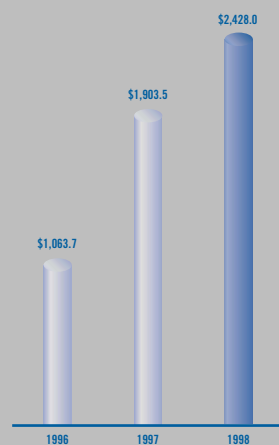


Financial Highlights

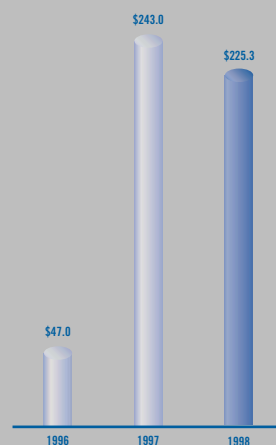
Year ended December 31,

	1998	1997	1996
<i>(Dollars in millions, except per share amounts and units)</i>			
Aircraft Deliveries	61	51	27
Net Revenues	\$ 2,428.0	\$ 1,903.5	\$ 1,063.7
Net Income	\$ 225.3	\$ 243.0	\$ 47.0
Earnings per Share (EPS)*	\$ 3.00	\$ 3.12	\$ 0.60
Pro Forma Fully Taxed EPS*	\$ 3.00	\$ 1.68	\$ 0.37
Contractual Backlog	\$ 3,301.9	\$ 2,782.1	\$ 3,104.0
Closing Market Price per Share	\$ 53.25	\$ 29.25	\$ 24.13
Aircraft in Service	933	894	879

Net Revenues



Net Income



Pro Forma Fully Taxed
Earnings per Share



Closing Market Price per Share



On The Front Cover

Lorem ipsum dolor sit amet consectetur adipiscing elit, sed diam nonummy nibh euismod tincidunt ut laoreet dolore magna aliquam erat volutpat ut wisi enim ad minim veniam, quis nostrud exercitatio ullamcorps lorem ipsum dolor sit amet consectetur adipiscing elit, sed diam nonummy nibh euismod.

Table of Contents

Letter to Shareholders	2
Managing Growth	5
Market Leadership	6
Product and Services Performance	8
Value-Added Services	12
Innovative Programs	14
Managing for Profitable Growth	16
Board of Directors	18
Financial Review	20

Management's Discussion and Analysis of Financial Condition and Results of Operations

Business

Gulfstream is recognized worldwide as a leading designer, developer, manufacturer and marketer of intercontinental business jet aircraft. The Company operates principally in three segments: New Aircraft, Pre-owned Aircraft and Aircraft Services. Within New Aircraft, the Company's current product offerings are the Gulfstream IV-SP, the Gulfstream V, Gulfstream Shares[®] (fractional ownership interest in Gulfstream IV-SPs and Gulfstream Vs), and Gulfstream LeaseSM. Also, the Company's financial services subsidiary, Gulfstream Financial Services Corporation, through its private label relationship with a third-party aircraft financing provider, offers customized products to finance the worldwide sale of Gulfstream aircraft. Within its Aircraft Services segment, the Company offers aftermarket maintenance services, spare parts, and engine and auxiliary power unit service and overhaul for both Gulfstream and other business jets. The Company's Pre-owned Aircraft segment markets and sells refurbished pre-owned Gulfstream aircraft and other business jets, acquired in trade, to a worldwide market.

The following discussion should be read in conjunction with the Consolidated Financial Statements and Notes thereto beginning on page 26, which are included herein.

Acquisition of K-C Aviation

On August 19, 1998, the Company completed the acquisition of K-C Aviation, Inc. for approximately \$250 million, including acquisition costs. The acquisition is a key part of Gulfstream's growth strategy and has allowed the Company to obtain a skilled workforce, as well as add additional capacity to accelerate its aircraft completions business, diversify and grow its aircraft maintenance and parts business, and strongly establish the Gulfstream name in the aircraft engine service market.

K-C Aviation was a leading provider of business aviation services and the largest independent completion center for business aircraft in North America. In addition to custom aircraft interiors, K-C Aviation was the second largest aircraft engine service center in the United States and also offers maintenance services, spare parts, auxiliary power unit service, avionics retrofit, non-destructive testing and component overhaul.

The purchase of K-C Aviation, Inc. was funded primarily from existing cash balances, and due to the timing of the closing of the transaction, also from the revolving credit facility. The acquisition has been accounted for as a purchase, and the purchase price exceeded the fair value of net assets acquired by approximately \$178 million. The discussion and analysis that follows reflects the combined results from the date of the acquisition.

Results of Operations

The following sets forth certain statistical data concerning the Company's deliveries, orders and backlog for new aircraft.

	1998	1997	1996
Units delivered during period:			
Gulfstream IV-SP	32	22	24
Gulfstream V	29	29	3
Total green deliveries	61	51	27
Units ordered during period:			
Gulfstream IV-SP	39	39	44
Gulfstream V	40	7	21
Total orders	79	46	65
Units in backlog at end of period:			
Gulfstream IV-SP ⁽¹⁾	50	43	27
Gulfstream V ⁽²⁾	56	45	67
Total backlog (in units) ⁽³⁾	106	88	94
Estimated backlog (in billions) ⁽³⁾	\$ 3.3	\$ 2.8	\$ 3.1

⁽¹⁾ Net of 1 cancellation in 1997, which relates to an order placed in that year.

