GENERAL DYNAMICS CORP
Form DEF 14A
March 15, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES

EXCHANGE ACT OF 1934

Filed by the registrant x

Filed by a party other than the registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

x Definitive Proxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material

Pursuant to Section 240.14a-12

¨ Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e) (2))

General Dynamics Corporation

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement if Other Than the Registrant)

Payment of filing fee (check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

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¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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March 15, 2013

Dear Fellow Shareholder:

You are invited to our Annual Meeting of Shareholders on Wednesday, May 1, 2013, at 9:00 a.m. local time. The meeting will be held at our headquarters located at 2941 Fairview Park Drive, Falls Church, Virginia. The principal items of business will be the election of directors, an advisory vote on the selection of the company s independent auditors, and an advisory vote to approve executive compensation. Shareholders may raise other matters as described in the accompanying proxy statement.

We are providing this year s proxy materials on the Internet for most of our shareholders as permitted by Securities and Exchange Commission rules. Internet access to our proxy materials will expedite receipt for many of our shareholders and help to keep mailing costs for our annual meeting as low as possible. Page 1 of our proxy statement provides additional information on proxy materials distribution.

Your vote is important. We encourage you to consider carefully the matters before us.

Sincerely yours,

Phebe N. Novakovic

Chairman and Chief Executive Officer

2941 Fairview Park Drive, Suite 100

Falls Church, Virginia 22042-4513

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NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Important Notice Regarding the Availability of Proxy Materials

for the Shareholder Meeting to Be Held on May 1, 2013

The Proxy Statement and 2012 Annual Report are available at www.generaldynamics.com/2013proxy.

The Annual Meeting of Shareholders of General Dynamics Corporation, a Delaware corporation, will be held on Wednesday, May 1, 2013, at 9:00 a.m. local time at the General Dynamics Corporation headquarters located at 2941 Fairview Park Drive, Falls Church, Virginia. Proposals to be considered at the Annual Meeting include:

(1) the election of 10 directors from the nominees named in the proxy statement;

(2) an advisory vote on the selection of KPMG LLP, an independent registered public accounting firm, as the company s independent auditors for 2013;

(3) an advisory vote to approve executive compensation;

(4) a shareholder proposal regarding lobbying disclosure, provided it is presented properly at the meeting;

(5) a shareholder proposal regarding a human rights policy, provided it is presented properly at the meeting; and

(6) the transaction of all other business that properly comes before the meeting or any adjournment or postponement of the meeting.

The Board of Directors unanimously recommends that you vote FOR proposals 1, 2 and 3.

The Board of Directors unanimously recommends that you vote AGAINST proposals 4 and 5.

The Board of Directors set the close of business on March 7, 2013, as the record date for determining the shareholders entitled to receive notice of, and to vote at, the Annual Meeting. It is important that your shares be represented and voted at the meeting. Please complete, sign and return a proxy card, or use the telephone or Internet voting systems.

A copy of the 2012 Annual Report accompanies this Notice and Proxy Statement and is available on the website listed above.

By Order of the Board of Directors,

Gregory S. Gallopoulos

Secretary

Falls Church, Virginia

March 15, 2013

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Proxy Statement

March 15, 2013

The Board of Directors of General Dynamics Corporation is soliciting your proxy for the Annual Meeting of Shareholders to be held on May 1, 2013, at 9:00 a.m. local time, or at any adjournment or postponement of the meeting. This Proxy Statement, and the accompanying Notice of Annual Meeting of Shareholders and proxy card, are being distributed on or about March 15, 2013, to holders of General Dynamics common stock, par value $1.00 per share (Common Stock). General Dynamics is a Delaware corporation.

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Information Regarding Voting

All shareholders of record at the close of business on March 7, 2013, are entitled to vote their shares of Common Stock at the Annual Meeting. On the record date, General Dynamics had 354,019,542 shares of Common Stock issued and outstanding.

Annual Meeting Attendance

Attending the Annual Meeting. All shareholders are welcome to attend the Annual Meeting. You will need an admission card or proof of ownership of Common Stock and personal photo identification for admission. If you hold shares directly in your name as a shareholder of record with our transfer agent, Computershare Trust Company, N.A. (Computershare), you may obtain an admission card through the telephone or Internet voting systems or by marking the appropriate box on your proxy card (if you received or requested one). If your shares are held by a bank, broker or other holder of record (commonly referred to as registered in street name), you are considered a beneficial owner of those shares rather than a shareholder of record. In that case, you must present at the Annual Meeting proof of your beneficial ownership of Common Stock, such as a recent bank or brokerage statement.

Quorum for the Transaction of Business. A quorum is the presence, in person or by proxy, of holders of a majority of the issued and outstanding shares of Common Stock as of the record date. If you submit a properly completed proxy in accordance with one of the voting procedures described below or appear at the Annual Meeting to vote in person, your shares of Common Stock will be considered present. For purposes of determining whether a quorum exists, abstentions and broker non-votes (as described below) will be counted as present. Once a quorum is present, voting on specific proposals may proceed. In the absence of a quorum, the Annual Meeting may be adjourned.

Proxy Materials Distribution

As permitted by the rules of the Securities and Exchange Commission (SEC), we are providing the proxy materials for our 2013 Annual Meeting via the Internet to most of our shareholders. Use of the Internet will expedite receipt of the 2013 proxy materials by many of our shareholders and will help to keep mailing costs for our Annual Meeting as low as possible. For shareholders who are participants in our 401(k) plans we are required to deliver proxy materials in hard copy. On March 15, we initiated delivery of proxy materials to our shareholders of record in one of two ways: (1) a notice containing instructions on how to access proxy materials via the Internet or (2) a printed copy of those materials. If you received a notice in lieu of a printed copy of the proxy materials, you will not automatically receive a printed copy of the proxy materials in the mail. Instead, the notice provides instructions on how to access the proxy materials on the Internet and how to vote online or by telephone. If you received such a notice and would also like to receive a printed copy of the proxy materials, the notice includes instructions on how you may request a printed copy.

Voting

Voting Procedures. You must be a shareholder of record on the record date to vote your shares at the Annual Meeting. Each shareholder of record is entitled to one vote on all matters presented at the Annual Meeting for each share of Common Stock held. You are considered a shareholder of record if your shares are registered directly in your name with Computershare as of the record date. If you are a shareholder of record, Computershare provides proxy materials to you on our behalf. If your shares are registered in different names or held in more than one account, you may receive more than one proxy card or set of voting instructions. In that case, you will need to vote separately for each set of shares in accordance with the following voting procedures.

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Shareholders of record may cast their vote by:

(1) signing and dating each proxy card received and returning each card using the prepaid postage envelope;
(2) calling 1-800-652-VOTE (1-800-652-8683) or, outside the United States, Canada and Puerto Rico, calling 1-781-575-2300 and following the instructions provided on the phone line;
(3) accessing www.envisionreports.com/gd and following the instructions provided online; or
(4) attending the Annual Meeting and voting by ballot.

The telephone and Internet voting systems are available 24 hours a day. They will close at 1:00 a.m. eastern time on May 1, 2013. **Please note that the voting deadline differs for participants in our 401(k) plans, as described below**. All shares represented by properly executed, completed and unrevoked proxies that are received on time will be voted at the Annual Meeting in accordance with the specifications made in the proxy card. If you return a signed proxy card but do not specifically direct the voting of shares, your proxy will be voted as follows:

(1) FOR the election of directors as described in this Proxy Statement;
(2) FOR the selection, on an advisory basis, of KPMG LLP as the independent auditors of the company;
(3) FOR the approval, on an advisory basis, of the compensation of the named executive officers;
(4) AGAINST the shareholder proposals described in this Proxy Statement; and
(5) in accordance with the judgment of the proxy holders for other matters that may properly come before the Annual Meeting.

If your shares are held by a bank, broker or other holder of record, you are the beneficial owner of those shares rather than the shareholder of record. If you are a beneficial owner, your bank, broker or other holder of record will forward the proxy materials to you. As a beneficial owner, you have the right to direct the voting of your shares by following the voting instructions provided with these proxy materials. Please refer to the proxy materials forwarded by your bank, broker or other holder of record to see if the voting options described above are available to you.

Fidelity Management Trust Company (Fidelity), as trustee, is the holder of record of the shares of Common Stock held in our 401(k) plans the General Dynamics Corporation 401(k) Plan and the General Dynamics Corporation 401(k) Plan for Represented Employees. If you are a participant in one of these plans, you are the beneficial owner of the shares of Common Stock credited to your plan account. As beneficial owner and named fiduciary, you have the right to instruct Fidelity, as plan trustee, how to vote your shares. If you do not provide Fidelity with timely voting instructions then, consistent with the terms of the plans, Evercore Trust Company, N.A. (Evercore) will direct Fidelity, in Evercore s discretion, how to vote the shares. Evercore serves as the independent fiduciary and investment manager for the General Dynamics Stock Fund of the 401(k) plans.

Computershare provides proxy materials to participants in these plans on behalf of Fidelity. If you are a plan participant and a shareholder of record, Computershare may combine the shares registered directly in your name and the shares credited to your 401(k) plan account onto one proxy card. If Computershare does not combine your shares, you will receive more than one set of proxy materials. In that case, you will need to submit a vote for each set of shares. The vote you submit via proxy card or the telephone or Internet voting systems will serve as your voting instructions to Fidelity. **To allow sufficient time for Fidelity to vote your 401(k) plan shares, your vote or any re-vote must be received by 9 a.m. eastern time on April 29, 2013.**

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Revoking a Proxy. A shareholder of record may revoke a proxy at any time before it is voted at the Annual Meeting by:

(1) sending written notice of revocation to our Corporate Secretary;
(2) submitting another proxy card that is dated later than the original proxy card;
(3) re-voting by using the telephone or Internet voting systems; or
(4) attending the Annual Meeting and voting by ballot (attendance at the Annual Meeting alone will not act to revoke a prior proxy).

Our Corporate Secretary must receive notice of revocation, or a subsequent proxy card, before the vote at the Annual Meeting for a revocation to be valid. Except as described above for participants in our 401(k) plans, a re-vote by the telephone or Internet voting systems must occur before 1:00 a.m. eastern time on May 1, 2013. If you are a beneficial owner, you must revoke your proxy through the appropriate bank, broker or other holder of record.

Vote Required

Broker Non-Vote. A broker non-vote occurs when a bank, broker or other holder of record holding shares for a beneficial owner does not vote on a particular proposal because that holder does not have discretionary voting power for the proposal and has not received voting instructions from the beneficial owner. Banks, brokers and other holders of record have discretionary authority to vote shares without instructions from beneficial owners only on matters considered routine by the New York Stock Exchange, such as the advisory vote on the selection of the independent auditors. On non-routine matters, such as the election of directors, executive compensation matters and the shareholder proposals, these banks, brokers and other holders of record do not have discretion to vote uninstructed shares and thus are not entitled to vote on such proposals, resulting in a broker non-vote for those shares. **We encourage all shareholders that hold shares through a bank, broker or other holder of record to provide voting instructions to such parties to ensure that their shares are voted at the Annual Meeting.**

Proposal 1 Election of the Board of Directors of the Company. Directors will be elected by a majority of the votes cast and entitled to vote at the Annual Meeting. A majority of the votes cast means that the number of votes cast for a director s election exceeds the number of votes cast against that director s election. You may vote for, vote against or abstain from voting for any or all nominees. Abstentions and broker non-votes will not be counted as a vote cast for or against a director s election.

Proposal 2 Selection of Independent Auditors. This proposal requires an affirmative vote of a majority of shares present in person or represented by proxy and entitled to vote at the Annual Meeting to be approved. You may vote for, vote against or abstain from voting on this matter. Abstentions will have the effect of a vote against this proposal.

Proposal 3 Advisory Vote to Approve Executive Compensation. This proposal requires an affirmative vote of a majority of shares present in person or represented by proxy and entitled to vote at the Annual Meeting to be approved. You may vote for, vote against or abstain from voting on this matter. Abstentions will have the effect of a vote against this proposal.

Proposals 4 and 5 Shareholder Proposals. Proposals 4 and 5 each require an affirmative vote of a majority of shares present in person or represented by proxy and entitled to vote on the proposal to be approved. You may vote for, vote against or abstain from voting on these matters. Abstentions will have the effect of a vote against these proposals.

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Voting Tabulation. Representatives of American Election Services, LLC, will tabulate the vote at the Annual Meeting.

Proxy Solicitation. The Board of Directors is soliciting proxies from shareholders. Directors, officers and other employees of General Dynamics may solicit proxies from our shareholders by mail, e-mail, telephone, facsimile or in person. In addition, Innisfree M&A Incorporated (Innisfree), 501 Madison Avenue, New York, New York, is soliciting brokerage firms, dealers, banks, voting trustees and their nominees.

We will pay Innisfree approximately $15,000 for soliciting proxies for the Annual Meeting and will reimburse brokerage firms, dealers, banks, voting trustees, their nominees and other record holders for their out-of-pocket expenses in forwarding proxy materials to the beneficial owners of Common Stock. We will not provide compensation, other than their usual compensation, to our directors, officers and other employees who solicit proxies.

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Election of the Board of Directors of the Company

(Proposal 1)

This year 10 nominees are standing for election to the Board of Directors. Each nominee elected as a director will hold office until:

(1) the next annual meeting and his or her successor is elected and qualified, or

(2) his or her earlier death, removal or resignation.

In the event that any nominee withdraws or for any reason is unable to serve as a director, your proxy will be voted for any remaining nominees (except as otherwise indicated in your proxy) and any replacement nominee designated by the Nominating and Corporate Governance Committee of the Board of Directors.

Mary T. Barra, 51, director since 2011.

Senior Vice President, Global Product Development, of General Motors Company since February 2011. Vice President, Global Human Resources, from 2009 to January 2011. Vice President, Global Manufacturing Engineering, from 2008 to 2009. Executive Director, Vehicle Manufacturing Engineering, from 2004 to 2008.

Ms. Barra s business and educational background, including a bachelor s degree in electrical engineering and a master s degree in business administration, enables her to provide valuable strategic, operational and business advice to the company. Ms. Barra s current position with General Motors as senior vice president, global product development, and her former positions as vice president, global human resources, and vice president, global manufacturing engineering, position her well to advise our businesses on a broad range of matters in the areas of human resources, engineering, manufacturing, and research and development. Her strong and diversified business background provides her with a deep understanding of the challenges facing large public companies with complex global operations.

Nicholas D. Chabraja, 70, director since 1994.

Chairman from June 1997 to May 2010. Chief Executive Officer from June 1997 to July 2009. Vice Chairman from December 1996 to May 1997. Executive Vice President from March 1994 to December 1996. Mr. Chabraja currently serves as a director of Northern Trust Corporation and as non-executive chairman of Tower International, Inc. He served as a director of Ceridian Corporation, a former public *company, within the past five years.*

Mr. Chabraja s 15 years of service as a senior executive officer and 12-year tenure as chairman and chief executive officer of our company make him an experienced and trusted advisor. He has in-depth knowledge of all aspects of General Dynamics and a deep understanding and appreciation of our customers, business operations and approach to risk management. His service at General Dynamics combined with his service on other public company boards provides him with a valuable perspective on governance and management matters that face large public companies.

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James S. Crown, 59, director since 1987.

Lead Director since May 2010. President of Henry Crown and Company (diversified investments) since 2002. Vice President of Henry Crown and Company from 1985 to 2002. Mr. Crown currently serves as a director of J.P. Morgan Chase & Co. He served as a director of Sara Lee Corporation within the past five years.

As the longest-serving member of our board and a significant shareholder, Mr. Crown has an abundance of knowledge regarding General Dynamics and its history. As president of Henry Crown and Company, a private investment firm with diversified interests, Mr. Crown has broad experience in general business management and capital deployment strategies. His many years of service as a director of our company and two other large public companies provide him with a deep understanding of the roles and responsibilities of a board of a large public company.

William P. Fricks, 68, director since 2003.

Chairman and Chief Executive Officer of Newport News Shipbuilding Inc. from 1997 to 2001. Chief Executive Officer and President of Newport News Shipbuilding Inc. from 1995 to 1996.

Mr. Fricks prior senior executive positions at Newport News Shipbuilding Inc., including chairman and chief executive officer, president and chief executive officer, vice president-finance, controller and treasurer, give him critical knowledge of the management, financial and operational requirements of a large company and a keen understanding of our key customers. In these positions, Mr. Fricks gained extensive experience in dealing with accounting principles and financial reporting, evaluating financial results and the financial reporting process of a large company. Based on this experience, the Board has determined that Mr. Fricks is an Audit Committee Financial Expert.

Paul G. Kaminski, 70, director since 1997.

Under Secretary of U.S. Department of Defense for Acquisition and Technology from 1994 to 1997. Chairman and Chief Executive Officer of Technovation, Inc., (consulting) since 1997. Senior Partner of Global Technology Partners, LLC, (consulting) from 1998 to 2010.

Dr. Kaminski s prior service as the Under Secretary of Defense for Acquisition and Technology provides him with valuable insight into research and development, procurement, acquisition reform and logistics at the U.S. Department of Defense. In addition, Dr. Kaminski s education and business background in advanced technology, including dual master s degrees in aeronautics-astronautics and electrical engineering and a doctorate in aeronautics and astronautics, enables him to provide valuable strategic and business advice to our aerospace and defense businesses.

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John M. Keane, 70, director since 2004.

Retired General, U.S. Army. Vice Chief of Staff of the Army from 1999 to 2003. President of GSI, LLC, (consulting) since 2004. Senior Partner of SCP Partners (private equity) from 2009 to 2012. Managing Director of Keane Advisors, LLC, (private equity) from 2005 to 2009. Chairman of the Institute for the Study of War. Mr. Keane currently serves as a director of MetLife, Inc. He served as a director of Cyalume Technologies Holdings, Inc., and M&F Worldwide Corp., each a former public company, within the past five years.

Prior to retiring from the U.S. Army at the rank of General, Mr. Keane served as Vice Chief of Staff of the Army. As a senior officer, Mr. Keane managed significant operating budgets and addressed complex operational and strategic issues. Mr. Keane s astute appreciation for the complexities of the U.S. military and the defense industry combined with his demonstrated leadership and management skills make him a valuable advisor to our aerospace and defense businesses. Mr. Keane has gained a strong understanding of public company governance and operations through his service on three public company boards.

Lester L. Lyles, 66, director since 2003.

Retired General, U.S. Air Force. Commander, Air Force Materiel Command from 2000 to 2003. Vice Chief of Staff of the Air Force from 1999 to 2000. Chairman of the Board of United States Automobile Association since November 2012 and Vice Chairman from November 2008 to November 2012. Mr. Lyles currently serves as a director of KBR, Inc., and Precision Castparts Corp. He served as a director of DPL, Inc., and MTC Technologies, Inc., each a former public company, within the past five years.

Prior to retiring from the U.S. Air Force at the rank of General, Mr. Lyles served as Commander of the Air Force Materiel Command and Vice Chief of Staff of the U.S. Air Force. In these positions, Mr. Lyles managed significant operating budgets and addressed complex operational issues. The broad knowledge of the U.S. military and the defense industry he attained through these experiences, combined with his engineering and aerospace educational background, enable Mr. Lyles to provide critical strategic and business advice to our aerospace and defense businesses. In addition, Mr. Lyles has gained a thorough understanding of challenges that face public companies through his service on public company boards.

Phebe N. Novakovic, 55, director since 2012.

Chairman and Chief Executive Officer of the company since January 2013. President and Chief Operating Officer of the company from May 2012 through December 2012. Executive Vice President, Marine Systems, from May 2010 to May 2012. Senior Vice President, Planning and Development, from 2005 to May 2010. Vice President, Strategic Planning, from 2002 to 2005. Ms. Novakovic currently serves as a director of Abbott Laboratories.

Ms. Novakovic s service as a senior officer of General Dynamics since 2002 makes her a valuable and trusted advisor. Through her roles as chairman and chief executive officer, president and chief operating officer, and executive vice president, Marine Systems, she has developed a deep understanding of the company s business operations, growth opportunities and challenges. As senior

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vice president, planning and development, she gained a strong understanding of our core customers and the global marketplace in which we operate. Ms. Novakovic s current service as a public company director provides her with a valuable perspective on corporate governance matters and the roles and responsibilities of a public company board.

William A. Osborn, 65, director since 2009.

Chairman of Northern Trust Corporation (multibank holding company) from October 1995 to November 2009. Chief Executive Officer of Northern Trust Corporation from 1995 through 2007 and President of Northern Trust Corporation and The Northern Trust Company (banking services) from 2003 to 2006. Mr. Osborn currently serves as a director of Abbott Laboratories and Caterpillar, Inc. He served as a director of Northern Trust Corporation within the past five years.

