent liabilities:					
Long-term debt	3,385	24	—	—	3,409
Other liabilities	2,122	2,027	433	—	4,582
Total noncurrent liabilities	5,507	2,051	433	—	7,991
Intercompany	20,562	(20,761)	199	—	—
Shareholders' equity:					
Common stock	482	6	2,043	(2,049)	482
Other shareholders' equity	12,637	30,960	3,831	(34,791)	12,637
Total shareholders' equity	13,119	30,966	5,874	(36,840)	13,119
Total liabilities and shareholders' equity	$40,778	$19,319	$11,075	$(36,840)	$34,332

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CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS (UNAUDITED)

Six Months Ended June 30, 2013	Parent	Guarantors on a Combined Basis	Other Subsidiaries on a Combined Basis	Consolidating Adjustments	Total Consolidated
Net cash provided by operating activities *	$(36)	$1,182	$(59)	$—	$1,087
Net cash used by investing activities *	2	(147)	(16)	—	(161)
Cash flows from financing activities:					
Purchases of common stock	(485)	—	—	—	(485)
Other, net	30	—	—	—	30
Net cash used by financing activities *	(455)	—	—	—	(455)
Net cash used by discontinued operations	(10)	—	—	—	(10)
Cash sweep/funding by parent	943	(1,035)	92	—	—
Net increase in cash and equivalents	444	—	17	—	461
Cash and equivalents at beginning of period	2,300	—	996	—	3,296
Cash and equivalents at end of period	$2,744	$—	$1,013	$—	$3,757
Six Months Ended June 29, 2014					
Net cash provided by operating activities *	$187	$1,197	$(90)	$—	$1,294
Net cash used by investing activities *	1	(132)	(14)	—	(145)
Cash flows from financing activities:					
Purchases of common stock	(2,691)	—	—	—	(2,691)
Proceeds from option exercises	415	—	—	—	415
Dividends paid	(411)	—	—	—	(411)
Other, net	54	—	—	—	54
Net cash used by financing activities *	(2,633)	—	—	—	(2,633)
Net cash provided by discontinued operations	24	—	—	—	24
Cash sweep/funding by parent	1,124	(1,065)	(59)	—	—
Net decrease in cash and equivalents	(1,297)	—	(163)	—	(1,460)
Cash and equivalents at beginning of period	4,179	—	1,122	—	5,301
Cash and equivalents at end of period	$2,882	$—	$959	$—	$3,841

* Continuing operations only

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

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

BUSINESS OVERVIEW

General Dynamics is an aerospace and defense company that offers a broad portfolio of products and services in business aviation; combat vehicles, weapons systems and munitions; shipbuilding; and communication and information technology systems and solutions. We operate globally through four business groups: Aerospace, Combat Systems, Marine Systems and Information Systems and Technology. Our primary customers are the U.S. government, including the Department of Defense, intelligence community and other U.S. government customers; international governments; and a wide range of corporate and individual customers for business jets. The following discussion should be read in conjunction with our 2013 Annual Report on Form 10-K and with the unaudited Consolidated Financial Statements included in this Form 10-Q. The unaudited Consolidated Financial Statements have been restated to reflect the results of operations of our axle business in discontinued operations (for further discussion, see Note A to the unaudited Consolidated Financial Statements).

RESULTS OF OPERATIONS

INTRODUCTION

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

In the Aerospace group, contracts for new aircraft have two major phases: the manufacture of the “green” aircraft and the aircraft’s outfitting, which includes exterior painting and installation of customer-selected interiors. We record revenues on these contracts at the completion of these two phases: when green aircraft are delivered to and accepted by the customer, and when the customer accepts final delivery of the outfitted aircraft. Revenues associated with the group’s completions of other original equipment manufacturers' (OEMs) aircraft and the group's services businesses are recognized as work progresses or upon delivery of services. Fluctuations in revenues from period to period result from the number and mix of new aircraft deliveries (green and outfitted), progress on aircraft completions and the level of aircraft service activity during the period.