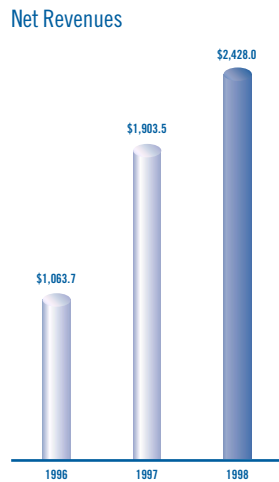
⁽²⁾ Net of 1 cancellation in 1996, which relates to an order placed in a prior year.

⁽³⁾ Backlog excludes 11 Mid East Share contracts. See discussion of Contractual Backlog on page 24.

The Company recognizes revenue for the sale of a new "green" aircraft (i.e., before exterior painting and installation of customer selected interiors and optional avionics) when that aircraft is delivered to the customer. Revenues from completion services are recorded when the outfitted aircraft is delivered to the customer. Revenues on all other products and services, including pre-owned aircraft, are recognized when such products are delivered or such services are performed. Generally, aircraft deliveries remain relatively smooth throughout a year. However, aircraft deliveries can vary significantly depending upon the timing of contract execution and final customer acceptance. Accordingly, the Company's revenues can vary significantly from quarter to quarter.

Total Company Revenues and Gross Margin

In 1998, total Company revenues increased by \$524.5 million to \$2,428.0 million from \$1,903.5 million in 1997. In 1997, total Company revenues increased \$839.8 million from \$1,063.7 million in 1996. The increase in revenues is principally attributable to the increase in new aircraft deliveries to 61 in 1998 from 51 in 1997 and 27 in 1996. The Company's 1998 results of operations include revenues of K-C Aviation, Inc. from the date of acquisition, totaling \$84.9 million, a significant portion of which resulted from the delivery of eight non-Gulfstream completions. Cost of sales of the acquired business includes a non-cash acquisition related charge of \$7.2 million for



the fair value step-up related to the sale of inventories. Excluding pre-owned aircraft, which generally are sold at break-even levels, and the non-cash inventory step-up, the Company's gross margin percentage for 1998 was 23.6% compared to 20.2% for 1997 and 25.3% in 1996.

The following table displays net revenues and gross margin for the Gulfstream Aerospace Corporation reportable segments for each of the three years in the period ended December 31, 1998, which correspond to the segment information presented in Note 15 to the consolidated financial statements.

Net Revenues	1998	1997	1996
<i>(Dollars in millions)</i>			
New Aircraft	\$ 1,909.0	\$ 1,492.0	\$ 740.5
Aircraft Services	281.8	201.1	169.9
Pre-owned Aircraft	237.2	210.4	153.3
Total Net Revenues	\$ 2,428.0	\$ 1,903.5	\$ 1,063.7

Gross Margin	1998	1997	1996
<i>(Dollars in millions)</i>			
New Aircraft	\$ 464.3	\$ 297.5	\$ 193.9
Aircraft Services	53.7	45.0	36.5
Pre-owned Aircraft	11.4	8.2	(1.7)
Gross Margin	\$ 529.4	\$ 350.7	\$ 228.7

New Aircraft

New Aircraft segment revenues have continued to grow over the last three years, reaching \$1,909.0 million in 1998, after increasing to \$1,492.0 million in 1997 from \$740.5 in 1996. This represents a 27.9% increase in 1998 over 1997 and a two-fold increase in 1997 compared with 1996. The overall growth in New Aircraft revenues is primarily due to the increasing level of production to meet the expanded product demand. See also "Liquidity and Capital Resources" and "Contractual Backlog". In 1998, the New Aircraft segment delivered a total of 61 green aircraft including both GIV-SPs and Gulfstream Vs compared to 51 in 1997 and 27 in 1996. The increase in 1998 over 1997 is driven by delivery of 10 additional Gulfstream IV-SP aircraft. The increase in 1997 over 1996 is driven by delivery of 26 additional Gulfstream V aircraft, which commenced delivery in December 1996.

The gross margins for New Aircraft were \$464.3 million, \$297.5 million, and \$193.9 million for 1998, 1997 and 1996, respectively. Gross margin percentage increased to 24.3% in 1998 from 19.9% in 1997 but declined from 26.2% in 1996. The increase in gross margin percentage in 1998 is primarily attributable to reductions in new aircraft production costs. The decline in gross margin percentage in 1997 is primarily attributable to the introduction of the Gulfstream V aircraft into production and the higher costs experienced in 1997 associated with the early stages of the Gulfstream V production and completions.

Aircraft Services

Revenues for Aircraft Services increased 40.1% to \$281.8 million in 1998 from \$201.1 million in 1997. In 1997 Aircraft Services revenues increased 18.4% over 1996. Contributing to the revenue increase in 1998 was \$57.4 million of revenues resulting from the acquisition of the former K-C Aviation. The continuing growth in Aircraft Services revenue from 1996 to 1998 is directly related to the Company's success in significantly increasing market share.