Mr. Osborn s prior service as a senior executive of Northern Trust Corporation, including as chairman and chief executive officer, and president and chief operating officer, provides him with extensive knowledge of the complex financial, operational and governance issues of a large public company. He brings to our Board a well-developed awareness of financial strategy and asset management and a strong understanding of public company governance. The Board has determined that Mr. Osborn s extensive experience with accounting principles, financial reporting and evaluation of financial results qualifies him as an Audit Committee Financial Expert.

Robert Walmsley, 72, director since 2004.

Retired Vice Admiral, Royal Navy. Chief of Defence Procurement for the United Kingdom Ministry of Defence from 1996 to 2003. Senior Advisor to Morgan Stanley & Co. Limited (investment banking) from February 2004 to October 2012. Mr. Walmsley currently serves as a director of Cohort plc and Ultra Electronics plc. He served as a director of British Energy Group plc, a former public company, within the past five years.

Mr. Walmsley s prior service as Chief of Defence Procurement for the United Kingdom Ministry of Defence gives him acute comprehension of international defense matters. Moreover, his service as a Vice Admiral in the Royal Navy and his appointments as Controller, Chairman of the Naval Nuclear Technical Safety Panel and Director General, Submarines, provide him with an important perspective on our aerospace and defense businesses. Mr. Walmsley s service as a public company director in the United States and the United Kingdom positions him well to understand complex operational and governance matters at a large public company.

Based on its Bylaws and Corporate Governance Guidelines, the company s policy is not to nominate individuals for election to the Board of Directors who have reached the age of 72 as of the scheduled date for the annual meeting. However, the Nominating and Corporate Governance Committee recommended and the Board unanimously requested that Robert Walmsley stand for re-election. The Board took this action in recognition of the continued valuable counsel and insight that Mr. Walmsley provides to the Board with respect to international defense matters and the complex operational and governance matters of a large public company.

Your Board of Directors unanimously recommends a vote FOR all the director nominees listed above.

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Governance of the Company

Board of Directors

The Board of Directors oversees General Dynamics business and affairs pursuant to the General Corporation Law of the State of Delaware and our Certificate of Incorporation and Bylaws. The Board is the ultimate decision-making body, except on matters reserved for the shareholders.

Corporate Governance Guidelines

Our Board of Directors believes that a commitment to good corporate governance enhances shareholder value. To that end, on the recommendation of the Nominating and Corporate Governance Committee, the Board has adopted governance policies and procedures to ensure effective governance of both the Board and the company. The policies and procedures are stated in the General Dynamics Corporate Governance Guidelines, available on our website at www.generaldynamics.com, under the Investor Relations Corporate Governance captions. The Board regularly reviews these guidelines and updates them periodically in response to changing regulatory requirements and evolving best practices.

Codes of Ethics

Since the inception of a formal ethics program in 1985, our Board of Directors and management have devoted significant time and resources to maintaining an active and robust ethics program. We have a Standards of Business Ethics and Conduct Handbook that applies to all employees. This handbook, known as the Blue Book, has been updated and improved as we have grown and changed over the years. Our ethics program also includes a 24-hour ethics helpline, which employees can access via telephone or online, to communicate any business ethics-related concerns, and periodic training on ethics and compliance topics for all employees.

We also have adopted ethics codes specifically applicable to our financial professionals and our Board of Directors. The Code of Ethics for Financial Professionals, which supplements the Blue Book, applies to our chief executive officer, chief financial officer, controller and any person performing similar financial functions. Also, there is a Code of Conduct for Members of the Board of Directors that embodies our Board s commitment to manage our business in accordance with the highest standards of ethical conduct.

Copies of the Standards of Business Ethics and Conduct Handbook, Code of Ethics and Code of Conduct are available on our website at www.generaldynamics.com, under the Investor Relations Corporate Governance captions, or in print upon request. We will disclose on our website any amendments to or waivers from the Standards of Business Ethics and Conduct, Code of Ethics or Code of Conduct on behalf of any of our executive officers, financial professionals or directors.

Related Person Transactions Policy

Our Board of Directors has adopted a written policy on the review and approval of related person transactions. Related persons covered by the policy are:

(1) executive officers, directors and director nominees;

(2) any person who is known to be a beneficial owner of more than 5 percent of our voting securities;

(3) any immediate family member of any of the foregoing persons; or

(4) any entity in which any of the foregoing persons has or will have a direct or indirect material interest.

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A related person transaction is defined by this policy as a transaction, arrangement or relationship (or any series of similar transactions, arrangements or relationships) in which: (1) General Dynamics will be a participant; (2) the amount involved exceeds $120,000; and (3) any related person will have a direct or indirect material interest. The following interests and transactions are not subject to the policy:

(1) director compensation that has been approved by the Board;

(2) a transaction where the rates or charges are determined by competitive bid; or

(3) a compensatory arrangement solely related to employment with General Dynamics (or a subsidiary) that has been approved by the Compensation Committee, or recommended by the Compensation Committee to the Board.

The Nominating and Corporate Governance Committee is responsible for reviewing, approving and, where applicable, ratifying related person transactions. If a member of the committee has an interest in a related person transaction, then he or she will not be part of the review process.

In considering the appropriate action to be taken regarding a related person transaction, the committee or the Board will consider the best interests of General Dynamics and whether the transaction is fair to the company, is on terms that would be obtainable in an arm s-length transaction and serves a compelling business reason, and any other factors it deems relevant. As a condition to approving or ratifying any related person transaction, the committee or the Board may impose whatever conditions and standards it deems appropriate, including periodic monitoring of ongoing transactions.

The following transaction with a related person was determined to pose no actual conflict of interest and was approved by the committee pursuant to our related person transactions policy:

In a Schedule 13G filing made with the SEC, BlackRock, Inc., a global provider of investment, advisory and risk management solutions, reported beneficial ownership of more than 5 percent of General Dynamics outstanding common stock as of December 31, 2012. In a subsequent Schedule 13G filing in March 2013, BlackRock reported that, effective February 28, 2013, it holds less than 5 percent of General Dynamics Common Stock. An affiliate of BlackRock provides investment management and transition management services for certain of the company s benefit plans. The agreements with BlackRock were negotiated in arm s-length transactions and the ownership of General Dynamics stock plays no role in the business relationship between the company and BlackRock. In addition, we believe that the agreements represent standard terms and conditions for investment management and transition management services. For providing the services, BlackRock received fees in 2012 totaling approximately $2.4 million. In accordance with the Related Person Transactions Policy, the Nominating and Corporate Governance Committee reviewed and approved the services for 2012 and approved the continuation of the services in 2013.

Director Independence

Our Board of Directors assesses the independence of our directors and examines the nature and extent of any relationships between General Dynamics and our directors, their families and their affiliates. For a director to be considered independent, the Board must determine that a director does not have any

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direct or indirect material relationship with General Dynamics. Our Board has established director independence guidelines (the Director Independence Guidelines) as part of the Corporate Governance Guidelines to assist in determining director independence in accordance with the rules of the New York Stock Exchange. The Director Independence Guidelines provide that an independent director:

(1) is not an employee, nor has an immediate family member who is an executive officer, of General Dynamics;

(2) does not receive, nor has an immediate family member who receives, any direct compensation from General Dynamics, other than director and committee fees;

(3) does not receive, directly or indirectly, any consulting, advisory or other compensatory fee from General Dynamics, other than director and committee fees;

(4) is not, nor has an immediate family member who is, employed as an executive officer of another company where any executive officer of General Dynamics serves on that company s compensation committee;

(5) is not a current partner of, or employed by, a present internal or external auditor of General Dynamics;

(6) does not have an immediate family member who is a current partner of, or an employee assigned to work personally on General Dynamics audit by, a present internal or external auditor of General Dynamics;

(7) except as otherwise provided in (8) below, is not an executive officer nor an employee, nor has an immediate family member who is an executive officer, of a company that makes payments to, or receives payments from, General Dynamics for property or services in an amount that, in any single fiscal year, exceeds the greater of $1 million or 2 percent of the revenues of that company; and

(8) is not a director, trustee or executive officer of a charitable organization that, in any single fiscal year, receives contributions from General Dynamics in an amount that exceeds the greater of $1 million or 2 percent of the revenues of that organization.

For purposes of the Director Independence Guidelines, references to General Dynamics include any of our subsidiaries and the term immediate family member includes a person s spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone (other than domestic employees) who shares the person s home.

In March 2013, the Board of Directors considered whether each member of the Board meets the definition of an independent director in accordance with the rules of the New York Stock Exchange and the Director Independence Guidelines. The Board determined that Mary T. Barra, James S. Crown, William P. Fricks, Paul G. Kaminski, John M. Keane, Lester L. Lyles, William A. Osborn and Robert Walmsley each qualifies as an independent director. The Board also determined that Nicholas D. Chabraja and Phebe N. Novakovic are not independent directors. To make these independence determinations, the Board reviewed all relationships between General Dynamics and the directors and affirmatively determined that none of the directors who qualifies as independent has a material business, financial or other type of relationship with General Dynamics (other than as a director or shareholder of the company). Specifically, the Board considered the following relationships and found them to be immaterial for the reasons discussed below:

Ms. Barra and Messrs. Crown, Kaminski, Keane, Lyles and Osborn serve as members of the boards of trustees of charitable and other non-profit organizations to which General Dynamics has

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made payments or contributions in the usual course of our business and annual giving programs. Each of the payments or contributions by General Dynamics was below $180,000. Mr. Kaminski s son-in-law is an employee (and not an executive officer) of a subsidiary of General Dynamics. The compensation paid to his son-in-law in 2012 did not exceed $120,000. In addition, Messrs. Crown, Kaminski, Keane, Lyles, Osborn and Walmsley serve as directors of companies, Mr. Walmsley serves as a consultant to companies, Ms. Barra and Mr. Crown are executive officers of companies, and Mr. Crown is an executive officer of a company that is the manager of a company to which General Dynamics has sold products and services, or from which General Dynamics has purchased products and services, in the ordinary course of business. None of the directors had any material interest in, or received any special compensation in connection with, these ordinary-course business relationships.

Board Leadership Structure

Our Board elects a chairman from among the directors and determines whether to separate or combine the roles of chairman and chief executive officer based on what it believes best serves the needs of the company and its shareholders at any particular time. In June 2012, the Board of Directors elected Ms. Novakovic to succeed Mr. Johnson as chairman and chief executive officer upon his retirement. In January 2013, Ms. Novakovic assumed that position. The Board believes that Ms. Novakovic s deep understanding of the company s business, operations, growth opportunities, challenges and risk management practices gained through several leadership positions enable her to provide strong and effective leadership to the Board and to ensure that the Board is informed of important issues facing the company. The Board also believes that having a combined role promotes a cohesive, strong and consistent vision and strategy for the company.

The Board has created the position of a lead director, selected annually by the Board from among the independent directors. Mr. Crown currently serves as lead director. The Board believes that the lead director position provides additional independent oversight of senior management and board matters. The selection of a lead director facilitates communication among the directors or between any of them and the chairman. Directors frequently communicate among themselves and directly with the chairman.

The lead director s authority and responsibilities are as follows:

(1) acts as chair at board meetings when the chairman is not present, including meetings of the non-management directors;

(2) has the authority to call meetings of the non-management directors;

(3) coordinates activities of the non-management directors and serves as a liaison between the chairman and the non-management directors;

(4) works with the chairman to develop and agree to meeting schedules and agendas, and agree to the nature of the information that will be provided to directors in advance of meetings;

(5) is available for consultation and communication with significant shareholders, when appropriate; and

(6) performs such other duties as the Board may determine from time to time.

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Risk Oversight

We believe the Board leadership structure as described supports a risk-management process in which senior management is responsible for our company s day-to-day risk-management processes and the Board provides oversight of those processes. To fulfill this responsibility, the Board oversees management of risks across the company at both the full Board and committee levels.

The full Board reviews and approves annually a corporate policy addressing the delegation of authority and assignment of responsibility to ensure that the responsibilities and authority delegated to senior management are appropriate from an operational and risk-management perspective. In addition, the Board assesses the company s strategic and operational risks throughout the year, with particular focus on these risks at an annual three-day Board meeting in late January/early February. At this meeting, senior management reports on the opportunities and risks faced by the company in the markets in which the company conducts business. Additionally, each business unit president and each business group executive vice president presents the unit s and group s respective operating plan and strategic initiatives for the year, including notable business opportunities and risks facing the business unit and group. The Board reviews, adjusts where appropriate, and approves the business unit and business group goals and adopts our company operating plan for the year. These plans and related risks are then monitored throughout the year as part of periodic financial and performance reports given to the Board by the chief financial officer and executive vice presidents of each business group. The Board also receives briefings from senior management concerning a variety of matters and related risks to the company, including defense budget and acquisition matters and specific customer or program developments.

In addition, the Audit Committee has responsibility for oversight of the company s policies and practices concerning overall risk assessment and risk management. The committee reviews and takes appropriate action with respect to the company s annual and quarterly financial statements, the internal audit program, the ethics program and disclosures made with respect to the company s internal controls. To facilitate these risk oversight responsibilities, the committee receives regular briefings from members of senior management on the internal audit plan; Sarbanes-Oxley 404 compliance; significant litigation and other legal matters; ethics program matters; and health, safety and environmental matters. The committee also holds regular executive sessions with the staff vice president, Internal Audit, and regular executive sessions with the partners of the KPMG LLP audit team.

In addition to the Audit Committee s role in risk oversight, each of the other Board committees considers risk as it relates to its particular areas of responsibility. The Finance and Benefit Plans Committee oversees the management of the company s finance policies and the assets of the company s defined benefit plans for employees. To assess risks in these areas, the committee receives regular briefings from our vice president and treasurer, and our chief financial officer, on finance policies and asset performance. The Compensation Committee oversees and administers our incentive and equity compensation programs to ensure that the programs create incentives for strong operational performance and for the long-term benefit of the company and its shareholders. The committee receives briefings from the chairman and chief executive officer and the senior vice president, Human Resources and Administration, on compensation matters. Finally, the Nominating and Corporate Governance Committee oversees risks related to board composition and governance matters and receives briefings from the senior vice president, general counsel and secretary.

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Board Meetings and Attendance

During 2012, the Board of Directors held nine meetings. This included a three-day meeting in February to review our 2012 operating plan, including the operating plan of each of our business units and business groups. In August 2012, the Board visited the Groton, Connecticut, facility of our General Dynamics Electric Boat business unit and met with that business unit s management team. Each of our directors attended at least 80 percent of the meetings of the Board and committees on which they served in 2012. We encourage directors to attend each annual meeting of shareholders. All of our directors attended the 2012 meeting of shareholders.

Executive Sessions of the Board

Our Board holds executive sessions of the non-management directors in conjunction with all regularly scheduled Board meetings. The non-management directors may also meet without management present at other times as desired by any non-management director. The lead director serves as chair at the executive sessions.

Board Committees

The Board of Directors has four standing committees, described below. Currently, three of the four Board committees are composed of independent, non-management directors, including those committees that are required by the rules of the New York Stock Exchange to be composed solely of independent directors. Each of the Board committees has a written charter. Copies of these charters are available on our website at www.generaldynamics.com, under the Investor Relations Corporate Governance captions, or in print upon request.

Committee Members. Listed below are the members of each of the four standing committees as of March 7, 2013, with the chair appearing first.

Audit	Compensation	Finance and Benefit Plans	Nominating and Corporate Governance
William P. Fricks	William A. Osborn	Paul G. Kaminski	James S. Crown
James S. Crown	Mary T. Barra	Nicholas D. Chabraja	Mary T. Barra
Lester L. Lyles	James S. Crown	John M. Keane	John M. Keane
William A. Osborn	William P. Fricks	William A. Osborn	Lester L. Lyles
Robert Walmsley	Paul G. Kaminski		Robert Walmsley

Audit Committee. This committee provides oversight for accounting, financial reporting, internal control, auditing and regulatory compliance activities. It selects and evaluates our independent auditors and evaluates their independence. In addition, this committee reviews our audited consolidated financial statements with management and the independent auditors, recommends to the Board whether the audited consolidated financial statements should be included in our annual report on Form 10-K and prepares a report to shareholders that is included in our proxy statement. This committee evaluates the performance, responsibilities, budget and staffing of the internal audit function, as well as the scope of the internal audit plan. The committee also monitors management s implementation of the policies, practices and programs of the company in several areas, including business ethics and conduct, employee safety and health standards, and environmental matters. This committee held 11 meetings in 2012. The Board of Directors has determined that Mr. Fricks, the chair of the Audit Committee, and Mr. Osborn each qualifies as an Audit Committee Financial Expert as defined by the SEC.

Compensation Committee. This committee evaluates the performance of the chief executive officer and other officers and reviews and approves their compensation. The processes and procedures for the review and approval of executive compensation are described in the Compensation Discussion and Analysis section of this Proxy Statement. In addition, this committee has responsibility for recommending to the Board the level and form of compensation and benefits for directors. It also administers our incentive compensation plans and reviews and monitors succession plans for the chief executive officer and other officers. This committee held five meetings in 2012.

Consistent with its obligations and responsibilities, the Compensation Committee may form subcommittees of one or more members of the committee and delegate its authority to the subcommittees as it deems appropriate. In addition, the committee has the authority to retain and terminate external advisors in connection with the discharge of its duties. The committee s charter also provides that the committee has sole authority to approve consultant fees (to be funded by the company) and the terms of the consultant s retention. Pursuant to the charter, the Compensation Committee has, from time to time, engaged PricewaterhouseCoopers LLP (PwC) as a compensation consultant to provide advice on executive compensation matters. In 2012, the committee, after reviewing fees paid by the company to PwC for other services and considering PwC s independence generally, engaged PwC to provide context on the current executive compensation landscape from the perspective of regulators, shareholders and the competitive market, and to conduct a review of our executive compensation processes. PwC is also available to provide advice to the chairman of the Compensation Committee or the Compensation Committee as a whole on executive compensation matters on an as-needed basis. PwC attends Compensation Committee meetings upon the request of the committee s chair and may also provide observations and insights to the committee related to the amount or form of compensation for our executives.

In 2012, the chair of the Compensation Committee approved fees of approximately $40,000 to PwC in its capacity as external advisor to the Compensation Committee. Management neither made, nor recommended, the decision to engage PwC. The PwC group providing compensation services to the Compensation Committee reports directly to the chairman of the Compensation Committee and is not involved in providing any other services to the company. During 2012, we also retained PwC to provide services to the company unrelated to executive compensation including tax and other business-related services. The aggregate fees paid for those services in 2012 were approximately $3.2 million. In February 2013, the Compensation Committee undertook an assessment of PwC s services for the committee and the company and determined that no conflict of interest exists.

Finance and Benefit Plans Committee. This committee oversees the management of the finance policies of General Dynamics to ensure that those policies are in keeping with the company s overall business objectives. The committee also oversees the assets of certain employee benefit plans of the company. With respect to those plans that name the company or one of its subsidiaries as the investment fiduciary, and for which the company or one of its subsidiaries has not appointed the management investment committee as investment fiduciary, the committee provides strategic oversight of the management of the assets; reviews and approves investment policy recommendations made by management; and reviews and approves the retention of third parties for administration and management services related to trust assets. This committee held four meetings in 2012.

Nominating and Corporate Governance Committee. This committee evaluates board and management effectiveness; advises the Board on corporate governance matters; monitors developments, trends and best practices in corporate governance; and recommends corporate governance guidelines that comply with legal and regulatory requirements. It also identifies qualified individuals to serve as directors and recommends the director nominees proposed either for election at the annual meeting of shareholders or to fill vacancies and newly created directorships between annual meetings. This committee held four meetings in 2012.

Director Nominations

The Nominating and Corporate Governance Committee considers director nominees from various sources. The committee considers and makes recommendations to the Board concerning the appropriate size and composition of the Board, including the relevant characteristics and experience required of new members. Nominees are chosen with the primary goal of ensuring that the entire Board collectively serves the interests of shareholders based on the attributes, experience, qualifications and skills noted below. In assessing director candidates, the Nominating and Corporate Governance Committee considers the background and professional experience of the candidates in the context of the current Board composition to ensure there is a diverse range of backgrounds, talent, skill and expertise among the directors. Relevant criteria considered by the committee include: business and financial expertise, technical expertise and familiarity with issues affecting aerospace and defense businesses. The committee also carefully considers any potential conflicts of interest. All nominees must possess good judgment, an inquiring and independent mind, and a reputation for the highest personal and professional ethics, integrity and values. Nominees must be willing to devote sufficient time and effort to carrying out their duties and responsibilities and should be committed to serve on the Board for an extended period of time.