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

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

the market for pre-owned aircraft, and the level of general and administrative (G&A) and net research and development (R&D) costs incurred by the group.
In the defense groups, revenue on long-term government contracts is recognized as work progresses, either as products are produced or services are rendered. As a result, variations in revenues are discussed generally in terms of volume, typically measured by the level of activity on individual contracts or programs. Year-over-year variances attributed to volume are due to changes in production or service levels and delivery schedules.
Operating costs for the defense groups consist of labor, material, subcontractor, overhead and G&A costs and are recognized generally as incurred. Variances in costs recognized from period to period primarily reflect increases and decreases in production or activity levels on individual contracts and, therefore, result largely from the same factors that drive variances in revenues.
Operating earnings and margins in the defense groups are driven by changes in volume, performance or contract mix. Performance refers to changes in profitability based on revisions to estimates at completion on individual contracts. These revisions result from increases or decreases to the estimated value of the contract, the estimated costs to complete or both. Therefore, changes in costs incurred in the period compared with prior periods do not necessarily impact profitability. It is only when total estimated costs at completion on a given contract change without a corresponding change in the value of that contract that the profitability of that contract may be impacted. Contract mix refers to changes in the volume of higher- vs. lower-margin work. Additionally, higher or lower margins can be inherent in the contract type (e.g., fixed-price/cost-reimbursable) or type of work (e.g., development/production).

CONSOLIDATED OVERVIEW

Three Months Ended	June 30, 2013		June 29, 2014		Variance			
Revenues	$7,834		$7,474		$(360	)	(4.6	)%
Operating costs and expenses	6,873		6,525		348		5.1	%
Operating earnings	961		949		(12	)	(1.2	)%
Operating margins	12.3	%	12.7	%				
Six Months Ended	June 30, 2013		June 29, 2014		Variance			
Revenues	$15,148		$14,739		$(409	)	(2.7	)%
Operating costs and expenses	13,344		12,916		428		3.2	%
Operating earnings	1,804		1,823		19		1.1	%
Operating margins	11.9	%	12.4	%				

Our revenues and operating costs and expenses were lower in the second quarter of 2014 compared with the prior-year period resulting in higher margins. The lower revenues reflect lower volume in our Information Systems and Technology group primarily due to decreased U.S. Army spending as a result of its lower operating tempo in hostile areas. For the six-month period, lower volume in our Information Systems and Technology and Combat Systems groups, also due to decreased U.S. Army spending, was partially offset by increased aircraft deliveries in our Aerospace group. Operating margins were up in 2014 compared with the prior-year periods primarily due to growth in higher-margin aircraft manufacturing, outfitting and completions revenues in the Aerospace group and improved performance in the Information Systems and Technology group.

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REVIEW OF BUSINESS GROUPS

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

AEROSPACE

Three Months Ended	June 30, 2013	June 29, 2014	Variance	
Revenues	$2,053	$1,995	$(58)	(2.8)%
Operating earnings	389	384	(5)	(1.3)%
Operating margin	18.9%	19.2%		
Gulfstream aircraft deliveries (in units):				
Green	35	33	(2)	(5.7)%
Outfitted	36	38	2	5.6%
Six Months Ended	June 30, 2013	June 29, 2014	Variance	
Revenues	$3,831	$4,120	$289	7.5%
Operating earnings	699	788	89	12.7%
Operating margin	18.2%	19.1%		
Gulfstream aircraft deliveries (in units):				
Green	65	68	3	4.6%
Outfitted	65	77	12	18.5%

Operating Results

The changes in the Aerospace group's revenues in the second quarter and first six months of 2014 compared with the prior-year periods consisted of the following:

	Second Quarter	Six Months
Aircraft manufacturing, outfitting and completions	$(44)	$299
Pre-owned aircraft	(43)	(83)
Aircraft services	29	73
Total (decrease) increase	$(58)	$289

Aircraft manufacturing, outfitting and completions revenues increased in the first half of 2014 primarily due to additional deliveries of G650 aircraft. Production rates and productivity for the G650 have been increasing since initial green deliveries in 2011. In the second quarter of 2014, revenues were down slightly due to the timing of deliveries from quarter to quarter. Pre-owned aircraft sales decreased as we had no sales in 2014 compared to three sales in the second quarter and five in the first half of 2013. We had four pre-owned aircraft in inventories on June 29, 2014, valued at $45, two of which are under contract. Aircraft services revenues continue to exceed the prior-year periods due to increased maintenance work in 2014.