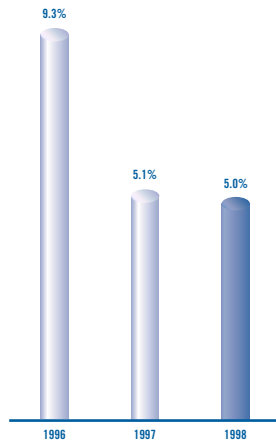
Gross margin percentages for Aircraft Services were 19.1% in 1998, a decrease from 22.4% in 1997, after increasing from 21.5% in 1996. The decrease in gross margins in 1998 from 1997 resulted principally from lower levels of gross margins realized on revenues from the acquired K-C Aviation business. The increase in 1997 compared with 1996 is primarily attributable to improved operating performance.

Pre-owned Aircraft

Pre-owned Aircraft revenues were \$237.2 million in 1998, \$210.4 million in 1997 and \$153.3 million in 1996. These increases represent a 12.7% growth in 1998 over 1997 compared to a 37.2% increase from 1996 to 1997. This increase in revenue year over year is a function of the volume of units delivered and the mix of aircraft sold (i.e., Gulfstream IIs, IIIs, and IVs, etc.).

Gross margins for the Pre-owned Aircraft segment can vary from year to year depending on the mix of aircraft sold and current market conditions. Generally, gross margins on pre-owned aircraft sales have been at or near break-even, with 1998 gross margins reflecting favorable market conditions.

**Selling and Administrative Expense
% of Net Revenues**



Selling and Administrative Expense. Selling and administrative expense increased by \$23.8 million, or 24.4%, to \$121.3 million in 1998 from \$97.5 million in 1997. Selling and administrative expense decreased \$2.0 million in 1997 from \$99.5 million in 1996. As a percentage of net revenues, selling and administrative expenses decreased slightly to 5.0% in 1998 from 5.1% in 1997 and 9.3% in 1996. Expenses were higher in 1998 due principally to increased levels of sales and marketing expenses and administrative costs associated with the acquisition of K-C Aviation, Inc. Expenses were higher in 1996 due principally

to the level of advertising and marketing expense associated with the certification and initial customer deliveries of the Gulfstream V.

Stock Option Compensation Expense. Non-cash compensation charges related to stock options were \$6.9 million in 1998, \$1.6 million in 1997 and \$7.2 million in 1996. The 1998 expense includes \$5.8 million related to modification of certain prior grants in connection with the retirement of a senior executive during the fourth quarter.

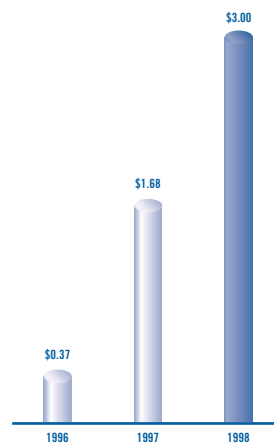
Research and Development Expense. Research and development expense was \$10.0 million in 1998, relatively unchanged from the \$10.8 million incurred in 1997, and significantly below the \$58.1 million incurred in 1996. Research and development expense decreased during 1998 and 1997 from 1996 principally as a result of the substantial completion of the Gulfstream V development program. Research and development expense for 1997 and 1996 are net of credits of \$10.0 million and \$8.0 million, respectively, for launch assistance funds received from vendors participating in the development of the Gulfstream V. Research and development expenditures in 1999 and the near-term future are expected to stem principally from product improvements and enhancements, rather than new aircraft development.

Amortization of Intangibles and Deferred Charges. This non-cash expense includes amortization of goodwill and other intangible assets consisting of aftermarket service, aftermarket product support, as well as deferred financing charges related to the Company's pre-existing and new bank credit facilities. Amortization of intangibles and deferred charges were \$9.3 million for 1998, \$7.3 million in 1997 and \$9.4 million in 1996. The increase in 1998 was a result of additional goodwill amortization directly attributable to the acquisition of K-C Aviation. The decrease in 1997 from 1996 was a result of the accelerated amortization in 1996 of financing charges associated with the Company's prior bank credit facilities, which were repaid in October 1996. Amortization will increase in 1999 as a result of a full year of amortization attributable to the acquisition. See "Liquidity and Capital Resources".

Interest Income and Expense. Interest income decreased by \$4.2 million to \$7.3 million in 1998 from \$11.5 million in 1997. Interest income decreased \$3.1 million in 1997 from \$14.6 million in 1996. The decrease in both periods was a result of lower average cash balances the Company had invested in compared to the previous year, principally as a result cash used for the Company's 1998 share repurchase program and the acquisition of K.C. Aviation. Interest expense consists almost entirely of interest paid on long-term borrowings under the Company's bank credit facilities. Interest expense decreased to \$28.0 million for 1998 from \$31.2 million in 1997. Interest expense increased \$13.3 million from \$17.9 million in 1996. This decrease in 1998 was due to a decrease in average borrowings, as well as lower average borrowing costs of 7.3% in 1998 versus 7.7% in 1997. The increase in 1997 from 1996 was due principally to an increase in average borrowings. See "Liquidity and Capital Resources".