Each year the directors undertake a self-assessment that elicits feedback on the performance and effectiveness of the Board and each committee. As part of this self-assessment, the directors are asked to consider whether, among other things, the current directors possess the appropriate mix of skills, experience and diverse viewpoints to enable the Board to function effectively. The results of the self-assessment are presented to the Nominating and Corporate Governance Committee and the full Board.

The Nominating and Corporate Governance Committee will consider director nominees recommended by shareholders. To recommend a qualified person to serve on the Board of Directors, a shareholder should write to the Corporate Secretary, General Dynamics Corporation, 2941 Fairview Park Drive, Suite 100, Falls Church, Virginia 22042. The written recommendation must contain (1) all information for each director nominee required to be disclosed in a proxy statement by the Securities Exchange Act of 1934, as amended (the Exchange Act); (2) the name and address of the shareholder making the recommendation, and the number of shares owned and the length of ownership; (3) a statement as to whether the director nominee meets the criteria for independence under the rules of the New York Stock Exchange and the Director Independence Guidelines; (4) a description of all arrangements or understandings, and the relationship, between the shareholder and the director nominee, as well as any similar arrangement, understanding or relationship between the director nominee or the shareholder and General Dynamics; and (5) the written consent of each director nominee to serve as a director if elected. The committee will consider and evaluate persons recommended by shareholders in the same manner as it considers and evaluates potential directors identified by the company.

Communications with the Board

Any shareholder or other interested party who has a concern or question about the conduct of General Dynamics may communicate directly with our non-management directors or the full Board. Communications may be confidential or anonymous. Communications should be submitted in writing to the chair of the Nominating and Corporate Governance Committee in care of the Corporate

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Secretary, General Dynamics Corporation, 2941 Fairview Park Drive, Suite 100, Falls Church, Virginia 22042. The Corporate Secretary will receive and process all written communications and will refer all substantive communications to the chair of the Nominating and Corporate Governance Committee in accordance with guidelines approved by the independent members of the Board. The chair of the Nominating and Corporate Governance Committee will review and, if necessary, investigate and address all such communications and will report the status of these communications to the non-management directors as a group or the full Board on a quarterly basis.

Our employees and other interested parties may also communicate concerns or complaints about our accounting, internal control over financial reporting or auditing matters directly to the Audit Committee. Communications may be confidential or anonymous and can be submitted in writing or reported by telephone. Written communications should be submitted to the chair of the Audit Committee in care of our ethics officer at the address in the preceding paragraph or at the address in the Standards of Business Ethics and Conduct Handbook provided to all employees. Our employees can call a toll-free helpline number or access the helpline at a web address, each of which is provided to all employees. The ethics officer will review, investigate and address any concerns or complaints unless the Audit Committee instructs otherwise. The ethics officer will report the status of all concerns and complaints to the Audit Committee. The Audit Committee may also direct that matters be presented to the full Board and may direct special treatment of any concern or complaint addressed to it, including the retention of outside advisors or counsel.

Director Orientation and Continuing Education

Within six months of election to the Board, each new director receives a director orientation. The orientation consists of a series of in-person briefings on our business operations; operating plans; significant financial, accounting and risk-management matters; corporate governance; investor relations; and key policies and practices. The chief executive officer, senior vice presidents and executive vice presidents provide in-depth reviews of the areas under their authority. Additionally, at this orientation a new director also receives briefings on the responsibilities, duties and activities of the committees on which the director will serve. The general counsel and chief financial officer also periodically provide materials and briefing sessions on subjects that assist the directors in discharging their duties. Annually, the Board holds a three-day meeting with our senior management to review and approve the operating plan of each of our business units and business groups and the company as a whole. In addition, directors visit our business units periodically. These visits allow the directors to interact with a broader group of our executives and employees and gain a firsthand view of our operations.

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Director Compensation

We compensate each non-management director for service on the Board of Directors. The Compensation Committee reviews director compensation on an annual basis. In early 2012, at the request of the committee, management reviewed director compensation at peer companies. In support of this review, management engaged Meridian Compensation Partners, LLC (Meridian), to conduct a director compensation survey that included cash retainers, meeting fees, equity compensation and additional director benefits. Meridian provided director compensation data for two peer groups. The first group consisted of the following companies with substantial aerospace or defense revenues:

The Boeing Company	Northrop Grumman Corporation
Goodrich Corporation	Raytheon Company
Honeywell International Inc.	Rockwell Collins, Inc.
L-3 Communications Holdings, Inc.	Textron Inc.
Lockheed Martin Corporation	United Technologies Corporation

To assist the Compensation Committee in understanding director compensation practices and trends in the broader industrial base, management also requested director compensation data from Meridian for a larger group of companies comprising the 10 companies listed above and 13 additional companies. The companies in the larger group were:

3M Company	Johnson Controls, Inc.
The Boeing Company	L-3 Communications Holdings, Inc.
Caterpillar, Inc.	Lockheed Martin Corporation
Deere & Company	Northrop Grumman Corporation
The Dow Chemical Company	Oshkosh Corporation
Emerson Electric Co.	Raytheon Company
Goodrich Corporation	Rockwell Collins, Inc.
Honeywell International Inc.	SAIC, Inc.
Illinois Tool Works Inc.	Textron Inc.
International Business Machines Corp.	Tyco International Ltd.
International Paper Company	United Technologies Corporation
ITT Corporation	

In each group, the average sales of the group approximated our sales. The Compensation Committee reviewed the survey data for these two peer groups provided to management by Meridian and, based on this review, recommended no change in director compensation. Accordingly, director compensation for 2012 included the following:

Annual Retainer	$70,000
Lead Director Additional Retainer	$25,000
Committee Chair Additional Annual Retainer	$10,000
Attendance Fees	$3,000 for each meeting of the Board of Directors; $2,000 for each meeting of any committee; and $3,000 per day for attending strategic or financial planning meetings sponsored by General Dynamics
Annual Equity Award	Approximately $122,000 on the date of award

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In early 2013, as part of its annual review of director compensation, the Compensation Committee requested that management update its director compensation analysis. Management again engaged Meridian to provide survey data for the core peer group listed above and a revised larger peer group consisting of the following companies:

3M Company
The Boeing Company
Caterpillar, Inc.
Cisco Systems, Inc.
Deere & Company
The Dow Chemical Company
Emerson Electric Co.
Goodrich Corporation
Honeywell International Inc.
Illinois Tool Works Inc.
Intel Corporation
International Business Machines Corp.
International Paper Company
Johnson Controls, Inc.
L-3 Communications Holdings, Inc.
Lockheed Martin Corporation
Northrop Grumman Corporation
Raytheon Company
Rockwell Collins, Inc.
SAIC, Inc.
Textron Inc.
Tyco International Ltd.
United Technologies Corporation

The committee reviewed the survey data regarding director compensation provided by Meridian and, based on this review, recommended no change to the annual retainer, lead director retainer, committee chair retainer, attendance fees, or annual equity award for the second consecutive year. The committee recommended, and the Board approved, a per diem fee of $10,000 for non-employee directors who perform specific projects for the company at the request of the chairman.

Non-management directors have the option of receiving all or part of their annual retainers in the form of Common Stock. The annual retainer, additional committee chair retainer (if any) and attendance fees paid to each director during 2012 are reflected in the Fees Earned or Paid in Cash column of the Director Compensation for Fiscal Year 2012 table, irrespective of whether a director took the annual retainer in shares of Common Stock. The annual equity award consists of a restricted stock award and a stock option award.

In connection with the creation of a Lead Director position by the Board in February 2010, the Compensation Committee asked management to provide information regarding amounts paid to lead directors. Management provided information for companies in the Fortune 200 with lead directors. Based upon this information, the committee established a $25,000 lead director additional retainer, which represented the median of the comparative data. Information provided in connection with the February 2013 annual review of director compensation showed that $25,000 continued to represent the median of the comparative data for lead director retainers.

In light of the travel required by service on the Board, we also provide each director with accidental death and dismemberment insurance coverage. Payments by General Dynamics for director accidental death and dismemberment insurance premiums are reflected in the All Other Compensation column of the Director Compensation for Fiscal Year 2012 table.

Director Stock Ownership Guidelines

The Board of Directors believes that each director should develop a meaningful ownership position in General Dynamics. Therefore, the Board of Directors adopted stock ownership guidelines for non-management directors. Pursuant to these guidelines, each non-management director is expected to own at least 4,000 shares of our Common Stock. Non-management directors are expected to achieve the target ownership threshold within five years of election to the Board. Management directors are subject to the ownership requirements discussed under Compensation

Discussion and Analysis   Stock Ownership Guidelines.

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Director Compensation Table

The table below provides total compensation for the last completed fiscal year for each of General Dynamics non-management directors serving during the year. The number of shares of restricted stock and the number of shares subject to options awarded to the directors annually are the same for each director.

Director Compensation for Fiscal Year 2012

Name	Fees Earned or Paid in Cash (a)	Stock Awards (b)	Option Awards (c)	All Other Compensation (d)	Total
Mary T. Barra	$ 127,000	$ 61,069	$ 60,868	$ 2,140	$ 251,077
Nicholas D. Chabraja	$ 117,000	$ 61,069	$ 60,868	$ 4,080	$ 243,017
James S. Crown	$ 182,000	$ 61,069	$ 60,868	$ 2,140	$ 306,077
William P. Fricks	$ 151,000	$ 61,069	$ 60,868	$ 4,080	$ 277,017
James L. Jones (e)	$ 118,000	$ 61,069	$ 60,868	$ 4,080	$ 244,017
George A. Joulwan (f)	$ 61,217	$ 61,069	$ 60,868	$ 1,634	$ 184,788
Paul G. Kaminski	$ 137,000	$ 61,069	$ 60,868	$ 4,080	$ 263,017
John M. Keane	$ 125,000	$ 61,069	$ 60,868	$ 4,080	$ 251,017
Lester L. Lyles	$ 137,000	$ 61,069	$ 60,868	$ 2,140	$ 261,077
William A. Osborn	$ 152,000	$ 61,069	$ 60,868	$ 2,140	$ 276,077
Robert Walmsley	$ 139,000	$ 61,069	$ 60,868	$ 5,828	$ 266,765

(a) Messrs. Fricks, Keane and Lyles elected to receive 100 percent of their annual retainer in Common Stock. As a result, they each received 1,027 shares of Common Stock with a grant date fair value of $69,880. Ms. Barra and Mr. Walmsley elected to receive 50 percent of their annual retainer in Common Stock. As a result, Ms. Barra received 513 shares of Common Stock with a grant date fair value of $34,906 and Mr. Walmsley received 358 shares of Common Stock with a grant date fair value of $24,360.

(b) The amounts reported in the Stock Awards column reflect the aggregate grant date fair value computed in accordance with Financial Accounting Standards Board ASC Topic 718, *Compensation Stock Compensation.* Assumptions used in the calculation of these amounts are included in Note O to our audited financial statements for the fiscal year ended December 31, 2012, included in our Annual Report on Form 10-K filed with the SEC on February 8, 2013. Restricted stock awards outstanding as of December 31, 2012, for each director were as follows: 1,400 for Ms. Barra; 3,630 for Mr. Chabraja; 2,910 for Messrs. Crown, Fricks, Joulwan, Kaminski, Keane, Lyles and Walmsley; 1,110 for Mr. Jones; and 1,950 for Mr. Osborn.

(c) The amounts reported in the Option Awards column reflect the aggregate grant date fair value computed in accordance with Financial Accounting Standards Board ASC Topic 718. Assumptions used in the calculation of these amounts are included in Note O to our audited financial statements for the fiscal year ended December 31, 2012, included in our Annual Report on Form 10-K filed with the SEC on February 8, 2013. Option awards outstanding as of December 31, 2012, for each director were as follows: 9,860 for Ms. Barra; 679,000 for Mr. Chabraja; 32,900 for Messrs. Crown, Fricks, Keane and Lyles; 7,090 for Mr. Jones; 21,800 for Mr. Joulwan; 21,800 for Mr. Kaminski; 15,200 for Mr. Osborn; and 27,350 for Mr. Walmsley.

(d) Amounts listed reflect payments by General Dynamics for accidental death and dismemberment insurance. For Mr. Walmsley, the amount also includes $1,748 for reimbursement of taxes related to payments for accidental death and dismemberment insurance.

(e) Mr. Jones resigned from the Board effective January 1, 2013.

(f) Mr. Joulwan retired from the Board effective May 2, 2012.

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Compensation Discussion and Analysis

Overview and Philosophy

Our 2012 performance did not reflect General Dynamics long history of excellent results. While some of our businesses performed extremely well, others experienced significant financial and operational challenges, driven in part by declining defense budgets worldwide that in many cases resulted in delayed contract awards and lower than anticipated volume. Our results also reflect some performance-related shortcomings that we are addressing in 2013 and several acquisitions that failed to meet expectations. In the current challenging budget environment, our businesses remain focused on execution as well as managing for profitability, including implementing cost-cutting measures and continuous improvement initiatives.

In determining 2012 compensation, our philosophy remains unaltered. We tie the majority of executive compensation to our performance as a company thereby aligning the interests of our executives with those of our shareholders. When company performance does not meet the mark, it is reflected in the executives compensation. Notable aspects of the Compensation Committee s March 2013 compensation determinations include:

- The Compensation Committee awarded bonus payments for 2012 that were significantly lower for certain named executive officers than the prior year s bonuses and that resulted in total cash compensation for all of our named executive officers below the 50th percentile of the competitive market data. Additionally, we reduced the number of executive compensation program participants to 450 from 500.

- All of our executive compensation program participants, including the named executive officers, forfeited the performance restricted stock units (PRSUs) granted to them in 2012, because we did not achieve the relevant performance metric, return on invested capital. This resulted in a forfeiture of $35 million in grant date fair value.

- The Compensation Committee held salaries for each named executive officer below the 50th percentile of the competitive market data.

Our executive compensation program is designed to create incentives for strong operational performance in the current year and for the long-term benefit of the company, thereby closely aligning the interests of management and our shareholders. At the executive level, the majority of compensation is equity-based, vests over time and is tied directly to long-term shareholder value. Stringent stock ownership levels for our executive officers, which require our executive officers to hold Common Stock with values ranging from eight to 15 times base salary, ensure that our management team is incentivized to act in the best interests of our shareholders. Additionally, we continue to offer only perquisites that we feel are reasonable and necessary to be competitive in attracting and retaining a strong management team. We also continue to have no employment agreements with our named executive officers.

While our company encountered significant challenges in 2012, our long-term performance has been strong. As the 10-year performance graph on the next page shows, in the past decade we have generated a total return for shareholders of 114 percent, higher than the Standard and Poor s® 500 Index. This graph also illustrates macroeconomic pressures affecting the broader markets over the past several years and defense spending concerns affecting our company and many of our competitors, particularly over the past several years.

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Ten-Year Historical Performance

(December 2002 December 2012)

Our Compensation Program

Executive Compensation Program Participants and Overview. The named executive officers included in the Summary Compensation Table are key members of our senior management team. This team, led by our chairman and chief executive officer, remains dedicated to achieving strong financial results and is compensated in ways to ensure a continual focus on creating shareholder value. Corporate executive vice presidents at the direction of the chief executive officer provide guidance to the individual operating business units within each of the business groups and report directly to the chief executive officer. A president of each business unit is responsible for profit and loss performance by that business unit and has a direct reporting line for their responsibilities to the chief executive officer. In 2012, the Board appointed Phebe N. Novakovic to the position of president and chief operating officer as part of our chief executive officer succession plan. Ms. Novakovic served in this role until assuming the position of chairman and chief executive officer in January 2013.

Approximately 450 employees, including our senior management team, participate in our executive compensation program, which includes a salary, a performance-based bonus and equity awards, along with standard company-provided benefits. Salaries are intended to provide executives with a fair and competitive wage. We use independently provided survey data to set salaries that are targeted at the median (50th percentile) for salaries of executives in comparable positions at our peer group companies. On average, however, salaries account for less than half of our senior executives compensation. The majority of their compensation is in the form of bonuses and equity awards, which are tied to the performance of the company, individual performance of the executive and, where applicable, that of their business group and, therefore, is at risk. For our named executive officers, 80 percent or more of their compensation is at risk. For our chairman and chief executive officer, that number is 85 percent. Bonuses, when earned, are paid in cash. Equity awards are granted as a combination of stock options, restricted stock and restricted stock units (RSUs).

In practice, equity awards provide the greatest risk and possible reward to our executives. The ultimate value of equity awards depends in large part on the impact of the company s future performance on the value of our Common Stock over the long term. This is essential in aligning the interests of management with the interests of shareholders. If the company does well, management and

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shareholders both benefit. Clearly, the opposite is also true, as can be seen in the values of the performance RSUs granted in 2012. Because of our focus on aligning the interests of management with those of our shareholders, as a matter of principle we do not consider the value of past equity awards when determining current compensation. Our responsibility in setting compensation is to ensure that the expected value of the equity awards, at the time they are received, is reasonable.

We believe that maintaining a focus on driving shareholder value starts by setting strong goals. Every year, senior management establishes business unit and business group operating goals and an operating plan for the company as a whole. Our Board of Directors reviews, adjusts where appropriate, and approves the business unit and business group goals and adopts our operating plan for the year. The Board reviews and monitors our performance throughout the year as compared to the plan. Our responsibility in setting the operating plan goals is to ensure that they are challenging but achievable in light of current market conditions, incentivize value creation and ultimately contribute to the creation of shareholder value.

The Annual Compensation Process. Setting compensation for our executives is a 16-month process that begins in the fall of each year when senior management establishes company operating goals for the coming year. The business unit presidents develop business plans and present the plans to the chairman and chief executive officer in November. She, in consultation with the chief financial officer and the executive vice presidents, establishes the business unit and business group operating goals and the company operating plan for the coming year based on those business unit plans. At a three-day Board meeting in late January/early February, the business unit presidents present their plans to the Board of Directors. The Board then reviews, adjusts where appropriate, and approves the business unit and business group operating goals and adopts our company operating plan for the year. Throughout the year, the Board reviews and monitors company performance as compared to the operating plan through a series of financial and operating reports given by the chief financial officer and the executive vice presidents.

A review of the year s performance begins the following January. At that time, the chairman and chief executive officer, the chief financial officer, and the executive vice presidents assess the performance of business units, business groups and the company compared with the operating plan goals adopted the prior year. This rigorous assessment results in a score for each business unit that focuses on key financial metrics (earnings before interest and taxes, referred to as EBIT, and cash) and programmatic goals. The chairman and chief executive officer and senior management report the results of that assessment to the Board of Directors at the Board s three-day meeting in late January/early February. Following these reports, the chairman and chief executive officer, after consultation with senior management, undertakes an initial discussion with the Compensation Committee regarding executive compensation for the year. The Compensation Committee convenes in early March to review and approve final executive compensation proposals. At this meeting, the chairman and chief executive officer provides the committee with a performance assessment of each officer (other than herself) and makes specific recommendations to the committee regarding each officer s compensation. The Compensation Committee reviews and approves compensation for the chairman and chief executive officer in executive session at the March meeting.

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The Compensation Committee, chairman and chief executive officer, and senior management are entrusted to exercise judgment in making the compensation recommendations and decisions. Although we use survey data to target each element of cash compensation and total equity compensation, the compensation determinations are not formulaic and involve the exercise of discretion by senior management and the Compensation Committee. We believe the adoption of a specific performance formula could inadvertently encourage undesirable behavior (*e.g.*, favoring achievement of particular financial objectives to the exclusion of other important objectives and values). To this end, we do not have targeted payout amounts, and the company, business group and individual performance categories for named executive officers are not assigned specific weights. We believe the use of discretion results in reasonable and rational compensation decisions, allowing us to set challenging goals while not encouraging excessive risk-taking that could be detrimental to our shareholders.

Components of Our Compensation Program

Our executive compensation program has two parts: direct compensation and benefits. Direct compensation consists of a base salary, a bonus and equity awards. Company-sponsored benefits include insurance plans, retirement plans and perquisites.

Direct Compensation

Salary. We pay executives an annual salary in cash targeted at the median (50th percentile) for salaries of executives in comparable positions at our peer group companies based on survey data. Salaries are reviewed annually, and increases, when they occur, are market driven. Generally, our disciplined process results in salaries at no more than the median. We believe that high-performing organizations make an effort to pay salaries at no more than market and therefore create a performance-based culture around bonus and equity incentives to encourage the achievement of challenging goals.