The changes in the group's operating earnings in the second quarter and first six months of 2014 compared with the prior-year periods consisted of the following:

	Second Quarter	Six Months
Aircraft manufacturing, outfitting and completions	$30	$140
Pre-owned aircraft	3	4
Aircraft services	1	4
G&A/other expenses	(39)	(59)
Total (decrease) increase	$(5)	$89

Aircraft manufacturing, outfitting and completions earnings grew in the second quarter and first half of 2014 due to increased G650 deliveries and favorable cost performance in aircraft manufacturing and outfitting activities. Partially offsetting these increases were higher R&D expenses compared with the prior-year period associated with ongoing product-development efforts. Overall, the Aerospace group's operating margins increased 30 basis points in the second quarter and 90 basis points in the first six months of 2014 compared with the prior-year periods.

Outlook

We expect an increase of approximately 8 percent in the group’s full-year revenues in 2014 compared with 2013 as a result of increased deliveries of newer Gulfstream aircraft models. Operating margins are expected to be around 18 percent.

COMBAT SYSTEMS

Three Months Ended	June 30, 2013	June 29, 2014	Variance	
Revenues	$1,472	$1,465	$(7)	(0.5)%
Operating earnings	219	220	1	0.5%
Operating margins	14.9%	15.0%		
Six Months Ended	June 30, 2013	June 29, 2014	Variance	
Revenues	$2,935	$2,723	$(212)	(7.2)%
Operating earnings	430	359	(71)	(16.5)%
Operating margins	14.7%	13.2%		

Operating Results

The decrease in the Combat Systems group's revenues in the second quarter and first six months of 2014 compared with the prior-year periods consisted of the following:

	Second Quarter	Six Months
U.S. military vehicles	$(144)	$(323)
Weapon systems and munitions	(26)	(63)
International military vehicles	163	174
Total decrease	$(7)	$(212)

U.S. military vehicles revenues were down in the second quarter and first six months of 2014 as a result of decreased U.S. Army spending, which impacted our major U.S. ground forces programs, including Stryker, Abrams, Buffalo and Mine Resistant, Ambush Protected (MRAP) vehicles. Revenues also decreased in weapons systems and munitions primarily due to lower tank ammunition production for international customers.

Revenues for international military vehicles were up significantly in the second quarter and first half of 2014 as work commenced on a $10 billion international order received in the first quarter of 2014. Work on this order in the second quarter and first six months of 2014 was somewhat offset by lower revenues on several other international contracts that are nearing completion, including Pandur vehicles for the Czech government and a foreign military sales contract to provide light armored vehicles.

The Combat Systems group's operating margins increased 10 basis points in the second quarter and decreased 150 basis points in the first six months of 2014 compared with the prior-year periods. Second quarter 2014 operating margins were up as a result of a reduced cost base in our European business following restructuring activities in 2013 and the first quarter of 2014. Operating margins in the first half of 2014 were negatively impacted by a $29 charge associated with the first-quarter restructuring activities as well as a shift in contract mix. The group's results in 2013 reflected a stronger mix of high-margin production programs and associated favorable revisions in estimates as contracts matured.

Outlook

We expect the Combat Systems group’s full-year revenues in 2014 to be about $5.7 billion, with operating margins around 15 percent as new international work offsets the majority of scheduled declines in U.S. military production.

MARINE SYSTEMS

Three Months Ended	June 30, 2013	June 29, 2014	Variance	
Revenues	$1,759	$1,851	$92	5.2 %
Operating earnings	178	174	(4)	(2.2)%
Operating margins	10.1 %	9.4 %		
Six Months Ended	June 30, 2013	June 29, 2014	Variance	
Revenues	$3,385	$3,452	$67	2.0 %
Operating earnings	337	340	3	0.9 %
Operating margins	10.0 %	9.8 %		

Operating Results

The increase in the Marine Systems group’s revenues in the second quarter and first six months of 2014 compared with the prior-year periods consisted of the following:

	Second Quarter	Six Months
Navy ship construction	$89	$154
Navy engineering, repair and other services	(66)	(164)
Commercial ship construction	69	77
Total increase	$92	$67

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The group’s U.S. Navy ship construction programs include Virginia-class submarines, DDG-1000 and DDG-51 destroyers, and Mobile Landing Platform (MLP) auxiliary support ships. The increase in construction revenues in 2014 is primarily due to higher volume on the Virginia-class program, including long-lead materials for Block IV, which was awarded in the second quarter. Revenues also increased on the DDG-51 program in connection with a multi-year contract awarded in the second quarter of 2013. Lower volume on the DDG-1000 and MLP programs largely offset the growth on the DDG-51 program.