Income Taxes. The Company recorded income tax expense of \$126.7 million for 1998, based on an annual effective tax rate of 36.0% as compared to an income tax benefit of \$33.9 million in 1997. No provision for income taxes was recorded in 1996, principally due to the utilization of net operating loss carryforwards. The Company, in estimating its ability to realize the benefit of its net deferred tax assets, considers both positive and negative evidence and gives greater weight to evidence that is objectively verifiable. As a result of numerous factors including, but not limited to, recent earnings trends and the size of its contractual backlog, the Company currently believes that its net deferred tax asset is more likely than not to be realized. In the third quarter of 1997, the Company released its deferred tax valuation allowance, totaling \$94.2 million. Of this amount, \$29.4 million related to the exercise of stock options and was credited to additional paid-in capital and \$64.8 million, was recorded as a one-time non-cash income tax benefit. During the fourth quarter of 1997, the Company recorded a provision for income taxes based on its overall estimated effective tax rate of 37.5%. The Company's net operating loss carryforward for regular federal income tax purposes at December 31, 1997 was approximately \$65.0 which was fully utilized during 1998.

**Pro Forma (Fully Taxed)
Earnings per Share**



Earnings Per Share. The Company reported diluted net income per share of \$3.00 for 1998 compared to diluted net income per share of \$3.12 for 1997 and diluted net income per share of \$0.60 in 1996. On a pro forma basis, assuming an effective tax rate of 37.5%, the Company's diluted net income per share would have been \$1.68 and \$0.37 for 1997 and 1996, respectively.

Consolidated Statements of Income

	<i>Year ended December 31,</i>		
	1998	1997	1996
<i>(In thousands, except per share amounts)</i>			
Net revenues	\$ 2,427,958	\$ 1,903,494	\$ 1,063,713
Cost and expenses			
Cost of sales	1,907,749	1,557,520	839,254
Selling and administrative	121,294	97,499	99,452
Stock option compensation expense	6,908	1,640	7,186
Research and development	10,030	10,792	58,118
Amortization of intangibles and deferred charges	9,285	7,347	9,434
Total costs and expenses	2,055,266	1,674,798	1,013,444
Income from operations	372,692	228,696	50,269
Interest income	7,280	11,532	14,605
Interest expense	(27,959)	(31,159)	(17,909)
Income before income taxes	352,013	209,069	46,965
Income tax expense (benefit)	126,725	(33,942)	—
Net income	\$ 225,288	\$ 243,011	\$ 46,965
Earnings per share:			
Basic	\$ 3.08	\$ 3.28	\$.64
Diluted	\$ 3.00	\$ 3.12	\$.60

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

	<i>December 31,</i>	
	1998	1997
<i>(In thousands, except for share amounts)</i>		
Assets		
Cash and cash equivalents	\$ 38,149	\$ 306,451
Accounts receivable (less allowance for doubtful accounts: \$2,525 and \$1,144)	263,959	177,228
Inventories	729,874	629,876
Deferred income taxes	17,132	33,795
Prepays and other assets	6,494	11,318
Total current assets	<u>1,055,608</u>	1,158,668
Property and equipment, net	166,777	134,611
Tooling, net of accumulated amortization: \$15,220 and \$7,680	36,415	43,471
Goodwill, net of accumulated amortization: \$11,268 and \$8,433	213,906	38,957
Other intangible assets, net	45,414	50,485
Deferred income taxes	22,011	32,950
Other assets and deferred charges	74,003	14,525
Total Assets	<u>\$ 1,614,134</u>	<u>\$ 1,473,667</u>
Liabilities and Stockholders' Equity		
Current portion of long-term debt	\$ 75,262	\$ 75,000
Accounts payable	182,040	147,618
Accrued liabilities	170,681	93,798
Customer deposits	488,218	546,441
Total current liabilities	<u>916,201</u>	862,857
Long-term debt	285,738	305,000
Accrued postretirement benefit cost	115,154	115,405
Customer deposits — long-term	94,445	88,075
Other long-term liabilities	6,916	9,573
Stockholders' equity		
Common stock, \$.01 par value; 300,000,000 shares authorized; shares issued: 89,818,774 and 86,522,089	898	865
Additional paid-in capital	444,301	370,258
Accumulated deficit	(672)	(225,960)
Accumulated other comprehensive income	(2,441)	(762)
Unamortized stock plan expense	(52)	(1,155)
Less: Treasury stock: 17,244,581 and 11,978,439 shares	<u>(246,354)</u>	<u>(50,489)</u>
Total stockholders' equity	<u>195,680</u>	<u>92,757</u>
Total Liabilities and Stockholders' Equity	<u>\$ 1,614,134</u>	<u>\$ 1,473,667</u>

G98 27

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Note 1 Summary of Significant Accounting Policies

Business

Gulfstream is primarily engaged in the design, development, production and sale of large business jet aircraft. The Company is also engaged in a number of related businesses, including: product support and services for customer-owned aircraft, which include maintenance services and replacement parts for both Gulfstream and non-Gulfstream aircraft, engine and auxiliary power unit service and overhaul, and the sale of pre-owned aircraft. The majority of the Company's aircraft are sold to domestic and multinational corporations and domestic and foreign governments.