Bonus. We award executives bonuses based on the prior year s performance of the company, their individual performance, and, where applicable, that of their business group. The bonus is designed to place at risk a significant portion of an executive s annual cash compensation. He or she has upside potential if the company, or the business group where applicable, performs well against the operating plan, and downside potential if performance does not meet expectations. When combined with base salaries, cash bonuses generally bring total cash compensation between the 50th and 75th percentiles of cash compensation for executives in comparable positions at our peer group companies based on survey data. However, total cash compensation can be below the 50th percentile when warranted by performance.

Equity Awards. We believe that equity awards are an effective tool for aligning executive interests with those of our shareholders. Accordingly, most of the potential value of our executives annual compensation is in the form of equity. In addition, we require officers to retain Common Stock until they own shares with a market value ranging from eight to 15 times their base salary, depending on the officer s position. Once an officer attains his or her required ownership level, the officer must maintain that ownership level until he or she no longer serves as an officer. As a result, our officers become shareholders with considerable personal financial interest in the health and performance of our company.

We determine the amount of equity awards to be granted to an executive in a particular year using a multiple of the executive s total cash compensation. Therefore, the ultimate value of the equity award

is driven in part by prior-year performance and in part by the executive s ability to create value going forward. As a reasonableness test, we base the multiples on survey data for the ratio of long-term incentives to cash compensation that our peer group companies award to their executives in similar positions. The ratio of long-term incentives to cash compensation for our executives is generally between the 50th and 75th percentiles of the survey data.

Equity awards consist of stock options, restricted stock and restricted stock units (RSUs). For March 2013 awards, the Compensation Committee approved an equity award allocation of one-half in stock options, one-quarter in restricted stock (or RSUs for some participants outside the United States due to tax considerations) and one-quarter in RSUs that are subject to a specific performance measure (PRSUs). We believe that providing a mix of stock options, restricted stock and PRSUs is conducive to creating a healthy risk and reward profile for our executives. Stock options are more sensitive to fluctuations in the stock market as well as company performance during the life of the options. Our current practice is to grant options that expire seven years after the date of grant. For PRSUs, the amount of units ultimately received will depend upon whether the applicable performance measure is met. We balance the risk inherent in stock options and PRSUs against the relative stability implicit in restricted stock to motivate our executives to achieve operating goals that are challenging, but achievable.

As a matter of practice, we grant equity awards on the first Wednesday of March each year. For new hires or promotions, equity awards are granted on the later of the effective date of the event or the date the award is approved by the Compensation Committee. The number of shares of restricted stock, RSUs and PRSUs awarded, and the exercise price of stock options, are based on the fair market value of our Common Stock on the date of the equity award. We define fair market value of our Common Stock as the average of the high and low stock price on the date of the equity award.

Restricted Stock. A grant of restricted stock is an award of shares of Common Stock that is released approximately four years after the grant date. Restricted stock awards are designed to attract and retain executives by providing them with some of the benefits associated with stock ownership during the restriction period, while incentivizing them to remain with General Dynamics. During the restriction period, recipients may not sell, transfer, pledge, assign or otherwise convey their restricted shares. Recipients are eligible, however, to vote their shares and receive dividend payments and other distributions on our Common Stock when declared by the Board of Directors. Restricted stock awards are service-based, meaning that the executives must remain in the employment of the company during the restriction period in order to receive the shares upon release. Executives who voluntarily resign or are terminated for cause prior to the end of the restriction period forfeit their restricted stock unless otherwise determined by the Compensation Committee. Finally, no one participant may be granted an award of more than 200,000 shares of restricted stock in any calendar year. In practice, the number of shares of restricted stock granted to the named executive officers is well below this share limit.

Restricted Stock Units. An RSU represents a promise by General Dynamics to deliver a share of Common Stock in the future, subject to certain conditions. While we have historically awarded RSUs to certain participants outside the United States only, in March 2012 PRSUs were awarded to all participants. These PRSUs have both a performance measure and a service component. Each year, the Compensation Committee determines the appropriate performance metric to be used, which for 2012 and 2013 awards was return on invested capital. We selected return on invested capital as the performance measure because it reflects our ability to generate returns from the capital invested in our company. This metric is a good measure of the company s economic

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efficiency and ability to create value. Depending on the company s performance in relation to this metric, the number of PRSUs earned may be less than, equal to or greater than the original number of PRSUs awarded. The earned units are then subject to three years of additional service-based vesting. The PRSUs will be credited with dividend equivalents in the form of additional PRSUs which are also subject to the performance and service conditions. We believe the combination of performance and service features for PRSUs strikes an appropriate balance between pay for performance and incentivizing executives to focus on operational goals on the one hand and executive retention considerations on the other hand. As with restricted stock grants, executives who voluntarily resign or are terminated for cause immediately forfeit all PRSUs that have not been released unless otherwise determined by the Compensation Committee.

Stock Options. Stock options give an executive the right to buy a share of our Common Stock in the future at a predetermined exercise price, which is established as the average of the high and low sales price of our Common Stock on the date of award. We value stock options using the Black-Scholes formula. The formula is based on a set of key variables and assumptions and is an accepted model for valuing stock options under Financial Accounting Standards Board ASC Topic 718. Stock options vest over two years: 50 percent of the grant is exercisable in one year; the remainder is exercisable the following year. Our outstanding options granted prior to 2011 expire five years after the grant date. Options granted beginning in 2011 expire seven years after the grant date. The Compensation Committee determined that a seven-year expiration date would better serve the company s retention goals by (1) bringing the option exercise date more in line with practices of other companies with whom we compete for talent and (2) more appropriately mitigating employees risk exposure to market volatility. No one recipient may be granted an award of options to purchase more than 1,000,000 shares of Common Stock in any calendar year. In practice, the number of shares underlying stock option awards granted to the named executive officers is well below this share limit. As with restricted stock and PRSU awards, executives who voluntarily resign or are terminated for cause immediately forfeit all options that have not vested unless otherwise determined by the Compensation Committee. Our equity compensation plan prohibits the repricing of stock options without the approval of shareholders.

Stock Ownership Guidelines and Hedging Policy. Our stock ownership and retention guidelines preclude corporate officers from selling shares of Common Stock until they own shares with a market value ranging from eight to 15 times their base salary. Shares held outright, unreleased shares of restricted stock or RSUs and shares (or share equivalents) held through our 401(k) plans are counted for purposes of meeting the ownership guidelines. The chief executive officer must retain ownership worth 15 times her base salary. Our executive vice presidents and senior vice presidents must retain ownership worth 10 times their respective base salaries. Vice presidents must retain ownership worth eight times their respective base salaries. When exercising options, executives who have not yet met the ownership guideline may sell shares acquired upon exercise to cover transaction costs and taxes and are expected to hold any remaining shares until the guidelines are met. Similarly, shares received upon release of restricted stock and RSUs may not be sold until the ownership guidelines are met. Once an officer attains his or her required ownership level, the officer must maintain that ownership level until he or she no longer serves as an officer. Based on data from the Center On Executive Compensation and Equilar, Inc., we believe our stock ownership and retention guidelines are some of the most stringent among public companies and strongly align the interests of management with the interests of shareholders because executives become shareholders with a considerable investment in General Dynamics. Our stock ownership and retention guidelines are reviewed annually by the Compensation Committee. In addition, our insider trading policy prohibits our directors and executive officers from engaging in hedging transactions.

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Market Data. To assist the Compensation Committee in its determinations for executive compensation, we utilize survey data provided by Aon Hewitt. Through the use of regression analysis using the scope and responsibilities of the position and company revenue, the Aon Hewitt data provide a median salary (the 50th percentile) and the 50th to 75th percentiles for total cash compensation for comparable positions at the peer group companies. Aon Hewitt also provides survey data for the 50th to 75th percentiles for ratios of long-term incentives to annual cash compensation for comparable positions at the peer group companies.

For the March 2013 compensation determinations, we obtained data about compensation levels at companies within two peer groups. These peer groups were used to benchmark the compensation for our named executive officers. The 2012 revenues of General Dynamics approximated both the median and mean revenues of both peer groups. In selecting the companies that comprise these peer groups, we considered the size, revenues, industry group, organizational structure and compensation practices of each peer company.

The core peer group consisted of companies in the aerospace and defense sector or companies that have substantial aerospace or defense revenues. We selected companies with whom we compete for business opportunities and executive talent. The companies in the core peer group were:

The Boeing Company
Goodrich Corporation
Honeywell International Inc.
L-3 Communications Holdings, Inc.
Lockheed Martin Corporation
Northrop Grumman Corporation
Raytheon Company
Rockwell Collins, Inc.
Textron Inc.
United Technologies Corporation

The broader peer group consisted of the companies in the core peer group plus 13 additional companies with similar complexity of operations and organizational structure as General Dynamics to provide a broader view of compensation for executives. The companies in the broader peer group were:

3M Company
The Boeing Company
Caterpillar, Inc.
Cisco Systems, Inc.
Deere & Company
The Dow Chemical Company
Emerson Electric Co.
Goodrich Corporation
Honeywell International Inc.
Illinois Tool Works Inc.
Intel Corporation
International Business Machines Corp.
International Paper Company
Johnson Controls, Inc.
L-3 Communications Holdings, Inc.
Lockheed Martin Corporation
Northrop Grumman Corporation
Raytheon Company
Rockwell Collins, Inc.
SAIC, Inc.
Textron Inc.
Tyco International Ltd.
United Technologies Corporation

Company-Provided Benefits

General Dynamics-provided benefits are an important tool used to attract and retain outstanding employees. Benefit packages are not, however, standard across General Dynamics. Instead, our business units and corporate headquarters tailor their individual offerings based on their competitive marketplace. As a business matter, we weigh the benefits we need to offer to attract and retain talented employees against the benefits we can afford to pay and remain competitive. Benefit levels are reviewed periodically to ensure they are cost-effective and competitive and support the overall needs of our employees.

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This section describes the benefits that we provide to key executives and notes those instances when benefits for the named executive officers differ from the general plan. In some instances, we also describe the programs we offer across the company as context to specific discussions about executive benefits.

Benefits for Active Employees. We make available medical, dental, life insurance and disability coverage to eligible, full-time U.S.-based employees, including all the named executive officers. Employees can select the level of coverage appropriate for their circumstances.

We provide, at no cost to the employee, group life insurance coverage worth one times base salary and 50 percent long-term disability coverage to the majority of U.S.-based employees. For our named executive officers, we also provide at no cost to the officers additional life insurance coverage worth a total of two times their base salary.

Retiree Benefits. Retiree benefits vary significantly across our U.S.-based business units and may include retiree medical and dental coverage. Eligible employees at our corporate headquarters, including the named executive officers, can elect, at their own expense, to continue COBRA-eligible benefits through General Dynamics until they reach age 65. There is no retiree medical or dental benefit available to employees at our headquarters after they have reached age 65.

Eligible key executives throughout the company can purchase group term life insurance prior to retiring. For executives who retire early (prior to age 65), we pay for insurance coverage equal to one-half the executive s base salary until the executive reaches age 65. For executives retiring at or after age 65, or for early retirees who have made a required election prior to turning 65, we pay for insurance coverage up to two times an executive s base salary. This coverage is ratably reduced over a five-year period following the executive s retirement, or beginning at age 65 for early retirees, subject to a maximum coverage level of 25 percent of the coverage in effect at the time of retirement.

Company-sponsored Retirement Plans. We provide a number of defined-benefit and defined-contribution retirement plans to our eligible employees, including the eligible named executive officers, through a combination of qualified and non-qualified plans.

Below are descriptions of the retirement plans that cover employees at our headquarters, including the named executive officers. Prior to his retirement, Mr. DeMuro has participated in a legacy retirement plan that is described on page 42 in the narrative discussion following the Pension Benefits for Fiscal Year 2012 table.

Defined-Benefit Retirement Plan. We sponsor the General Dynamics Salaried Retirement Plan, which is a funded, tax-qualified, noncontributory defined-benefit pension plan. The Salaried Retirement Plan was amended effective January 1, 2007, to exclude any employee initially hired after that date. The benefit formula under the Salaried Retirement Plan for employees hired before December 31, 2006, is 1.0 percent times a participant s highest final average pay multiplied by years of service earned on and after January 1, 2007, plus 1.3333 percent times a participant s highest final average pay prior to January 1, 2011, multiplied by years of service earned prior to January 1, 2007. The plan was further amended in January 2013 to freeze benefits as of December 31, 2013, under the plan for employees at our corporate headquarters, including the named executive officers. The benefit under the plan is payable as a life annuity. A participant s base salary and cash bonus are used to calculate retirement benefits. We make contributions to the Salaried Retirement Plan through payments into a trust fund from which the benefits are paid.

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Supplemental Retirement Plan. The amount of cash compensation used to calculate pension benefits for participants in the Salaried Retirement Plan is limited by the Internal Revenue Code ($250,000 in 2012 and $255,000 in 2013). To provide a benefit calculated on compensation in excess of this compensation limit, we provide eligible executives coverage under the General Dynamics Corporation Supplemental Retirement Plan. Benefits under the Supplemental Retirement Plan are general unsecured obligations of General Dynamics.

401(k) Plan. All our named executive officers are eligible to participate in the General Dynamics Corporation 401(k) Plan 4.5, formerly known as the General Dynamics Corporation Savings and Stock Investment Plan Plan 4.5 (the 401(k) Plan), a tax-qualified defined contribution retirement plan. All participants are eligible to make before-tax contributions and receive company matching contributions for the named executive officers under the 401(k) Plan. During 2012, the 401(k) Plan provided for a company-matching contribution of (1) 100 percent on before-tax contributions up to the first 3 percent of a participant s eligible pay and (2) 50 percent on before-tax contributions on the next 3 percent of a participant s eligible pay. Our matching contributions during 2012 for the named executive officers are included in footnote (d) to the All Other Compensation column of the Summary Compensation Table on page 36 of this Proxy Statement.

Supplemental Savings Plan. We provide a Supplemental Savings Plan to key employees, including all the named executive officers. The purpose of the Supplemental Savings Plan is to allow key executives to defer salary and receive matching contributions on compensation in excess of the compensation limit imposed by the Internal Revenue Service on earnings used to calculate 401(k) contributions. Our matching contributions during 2012 for the named executive officers are included in footnote (d) to the All Other Compensation column of the Summary Compensation Table on page 36 of this Proxy Statement.

Perquisites. We provide perquisites to key executive officers, including the named executive officers, as a recruiting and retention tool. We also provide perquisites to ensure the security and accessibility of our executives and to facilitate the transaction of business. We believe that our perquisites are appropriate. As a reasonableness test, we compare these perquisites to generally accepted corporate practices. Our policy is to not reimburse executive officers for personal taxes owed by them resulting from their receipt of perquisites.

The perquisites provided to our named executive officers in 2012 were: financial planning and tax preparation services; physical exams; home security systems; club memberships; personal liability and supplemental accidental death and dismemberment insurance; and the personal use of automobiles owned or leased by the company. In addition, personal use of our aircraft was provided to our chairman and chief executive officer as required by the Board to help ensure security and accessibility. In February 2013, the Compensation Committee determined to no longer provide leased cars to officers, with any existing leases to be terminated no later than December 31, 2014.

We have provided additional information on perquisites in footnote (d) to the All Other Compensation column of the Summary Compensation Table on page 36 of this Proxy Statement.

Change in Control Agreements

We have change in control agreements, also known as severance protection agreements, with key executives throughout the company, including each of the named executive officers. We believe that these agreements are an important tool for recruiting and retaining highly qualified executives who

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could have other job alternatives that may appear to the executive to be less risky absent these agreements. The agreements are structured to protect the interests of shareholders by including a double trigger mechanism that results in a severance payout only when:

(1) a change of control is consummated, and
(2) the executive s employment is terminated by the company without cause or by the executive for good reason within 24 months following the change in control.

A change in control is defined to include specified stock acquisition, merger or disposition transactions involving General Dynamics. Appropriate payment and benefit levels under the change in control agreements are evaluated and reviewed regularly. These reviews support our view that the agreements are consistent with market practice. The form of severance protection agreement for executive officers appointed after April 2009 excludes any provision for reimbursement of excise taxes that may become due upon a change in control.

Payments and benefits provided to our named executive officers pursuant to the change in control agreements are described in the Potential Payments upon Termination or Change in Control section beginning on page 44 of this Proxy Statement.

Analysis of 2012 Compensation for the Named Executive Officers

At the company s 2012 annual meeting of shareholders, a significant majority of our shareholders (approximately 77%) voted in favor of the company s advisory resolution to approve executive compensation. As a result, the Compensation Committee determined that its philosophy of tying a substantial portion of executive compensation to shareholder value, thereby aligning the interests of executives with those of the company s shareholders, is effective and supported by our shareholders and that no significant changes to the executive compensation program were necessary. The committee will continue to evaluate the executive compensation program to ensure adherence to its stated philosophy and good governance practices, and will continue to consider results of shareholder advisory votes on executive compensation when making future compensation decisions.

For 2012, our named executive officers were:

Phebe N. Novakovic, who served in the positions of President and Chief Operating Officer, and Executive Vice President, Marine Systems, during the year. On January 1, 2013, Ms. Novakovic assumed the position of Chairman and Chief Executive Officer.

L. Hugh Redd, who served as Senior Vice President and Chief Financial Officer in 2012.

Gerard J. DeMuro, who served as Executive Vice President, Information Systems and Technology, in 2012.

David K. Heebner, who served as Executive Vice President, Combat Systems, in 2012.

Jay L. Johnson, who served as Chairman and Chief Executive Officer in 2012.

The below section provides an analysis of the specific compensation that we paid to our named executive officers for 2012 based on the compensation philosophy articulated earlier in this Compensation Discussion and Analysis section.

Base Salaries

The Compensation Committee reviews salaries annually in February and March for the upcoming year. Salary increases, when they occur, are market driven. For 2012, the Compensation Committee approved the following salaries for the named executive officers, effective on March 19, 2012: Mr. Redd $790,000; Mr. DeMuro $710,000; Mr. Heebner $685,000; and Mr. Johnson $1,650,000. The 2012 salaries for these named executive officers were below the 50th percentile of the competitive market based on the survey data. Since the Summary Compensation Table on page 36 reflects total salaries paid in 2012, the salary data in the table includes the salaries paid for the first three months of 2012 at the 2011 salary level and the remaining nine months paid at the 2012 level. For Ms. Novakovic, the Compensation Committee approved a salary of $1,100,000 for her position as President and Chief Operating Officer, effective from May through December, which was at the 50th percentile of the competitive market data. In late 2012, the Compensation Committee also approved a salary of $1,500,000 for Ms. Novakovic effective upon her assumption of the chairman and chief executive officer position in January 2013, which was below the 50th percentile of the competitive market data.

Bonuses and Equity Awards

The majority of our executive compensation is performance-based. Bonuses are paid based on the prior year s performance of the company, individual performance of the executive and, where applicable, that of their business group. Equity awards are determined based on a multiple of the named executive officer s total cash compensation.

For 2012 compensation decisions, senior management and the Compensation Committee considered the results for the company and each of the business groups, as applicable, compared against the operating plan goals for 2012. In addition, for each named executive officer the committee considered the leadership and management skills of the officer during 2012. The committee also received a tally sheet for each named executive officer showing the various elements of the executive s compensation, benefits and stock ownership. These considerations are consistent with our belief that the use of discretion and judgment in setting compensation must be a part of any effective compensation program.

For officers who have responsibility for company-wide performance (our chief executive officer, chief financial officer, and president and chief operating officer), the Compensation Committee s operating performance review focused on earnings from continuing operations, free cash flow from operations and return on invested capital. We believe that these metrics are good indicators of the company s overall performance and lead to the creation of long-term value for our shareholders. In particular:

- earnings from continuing operations measures our ability to grow our businesses and maximize profitability;

- free cash flow from operations demonstrates our ability to efficiently convert operating earnings into cash for purposes such as repaying maturing debt, funding business acquisitions or capital investment projects that enhance our businesses, repurchasing our common stock and paying dividends; and

- return on invested capital reflects our ability to generate returns from the capital we have deployed in our operations. Return on invested capital is defined as net operating profit after taxes divided by the average debt and equity for the period. Net operating profit after taxes is defined as earnings from continuing operations plus after-tax interest and amortization expense.

For our executive vice presidents, the Compensation Committee reviewed the operating performance of their respective business groups and focused on EBIT and business group cash flow. We believe that EBIT measures the ability of our business groups to grow their businesses and maximize profitability through disciplined processes, continuous improvement and cost-cutting initiatives and that business group cash flow measures the ability of the business groups to efficiently convert operating earnings into cash.