The revenue decrease in Navy engineering, repair and other services was primarily due to lower spending by the Navy on submarine-related services.

Commercial ship construction revenues increased in the second quarter and first six months of 2014 as work ramped up on the group's construction of Jones Act ships. The group currently has 10 of these ships under contract, including one awarded in the second quarter of 2014.

Operating margins decreased in the second quarter and first six months of 2014 compared with the prior-year periods primarily due to a shift in contract mix as work on the new Virginia-class and DDG-51 contracts ramped up and mature, higher-margin contracts neared completion.

Outlook

We expect the Marine Systems group’s 2014 full-year revenues to increase about 4.5 percent from 2013 with operating margins in the high-9 percent range.

INFORMATION SYSTEMS AND TECHNOLOGY

Three Months Ended	June 30, 2013		June 29, 2014		Variance			
Revenues	$2,550		$2,163		$(387	)	(15.2	)%
Operating earnings	198		188		(10	)	(5.1	)%
Operating margins	7.8	%	8.7	%				
Six Months Ended	June 30, 2013		June 29, 2014		Variance			
Revenues	$4,997		$4,444		$(553	)	(11.1	)%
Operating earnings	383		371		(12	)	(3.1	)%
Operating margins	7.7	%	8.3	%				

Operating Results

The Information Systems and Technology group's revenues in the second quarter and first six months of 2014 compared with the prior-year periods were higher than our expectations. The change from 2013 consisted of the following:

	Second Quarter		Six Months	
Mobile communication systems	$(250	)	$(412	)
Information technology (IT) solutions and mission support services	(119	)	(92	)
Intelligence, surveillance and reconnaissance (ISR) systems	(18	)	(49	)
Total decrease	$(387	)	$(553	)

Revenues decreased approximately 25 percent in the mobile communication systems business in the second quarter and first six months of 2014 primarily as a result of decreased U.S. Army spending on several programs. Revenues decreased in both periods of 2014 in our IT services business due to lower volume on several programs, including our commercial wireless work. This decrease was partially offset in the first six months of 2014 by our work on a contract to provide contact-center services for the Centers for Medicare & Medicaid Services. These revenues and the associated headcount declined in the second quarter following high call volume in the first quarter of 2014.

The group's operating margins increased in the second quarter and first six months of 2014 compared with the prior-year periods due to the favorable impact of ongoing cost-reduction efforts, particularly in the mobile communication systems business, and solid operating performance across our lines of business. The effect of these efforts was offset in part because the group had fewer favorable revisions in contract estimates than 2013 as several programs neared completion.

Outlook

We expect 2014 full-year revenues in the Information Systems and Technology group to decrease 15 percent from 2013, largely due to slowed defense spending on major production programs in the mobile communication systems business discussed above. Operating margins are expected to be in the low-8 percent range.

CORPORATE

Corporate results consist primarily of compensation expense for stock options. Corporate operating costs totaled $23 in the second quarter of 2013 compared with $17 in the second quarter of 2014 and $45 in the first six months of 2013 compared with $35 in the 2014 period. We expect 2014 full-year Corporate operating costs of approximately $80.

OTHER INFORMATION

PRODUCT REVENUES AND OPERATING COSTS

Three Months Ended	June 30, 2013	June 29, 2014	Variance			
Revenues	$4,838	$4,659	$(179	)	(3.7	)%
Operating costs	3,805	3,637	(168	)	(4.4	)%
Six Months Ended	June 30, 2013	June 29, 2014	Variance			
Revenues	$9,229	$9,096	$(133	)	(1.4	)%
Operating costs	7,279	7,102	(177	)	(2.4	)%

The decrease in product revenues in the second quarter and first six months of 2014 compared with the prior-year periods consisted of the following:

	Second Quarter		Six Months	
Aircraft manufacturing and outfitting	$(44	)	$291	
Navy ship construction	89		154	
Military vehicle production	10		(144	)
Mobile communication products	(162	)	(255	)
Pre-owned aircraft sales	(43	)	(83	)
Other, net	(29	)	(96	)
Total decrease	$(179	)	$(133	)

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Aircraft manufacturing and outfitting revenues increased in the first six months of 2014 due to additional deliveries of G650 aircraft. Revenues increased in Navy ship construction mainly due to increased activity on the Virginia-class submarine program. Offsetting these increases, revenues decreased on several U.S. military vehicle production and mobile communication products programs due to lower U.S. Army spending. For the second quarter of 2014, lower U.S. military vehicle production was more than offset by increasing activity on a significant international vehicle order that was received in the first quarter of 2014. Pre-owned aircraft sales were down as there have been no sales through six months of 2014.