Basis of Consolidation and Use of Estimates

The consolidated financial statements include the accounts of the Company and majority-owned subsidiaries, all of which are wholly-owned. Material intercompany balances and transactions have been eliminated in consolidation. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make assumptions and estimates that directly affect the amounts reported in the consolidated financial statements. Significant estimates for which changes in the near term are considered reasonably possible and that may have a material effect on the financial statements are addressed in these notes to the consolidated financial statements.

Revenue Recognition

Contracts for new aircraft are segmented between the manufacture of the "green" aircraft (i.e., before exterior painting and installation of customer selected interiors and optional avionics) and its completion. Sales of new Gulfstream green aircraft are recorded as deliveries are made to the customer prior to the aircraft entering the completion process. With respect to completed aircraft, any costs related to parts to be installed and services to be performed under the contract, after the delivery of the aircraft, which are not significant, are included as cost of sales at the time of the sale of the new aircraft. Sales of all other products and services, including pre-owned aircraft, are recognized when delivered or the service is performed.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid financial instruments which have maturities of less than three months. The Company places its temporary cash investments with high credit quality financial institutions.

Inventories

Inventories of work in process and finished goods for aircraft are stated at the lower of cost (based on estimated average unit costs of the number of units in a production lot) or market. Raw materials, material components of other work in process and substantially all purchased parts inventories are stated at the lower of cost (first-in, first-out method) or market. Pre-owned aircraft acquired in connection with the sale of new aircraft are recorded at the lower of the trade-in value or estimated net realizable value.

Property and Equipment

Property and equipment are recorded at cost and depreciated by the straight-line method over their estimated useful lives ranging from 15 to 40 years for buildings and improvements and four to 20 years for all other property and equipment. The cost of maintenance and repairs is charged to operations as incurred; significant renewals and betterments are capitalized.

Tooling

Tooling is stated at cost and represents primarily production tooling relating to the Gulfstream V aircraft program. Tooling associated with the Gulfstream V is amortized to cost of sales on a unit basis over the first 200 units of the Gulfstream V program.

Intangibles and Other Assets

Goodwill, including goodwill arising from the 1998 acquisition of K-C Aviation, is being amortized using the straight-line method over 40 years. Other intangible assets consisting of aftermarket service and product support (i.e., customer lists) are being amortized on a straight-line basis over the expected useful lives which range from 10 to 21 years. The costs of obtaining bank financing have been included in other assets and deferred charges and are being amortized over the lives of the related bank borrowings.

Research and Development

Research and development expenses are charged directly to operations as incurred.

Product Warranties

Product warranty expense is recorded as aircraft are delivered based upon the estimated aggregate future warranty costs relating to the aircraft.

Customer Deposits

Substantially all customer deposits represent advance payments for new aircraft purchases. The deposits on aircraft that are expected to be delivered in the following year are classified as current in the accompanying consolidated balance sheets.

Concentrations of Credit

Financial instruments which may potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments and trade and contract receivables. Approximately 14.0% and 32.0%, respectively, of accounts receivable outstanding at December 31, 1998 and 1997 are represented by a contract receivable associated with the sale of multiple aircraft to one customer. Generally, contract receivables are satisfied prior to delivery of the outfitted aircraft. In the normal course of business the Company performs ongoing credit evaluations of its customers' financial position, and for trade receivables, generally requires no collateral from its customers. Overall, credit risks with respect to trade receivables are limited due to the Company's large number of customers and their dispersion across many industries and geographic regions.

Income Taxes

Deferred income taxes reflect the impact of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for tax purposes as well as tax credit carryforwards and loss carryforwards. These deferred income taxes are measured by applying enacted tax rates in the years in which the differences are expected to reverse. A valuation allowance reduces deferred tax assets when it is "more likely than not" that some portion or all of the deferred tax assets will not be realized.

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities reflected in the financial statements approximates fair value because of the short-term nature of these instruments. Based on the borrowing rates currently available to the Company for bank loans with similar terms and maturities, the Company estimates that the carrying value of its long-term debt approximates fair value.

Impairment of Long-Lived Assets

The Company periodically assesses the recoverability of assets based on its expectations of future profitability and undiscounted cash flow of the related operations and, when circumstances dictate, adjusts the carrying value of the asset. These factors, along with management's plans with respect to the operations, are considered in assessing the recoverability of goodwill, other purchased intangibles, and property and equipment.

Note 2 Business Acquisition

On August 19, 1998, the Company completed the acquisition of K-C Aviation, Inc. for approximately \$250 million, including acquisition costs. K-C Aviation was a leading provider of business aviation services and the largest independent completion center for business aircraft in North America. In addition to custom aircraft interiors, K-C Aviation was the second largest aircraft engine service center in the United States and offered maintenance services, spare parts, auxiliary power unit service, avionics retrofit, non-destructive testing and component overhaul.