For Ms. Novakovic, who served as Executive Vice President, Marine Systems, for a portion of 2012 and as President and Chief Operating Officer for the remainder of the year, the committee determined her bonus amount based upon her performance in both roles. Accordingly, the committee considered that (a) the Marine Systems group s EBIT of $750 million exceeded the plan goal of $676 million; and cash flow of $495 million exceeded the plan goal of $439 million, and (b) the company s free cash flow from operations of $2.237 billion exceeded the plan goal of $2.080 billion; while loss from continuing operations of $332 million was below the plan goal of $2.591 billion; and return on invested capital of negative 0.4 percent was below the plan goal of 15.8 percent. In addition, for Ms. Novakovic the committee recognized:

Her leadership as President and Chief Operating Officer in working closely with the business units to formulate 2013 operating plans reflective of both the opportunities and risks commensurate with the current dynamic and pressured budget environment.

Her leadership of the Marine Systems group as it exceeded plan EBIT and cash goals. The EBIT results were driven, in part, by the group s focus on continuous improvement initiatives, including exceeding cost reduction goals.

For Mr. Redd, the committee considered the company s financial performance mentioned above, as well as:

His responsibility for overseeing the company s Finance organization in light of significant impairments and charges that occurred during the year.

His oversight of the company s issuance of $2.4 billion of notes in November 2012 and the subsequent early redemption of three outstanding series of notes. Through this refinancing, the company took advantage of a favorable interest rate environment to significantly lower the weighted-average interest rate on our outstanding debt while extending the weighted-average maturity from 2.6 to 9.5 years.

For Mr. DeMuro, the committee considered that for 2012 the Information Systems and Technology group s loss before interest and taxes of $1.371 billion fell below the plan goal of $1.112 billion of EBIT; and cash flow of $771 million exceeded the plan goal of $756 million. The committee also considered:

The negative impact of several discrete charges totaling nearly $2.2 billion, reflecting the significant negative impact of slowed defense spending and government award activity as well as underperforming acquisitions.

Mr. DeMuro s oversight of the group s strong cash results, which exceeded the plan goal and reflected the group s continued focus on efficient cash conversion.

For Mr. Heebner, the committee considered that for 2012 the Combat Systems group s EBIT of $662 million fell below the plan goal of $1.223 billion; and cash flow of $731 million fell below the plan goal of $746 million. The committee also considered:

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The Combat Systems group s below-plan EBIT and cash performance that was driven by the negative impact of several discrete charges in our European operations caused, in part, by dynamic market conditions and resulting actions to restructure and reposition the business for a spending environment that is expected to be more constrained moving forward.

Mr. Heebner s guidance in helping the group to identify and pursue several domestic and international opportunities, including additional Abrams tank modernization work, Stryker double-V hull conversions and international vehicle exports which we expect to help buoy the Combat Systems business amidst pressured U.S. defense spending.

His focus on helping the group s businesses to achieve their continuous improvement and cost-cutting initiatives in order to maximize profitability.

For each individual discussed above, management provided the Compensation Committee with market data for each of their respective positions that reflected the 50th to 75th percentiles of total cash compensation for comparable positions at the peer group companies. Based upon the specific considerations for each individual, the company s or business group s performance for 2012, as applicable, and the market data, the Compensation Committee awarded bonus amounts of $2,000,000 for Ms. Novakovic, $500,000 for Mr. Redd, $500,000 for Mr. DeMuro and $905,000 for Mr. Heebner. These bonus amounts were determined by the committee in the exercise of its discretion taking all of the factors into consideration, rather than focusing upon any one factor.

For Mr. Johnson, his bonus was determined in accordance with the provisions of his retirement agreement entered into with the company in June 2012. As stated in his retirement agreement and discussed in our current report on Form 8-K filed with the SEC on June 6, 2012, Mr. Johnson received a bonus in the amount of $3,600,000 for his services during 2012.

The bonus award for each of the named executive officers resulted in total cash compensation below the 50th percentile of the competitive market based on the survey data for each named executive officer. Bonus awards are reflected in the Bonus column of the Summary Compensation Table.

The number of options, shares of restricted stock and PRSUs awarded to each named executive officer in 2012 is reflected in the Grants of Plan-Based Awards in Fiscal Year 2012 table. As described under Equity Awards, the Compensation Committee determines the amount of equity awards using a multiple of the executive s total cash compensation. The multiples are determined based upon the value of equity awards at peer group companies. The multiples approved by the committee for 2012 awards were: Ms. Novakovic 160%; Mr. Redd 145%; Mr. DeMuro 160%; Mr. Heebner 160%; and Mr. Johnson 235%. For each named executive officer, the ratio of long-term incentives to cash compensation used to determine the executive s equity-award multiple was between the 50th and 75th percentiles of the competitive market based on the survey data. Ms. Novakovic did not receive an equity award in 2012 related to her promotion to chairman and chief executive officer. Due to their retirements, neither Mr. Johnson nor Mr. DeMuro received an equity award in March 2013.

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The following graph depicts the 2012 compensation awarded to the named executive officers (other than Messrs. DeMuro and Johnson, who have retired or are retiring from the company) by type of compensation as a percentage of the executive s direct compensation. The graph demonstrates the compensation philosophy described in this Compensation Discussion and Analysis section under which the majority of our executives compensation is at risk in the form of performance-based bonuses and equity awards. Because the performance metric for the PRSUs, which are included in the Stock Awards shown in the table below, was not met, all of these PRSUs were forfeited by the named executive officers, with no value realized.

* Stock awards and stock option awards reflect the grant date fair value computed in accordance with Financial Accounting Standards Board Topic 718 as reported in the Summary Compensation Table.

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Executive Compensation

Summary Compensation

The Summary Compensation Table is formatted in accordance with Item 402(c) of Regulation S-K and shows base salary, cash bonus, equity awards restricted stock, restricted stock units and stock options and all other compensation, which includes among other things the value of perquisites, 401(k) contributions and tax reimbursements (see footnote (d) to the Summary Compensation Table for a complete listing of categories included in All Other Compensation). The table also includes a column titled Change in Pension Value and Nonqualified Deferred Compensation Earnings. For our eligible named executive officers, this includes only the change in pension value (see footnote (c)), which is an actuarial estimate of the present value of the future cost of pension benefits. The value does not reflect a current cash cost to General Dynamics or, necessarily, the pension benefit that an executive would receive, since that is determined by a number of factors, including length of service, age at retirement and longevity.

As we discuss in greater detail in the Compensation Discussion and Analysis section, our executive compensation program has two components: direct compensation and benefits. Direct compensation includes base salary, bonus and equity awards. Salary increases, when they occur, are market driven and can result in salaries up to the median (50th percentile) of the survey data based on the executive s experience. The bonus is designed to place at risk a significant portion of an executive s annual cash compensation. Total cash compensation (base salary and bonus) is targeted between the 50th and 75th percentiles of the survey data. Long-term equity compensation is determined based on a multiple of the executive s total cash compensation. Therefore, the ultimate value of the long-term equity compensation is driven in part by prior-year performance and in part by the executive s ability to create value going forward.

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Summary Compensation Table

Name and Principal Position	Year	Salary	Bonus (a)	Stock Awards (b)	Option Awards (b)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (c)	All Other Compensation (d)	Total
Phebe N. Novakovic Chairman and Chief Executive Officer (e)	2012	$ 944,166	$ 2,000,000	$ 1,699,440	$ 1,702,324	$ 477,286	$ 64,556	$ 6,887,772
	2011	620,000	850,000	760,070	1,519,928	243,089	81,794	4,074,881
L. Hugh Redd Senior Vice President and Chief Financial Officer	2012	$ 781,250	$ 500,000	$ 1,298,063	$ 1,297,901	$ 943,319	$ 75,349	$ 4,895,882
	2011	755,000	1,000,000	823,658	1,648,258	514,581	100,453	4,841,950
	2010	752,500	950,000	767,236	1,533,542	815,760	80,932	4,899,970
Gerard J. DeMuro Former Executive Vice President, Information Systems and Technology (f)	2012	$ 705,000	$ 500,000	$ 1,367,653	$ 1,368,206	$ 628,761	$ 69,153	$ 4,638,773
	2011	682,500	1,000,000	874,529	1,749,201	368,713	101,705	4,776,648
	2010	658,750	950,000	804,716	1,610,144	348,522	75,600	4,447,732
David K. Heebner Executive Vice President, Information Systems and Technology (g)	2012	$ 680,000	$ 905,000	$ 1,271,079	$ 1,272,650	$ 333,812	$ 84,020	$ 4,546,561
	2011	658,750	905,000	794,482	1,589,258	207,154	206,516	4,361,160
	2010	620,000	825,000	726,071	1,455,213	344,427	167,094	4,137,805
Jay L. Johnson Former Chairman and Chief Executive Officer (h)	2012	$ 1,587,500	$ 3,600,000	$ 6,167,929	$ 6,169,484		$ 485,849	$ 18,010,762
	2011	1,400,000	3,600,000	3,525,047	7,049,856		483,177	16,058,080
	2010	1,400,000	3,100,000	2,998,392	5,994,482		258,241	13,751,115

(a) Bonus payments are reported for the fiscal year in which the related services were rendered, although the actual payments are made in the succeeding year.

(b) The amounts reported in the Stock Awards and the Option Awards columns reflect aggregate grant date fair value computed in accordance with Financial Accounting Standards Board ASC Topic 718. These amounts reflect our calculation of the value of these awards at the grant date and do not necessarily correspond to the actual value that may ultimately be recognized by the named executive officer. Assumptions used in the calculation of these amounts are included in Note O to our audited financial statements for the fiscal year ended December 31, 2012, included in our Annual Report on Form 10-K filed with the SEC on February 8, 2013. The maximum grant date value of 2012 PRSUs for each named executive officer, which assumes a 200% maximum payout, is $1,699,440 for Ms. Novakovic; $1,298,063 for Mr. Redd; $1,367,653 for Mr. DeMuro; $1,271,079 for Mr. Heebner; and $6,167,929 for Mr. Johnson. However, because the performance metric for the PRSUs granted in 2012 was not met, all PRSUs have been forfeited by the named executive officers.

(c) The values listed in this column represent the change in the present value of accumulated benefits from December 31 of the prior year to December 31 of the respective year calculated for all the pension plans in which the executive participates. The values are an actuarial estimate of the present value of the future cost of pension benefits for each of the named executive officers and do not reflect a current cash cost to the company or, necessarily, the pension benefit that an executive would receive. Mr. Johnson did not participate in any of the company s pension plans.

(d) All Other Compensation includes the following items: (1) amounts reimbursed for the payment of taxes; (2) amounts contributed by General Dynamics under the 401(k) Plan and allocations to the Supplemental Savings Plan; (3) payments for term life insurance; and (4) noncash items provided to executive officers. Amounts reimbursed for the payment of taxes associated with a company-provided dining room benefit for 2012 were as follows: Ms. Novakovic $1,675;

Mr. Redd $1,973; Mr. DeMuro $2,089; Mr. Heebner $2,321; and Mr. Johnson $2,596. All employees at our corporate headquarters receive this dining room benefit and associated tax reimbursement. Amounts contributed by General Dynamics to the 401(k) Plan and allocations by General Dynamics to the Supplemental Savings Plan for 2012 were as follows: Ms. Novakovic $28,125; Mr. Redd $33,750; Mr. DeMuro $30,825; Mr. Heebner $29,700; and Mr. Johnson $62,775. Payments for term life insurance for 2012 were as follows: Ms. Novakovic $8,320; Mr. Redd $7,254; Mr. DeMuro $8,405; Mr. Heebner $17,870; and Mr. Johnson $32,823. Noncash items (perquisites) provided to named executive officers in 2012, which for one or more named executive officers is in the aggregate equal to or greater than $10,000, were as follows: financial planning and tax preparation services; home security systems; personal liability and supplemental accidental death and dismemberment insurance; personal use of automobiles owned or leased by the company; and, solely for the chairman and chief executive officer, personal use of company aircraft. Perquisites that exceeded the greater of $25,000 or 10 percent of the total amount of perquisites were as follows: Mr. Johnson $98,598 relates to home security and $264,517 relates to personal use of aircraft. The aggregate incremental cost to the company for the provision of home security systems represents the amounts paid by the company to third parties for the installation, servicing and monitoring of the systems. The aggregate incremental cost to General Dynamics for Mr. Johnson s personal travel aboard aircraft owned by the company (products of subsidiary Gulfstream Aerospace Corporation), as required by the Board to help ensure Mr. Johnson s security and accessibility, was $264,517. The aggregate incremental cost to General Dynamics of personal use of aircraft owned by the company is calculated based on the following variable operating costs to the company: fuel costs, trip-related maintenance expenses, landing fees, trip-related hangar and parking fees, on-board catering expenses and crew expenses. No additional direct operating cost is incurred if a family member accompanies an executive on a flight.

(e) Ms. Novakovic served as Executive Vice President, Marine Systems, until May 2, 2012. From May 2, 2012, through December 31, 2012, Ms. Novakovic served as President and Chief Operating Officer. Ms. Novakovic assumed the position of Chairman and Chief Executive Officer on January 1, 2013.

(f) Mr. DeMuro retired as Executive Vice President on February 28, 2013 and is retiring from the company effective March 31, 2013.

(g) Mr. Heebner served as Executive Vice President, Combat Systems, until March 6, 2013. On that date, Mr. Heebner assumed the position of Executive Vice President, Information Systems and Technology.

(h) Mr. Johnson retired from the company effective December 31, 2012.

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2012 Equity-Based Awards

General Dynamics long-term compensation for senior executives, including the named executive officers, consists of equity awards in the form of restricted stock, PRSUs and stock options. The following table provides information on the equity awards in 2012 for the named executive officers. The table includes the grant date of each equity award, the number of shares of restricted stock, PRSUs and stock options, the exercise price of the stock options, the closing price of our Common Stock on the date of grant and the grant date fair value of the equity awards. As discussed in the Compensation Discussion and Analysis section, we use the average of the high and low stock price of our Common Stock on the date of the grant, not the closing price, to value the restricted stock and PRSUs and set the exercise price for stock options.

Grants of Plan-Based Awards in Fiscal Year 2012

Name	Grant Date	Date of Compensation Committee Action	Estimated Possible Payouts Under Equity Incentive Plan Awards (a)			All Other Stock Awards: Number of Shares of Stock or Units (b)	All Other Option Awards: Number of Securities Underlying Options	Exercise or Base Price of Option Awards (c)	Closing Price on Date of Grant	Grant Date Fair Value of Stock and Option Awards (d)
			Threshold	Target	Maximum					
Phebe N. Novakovic	5/2/2012	5/1/2012	0	3,740	7,480	3,740				$ 507,892
	5/2/2012	5/1/2012					39,500	$ 67.90	$ 68.24	509,945
	3/7/2012	3/6/2012	0	8,390	16,780	8,390				1,191,548
	3/7/2012	3/6/2012					89,720	$ 71.01	$ 71.25	1,192,379
L. Hugh Redd	3/7/2012	3/6/2012	0	9,140	18,280	9,140				$ 1,298,063
	3/7/2012	3/6/2012					97,660	$ 71.01	$ 71.25	1,297,901
Gerard J. DeMuro	3/7/2012	3/6/2012	0	9,630	19,260	9,630				$ 1,367,653
	3/7/2012	3/6/2012					102,950	$ 71.01	$ 71.25	1,368,206
David K. Heebner	3/7/2012	3/6/2012	0	8,950	17,900	8,950				$ 1,271,079
	3/7/2012	3/6/2012					95,760	$ 71.01	$ 71.25	1,272,650
Jay L. Johnson	3/7/2012	3/6/2012	0	43,430	86,860	43,430				$ 6,167,929
	3/7/2012	3/6/2012					464,220	$ 71.01	$ 71.25	6,169,484

(a) These amounts relate to PRSUs granted in 2012. Each PRSU represents the right to receive a share of Common Stock upon release of the PRSU. The exact number of PRSUs that may be earned is determined based upon a performance metric set by the Compensation Committee, which for 2012 grants is the company s return on invested capital for 2012, and can range from 0 to 200 percent of the PRSUs originally awarded. Dividend equivalents accrue on PRSUs during the performance period and are subject to the same vesting conditions based upon performance. Following the one-year performance period, PRSUs remain subject to continuous service requirements and are released approximately four years from the original grant date. Based upon the company s return on invested capital in 2012, the actual number of PRSUs granted in 2012 was set at 0 percent of the original award, resulting in forfeiture of all PRSUs by the named executive officers.

(b) These amounts relate to shares of restricted stock that are released approximately four years after the grant date, subject to continuous service requirements.

(c) The exercise price for stock options is the average of the high and low stock price of our Common Stock on the date of grant.

(d) For PRSUs, the grant date fair value is calculated based upon the target payout amount.

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Option Exercises and Stock Vested

The following table shows the stock options exercised by the named executive officers and restricted stock released to them during 2012. As explained in the Compensation Discussion and Analysis section, we require officers to retain shares of Common Stock issued to them as compensation, up to pre-determined levels based on their position in General Dynamics. Our chief executive officer must retain ownership of Common Stock worth 15 times base salary. Our executive vice presidents and senior vice presidents must retain 10 times their respective base salaries. Vice presidents must retain eight times their respective base salaries. Once an ownership level is attained, the officer must maintain that minimum ownership level until he or she no longer serves as an officer of General Dynamics. Mr. Johnson, who did not meet the stock ownership requirements at the time of exercise, exercised options and held net shares, selling only enough shares to cover both the transaction costs and the income taxes due on the resulting gain. The amounts reported in the Value Realized on Exercise and the Value Realized on Vesting columns in the table below are before-tax amounts.

Option Exercises and Stock Vested in Fiscal Year 2012

	Option Awards		**Stock Awards**					
Name	**Number of Shares Acquired on Exercise**	**Value Realized on Exercise**	**Number of Shares Acquired on Vesting**	**Value Realized on Vesting**				
Phebe N. Novakovic	0	$ 0	5,690	$ 388,115				
L. Hugh Redd	0	$ 0	7,610	$ 519,078				
Gerard J. DeMuro	245,606	$ 8,075,193	9,120	$ 622,075				
David K. Heebner	40,000	$ 1,350,492	4,730	$ 322,633				
Jay L. Johnson	30,315							
Net properties, plants and equipment		17,033				68,249	14	85,296
Goodwill		12,877				16,720		29,597
Intangibles		820				87		907
Other assets	8	138	4	6	5	336	(125)	372
Total Assets	84,398	118,976	2,025	1,380	934	147,368	(184,213)	170,868
Liabilities and Stockholders Equity								
Accounts payable	25	18,675		6	3	14,252	(16,828)	16,133
Notes payable and long-term debt due within one year	1,000	17				92		1,109
Accrued income and other taxes		826		(1)	(2)	3,151	98	4,072

Employee benefit obligations		384				284	1	669
Other accruals	31	582	25	15	10	1,228	43	1,934
Total Current Liabilities	1,056	20,484	25	20	11	19,007	(16,686)	23,917
Long-term debt	4,383	6,010	1,999	1,250	848	7,213		21,703
Asset retirement obligations and accrued environmental costs		1,001				5,087		6,088
Joint venture acquisition obligation						6,595		6,595
Deferred income taxes	(3)	3,090		18	11	17,459	7	20,582
Employee benefit obligations		2,317				1,248		3,565
Other liabilities and deferred credits*	571	30,726		67	58	24,106	(53,218)	2,310
Total Liabilities	6,007	63,628	2,024	1,355	928	80,715	(69,897)	84,760
Minority interests		(19)				1,201	(2)	1,180
Retained earnings	37,261	26,272	1	(66)	(51)	30,972	(50,606)	43,783
Other stockholders equity	41,130	29,095		91	57	34,480	(63,708)	41,145
Total	$ 84,398	118,976	2,025	1,380	934	147,368	(184,213)	170,868

* *Includes intercompany loans.*

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	Millions of Dollars At December 31, 2006							
	ConocoPhillips	ConocoPhillips Company	ConocoPhillips Australia Funding Company	ConocoPhillips Canada Funding Company I	ConocoPhillips Canada Funding Company II	All Other Subsidiaries	Consolidating Adjustments	Total Consolidated
Balance Sheet								
Assets								
Cash and cash equivalents	$	116			1	1,042	(342)	817
Accounts and notes receivable	65	13,233	22	10	2	17,224	(16,450)	14,106
Inventories		2,906				2,247		5,153
Prepaid expenses and other current assets	11	895		10	7	4,067		4,990
Total Current Assets	76	17,150	22	20	10	24,580	(16,792)	25,066
Investments, loans and long-term receivables*	86,292	58,530	2,000	1,241	841	28,372	(156,563)	20,713
Net properties, plants and equipment		19,072				67,122	7	86,201
Goodwill		15,226				16,262		31,488
Intangibles		852				99		951
Other assets	10	141	5	35	24	195	(48)	362
Total Assets	86,378	110,971	2,027	1,296	875	136,630	(173,396)	164,781
Liabilities and Stockholders Equity								
Accounts payable	68	16,641		5	3	14,367	(16,450)	14,634
Notes payable and long-term debt due within one year	3,431	525				87		4,043
Accrued income and other taxes		732				3,577	98	4,407
Employee benefit obligations		464				431		895
Other accruals	50	804	24	16	10	1,565	(17)	2,452