Product operating costs were lower in the second quarter and first six months of 2014 compared with the prior-year periods. As shown below, the decrease in product operating costs was primarily due to lower volume. No other changes were individually significant.

	Second Quarter	Six Months
Primary changes due to volume:		
Aircraft manufacturing and outfitting	$(54)	$158
Navy ship construction	75	109
Military vehicle production	36	(72)
Mobile communication products	(142)	(231)
Pre-owned aircraft sales	(46)	(87)
	(131)	(123)
Other changes, net	(37)	(54)
Total decrease	$(168)	$(177)

SERVICE REVENUES AND OPERATING COSTS

Three Months Ended	June 30, 2013	June 29, 2014	Variance	
Revenues	$2,996	$2,815	$(181)	(6.0)%
Operating costs	2,554	2,402	(152)	(6.0)%
Six Months Ended	June 30, 2013	June 29, 2014	Variance	
Revenues	$5,919	$5,643	$(276)	(4.7)%
Operating costs	5,056	4,837	(219)	(4.3)%

The decrease in service revenues in the second quarter and first six months of 2014 compared with the prior-year periods consisted of the following:

	Second Quarter	Six Months
Navy engineering, repair and other services	$(66)	$(164)
IT services	(89)	(66)
Other, net	(26)	(46)
Total decrease	$(181)	$(276)

Navy engineering, repair and other services revenues decreased due to lower volume on various submarine programs, while IT service revenues decreased due to lower volume, particularly in our commercial wireless line of business.

Service operating costs were lower in the second quarter and first six months of 2014 compared with the prior-year periods. As shown below, the decrease in service operating costs was primarily due to lower volume. No other changes were individually significant.

	Second Quarter	Six Months
Navy engineering, repair and other services volume	$(50)	$(128)
IT services volume	(69)	(31)
Other changes, net	(33)	(60)
Total decrease	$(152)	$(219)

OTHER INFORMATION

G&A Expenses

As a percentage of revenues, G&A expenses were 6.6 percent in the first six months of 2014 and 6.7 percent in the same period of 2013. We expect G&A expenses in 2014 to be approximately 6.5 percent of revenues.

Interest, Net

Net interest expense in the first six months of 2014 was $46 compared with $41 in the same period in 2013. We expect full-year 2014 net interest expense to be approximately $90.

Effective Tax Rate

Our effective tax rate for the first six months of 2014 was 30.1 percent, compared with 31.4 percent in the prior-year period. We anticipate a full-year effective tax rate of approximately 30.5 percent in 2014.

Discontinued Operations, Net of Taxes

In June 2014, we committed to a plan to sell our axle business in the Combat Systems group. Accordingly, the results of operations of this business are reported in discontinued operations and were $1 and ($106) for the first six months of 2013 and 2014, respectively. The 2014 results include an after-tax loss of $106 to write down the net assets of the business to their estimated fair value. For further discussion, see Note A to the unaudited Consolidated Financial Statements.

BACKLOG AND ESTIMATED POTENTIAL CONTRACT VALUE

Our total backlog, including funded and unfunded portions, was $71.1 billion on June 29, 2014, up more than 25 percent from $55.9 billion on March 30, 2014. Our backlog does not include work awarded on unfunded indefinite delivery, indefinite quantity (IDIQ) contracts or unexercised options associated with existing firm contracts, which we refer to collectively as estimated potential contract value. On June 29, 2014, estimated potential contract value associated with IDIQ contracts and contract options was $28.4 billion. Combined, our total estimated contract value was $99.5 billion on June 29, 2014.