The purchase of K-C Aviation, Inc. was funded primarily from existing cash balances, and due to the timing of the closing of the transaction, also from the revolving credit facility.

The acquisition has been accounted for as a purchase, and accordingly, the operating results of K-C Aviation have been included in the Company's consolidated financial statements since the date of acquisition. The purchase price exceeded the fair value of net assets acquired by approximately \$178 million. In connection with the acquisition, the Company assumed \$51.2 million in liabilities.

The following unaudited pro forma summary presents the combined results of operations of the Company and K-C Aviation, as if the acquisition had occurred at the beginning of fiscal 1998 and 1997. The pro forma amounts give effect to certain adjustments, including the amortization of

goodwill and inventory step-up, reduced interest income from cash utilized to complete the acquisition and the related income tax effects.

The pro forma consolidated results are not indicative of results that would have occurred had the acquisition been in effect for the period presented, nor are they indicative of the results that are expected in the future.

Year ended December 31,	1998	1997
(In millions, except per share amounts)		
Pro forma Net revenues	\$ 2,551.2	\$ 2,090.6
Pro forma Income before income taxes	346.2	198.5
Pro forma Net income	221.6	236.4
Pro forma Earnings per share		
Basic	\$ 3.03	\$ 3.19
Diluted	2.95	3.03

Note 3 Inventories

Inventories consisted of the following at:

December 31,	1998	1997
(In thousands)		
Work in process	\$ 359,212	\$ 330,155
Raw materials	190,890	134,973
Vendor progress payments	85,605	60,606
Pre-owned aircraft	94,167	104,142
	<u>\$ 729,874</u>	<u>\$ 629,876</u>

Note 4 Property and Equipment

The major categories of property and equipment consisted of the following at:

December 31,	1998	1997
(In thousands)		
Land	\$ 4,409	\$ 4,109
Buildings and improvements	133,279	101,836
Machinery and equipment	161,326	130,491
Construction in progress	8,385	9,074
Total	<u>307,399</u>	<u>245,510</u>
Less accumulated depreciation	<u>(140,622)</u>	<u>(110,899)</u>
	<u>\$ 166,777</u>	<u>\$ 134,611</u>

Note 5 Other Intangible Assets

Other intangible assets are comprised of the following at:

December 31,	1998	1997
(In thousands)		
Aftermarket — Service Center	\$ 15,000	\$ 15,000
Aftermarket — Product Support	75,000	75,000
Total	<u>90,000</u>	<u>90,000</u>
Less accumulated amortization	<u>(44,586)</u>	<u>(39,515)</u>
	<u>\$ 45,414</u>	<u>\$ 50,485</u>

Note 6 Income Taxes

The components of income tax expense (benefit) consisted of the following:

Year ended December 31,	1998	1997
(In thousands)		
Current	\$ 63,922	\$ 3,925
Deferred	62,803	26,934
Decrease in valuation allowance	—	(64,801)
Income tax expense (benefit)	\$ 126,725	\$ (33,942)

Although the Company recorded net income during 1996, no provision for income taxes was recorded, principally as a result of utilization of net operating loss carryforwards. The Company made income tax payments of \$4.4 million, \$4.8 million and \$0.3 million for 1998, 1997 and 1996, respectively. The Company's provision for income taxes differed from the amount computed by applying the U.S. federal income tax rate as follows:

Year ended December 31,	1998	1997
(In thousands)		
Statutory federal tax rate	\$ 123,205	\$ 73,174
Foreign Sales Corporation tax benefit	(5,614)	(1,888)
State income tax provision	9,056	1,605
Decrease in valuation allowance	—	(64,801)
Net operating loss carryforwards	—	(43,613)
Other provision adjustments	78	1,581
Income tax expense (benefit)	\$ 126,725	\$ (33,942)

The tax effects of significant components of the Company's deferred tax assets and liabilities are as follows:

December 31,	1998	1997
(In thousands)		
Deferred tax assets related to:		
Postretirement benefits	\$ 43,183	\$ 43,386
Tax credit carryforwards	16,049	7,037
Warranty reserves	12,569	9,199
Net operating loss carryforwards	—	24,500
Intangible assets	—	7,031
Other	7,567	9,114
	79,368	100,267

Deferred tax liabilities related to:

Property and equipment, principally due to basis difference	(14,826)	(17,392)
Inventory	(11,295)	(9,147)
Pension and other employee benefits	(7,648)	(6,236)
Intangible assets	(2,053)	—
Other	(4,403)	(747)
	(40,225)	(33,522)
Net deferred tax assets	\$ 39,143	\$ 66,745

At December 31, 1998, the Company had available tax credit carryforwards for regular federal income tax purposes of approximately \$6.3 million which will expire beginning in 2009.

During the third quarter ended September 30, 1997, as a result of numerous factors, including, but not limited to the Company's earnings trends and the size of its contractual backlog, the Company determined that its net deferred tax asset is more likely than not to be realized, and, released its deferred tax valuation allowance, totaling \$94.2 million. Of this amount, \$29.4 million related to the exercise of stock options was credited to additional paid-in capital and the remainder, \$64.8 million, was recorded as a one-time, non-cash income tax benefit.