Total Current Liabilities	3,549	19,166	24	21	13	20,027	(16,369)	26,431
Long-term debt	6,521	6,036	1,999	1,250	848	6,437		23,091
Asset retirement obligations and accrued environmental costs		1,095				4,524		5,619
Deferred income taxes	(8)	2,969		16	10	17,086	1	20,074
Employee benefit obligations		2,379				1,288		3,667
Other liabilities and deferred credits*	29	28,306				22,300	(48,584)	2,051
Total Liabilities	10,091	59,951	2,023	1,287	871	71,662	(64,952)	80,933
Minority interests		(19)				1,221		1,202
Retained earnings	34,756	22,939	4	29	26	28,029	(44,491)	41,292
Other stockholders equity	41,531	28,100		(20)	(22)	35,718	(63,953)	41,354
Total	$ 86,378	110,971	2,027	1,296	875	136,630	(173,396)	164,781

**Includes intercompany loans.*

	Millions of Dollars Six Months Ended June 30, 2007							
	ConocoPhillips	ConocoPhillips Company	ConocoPhillips Australia Funding Company	ConocoPhillips Canada Funding Company I	ConocoPhillips Canada Funding Company II	All Other Subsidiaries	Consolidating Adjustments	Total Consolidated
Statement of Cash Flows								
Cash Flows From Operating Activities								
Net Cash Provided by (Used in) Operating Activities	$ 7,762	(777)	5			4,755	(106)	11,639
Cash Flows From Investing Activities								
Acquisition of Burlington Resources Inc.								
Capital expenditures and investments, including dry hole costs		(1,148)				(4,301)	102	(5,347)
Proceeds from asset dispositions		951				1,679	(415)	2,215
Long-term advances/loans to affiliates		(118)				(1,137)	929	(326)
Collection of advances/loans to affiliates		811					(745)	66
Other	1	18						19
Net Cash Provided by (Used in) Investing Activities	1	514				(3,759)	(129)	(3,373)
Cash Flows From Financing								

Activities							
Issuance of debt	(36)	929			801	(929)	765
Repayment of debt	(4,564)	(547)			(755)	745	(5,121)
Issuance of company common stock	181						181
Repurchase of company common stock	(2,000)						(2,000)
Dividends paid on company common stock	(1,342)		(5)		(316)	321	(1,342)
Other	(2)	50			(513)	312	(153)
Net Cash Provided by (Used in) Financing Activities	(7,763)	432	(5)		(783)	449	(7,670)
Effect of Exchange Rate Changes on Cash and Cash Equivalents					(2)		(2)
Net Change in Cash and Cash Equivalents		169			211	214	594
Cash and cash equivalents at beginning of year		116		1	1,042	(342)	817
Cash and Cash Equivalents at End of Year	$	285		1	1,253	(128)	1,411

	Millions of Dollars					
	Six Months Ended June 30, 2006					
	ConocoPhillips	ConocoPhillips Company	ConocoPhillips Australia Funding Company	All Other Subsidiaries	Consolidating Adjustments	Total Consolidated
Statement of Cash Flows						
Cash Flows From Operating Activities						
Net Cash Provided by Operating Activities	$ 25,609	1,929		2,493	(20,387)	9,644
Cash Flows From Investing Activities						
Acquisition of Burlington Resources Inc.				(14,284)		(14,284)
Capital expenditures and investments, including dry holes	(17,494)	(2,212)		(6,385)	18,175	(7,916)
Proceeds from asset dispositions		7		66		73
Long-term advances/loans to affiliates	(14,989)	(138)	(1,992)	(3,861)	20,604	(376)
Collection of advances/loans to affiliates		2,510		1,103	(3,503)	110
Net Cash Provided by (Used in) Investing Activities	(32,483)	167	(1,992)	(23,361)	35,276	(22,393)
Cash Flows From Financing Activities						
Issuance of debt	13,695	18,612	2,000	2,171	(20,604)	15,874
Repayment of debt	(5,400)	(1,250)		(159)	3,503	(3,306)
Issuance of company common stock	104					104
Repurchase of company common stock	(425)					(425)
Dividends paid on company common stock	(1,091)	(20,000)		(387)	20,387	(1,091)
Other	(9)	(30)	(8)	18,175	(18,175)	(47)

Net Cash Provided by (Used in) Financing Activities	6,874	(2,668)	1,992	19,800	(14,889)	11,109
Effect of Exchange Rate Changes on Cash and Cash Equivalents				80		80
Net Change in Cash and Cash Equivalents		(572)		(988)		(1,560)
Cash and cash equivalents at beginning of year		613		1,601		2,214
Cash and Cash Equivalents at End of Period		$ 41		613		654

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

Management s Discussion and Analysis contains forward-looking statements including, without limitation, statements relating to our plans, strategies, objectives, expectations, and intentions, that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words intends, believes, expects, pla scheduled, anticipates, estimates, and similar expressions identify forward-looking statements. We do not undertake to update, revise or correct any of the forward-looking information. Readers are cautioned that such forward-looking statements should be read in conjunction with the disclosures under the heading: CAUTIONARY STATEMENT FOR THE PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 beginning on page 55.

BUSINESS ENVIRONMENT AND EXECUTIVE OVERVIEW

ConocoPhillips is an international, integrated energy company. We are the third largest integrated energy company in the United States, based on market capitalization and proved reserves. At June 30, 2007, we had total assets of $171 billion. Our stock is listed on the New York Stock Exchange under the symbol COP.

Our Exploration and Production (E&P) segment had a net loss of $2,404 million in the second quarter of 2007. This compares with E&P net income of $2,329 million in the first quarter of 2007, and net income of $3,304 million in the second quarter of 2006. In the second quarter of 2007, we recorded a non-cash impairment of $4,588 million before-tax ($4,512 million after-tax) related to the expropriation of our oil interests in Venezuela. For additional information, see the Expropriated Assets section of Note 10 Impairments, in the Notes to Consolidated Financial Statements.

Crude oil and natural gas prices, along with refining margins, are driven by market factors over which we have no control. The results for the second quarter of 2007, compared with the first quarter of 2007, were impacted by an increase in crude oil prices. Industry crude oil prices for West Texas Intermediate averaged $64.89 per barrel in the second quarter of 2007, or $6.90 per barrel higher than the first quarter of 2007. Crude oil prices were influenced by higher worldwide demand and relatively flat crude oil production, which resulted in lower crude oil inventory levels compared with 2006.

Industry natural gas prices for Henry Hub increased during the second quarter of 2007 to $7.55 per million British thermal units (MMBTU), up $0.78 per MMBTU from the first quarter of 2007. Natural gas prices trended higher during the second quarter due to colder than normal weather conditions early in the quarter and industry storage levels that were lower than 2006.

Our Refining and Marketing segment had net income of $2,358 million in the second quarter of 2007, compared with $1,136 million in the first quarter of 2007, and $1,708 million in the second quarter of 2006. Second-quarter 2007 realized refining and marketing margins were higher than the previous period due to improved market conditions.

On January 3, 2007, we closed on the business venture with EnCana Corporation to create an integrated North American heavy-oil business. The venture consists of two 50/50 operating business ventures, a Canadian upstream general partnership, FCCL Oil Sands Partnership, and a U.S. downstream limited liability company, WRB Refining LLC. We use the equity method of accounting for both business ventures, and the transaction is reflected in our results of operations beginning in the first quarter of 2007.

On March 31, 2006, we completed the $33.9 billion acquisition of Burlington Resources Inc. (Burlington Resources). This acquisition is reflected in our results of operations beginning in the second quarter of 2006.

In July 2007, we announced plans to repurchase up to $15 billion of our common stock through the end of 2008. We expect to purchase approximately $2 billion to $3 billion under this program in the third quarter of 2007.

RESULTS OF OPERATIONS

Unless otherwise indicated, discussion of results for the three- and six-month periods ending June 30, 2007, is based on a comparison with the corresponding periods of 2006.

Consolidated Results

A summary of net income (loss) by business segment follows:

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
Exploration and Production (E&P)	**$ (2,404)**	3,304	**(75)**	5,857
Midstream	**102**	108	**187**	218
Refining and Marketing (R&M)	**2,358**	1,708	**3,494**	2,098
LUKOIL Investment	**526**	387	**782**	636
Chemicals	**68**	103	**150**	252
Emerging Businesses	**(12)**	(12)	**(13)**	(4)
Corporate and Other	**(337)**	(412)	**(678)**	(580)
Net income	**$ 301**	5,186	**3,847**	8,477

Net income was $301 million in the second quarter of 2007, compared with $5,186 million in the second quarter of 2006. For the six-month periods ended June 30, 2007 and 2006, net income was $3,847 million and $8,477 million, respectively. The lower results in both 2007 periods were primarily the result of a complete impairment ($4,512 million after-tax) of our oil interests in Venezuela, resulting from their expropriation on June 26, 2007. In addition, lower crude oil prices in the E&P segment contributed to lower results in the 2007 periods.

The results in both 2007 periods benefited from:

- Improved refining and marketing margins in the R&M segment.
- The net benefit from asset rationalization efforts in our E&P and R&M segments.
- Higher natural gas prices in the E&P segment.
- Increased equity earnings from our investment in LUKOIL.

The six-month period of 2007 also benefited from the inclusion of Burlington Resources results in our results of operations for the entire six-month period.

See the Segment Results section for additional information on our segment results.

Income Statement Analysis

Equity in earnings of affiliates increased 29 percent in the second quarter of 2007 and 15 percent in the six-month period, reflecting results from:

WRB Refining LLC, our new downstream business venture with EnCana.

LUKOIL, reflecting increased estimated volumes and petroleum product prices, as well as an increase in our equity ownership.

The increase in both periods was offset partially by lower earnings from our heavy-oil joint ventures in Venezuela (Hamaca and Petrozuata), due to lower production volumes and higher taxes. Earnings from our chemicals joint venture, Chevron Phillips Chemical Company LLC, decreased due to lower olefins and polyolefins margins and an asset retirement expense in the second quarter of 2007. In addition, earnings from DCP Midstream, our midstream joint venture, decreased primarily due to higher operating costs.

Other income increased significantly during the second quarter and six-month period of 2007. The increase was primarily due to higher net gains on asset dispositions associated with asset rationalization efforts.

Exploration expenses increased significantly during the second quarter and six-month period of 2007, primarily due to increased drilling and seismic expenditures, as well as increased exploratory activity following the Burlington Resources acquisition.

Depreciation, depletion and amortization (DD&A) increased 28 percent in the six-month period of 2007, primarily resulting from the addition of Burlington Resources assets in the E&P segment s depreciable asset base.

Impairment expropriated assets reflects a non-cash impairment of $4,588 million before-tax related to the expropriation of our oil interests in Venezuela. For additional information, see the Expropriated Assets section of Note 10 Impairments, in the Notes to Consolidated Financial Statements, which is incorporated herein by reference.

Interest and debt expense decreased 11 percent in the second quarter of 2007, primarily due to lower average debt levels compared with the corresponding period of 2006. Interest and debt expense increased 32 percent during the first six months of 2007, primarily due to higher average debt levels as a result of the financing required to partially fund the Burlington Resources acquisition.

Foreign currency transaction gains in the second quarter of 2007 primarily reflect the strengthening of the Canadian dollar against the U.S. dollar.

Segment Results
E&P

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
	Millions of Dollars			
Net Income (Loss)				
Alaska	**$ 535**	760	**1,042**	1,452
Lower 48	**520**	540	**929**	1,029
United States	**1,055**	1,300	**1,971**	2,481
International	**(3,459)**	2,004	**(2,046)**	3,376
	$ (2,404)	3,304	**(75)**	5,857
	Dollars Per Unit			
Average Sales Prices				
Crude oil (per barrel)				
United States	**$ 61.91**	64.09	**57.86**	61.06
International	**67.16**	67.27	**61.16**	64.12
Total consolidated	**64.55**	65.89	**59.61**	62.75
Equity affiliates*	**47.74**	52.28	**44.24**	47.53
Worldwide E&P	**61.97**	64.34	**57.53**	60.76
Natural gas (per thousand cubic feet)				
United States	**6.49**	5.78	**6.34**	6.37
International	**6.42**	5.92	**6.46**	6.43
Total consolidated	**6.45**	5.86	**6.41**	6.40
Equity affiliates*	**.37**	.36	**.42**	.29
Worldwide E&P	**6.44**	5.85	**6.40**	6.39
Natural gas liquids (per barrel)				
United States	**44.17**	40.45	**41.04**	41.28
International	**45.64**	43.28	**42.30**	43.27
Total consolidated	**44.80**	41.75	**41.60**	42.25
Equity affiliates*				
Worldwide E&P	**44.80**	41.75	**41.60**	42.25
	Millions of Dollars			
Worldwide Exploration Expenses				
General administrative; geological and geophysical; and lease rentals	**$ 126**	86	**240**	160
Leasehold impairment	**59**	33	**145**	52
Dry holes	**74**	15	**136**	34
	$ 259	134	**521**	246

**Excludes our equity share of LUKOIL reported in the LUKOIL Investment segment.*

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
	Thousands of Barrels Daily			
Operating Statistics				
Crude oil produced				
Alaska	**267**	279	**272**	281
Lower 48	**105**	120	**104**	92
United States	**372**	399	**376**	373
Europe	**193**	249	**214**	249
Asia Pacific	**93**	109	**95**	109
Canada	**19**	27	**20**	25
Middle East and Africa	**73**	132	**84**	91
Other areas	**10**	8	**10**	4
Total consolidated	**760**	924	**799**	851
Equity affiliates*				
Canada	**28**		**26**	
Russia and Caspian	**15**	15	**15**	15
Venezuela	**85**	106	**83**	108
	888	1,045	**923**	974
Natural gas liquids produced				
Alaska	**18**	20	**20**	21
Lower 48	**71**	70	**70**	50
United States	**89**	90	**90**	71
Europe	**11**	12	**12**	13
Asia Pacific	**15**	20	**13**	20
Canada	**28**	30	**30**	20
Middle East and Africa	**2**		**2**	1
	145	152	**147**	125
	Millions of Cubic Feet Daily			
Natural gas produced**				
Alaska	**100**	163	**111**	163
Lower 48	**2,219**	2,265	**2,205**	1,767
United States	**2,319**	2,428	**2,316**	1,930
Europe	**921**	1,109	**1,003**	1,114
Asia Pacific	**603**	603	**601**	534
Canada	**1,133**	1,204	**1,142**	816

Middle East and Africa	**127**	131	**134**	126
Other areas	**21**	23	**22**	12
Total consolidated	**5,124**	5,498	**5,218**	4,532
Equity affiliates*				
Venezuela	**9**	10	**9**	10
	5,133	5,508	**5,227**	4,542

**Excludes our equity share of LUKOIL reported in the LUKOIL Investment segment.*

***Represents quantities available for sale. Excludes gas equivalent of natural gas liquids shown above.*

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
	Thousands of Barrels Daily			
Mining operations				
Syncrude produced	**21**	19	**22**	18

The E&P segment explores for, produces and markets crude oil, natural gas, and natural gas liquids on a worldwide basis. It also mines deposits of oil sands in Canada to extract the bitumen and upgrade it into a synthetic crude oil. At June 30, 2007, our E&P operations were producing in the United States, Norway, the United Kingdom, the Netherlands, Canada, Nigeria, Ecuador, Argentina, offshore Timor Leste in the Timor Sea, Australia, China, Indonesia, Algeria, Libya, Vietnam, and Russia.

The E&P segment reported a net loss of $2,404 million in the second quarter of 2007, compared with net income of $3,304 million in the second quarter of 2006. In the second quarter of 2007, we recorded a non-cash impairment of $4,588 million before-tax ($4,512 million after-tax) related to the expropriation of our oil interests in Venezuela. For additional information, see the Expropriated Assets section of Note 10 Impairments, in the Notes to Consolidated Financial Statements, which is incorporated herein by reference. In addition to this impairment, results for the second quarter of 2007 reflect higher taxes, lower sales volumes, the effect of asset rationalization efforts, and lower crude oil prices. These decreases were partially offset by higher natural gas prices.

The net loss for the E&P segment was $75 million in the six-month period of 2007, compared with net income of $5,857 million in the corresponding period of 2006. The results for the six-month period reflect the impairment of expropriated assets in Venezuela, as well as higher taxes, lower sales volumes, and higher operating costs and DD&A expense. These decreases were partially offset by the inclusion of Burlington Resources results for the entire six-month period of 2007, as well as a net benefit from asset rationalization efforts.

See the Business Environment and Executive Overview section for additional information on industry crude oil and natural gas prices.

U.S. E&P

Net income from our U.S. E&P operations decreased 19 percent in the second quarter of 2007, primarily due to lower crude oil and natural gas volumes, higher production taxes in Alaska, higher operating costs, and lower crude oil prices. These decreases were partially offset by higher natural gas prices.

Net income for the first six months of 2007 decreased 21 percent, primarily due to lower crude oil prices, lower crude oil production levels and higher production taxes in Alaska, and higher operating and DD&A expense. These decreases were partially offset by higher volumes in the Lower 48, primarily due to the inclusion of Burlington Resources results in our results of operations for the entire six-month period of 2007. In addition, results included gains on the sale of assets in Alaska and the Gulf of Mexico.

U.S. E&P production on a barrel-of-oil-equivalent (BOE) basis averaged 848,000 BOE per day in the second quarter of 2007, a decrease of 5 percent from 894,000 BOE per day in the second quarter of 2006. Production was impacted in 2007 by normal field decline, offset slightly by new production from satellite fields in Alaska.

International E&P

International E&P reported a net loss of $3,459 million in the second quarter of 2007, compared with net income of $2,004 million in the second quarter of 2006. The results were impacted by the impairment of expropriated assets in Venezuela, as well as higher taxes in the United Kingdom and Venezuela, and a tax benefit in Canada included in results for the second quarter of 2006. Net income was also negatively impacted by lower crude oil, natural gas, and natural gas liquids volumes, offset slightly by higher natural gas prices.

Our international E&P operations reported a net loss of $2,046 million in the six-month period of 2007, compared with net income of $3,376 in the corresponding period of 2006. The results were impacted by the impairment of expropriated assets, as well as higher taxes in the United Kingdom and Venezuela, a tax benefit in Canada included in 2006 results, and lower crude oil sales volumes. These decreases were partially offset by the inclusion of Burlington Resources results for the entire six-month period, as well as a net benefit associated with our asset rationalization efforts.

International E&P production averaged 1,041,000 BOE per day in the second quarter of 2007, a decrease of 15 percent from 1,221,000 BOE per day in the second quarter of 2006. Production was impacted in 2007 by planned maintenance in the North Sea, the effect of asset dispositions, our exit from Dubai, production sharing contract impacts, and OPEC quota reductions. These decreases were slightly offset by production volumes from our upstream business venture with EnCana.

Estimated production for the first six months of 2007 at Petrozuata and Hamaca was 83,000 net barrels per day of crude oil after application of disproportionate OPEC restrictions imposed by the Venezuela government for January through mid-May, 2007. The estimated net loss attributable to our Venezuelan operations for the first six months of 2007 was $4,393 million, including the $4,512 million (after-tax) impairment of our expropriated Venezuelan oil assets.

ConocoPhillips 40 percent interest in Block 2 of Plataforma Deltana, a natural gas region on Venezuela s continental shelf, was not included in the Nationalization Decree. We continue to evaluate our opportunities for commercial development of Block 2.

Our Canadian Syncrude mining operations produced 21,000 barrels per day in the second quarter of 2007, compared with 19,000 barrels per day in the second quarter of 2006.

Midstream

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
	Millions of Dollars			
Net Income*	**$ 102**	108	**187**	218
**Includes DCP Midstream-related net income:*	***$ 76***	*91*	***126***	*184*
	Dollars Per Barrel			
Average Sales Prices				
U.S. natural gas liquids*				
Consolidated	**$ 45.19**	41.73	**41.46**	39.69
Equity	**44.30**	41.18	**40.43**	39.24

**Prices are based on index prices from the Mont Belvieu and Conway market hubs that are weighted by natural gas liquids component and location mix.*

	Thousands of Barrels Daily			
Operating Statistics				
Natural gas liquids extracted*	**211**	211	**204**	209
Natural gas liquids fractionated**	**176**	139	**175**	146

**Includes our share of equity affiliates.*
***Excludes DCP Midstream.*

The Midstream segment purchases raw natural gas from producers and gathers natural gas through an extensive network of pipeline gathering systems. The natural gas is then processed to extract natural gas liquids from the raw gas stream. The remaining residue gas is marketed to electrical utilities, industrial users, and gas marketing companies. Most of the natural gas liquids are fractionated separated into individual components like ethane, butane and propane and marketed as chemical feedstock, fuel, or blendstock. The Midstream segment consists of our equity investment in DCP Midstream, LLC, as well as our other natural gas gathering and processing operations, and natural gas liquids fractionation and marketing businesses, primarily in the United States and Trinidad.