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

	Funded	Unfunded	Total Backlog	Estimated Potential Contract Value	Total Estimated Contract Value
	March 30, 2014				
Aerospace	$12,747	$199	$12,946	$2,000	$14,946
Combat Systems	15,870	885	16,755	8,143	24,898
Marine Systems	12,447	5,248	17,695	2,046	19,741
Information Systems and Technology	7,134	1,343	8,477	16,494	24,971
Total	$48,198	$7,675	$55,873	$28,683	$84,556
	June 29, 2014				
Aerospace	$12,556	$172	$12,728	$1,920	$14,648
Combat Systems	15,363	852	16,215	8,074	24,289
Marine Systems	15,458	17,747	33,205	1,938	35,143
Information Systems and Technology	7,343	1,602	8,945	16,477	25,422
Total	$50,720	$20,373	$71,093	$28,409	$99,502

AEROSPACE

Aerospace funded backlog represents aircraft orders for which we have definitive purchase contracts and deposits from customers. Unfunded backlog consists of agreements to provide future aircraft maintenance and support services. Estimated potential contract value represents primarily options to purchase new aircraft and long-term agreements with fleet customers.

The group ended the second quarter of 2014 with $12.7 billion of backlog, compared with $12.9 billion on March 30, 2014. The group experienced strong demand in the quarter with order activity across its product portfolio.

The group's backlog was lowered in recent years as G650 production has ramped up to fulfill the substantial orders we received upon introduction of the aircraft in 2008. Backlog will likely decrease over the next several years as the time period between customer order and delivery of the G650 aircraft normalizes.

DEFENSE GROUPS

The total backlog in our defense groups represents the estimated remaining sales value of work to be performed under firm contracts. The funded portion of this backlog includes items that have been authorized and appropriated by the Congress and funded by the customer, as well as commitments by international customers that are similarly approved and funded by their governments. While there is no guarantee that future budgets and appropriations will provide funding for a given program, we have included in total backlog only firm contracts at the amounts we believe are likely to receive funding. Total backlog in our defense groups was $58.4 billion on June 29, 2014, up 36 percent from $42.9 billion on March 30, 2014. The most significant contributor to the growth in backlog was a contract awarded by the U.S. Navy to construct 10 additional Virginia-class submarines. Estimated potential contract value was $26.5 billion on June 29, 2014, down slightly from $26.7 billion on March 30, 2014. Each of our defense groups received notable contract awards during the quarter.

Combat Systems awards included the following:

- $290 from the U.S. Army under the Stryker wheeled armored vehicle program for the production of 93 double-V-hulled vehicles and for contractor logistics support.
- $50 from the U.S. Marine Corps for production of seven light armored vehicle (LAV) upgrade kits, testing and customer support.

Marine Systems awards included the following:

- $17.8 billion from the Navy for the construction of 10 Virginia-class submarines under the multi-year Block IV contract, including $1.2 billion that was previously recognized as orders for long-lead material.
- $125 for the construction of a Jones Act product carrier from an affiliate of American Petroleum Tankers.
- $85 from the Navy for design work, including advanced nuclear plant studies, for the next-generation ballistic-missile submarine.
- $65 from the Navy for long-lead material for the fourth Mobile Landing Platform (MLP), configured as an Afloat Forward Staging Base (AFSB).

Information Systems and Technology awards included the following:

- $645 to extend the period of performance for support on the Canadian Maritime Helicopter Project (MHP).
- $425 from the Centers for Medicare & Medicaid Services (CMS) for contact-center services.
- $105 from the Navy for the procurement of material to support production of guidance and missile hardware.
- $80 from the Army under the Warfighter Information Network-Tactical (WIN-T) program for equipment and support services.
- $75 to provide design and support services on the U.S. Air Force’s Space Fence program.
- $70 from the Army for ruggedized computing equipment under the Common Hardware Systems-4 (CHS-4) program.
- $60 from the U.K. Ministry of Defence for tactical communication systems spares and services.
- An IDIQ contract from the Department of Homeland Security (DHS) to enhance mission effectiveness and create economies of scale through enhanced integration and consolidation. The program has a maximum potential value of $700 over seven years.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

We ended the second quarter of 2014 with a cash balance of $3.8 billion, compared with $5.3 billion at the end of 2013. Our net debt position, defined as cash and equivalents less debt, was $69 at the end of the second quarter of 2014, as compared with a net cash position of $1.4 billion at the end of 2013. The change was primarily driven by the share repurchase activity discussed below. The following is a discussion of our major operating, investing and financing activities, as classified on the unaudited Consolidated Statements of Cash Flows, in the first six months of 2013 and 2014.