The Company is involved in tax audits by the Internal Revenue Service covering the years 1990 through 1994. The revenue agent's reports include several proposed adjustments involving the deductibility of certain compensation expense, items relating to the initial capitalization of the Company, the allocation of the original purchase price for the acquisition by the Company of the Gulfstream business, including the treatment of advance payments with respect to the cost of aircraft that were in backlog at the time of the acquisition, and the amortization of amounts allocated to intangible assets. The Company believes that the ultimate resolution of these issues will not have a material adverse effect on its financial statements because the financial statements already reflect what the Company currently believes is the expected loss of benefit arising from the resolution of these issues.

Note 7 Accrued Liabilities

Accrued liabilities are comprised of the following at:

December 31,	1998	1997
(In thousands)		
Income taxes	\$ 51,615	\$ —
Employee compensation and benefits	36,954	33,245
Accrued warranty	32,017	23,844
Uncompleted work on delivered aircraft	20,798	11,098
Other	29,297	25,611
	\$ 170,681	\$ 93,798

Note 8 Long-term Debt

Long-term debt consisted of the following at:

December 31,	1998	1997
(In thousands)		
Notes payable	\$ 56,000	\$ —
Term loans	305,000	380,000
	361,000	380,000
Less current portion	(75,262)	(75,000)
	\$ 285,738	\$ 305,000

On November 30, 1998, the Company issued notes totaling \$56 million secured by three pre-owned aircraft used as core fleet in the Gulfstream Shares Program. The notes underlying the agreement have substantially

identical terms and are repayable in consecutive monthly installments of principal commencing December 31, 1999 with a final maturity on November 30, 2008; aggregate principal payments for each of the following years are as follows: 1999 – \$0.3 million; 2000 through 2007 – \$3.1 million; 2008 – \$30.6 million. Interest is payable monthly from November 30, 1998 and is based on LIBOR plus 1.4%.

On October 16, 1996, the Company entered into a long-term credit agreement under which the lenders who are parties to the credit agreement made available to the Company a \$400 million term loan facility and a \$250 million revolving credit facility. A portion of the revolving credit facility, in an amount not to exceed \$150 million, may be used (to the extent available) for standby and commercial letters of credit, and up to \$200 million of the revolving credit facility will be available to the Company for borrowings. Concurrent with entering into the credit agreement, the Company repaid all amounts outstanding under its pre-existing credit agreements totaling \$107.7 million, and terminated such agreements.

The term loan is repayable in consecutive quarterly installments with a final maturity on September 30, 2002, in aggregate amounts for each of the following years as follows: 1999 through 2001 – \$75.0 million; 2002 – \$80.0 million. The revolving credit facility expires September 30, 2002 with any outstanding amounts due on that date. The Company is required to pay commitment fees on the average daily unutilized portion of the term loan facility and the revolving credit facility, which fees were initially set at 0.375% per annum. The credit agreement permits the Company to choose either the Adjusted Base Rate (the “ABR”) interest option which is based on the greater of the prime rate or the federal funds rate, or LIBOR, in each case, plus an applied margin. The interest rates and commitment fees are subject to change based on the Company’s performance with respect to certain financial ratios set forth in the credit agreement.

The credit agreement includes restrictions as to, amongst other things, the amount of additional indebtedness, contingent obligations, liens, capital expenditures, and dividends, and requires the maintenance of certain financial ratios. At December 31, 1998, the credit agreement prohibited the payment of dividends. In addition, under the credit agreement, certain changes in control of the Company would cause an event of default and the banks could declare all outstanding borrowings under the credit agreement immediately due and payable. None of the restrictions contained in the credit agreement are expected to have a significant effect on the ability of the Company to operate. As of December 31, 1998, the Company was in compliance with all financial and operating covenants under the credit agreement.

The Company has pledged the common stock of certain of its subsidiaries as well as certain intercompany notes as collateral under the credit agreement, and the Company and certain of its subsidiaries have guaranteed repayment of amounts borrowed under the credit agreement.

The available revolving credit commitment was \$213.6 million and \$203.6 million at December 31, 1998 and 1997, respectively. At December 31, 1998 and December 31, 1997, the Company had outstanding letters of credit totaling \$56.9 million and \$46.4 million, respectively.

The effective interest rate on the Company’s long-term debt at December 31, 1998 and 1997 was 6.2 % and 6.9%, respectively. The Company paid interest of \$29.2 million, \$32.3 million, and \$12.9 million during the years 1998, 1997 and 1996, respectively.

Note 9 Leases

The Company has various operating leases for both real and personal property including Company aircraft. Rental expense for 1998, 1997 and 1996 was \$15.5 million, \$10.9 million and \$13.4 million, respectively. Future minimum lease payments for all noncancelable operating leases having a remaining term in excess of one year at December 31, 1998 aggregated approximately \$40.0 million, and payments during the next five years are: 1999, \$13.0 million; 2000, \$9.6 million; 2001, \$7.0 million; 2002, \$2.1 million; 2003, \$1.4 million. The Company also receives sub-lease rental income under an operating lease which ends November 1999; the approximate future minimum sub-lease rental income is \$2.3 million.