Net income from the Midstream segment decreased 6 percent in the second quarter of 2007 and 14 percent in the first six months of 2007. The decrease in both periods reflects a gradual shift in natural gas purchase contract terms that are more favorable to natural gas producers. In addition, earnings from DCP Midstream were lower in both periods, primarily due to increased operating costs, mainly repairs, maintenance and asset integrity work. The decrease in both periods was slightly offset by higher natural gas liquids prices.

R&M

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
	Millions of Dollars			
Net Income				
United States	**$ 1,879**	1,433	**2,775**	1,730
International	**479**	275	**719**	368
	$ 2,358	1,708	**3,494**	2,098
	Dollars Per Gallon			
U.S. Average Sales Prices*				
Gasoline				
Wholesale	**$ 2.50**	2.32	**2.19**	2.06
Retail	**2.68**	2.47	**2.36**	2.19
Distillates wholesale	**2.24**	2.24	**2.09**	2.08

**Excludes excise taxes.*

	Thousands of Barrels Daily			
Operating Statistics				
Refining operations*				
United States				
Crude oil capacity	**2,033**	2,208	**2,033**	2,208
Crude oil runs	**1,896**	2,000	**1,917**	1,921
Capacity utilization (percent)	**93%**	91	**94**	87
Refinery production	**2,087**	2,198	**2,119**	2,093
International				
Crude oil capacity	**696**	693	**696**	608
Crude oil runs	**650**	649	**637**	570
Capacity utilization (percent)	**93%**	94	**92**	94
Refinery production	**664**	695	**654**	599
Worldwide				
Crude oil capacity	**2,729**	2,901	**2,729**	2,816
Crude oil runs	**2,546**	2,649	**2,554**	2,491
Capacity utilization (percent)	**93%**	91	**94**	88
Refinery production	**2,751**	2,893	**2,773**	2,692

**Includes our share of equity affiliates, except for our share of LUKOIL, which is reported in the LUKOIL Investment segment.*

Petroleum products sales volumes

United States				
Gasoline	**1,300**	1,300	**1,279**	1,279
Distillates	**827**	820	**845**	817
Other products	**503**	555	**491**	536
	2,630	2,675	**2,615**	2,632
International	**739**	871	**726**	784
	3,369	3,546	**3,341**	3,416

The R&M segment s operations encompass refining crude oil and other feedstocks into petroleum products (such as gasoline, distillates and aviation fuels); buying, selling and transporting crude oil; and buying, transporting, distributing and marketing petroleum products. R&M has operations mainly in the United States, Europe and Asia Pacific.

Net income from the R&M segment increased 38 percent in the second quarter of 2007 and 67 percent in the first six months of 2007. The increase in both periods was primarily due to higher worldwide refining and marketing margins and a net benefit from asset rationalization efforts. In addition, costs associated with turnaround activities and 2006 hurricane impacts were lower. The results for the six-month period of 2007 also included a reduction of previously reported impairments on held-for-sale assets. Both 2007 periods were impacted by the contribution of assets to WRB Refining LLC (WRB), our downstream business venture with EnCana.

U.S. R&M

Net income from our U.S. R&M operations increased 31 percent in the second quarter of 2007 and 60 percent in the first six months of 2007. Both increases were primarily the result of higher refining and marketing margins and lower costs associated with turnaround activity and 2006 hurricane impacts. The results for both 2007 periods were impacted by the contribution of assets to WRB.

Our U.S. refining capacity utilization rate was 93 percent in the second quarter of 2007, compared with 91 percent in the second quarter of 2006. The utilization rate improved due to reduced turnaround activity in the second quarter of 2007, compared with the corresponding period of 2006.

International R&M

Net income from our international R&M operations increased 74 percent in the second quarter of 2007 and 95 percent in the first six months of 2007. The increase in both periods resulted primarily from the net benefit of asset rationalization efforts, as well as higher refining and marketing margins. The six-month period also benefited from a slight increase in refining volumes.

Our international refining capacity utilization rate was 93 percent in the second quarter of 2007, compared with 94 percent in the second quarter of 2006. The utilization rate was affected by lower turnaround activity at Humber, offset by lower throughput at the Wilhelmshaven refinery in Germany in response to market conditions. We expect to temporarily idle the Wilhelmshaven refinery in the third quarter of 2007 due to the refinery s production of lower-value fuel oil and intermediate feedstocks, as well as current market conditions. We are continuing to examine alternative means of upgrading the refinery to improve its ability to process lower-cost crude oil and increase its yield of transportation fuels.

LUKOIL Investment

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
Net Income	**$ 526**	387	**782**	636

Operating Statistics*

Net crude oil production (thousands of barrels daily)	**427**	346	**411**	326
Net natural gas production (millions of cubic feet daily)	**278**	343	**293**	221
Net refinery crude oil processed (thousands of barrels daily)	**184**	168	**202**	165

**Represents our net share of our estimate of LUKOIL s production and processing.*

This segment represents our investment in the ordinary shares of LUKOIL, an international, integrated oil and gas company headquartered in Russia, which we account for under the equity method. As of June 30, 2007, our ownership interest in LUKOIL was 20 percent based on 851 million issued shares. Our ownership interest based on estimated shares outstanding, used for equity-method accounting, was 20.5 percent at June 30, 2007.

Because LUKOIL s accounting cycle close and preparation of U.S. generally accepted accounting principles financial statements occur subsequent to our reporting deadline, our equity earnings and statistics for our LUKOIL investment are estimated, based on current market indicators, historical production and cost trends of LUKOIL, and other objective data. Once the difference between actual and estimated results is known, an adjustment is recorded. This estimate-to-actual adjustment will be a recurring component of future period results.

In addition to our estimate of our equity share of LUKOIL s earnings, this segment reflects the amortization of the basis difference between our equity interest in the net assets of LUKOIL and the historical cost of our investment in LUKOIL, and also includes the costs associated with our employees seconded to LUKOIL and accruals for dividend withholding taxes.

Net income from the LUKOIL Investment segment increased 36 percent in the second quarter of 2007 and 23 percent in the first six months of 2007. The increase in both periods was primarily due to higher estimated volumes and petroleum product prices, as well as an increase in our equity ownership. These increases were partially offset by an alignment of estimated net income to reported results, as well as higher estimated operating costs.

Chemicals

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
Net Income	**$ 68**	103	**150**	252

The Chemicals segment consists of our 50 percent interest in Chevron Phillips Chemical Company LLC (CPChem), which we account for under the equity method. CPChem uses natural gas liquids and other feedstocks to produce petrochemicals. These products are then marketed and sold, or used as feedstocks to produce plastics and commodity chemicals.

Net income from the Chemicals segment decreased 34 percent in the second quarter of 2007 and 40 percent in the first six months of 2007. Results for both periods reflect lower margins from olefins and polyolefins, charges related to the retirement of certain assets by CPChem, and higher maintenance and repair costs. The six-month period also reflects a business interruption insurance claim benefit recognized in 2006. The decrease in both periods was slightly offset by higher margins from aromatics and styrenics.

Emerging Businesses

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
Net Income (Loss)				
Power	**$ (1)**	3	**12**	34
Other	**(11)**	(15)	**(25)**	(38)
	$ (12)	(12)	**(13)**	(4)

The Emerging Businesses segment represents our investment in new technologies or businesses outside our normal scope of operations. Activities within this segment are currently focused on power generation and other items, such as carbon-to-liquids, technology solutions, and alternative energy and programs, such as advanced hydrocarbon processes, energy conversion technologies, new petroleum-based products, and renewable fuels.

The Emerging Businesses segment reported a net loss of $12 million in the second quarter of 2007, the same as the corresponding quarter of 2006. The first six months of 2007 resulted in a net loss of $13 million, compared with a net loss of $4 million in the first six months of 2006. Both periods reflect lower margins from the Immingham power plant in the United Kingdom, offset partially by the 2006 write-down of a damaged gas turbine at a domestic power plant.

Corporate and Other

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006*	**2007**	2006*
Net Loss				
Net interest	**$ (224)**	(267)	**(468)**	(360)
Corporate general and administrative expenses	**(54)**	(39)	**(77)**	(65)
Acquisition/merger-related costs	**(16)**	(39)	**(29)**	(44)
Other	**(43)**	(67)	**(104)**	(111)
	$ (337)	(412)	**(678)**	(580)

* *Certain amounts have been reclassified to conform to current period presentation.*

Net interest consists of interest and financing expense, net of interest income and capitalized interest, as well as premiums incurred on the early retirement of debt. Net interest decreased 16 percent in the second quarter of 2007, primarily due to lower interest expense and higher amounts of interest being capitalized. Net interest increased 30 percent in the first six months of 2007, primarily due to higher average debt levels as a result of the financing required to partially fund the acquisition of Burlington Resources. In addition, net interest increased due to a premium on the early retirement of debt paid in the first quarter of 2007. These increases were partially offset by higher amounts of interest being capitalized.

Corporate general and administrative expenses increased 38 percent in the second quarter of 2007 and 18 percent in the first six months of 2007. The increase in both periods was primarily due to increased benefit-related expenses.

Acquisition/merger-related costs include seismic relicensing and other transition costs associated with the Burlington Resources acquisition.

The category Other includes certain foreign currency transaction gains and losses, and environmental costs associated with sites no longer in operation. Results from Other improved in both 2007 periods primarily due to reduced foreign currency losses.

CAPITAL RESOURCES AND LIQUIDITY
Financial Indicators

	Millions of Dollars	
	At June 30 2007	At December 31 2006
Notes payable and long-term debt due within one year	**$ 1,109**	4,043
Total debt*	**$ 22,812**	27,134
Minority interests	**$ 1,180**	1,202
Common stockholders equity	**$ 84,928**	82,646
Percent of total debt to capital**	**21%**	24
Percent of floating-rate debt to total debt	**30%**	41

**Total debt includes notes payable and long-term debt due within one year, and long-term debt, as shown on our consolidated balance sheet.*
***Capital includes total debt, minority interests and common stockholders equity.*

To meet our short- and long-term liquidity requirements, we look to a variety of funding sources. Cash generated from operating activities is the primary source of funding. In addition, during the first six months of 2007, we raised $2,215 million from the sale of assets. During the first six months, available cash was used to support our ongoing capital expenditures and investments program, repurchase shares of our common stock, repay debt, provide loan financing to certain equity affiliates, pay dividends, and meet the funding requirements related to the business venture with EnCana Corporation (EnCana), which closed January 3, 2007. Total dividends paid on our common stock during the first six months were $1,342 million. During the first half of 2007, cash and cash equivalents increased $594 million to $1,411 million.

In addition to cash flows from operating activities and proceeds from asset sales, we rely on our cash balance, commercial paper and credit facility programs, and our shelf registration statements, to support our short- and long-term liquidity requirements. We anticipate these sources of liquidity will be adequate to meet our funding requirements through 2008, including our capital spending program, our share repurchase programs, dividend payments, required debt payments and the funding requirements related to our business venture with EnCana.

Significant Sources of Capital

Operating Activities

During the first six months of 2007, cash of $11,639 million was provided by operating activities, a 21 percent increase from cash from operations of $9,644 million in the corresponding period of 2006. Contributing to the increase was a lower inventory build in the 2007 period, the impact of the Burlington Resources acquisition late in the first quarter of 2006, and higher refining and marketing margins in 2007.

While the stability of our cash flows from operating activities benefits from geographic diversity and the effects of upstream and downstream integration, our short- and long-term operating cash flows are highly dependent upon prices for crude oil, natural gas and natural gas liquids, as well as refining and marketing margins. During the first six months of 2007 and 2006, we benefited from favorable crude oil and natural gas prices, as well as refining margins. The sustainability of these prices and margins is driven by market conditions over which we have no control. Absent other mitigating factors, as these prices and margins fluctuate, we would expect a corresponding change in our operating cash flows.

The level of our production volumes of crude oil, natural gas and natural gas liquids also impacts our cash flows. These production levels are impacted by such factors as acquisitions and dispositions of fields, field production decline rates, new technologies, operating efficiency, weather conditions, the addition of proved reserves through exploratory success, and the timely and cost-effective development of those proved reserves. While we actively manage certain factors that affect production, they can cause variability in cash flows, although historically this variability has not been as significant as that experienced with commodity prices and refining margins.

In addition, the level and quality of output from our refineries impacts our cash flows. The output at our refineries is impacted by such factors as operating efficiency, maintenance turnarounds, feedstock availability and weather conditions. We actively manage the operations of our refineries and typically any variability in their operations has not been as significant to cash flows as that experienced with refining margins.

In 2006, we received approximately $1.1 billion in distributions from two heavy-oil projects in Venezuela. The majority of these distributions represented operating results from previous years. We did not receive a distribution related to these projects in the first six months of 2007. See the Outlook section for additional discussion concerning our operations in Venezuela.

Asset Sales

Proceeds from asset sales during the first six months of 2007 were $2,215 million, compared with $73 million for the same period of 2006.

Commercial Paper and Credit Facilities

At June 30, 2007, we had two revolving credit facilities totaling $5 billion that expire in October 2011. Also, we had a $2.5 billion revolving credit facility whose expiration date was extended one year, in the first quarter of 2007, to April 2012 at a reduced commitment level of $2.3 billion during the one-year extension period. These facilities may be used as direct bank borrowings, as support for the ConocoPhillips $7.5 billion commercial paper program, as support for the ConocoPhillips Qatar Funding Ltd. $1.5 billion commercial paper program, or as support for issuances of letters of credit totaling up to $750 million. At June 30, 2007 and December 31, 2006, we had no outstanding borrowings under the credit facilities, but $41 million in letters of credit had been issued at both dates. Under both commercial paper programs, there was $535 million of commercial paper outstanding at June 30, 2007, compared with $2,931 million at December 31, 2006.

At June 30, 2007, our primary funding source for short-term working capital needs was the ConocoPhillips $7.5 billion commercial paper program, a portion of which may be denominated in other currencies (limited to euro 3 billion equivalent). Commercial paper maturities are generally limited to 90 days. Based on $535 million of commercial paper outstanding and $41 million of issued letters of credit, we had access to $6.9 billion in unused borrowing capacity under the three revolving credit facilities at June 30, 2007.

Shelf Registrations

We have a universal shelf registration statement on file with the SEC under which we, as a well-known seasoned issuer, have the ability to issue and sell an indeterminate amount of various types of debt and equity securities.

We also have on file with the SEC a shelf registration statement under which ConocoPhillips Canada Funding Company I and ConocoPhillips Canada Funding Company II, both wholly owned subsidiaries, could issue an indeterminate amount of senior debt securities, fully and unconditionally guaranteed by ConocoPhillips and ConocoPhillips Company.

Minority Interests

At June 30, 2007, we had outstanding $1,180 million of equity in less than wholly owned consolidated subsidiaries held by minority interest owners, including a minority interest of $508 million in Ashford Energy Capital S.A. and a minority interest of $648 million related to Darwin LNG, located in northern Australia.

Off-Balance Sheet Arrangements

As part of our normal ongoing business operations and consistent with industry practice, we enter into numerous agreements with other parties to pursue business opportunities, which share costs and apportion risks among the parties as governed by the agreements. At June 30, 2007, we were liable for certain contingent obligations under the following contractual arrangements:

Qatargas 3: Qatargas 3 is an integrated project to produce and liquefy natural gas from Qatar s North field. We own a 30 percent interest in the project. Our interest is held through a jointly owned company, Qatar Liquefied Gas Company Limited (3), for which we use the equity method of accounting. Qatargas 3 secured project financing of $4 billion in December 2005, consisting of $1.3 billion of loans from export credit agencies (ECA), $1.5 billion from commercial banks, and $1.2 billion from ConocoPhillips. The ConocoPhillips loan facilities have substantially the same terms as the ECA and commercial bank facilities. Prior to project completion certification, all loans, including the ConocoPhillips loan facilities, are guaranteed by the participants, based on their respective ownership interests. Accordingly, our maximum exposure to this financing structure is $1.2 billion. Upon completion certification, which is expected to be December 31, 2009, all project loan facilities, including the ConocoPhillips loan facilities, will become non-recourse to the project participants. At June 30, 2007, Qatargas 3 had $1.8 billion outstanding under all the loan facilities, of which ConocoPhillips provided $540 million, including accrued interest.

Rockies Express Pipeline LLC: In June 2006, we issued a guarantee for 24 percent of the $2.0 billion in credit facilities of Rockies Express Pipeline LLC (Rockies Express), which will be used to construct a natural gas pipeline across a portion of the United States. The maximum potential amount of future payments to third-party lenders under the guarantee is estimated to be $480 million, which could become payable if the credit facility is fully utilized and Rockies Express fails to meet its obligations under the credit agreement. It is anticipated that construction completion will be achieved at the end of 2009, and refinancing will take place at that time, making the debt non-recourse.

Other: At June 30, 2007, we had guarantees outstanding for our portion of joint-venture debt obligations, which have terms of up to 17 years. The maximum potential amount of future payments under the guarantees was approximately $120 million. Payment would be required if a joint venture defaults on its debt obligations.

For additional information about guarantees, see Note 13 Guarantees, in the Notes to Consolidated Financial Statements, which is incorporated herein by reference.

Capital Requirements

Our debt balance at June 30, 2007, was $22.8 billion, a decrease of $4.3 billion during the first six months of 2007.

On February 9, 2007, we announced plans to purchase $4 billion of our common stock in 2007. During the first six months of 2007, we purchased 28.7 million shares of our common stock at a cost of $2.0 billion, including 73,000 shares at a cost of $5 million from a consolidated Burlington Resources grantor trust. On July 9, 2007, we announced plans to repurchase up to $15 billion of our common stock through the end of 2008. This amount includes $2 billion remaining under the $4 billion program announced in February 2007. We anticipate third-quarter 2007 share repurchases to be approximately $2 billion to $3 billion.

In December 2005, we entered into a credit agreement with Qatargas 3 to provide loan financing of approximately $1.2 billion for the construction of an LNG train in Qatar. This financing will represent 30 percent of the project s total debt financing. Through June 30, 2007, we had provided $540 million in loan financing, including accrued interest. See the Off-Balance Sheet Arrangements section for additional information on Qatargas 3.

In 2004, we finalized our transaction with Freeport LNG Development, L.P. (Freeport LNG) to participate in an LNG receiving terminal in Quintana, Texas. We entered into a credit agreement with Freeport LNG to provide loan financing of approximately $630 million for the construction of the facility, which began in early 2005. Through June 30, 2007, we had provided $607 million in loan financing, including accrued interest.

In the fall of 2004, ConocoPhillips and LUKOIL agreed to the expansion of the Varandey terminal as part of our investment in the OOO Naryanmarneftegaz (NMNG) joint venture. We have an obligation to provide loan financing to Varandey Terminal Company for 30 percent of the costs of the terminal expansion, but we will have no governance or ownership interest in the terminal. We estimate our total loan obligation for the terminal expansion to be approximately $525 million at current exchange rates, including interest to be accrued during construction. This amount will be adjusted as the project s cost estimate and schedule are updated and the ruble exchange rate fluctuates. Through June 30, 2007, we had provided $255 million in loan financing, including accrued interest.

Our loans to Qatargas 3, Freeport LNG and Varandey Terminal Company are included in the Loans and advances related parties line on our consolidated balance sheet.

On January 3, 2007, we closed on the previously announced business venture with EnCana. As part of this transaction, we are obligated to contribute $7.5 billion, plus accrued interest, over a 10-year period, beginning in 2007, to the upstream business venture formed as a result of the transaction. An initial cash contribution of $188 million was made upon closing in January. Quarterly principal and interest payments of $237 million began in the second quarter of 2007, and will continue until the balance is paid. This obligation is reflected as a liability on our June 30, 2007, consolidated balance sheet. Of the principal obligation amount, approximately $578 million is short-term and is included in the Accounts payable related parties line on our consolidated balance sheet. The principal portion of these payments is presented on our consolidated statement of cash flows as an other financing activity. Interest accrues at a fixed annual rate of 5.3 percent on the unpaid principal balance.