OPERATING ACTIVITIES

We generated cash from operating activities of $1.3 billion in the first six months of 2014, compared with $1.1 billion in the same period in 2013. The primary driver of cash flows in both periods was net earnings offset in part by growth in operating working capital (OWC). While we started work on a large international order received in the first quarter of 2014 in our Combat Systems group, significant customer deposits associated with this contract were not received until July of 2014.

INVESTING ACTIVITIES

We used $145 for investing activities in the first six months of 2014, compared with $161 in the same period in 2013. The primary use of cash for investing activities in both periods was capital expenditures. We expect capital expenditures of approximately 2 percent of anticipated revenues in 2014.

FINANCING ACTIVITIES

Cash used for financing activities was $2.6 billion in the first six months of 2014, compared with $455 in the same period in 2013. Our financing activities include debt issuances and repayments, repurchases of common stock and payment of dividends. Net cash from financing activities also includes proceeds received from stock option exercises. In the first six months of 2014, we repurchased approximately 25 million of our outstanding shares. Of this amount, 11.4 million shares were repurchased on January 24, 2014, for $1.2 billion under an accelerated share repurchase (ASR) program facilitated through a financial institution. Our final cost of the ASR program will be determined based on the weighted-average daily market price of our stock during the term of the agreement, which expires later in 2014. On February 5, 2014, with shares from the prior authorization largely exhausted by the ASR program, the board of directors authorized management to repurchase 20 million additional shares of common stock on the open market. Subsequently, we repurchased an additional 13.6 million shares at an average price of $112 per share. On June 29, 2014, 6.4 million shares remain authorized by our board of directors for repurchase, approximately 2 percent of our total shares outstanding. We repurchased 7.6 million shares at an average price of $77 per share in the first six months of 2013.

On March 5, 2014, our board of directors declared an increased quarterly dividend of $0.62 per share – the 17th consecutive annual increase. The board had previously increased the quarterly dividend to $0.56 per share in March 2013. The first half of 2013 included only one quarterly dividend payment as we accelerated our first quarter 2013 dividend payment to December 2012.

We had no commercial paper outstanding on June 29, 2014. We have $2 billion in bank credit facilities that remain available, including a $1 billion facility expiring in July 2016 and a $1 billion facility expiring in July 2018. These facilities provide backup liquidity to our commercial paper program. We also have an effective shelf registration on file with the Securities and Exchange Commission that allows us to access the capital markets. We have no material repayments of long-term debt scheduled until $500 million of fixed-rates notes mature in January 2015. As we approach the maturity date of this debt, we will determine whether to repay these notes with cash on hand or refinance the obligation. See Note H to the unaudited Consolidated Financial Statements for additional information regarding our debt obligations, including scheduled debt maturities.

NON-GAAP FINANCIAL MEASURES – FREE CASH FLOW

We define free cash flow from operations as net cash provided by operating activities less capital expenditures. We believe free cash flow from operations is a useful measure for investors, because it portrays our ability to generate cash from our 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 the free cash flow from operations with net cash provided by operating activities, as classified on the unaudited Consolidated Statements of Cash Flows:

Six Months Ended	June 30, 2013		June 29, 2014	
Net cash provided by operating activities	$1,087		$1,294	
Capital expenditures	(165	)	(162	)
Free cash flow from operations	$922		$1,132	
Cash flows as a percentage of earnings from continuing operations:				
Net cash provided by operating activities	90	%	104	%
Free cash flow from operations	76	%	91	%

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

ADDITIONAL FINANCIAL INFORMATION

ENVIRONMENTAL MATTERS AND OTHER CONTINGENCIES

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

APPLICATION OF CRITICAL ACCOUNTING POLICIES

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

Accounting for long-term contracts and programs involves the use of various techniques to estimate total contract revenues and costs. Contract estimates are based on various assumptions to project the outcome of future events that often span several years. We review our performance monthly and update our contract estimates at least annually and often quarterly, as well as when required by specific events and circumstances. We recognize changes in estimated profit on contracts under the reallocation method. Under this method, the impact of revisions in estimates is recognized prospectively over the remaining contract term. The net increase in our operating earnings (and on a per-share basis) from the favorable impact of revisions in contract estimates totaled $83 ($0.15) and $191 ($0.35) for the three- and six-month periods ended June 30, 2013, and $62 ($0.12) and $100 ($0.19) for the three- and six-month periods ended June 29, 2014, respectively. While no revisions on any one contract were material to our unaudited Consolidated Financial Statements in the second quarter and first six months of 2014, the amount decreased compared with the prior-year periods as 2013 included higher favorable revisions in contract estimates on several programs nearing completion in the Combat Systems and Information Systems and Technology groups.