Note 10 Employee Benefit Plans

Pension Plans

The Company maintains four defined benefit pension plans covering substantially all employees. Benefits paid to retirees are based primarily on age at retirement, years of credited service and compensation earned during employment. The Company’s funding policy complies with the requirements of Federal law and regulations. The Company’s total pension fund contributions were \$25.0 million, \$25.0 million, and \$34.4 million in 1998, 1997 and 1996, respectively. Effective August 19, 1998 and as part of the acquisition described in Note 2, the Company adopted a new pension plan, covering all employees of the acquired company and all non-vested employees of the Company except for those covered under a collective bargaining agreement.

Other Benefit Plans

In addition to pension benefits, the Company provides certain health care insurance benefits to retired Company employees and their dependents. The Company currently funds these plans on a pay-as-you-go basis. Substantially all of the Company’s salaried employees and certain hourly employees become eligible for such benefits when they attain certain age and service requirements while employed by the Company. In December 1998, a Voluntary Employees’ Beneficiary Association Trust was established and funded with \$14.3 million of Company funds for the purpose of paying retiree claims. The Company will periodically obtain reimbursement from the Trust for retiree claims.

The Company has supplemental benefit plans covering certain key executives. These plans provide for benefits which supplement those provided by the Company’s other retirement plans.

The following table is based on an actuarial valuation date as of September 30, and amounts recognized in the Company's consolidated financial statements as of December 31. The following provides a reconciliation of benefit obligations, plan assets and funded status of the plans:

	Pension Benefits		Other Benefits	
	1998	1997	1998	1997
(In thousands)				
Change in Benefit Obligation				
Benefit obligation at beginning of year	\$ 255,074	\$ 213,080	\$ 96,788	\$ 87,231
Service cost	17,599	12,466	5,616	4,283
Interest cost	18,842	16,743	7,277	6,820
Amendments	—	—	(2,742)	(879)
Actuarial (gain) loss	41,451	20,470	(34)	1,983
Benefits paid	(7,995)	(7,685)	(3,900)	(2,650)
Benefit obligation at end of year	\$ 324,971	\$ 255,074	\$ 103,005	\$ 96,788
Change in Plan Assets				
Fair value of plan assets at beginning of year	\$ 239,001	\$ 163,598	\$ —	\$ —
Actual return on plan assets	9,164	49,892	—	—
Company contributions	25,000	33,196	3,900	2,650
Benefits paid	(7,995)	(7,685)	(3,900)	(2,650)
Fair value of plan assets at end of year	\$ 265,170	\$ 239,001	\$ —	\$ —
Funded Status of the Plans				
Unrecognized actuarial (gain) loss	\$ (59,801)	\$ (16,073)	\$ (103,005)	\$ (96,788)
Unrecognized prior service cost (benefit)	48,718	(3,900)	(15,472)	(15,839)
Contributions paid in fourth quarter	5,393	5,860	(16,079)	(7,599)
Prepaid (accrued) benefit cost	6,250	6,250	15,168	809
	\$ 560	\$ (7,863)	\$ (119,388)	\$ (119,417)
Amounts Recognized in the Consolidated Balance Sheets Consist of:				
Prepaid benefit cost	\$ 190	\$ 2,453	\$ —	\$ —
Accrued benefit liability	(5,125)	(10,316)	(120,341)	(120,343)
Intangible asset	2,334	—	209	164
Accumulated other comprehensive income	3,161	—	744	762
Net amount recognized	\$ 560	\$ (7,863)	\$ (119,388)	\$ (119,417)

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for the pension plan with accumulated benefit obligations in excess of plan assets were \$20.9 million, \$20.9 million, and \$19.8 million, respectively, as of December 31, 1998, and \$17.0 million, \$17.0 million, and \$17.8 million, respectively, as of December 31, 1997.

Accumulated other comprehensive income represents minimum pension liability adjustments.

Net periodic pension and other benefit costs include the following components:

Year ended December 31,	Pension Benefits			Other Benefits		
	1998	1997	1996	1998	1997	1996
(In thousands)						
Service cost	\$ 17,599	\$ 12,466	\$ 11,258	\$ 5,616	\$ 4,283	\$ 4,162
Interest cost	18,842	16,743	14,966	7,277	6,820	6,581
Expected return on plan assets	(20,442)	(16,385)	(12,950)	—	—	—
Amortization of prior service cost	467	467	313	(873)	(489)	(430)
Recognized actuarial (gain) loss	111	—	—	(400)	(648)	(377)
Net periodic benefit cost	\$ 16,577	\$ 13,291	\$ 13,587	\$ 11,620	\$ 9,966	\$ 9,936
Weighted-average assumptions:						
Discount rate	6.75%	7.50%	8.00%	6.75%	7.50%	8.00%
Expected return on plan assets	9.50%	9.50%	9.50%	—	—	—
Rate of compensation increase	4.75%	4.75%	4.75%	—	—	—