Effective January 15, 2007, we redeemed the 8% Junior Subordinated Deferrable Interest Debentures due 2037, at a premium of $14 million, plus accrued interest. This redemption resulted in the immediate redemption by Phillips 66 Capital II of $350 million of 8% Capital Securities. See Note 11 Debt, in the Notes to Consolidated Financial Statements, for additional information.

Also, in January 2007, we redeemed our $153 million 7.25% Notes due 2007 upon their maturity. In February 2007, we reduced our Floating Rate Five-Year Term Note due 2011 from $5 billion to $4 billion, with a subsequent reduction in July 2007 to $3 billion. In April 2007, we redeemed our $1 billion Floating Rate Notes due 2007 upon their maturity.

In May 2007, Polar Tankers Inc., a wholly owned subsidiary, issued an offering of $645 million 5.951% Notes due 2037. The notes are fully and unconditionally guaranteed by ConocoPhillips and ConocoPhillips Company.

Contractual Obligations

Our contractual purchase obligations at June 30, 2007, were estimated to be $111 billion, an increase of $18 billion from the amount reported at December 31, 2006, of $93 billion. The increase primarily results from the joint venture acquisition obligation, as well as mostly higher crude oil, natural gas and NGL prices, and commodity derivative positions.

Capital Spending

Capital Expenditures and Investments

	Millions of Dollars Six Months Ended June 30	
	2007	2006
E&P		
United States Alaska	**$ 324**	439
United States Lower 48	**1,392**	736
International	**3,002**	3,203
	4,718	4,378
Midstream	**2**	2
R&M		
United States	**388**	822
International	**88**	1,288
	476	2,110
LUKOIL Investment		1,260
Chemicals		
Emerging Businesses	**65**	40
Corporate and Other	**86**	126
	$ 5,347	7,916
United States	**$ 2,191**	2,161
International	**3,156**	5,755
	$ 5,347	7,916

E&P

UNITED STATES

Alaska

During the first six months of 2007, we continued development drilling in the Greater Kuparuk Area (including the West Sak development), the Greater Prudhoe Area, and the Alpine field and Alpine satellite

fields. Work on a project to upgrade the Trans-Alaska Pipeline System pump stations continued with the first pump station placed on line in February 2007.

Lower 48 States

Onshore, we focused on natural gas developments in the San Juan Basin of New Mexico, the Lobo Trend of South Texas, the Bossier and Cotton Valley Trends of East Texas and North Louisiana, the Barnett Shale Trend of North Texas, and the Anadarko Basin of western Oklahoma. We also continue to pursue oil development in the Williston Basin of Montana and North Dakota, as well as oil and gas developments in southern Louisiana and in the Permian Basin of West Texas. In addition, we invested funds on a new gas development project in the Piceance Basin of northwest Colorado.

Offshore, expenditures were primarily focused on the Ursa development in the Gulf of Mexico.

CANADA

During the first six months of 2007, we continued with the development of our Surmont heavy-oil project, where steam injection began in the second quarter, and initial production is expected in the last half of 2007. We also continued the development of our conventional oil and gas reserves in western Canada. In addition, we paid approximately $236 million related to our initial cash contribution and quarterly interest payment to the upstream business venture with EnCana. See Note 17 Joint Venture Acquisition Obligation, in the Notes to Consolidated Financial Statements, for additional information.

EUROPE

In the U.K. and Norwegian sectors of the North Sea, funds were invested during the first half of 2007 for development of the Britannia satellite fields, Callanish and Brodgar, where production is expected to begin in 2008; the Alvheim project, where production is scheduled to begin later in 2007; the Statfjord Late-Life Project, where production is targeted to startup in late 2007; and continued development of the Ekofisk Area.

MIDDLE EAST AND AFRICA

Libya

During the first half of 2007, funds were expended to continue the development of the Waha concessions.

Qatar

In Qatar, work continued on Qatargas 3, an integrated project to produce and liquefy natural gas from Qatar s North field.

Algeria

In Algeria, during the first six months of 2007, funds were invested in three fields in Block 405A, the Menzel Lejmat North field, the Ourhoud field, and the EMK (El Merk) oil field unit, which extends into the southeastern area of Block 405A.

RUSSIA AND CASPIAN

Russia

Through OOO Naryanmarneftegaz, a joint venture with LUKOIL, we are working to develop the Yuzhno Khylchuyu field in the northern part of Russia s Timan-Pechora province.

Caspian

We continued to participate in construction activities to develop the Kashagan field on the Kazakhstan shelf in the Caspian Sea. Kashagan Phase I Development is in the execution phase, aiming for first production in 2010. The revised Kashagan Development Plan was submitted to the Republic of Kazakhstan Authority at the end of June 2007.

ASIA PACIFIC

Indonesia

During the first six months of 2007, we continued to invest funds on the development of the Belanak, Kerisi, Hiu, Belut, Ujung Pangkah, and Suban Phase II projects.

China

Work continued on the development of Phase II of the Peng Lai 19-3 field, as well as concurrent development of the nearby Peng Lai 25-6 field in 2007.

R&M

In the United States, we expended funds during the first half of 2007 related to sustaining and improving the existing business with a focus on reliability, energy efficiency, capital maintenance and regulatory compliance. Work also continued on projects to increase crude oil capacity, expand conversion capability and increase clean product yield. Construction of a new coker at the Borger refinery, part of WRB, our downstream business venture with EnCana, was completed in the second quarter of 2007.

Internationally, our focus during the first six months of 2007 was on projects related to reliability, safety and the environment.

Contingencies

Legal and Tax Matters

We accrue for non-income-tax-related contingencies when a loss is probable and the amounts can be reasonably estimated. In the case of income-tax-related contingencies, we adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48), effective January 1, 2007. FIN 48 requires a cumulative probability-weighted loss accrual in cases where sustaining a tax position is less than certain. Based on currently available information, we believe it is remote that future costs related to known contingent liability exposures will exceed current accruals by an amount that would have a material adverse impact on our financial statements.

Environmental

We are subject to the same numerous international, federal, state, and local environmental laws and regulations, as are other companies in the petroleum exploration and production, refining and crude oil and refined product marketing and transportation businesses. For a discussion of the most significant of these environmental laws and regulations, including those with associated remediation obligations, see the Environmental section in Management s Discussion and Analysis of Financial Condition and Results of Operations on pages 85 through 88 of our 2006 Form 10-K.

We, from time to time, receive requests for information or notices of potential liability from the Environmental Protection Agency and state environmental agencies alleging that we are a potentially responsible party under the Federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) or an equivalent state statute. On occasion, we also have been made a party to cost recovery litigation by those agencies or by private parties. These requests, notices and lawsuits assert potential liability for remediation costs at various sites that typically are not owned by us, but allegedly contain wastes attributable to our past operations. As of December 31, 2006, we reported we had been notified of potential liability under CERCLA and comparable state laws at 64 sites around the United States. At June 30, 2007, we had resolved three of these sites and had received four new notices of potential liability, leaving 65 unresolved sites where we have been notified of potential liability.

At June 30, 2007, our balance sheet included a total environmental accrual of $1,027 million, compared with $1,062 million at December 31, 2006. We expect to incur a substantial majority of these expenditures within the next 30 years.

Notwithstanding any of the foregoing, and as with other companies engaged in similar businesses, environmental costs and liabilities are inherent in our operations and products, and there can be no assurance that material costs and liabilities will not be incurred. However, we currently do not expect any material adverse effect on our results of operations or financial position as a result of compliance with environmental laws and regulations.

NEW ACCOUNTING STANDARDS

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. This Statement permits an entity to choose to measure financial instruments and certain other items similar to financial instruments at fair value, with all subsequent changes in fair value for the financial instrument reported in earnings. By electing the fair value option in conjunction with a derivative, an entity can achieve an accounting result similar to a fair-value hedge without having to comply with complex hedge accounting rules. This Statement is effective January 1, 2008. We are currently evaluating the Statement, but we do not expect any significant impact to our consolidated financial statements.

OUTLOOK

Alaska

In June 2007, the governor of Alaska signed the Alaska Gasline Inducement Act (AGIA) into law. AGIA establishes a process for the state to solicit and evaluate proposals for an Alaskan gas pipeline project. Throughout 2007, we expect to be involved in efforts to try to find a way to advance an Alaska North Slope gas pipeline project.

Venezuela

On June 26, 2007, we announced we had been unable to reach agreement with respect to our migration to an *empresa mixta* structure mandated by the Nationalization Decree. Therefore, pursuant to the Nationalization Decree, Petróleos de Venezuela S.A. (PDVSA) or its affiliates directly assumed the activities associated with ConocoPhillips interests in the Petrozuata and Hamaca heavy-oil ventures and the offshore Corocoro development project.

Negotiations continue between ConocoPhillips and Venezuelan authorities concerning appropriate compensation for the expropriation of the company s oil interests. We continue to preserve all our rights with respect to this situation, including our rights under the contracts we signed and under international and Venezuelan law. We will continue to evaluate our options, including international arbitration, in realizing adequate compensation for the value of our oil investments and operations in Venezuela.

Other

In E&P, we expect our third quarter 2007 production to be lower than the level in the second quarter of 2007 due to the expropriation of our Venezuelan oil projects, unplanned downtime in the United Kingdom as a result of damage and repairs on a third-party pipeline, and planned downtime in the Timor Sea and Alaska.

In R&M, we expect our crude oil capacity utilization in the third quarter of 2007 to be similar to the previous quarter.

CAUTIONARY STATEMENT FOR THE PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify our forward-looking statements by the words anticipate, estimate, believe, continue, could, intend, may, plan, potential, predict, should, wi projection, forecast, goal, guidance, outlook, effort, target and similar expressions.

We based the forward-looking statements relating to our operations on our current expectations, estimates and projections about ourselves and the industries in which we operate in general. We caution you that these statements are not guarantees of future performance and involve risks, uncertainties and assumptions that we cannot predict. In addition, we based many of these forward-looking statements on assumptions about future events that may prove to be inaccurate. Accordingly, our actual outcomes and results may differ materially from what we have expressed or forecast in the forward-looking statements. Any differences could result from a variety of factors, including the following:

- Fluctuations in crude oil, natural gas and natural gas liquids prices, refining and marketing margins and margins for our chemicals business.

- The operation and financing of our midstream and chemicals joint ventures.

- Potential failure or delays in achieving expected reserve or production levels from existing and future oil and gas development projects due to operating hazards, drilling risks and the inherent uncertainties in predicting oil and gas reserves and oil and gas reservoir performance.

- Unsuccessful exploratory drilling activities.

- Failure of new products and services to achieve market acceptance.

- Unexpected changes in costs or technical requirements for constructing, modifying or operating facilities for exploration and production projects, manufacturing or refining.

- Unexpected technological or commercial difficulties in manufacturing, refining, or transporting our products, including synthetic crude oil and chemicals products.

- Lack of, or disruptions in, adequate and reliable transportation for our crude oil, natural gas, natural gas liquids, LNG and refined products.

- Inability to timely obtain or maintain permits, including those necessary for construction of LNG terminals or regasification facilities, comply with government regulations, or make capital expenditures required to maintain compliance.

- Failure to complete definitive agreements and feasibility studies for, and to timely complete construction of, announced and future LNG and refinery projects and related facilities.

- Potential disruption or interruption of our operations due to accidents, extraordinary weather events, civil unrest, political events or terrorism.

International monetary conditions and exchange controls.

55

Liability for remedial actions, including removal and reclamation obligations, under environmental regulations.

Liability resulting from litigation.

General domestic and international economic and political developments, including armed hostilities, expropriation of assets, changes in governmental policies relating to crude oil, natural gas, natural gas liquids or refined product pricing and taxation, other political, economic or diplomatic developments, and international monetary fluctuations.

Changes in tax and other laws, regulations (including alternative energy mandates), or royalty rules applicable to our business.

Inability to obtain economical financing for projects, construction or modification of facilities and general corporate purposes.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information about market risks for the six months ended June 30, 2007, does not differ materially from that discussed under Item 7A of ConocoPhillips Annual Report on Form 10-K for the year ended December 31, 2006.

Item 4. CONTROLS AND PROCEDURES

As of June 30, 2007, with the participation of our management, our Chairman, President and Chief Executive Officer (principal executive officer) and our Executive Vice President, Finance, and Chief Financial Officer (principal financial officer) carried out an evaluation, pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (the Act), of the effectiveness of the design and operation of ConocoPhillips disclosure controls and procedures (as defined in Rule 13a-15(e) of the Act). Based upon that evaluation, our Chairman, President and Chief Executive Officer and our Executive Vice President, Finance, and Chief Financial Officer concluded that our disclosure controls and procedures were operating effectively as of June 30, 2007.

There have been no changes in our internal control over financial reporting, as defined in Rule 13a-15(f) of the Act, in the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The following is a description of reportable legal proceedings including those involving governmental authorities under federal, state and local laws regulating the discharge of materials into the environment for this reporting period. The following proceedings include those matters that arose during the second quarter of 2007 and any material developments with respect to those matters previously reported in ConocoPhillips 2006 Form 10-K or first-quarter 2007 10-Q. While it is not possible to accurately predict the final outcome of these pending proceedings, if any one or more of such proceedings were decided adversely to ConocoPhillips, we expect there would be no material effect on our consolidated financial position. Nevertheless, such proceedings are reported pursuant to the U.S. Securities and Exchange Commission s regulations.

New Matters

In April 2004, in response to several historic spills at the Albuquerque Products Terminal, we received an Administrative Compliance Order from the New Mexico Environment Department. The order does not propose a penalty assessment, but rather attempts to impose specific design, construction and operational changes. We have been in negotiations with the agency and have recently proposed a settlement offer of $100,000. We will continue to work with the agency to resolve this matter.

On April 30, 2007, the Borger refinery received an offer to settle a range of violations alleged in a March 16, 2007, Notice of Enforcement issued by the Texas Commission on Environmental Quality (TCEQ). The alleged violations relate to air quality permit limits, emission events, testing requirements, and reporting or recordkeeping requirements. We have agreed to the proposed penalty of $169,799 and will continue to work with the agency to close this matter.

In June 2007, the Ferndale refinery was informed by the U.S. Environmental Protection Agency (EPA) that it will seek penalties for Ferndale s alleged failure to comply with certain portions of the Benzene Waste Operations rule. The government alleges the facility has not complied with certain equipment maintenance and inspection rules since 1993. We intend to negotiate a settlement with the EPA and the Department of Justice.

The Refinery Enforcement Initiative Consent Decree between ConocoPhillips Company, the United States, the Commonwealth of Pennsylvania and others provides for penalties for certain acid gas flaring incidents. The Pennsylvania Department of Environmental Protection (PADEP) has informed the Trainer refinery that it intends to seek penalties for acid gas flaring which occurred during April and/or May 2007. We are currently assessing this matter and expect to work with the PADEP to resolve it.

Matters Previously Reported

In December 2005, the TCEQ proposed an administrative penalty of $120,132 for alleged violations of the Texas Clean Air Act at the Borger refinery. The allegations relate to unexcused emission events, reporting and recordkeeping requirements, leak detection and repair, flare outages, and Title V permit reporting. We have paid an administrative penalty of $57,716, and agreed to perform Supplemental Environmental Projects totaling an additional $57,716. We anticipate this settlement agreement will be resolved through final approval by the full TCEQ commission.

On January 22, 2007, the Ferndale Refinery received a Notice of Violation (NOV) from the Northwest Clean Air Agency, which alleges that the vapor recovery equipment at the refinery s truck loading terminal exceeded the maximum pressure limit during loading. The NOV also alleges that notification of the underlying source test was reported late. ConocoPhillips resolved this NOV in May 2007, with a settlement payment of $52,500 to the Northwest Clean Air Agency.

On November 28, 2006, the state of Alaska, Department of Environmental Conservation (ADEC), notified ConocoPhillips Alaska, Inc. (CPAI) of an alleged violation of the Air Quality Control permit for the Central Production Facility #1, Kuparuk River Unit Topping Plant at the Kuparuk field on the North Slope of Alaska. The NOV alleged that CPAI had not operated an emissions monitoring unit at the topping plant. In June 2007, we settled the NOV by paying $97,094 to ADEC in full settlement of the matter.

Item 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2006.

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

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased*	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs**	Millions of Dollars Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs**
April 1-30, 2007	4,095,007	$ 69.46	4,090,000	$ 2,823
May 1-31, 2007	4,545,825	72.31	4,532,190	2,495
June 1-30, 2007	4,954,578	78.39	4,952,500	2,107
Total	13,595,410	$ 73.66	13,574,690	

**Includes the repurchase of common shares from company employees in connection with the company s broad-based employee incentive plans.*

***On January 12, 2007, we announced a stock repurchase program that provided for the repurchase of up to $1 billion of* *the company s common stock. On February 9, 2007, we announced plans to purchase $4 billion of our common stock in 2007, including the $1 billion announced on January 12, 2007. On July 9, 2007, we announced plans to repurchase up to $15 billion of the company s common stock through the end of 2008, which includes the $2 billion remaining under the previously announced $4 billion stock buyout authorization. Acquisitions for the share repurchase programs are made at management s discretion, at prevailing prices, subject to market conditions and other factors. Purchases may be increased, decreased or discontinued at any time without prior notice. Shares of stock repurchased under the plans are held as* *treasury shares.*

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held our annual stockholders meeting on May 9, 2007. A brief description of each proposal and the voting results follow:

A company proposal to elect six directors.

	For	Against	Abstain
James E. Copeland, Jr.	1,413,582,459	25,593,225	8,583,552
Kenneth M. Duberstein	1,405,483,740	33,573,007	8,702,489
Ruth R. Harkin	1,414,381,388	24,987,182	8,390,666
William R. Rhodes	1,410,288,680	28,841,412	8,629,144
J. Stapleton Roy	1,412,975,202	26,321,526	8,462,508
William E. Wade, Jr.	1,413,394,724	25,845,848	8,518,664

Those directors whose term of office continued were as follows: Richard L. Armitage, Richard H. Auchinleck, Norman R. Augustine, Charles C. Krulak, Harold W. McGraw III, James J. Mulva, Harald J. Norvik, William K. Reilly, Bobby S. Shackouls, Victoria J. Tschinkel, and Kathryn C. Turner.

A company proposal to ratify the appointment of Ernst & Young LLP as ConocoPhillips independent registered public accounting firm for 2007.

For	1,428,409,973
Against	14,059,578
Abstentions	5,289,241
Broker Non-Votes	444

A shareholder proposal requesting ConocoPhillips provide a report, updated semi-annually, concerning corporate political contributions.

For	127,031,053
Against	937,916,545
Abstentions	183,153,585
Broker Non-Votes	199,658,053

A shareholder proposal outlining certain qualifications for Director nominees.

For	67,182,790
Against	1,076,183,053
Abstentions	104,735,345
Broker Non-Votes	199,658,048

A shareholder proposal requesting the Board of Directors prepare a report, at a reasonable cost and omitting proprietary information, on the potential environmental damage that would result from drilling for oil and gas in the area inside the National Petroleum Reserve Alaska originally protected by the

1998 Record of Decision. The report should consider the implications of a policy of refraining from drilling in such areas and should be available to investors by the 2008 annual meeting.

For	286,071,802
Against	784,351,356
Abstentions	177,678,028
Broker Non-Votes	199,658,050

A shareholder proposal requesting the Board of Directors prepare a report by November 2007, at a reasonable cost and omitting proprietary information, concerning ConocoPhillips policies and procedures regarding the recognition of Indigenous Rights.

For	105,488,682
Against	962,709,927
Abstentions	179,902,577
Broker Non-Votes	199,658,050

A shareholder proposal requesting the Board of Directors prepare a report to shareholders, at a reasonable cost and omitting proprietary information, on how the corporation ensures it is accountable for its environmental impacts in all of the communities where it operates.

For	99,198,229
Against	958,990,839
Abstentions	189,912,118
Broker Non-Votes	199,658,050

All six nominated directors were elected and the appointment of the independent auditors was ratified. The five shareholder proposals were not ratified.

Item 6. EXHIBITS

Exhibits

10 Aircraft Time Sharing Agreement by and between James J. Mulva and ConocoPhillips.

12 Computation of Ratio of Earnings to Fixed Charges.

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

32 Certifications pursuant to 18 U.S.C. Section 1350.

SIGNATURE

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 thereunto duly authorized.

CONOCOPHILLIPS

/s/ Rand C. Berney

Rand C. Berney
Vice President and Controller
(Chief Accounting and Duly Authorized Officer)

August 1, 2007

EXHIBIT INDEX

<u>Exhibits</u>

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32	Certifications pursuant to 18 U.S.C. Section 1350.