In the second quarter of 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. ASU 2014-9 prescribes a single, common revenue standard that replaces most existing revenue recognition guidance in GAAP. The standard outlines a five-step model, whereby revenue is recognized as performance obligations within a contract are satisfied. The standard also requires new, expanded disclosures regarding revenue recognition. ASU 2014-9 is effective in the first quarter of 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition method nor have we determined the effect of the standard on our consolidated financial statements.

The required adoption of the ASU in 2017 will preclude our use of the reallocation method of recognizing revisions in estimated profit on contracts discussed above. Because changes in estimated profit will be recognized in the period they are identified (cumulative catch-up method), rather than prospectively over the remaining contract term, we expect that the impact of revisions of contract estimates may be larger and potentially more variable from period to period. Anticipated losses on contracts will continue to be recognized in the quarter they are identified.

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

We believe that our judgment is applied consistently and produces financial information that fairly depicts the results of operations for all periods presented. For a full discussion of our critical accounting policies, see our Annual Report on Form 10-K for the year ended December 31, 2013.

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, 2013.

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 June 29, 2014. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, on June 29, 2014, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 29, 2014, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements that are based on management's expectations, estimates, projections and assumptions. Words such as "expects," "anticipates," "plans," "believes," "scheduled," "outlook," "estimates," "should" and variations of these words and similar expressions are intended to identify forward-looking statements. These include but are not limited to projections of revenues, earnings, operating margins, segment performance, cash flows, contract awards, aircraft production, deliveries and backlog. Forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as amended. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict. Therefore, actual future results and trends may differ materially from what is forecast in forward-looking statements due to a variety of factors, including the risk factors discussed in Item 1A of our Annual Report on Form 10-K. These factors include, without limitation:

- general U.S. and international political and economic conditions;
- decreases in U.S. government defense spending or changing priorities within the defense budget and the impacts of the Budget Control Act of 2011, including sequester;
- termination or restructuring of government contracts due to unilateral government action;
- differences in anticipated and actual program performance, including the ability to perform under long-term fixed-price contracts within estimated costs, and performance issues with key suppliers and subcontractors;
- expected recovery on contract claims and requests for equitable adjustment;
- changing customer demand or preferences for business aircraft, including the effects of economic conditions on the business-aircraft market;
- potential for changing prices for energy and raw materials; and
- the status or outcome of legal and/or regulatory proceedings.

All forward-looking statements speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. All subsequent written and oral forward-looking statements attributable to the company or any person acting on the company's behalf are qualified by the cautionary statements in this section. We do not undertake any obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date of this report except as expressly required to do so by law.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For information relating to legal proceedings, see Note L to the unaudited Consolidated Financial Statements contained in Part I, Item 1 of this quarterly report on Form 10-Q.

ITEM 1A. RISK FACTORS
There have been no material changes with respect to this item from the disclosure included in our Annual Report on Form 10-K for the year ended December 31, 2013.

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

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

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program*	Maximum Number of Shares that May Yet Be Purchased Under the Program*
Pursuant to Share Buyback Program				
3/31/14-4/27/14	1,078,700	$108.39	1,078,700	15,998,152
4/28/14-5/25/14	7,275,000	$112.62	7,275,000	8,723,152
5/26/14-6/29/14	2,329,000	$118.84	2,329,000	6,394,152
Total	10,682,700	$113.55		

* On February 5, 2014, with shares from the prior authorization largely exhausted, the board of directors authorized management to repurchase 20 million shares of common stock.

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

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ITEM 6. EXHIBITS

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

* Indicates a management contract or compensatory plan or arrangement.
** Incorporated herein by reference from the company’s quarterly report on Form 10-Q for the period ended March 30, 2014, filed with the Commission April 23, 2014.
*** Filed herewith.

SIGNATURES

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

GENERAL DYNAMICS CORPORATION

by

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

Dated: July 23, 2014

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