# BOEING

## Jefferies Global Industrials Conference

## August 5, 2020

(The following may contain unintelligible or misunderstood words due to the recording quality.)

SK = Sheila Kahyaoglu, Managing Director, Jefferies
GS = Greg Smith, Executive Vice President of Enterprise Operations, Chief Financial Officer, and interim leader of Communications, Boeing

SK: Welcome to our Industrials Conference. Today we're lucky enough to have Boeing here and Greg Smith with us who is Executive Vice President of Enterprise Operations and Communications. He's Chief Financial Officer of the company, as well. Greg has been CFO since 2011, but he always adds another title to his résumé every time we speak. So with that we'll kick it off into a few Fireside Chat questions. Thank you, Greg, for being here.

GS: No, thanks for having me.

SK: Greg, I guess when we were at the Industrials Conference two years ago today, the biggest issue at Boeing was MAX production rates reaching 52 per month. The world is upside down now, despite a lot of the risk-mitigation measures you put in place over the past decade and a lot doesn't seem quite right. How do we think about the Commercial market recovery? And also it seems like the Commercial jet market will be one that's largely replacement-driven over the next decade or so. What are you hearing from your customers in terms of retirements and some of the replacement needs as they're talking about their fleet?

GS: Yeah. No. It's obviously top of the agenda, Sheila, as we, kind of think about near term, how we're seeing the market and then longer term. And that's all informed by discussions with our customers. And as we discussed last week on the earnings call, having detailed discussions with each of them by model and by time horizon around how they plan to take aircraft and implement them into their fleet and either replace or retire, add to their current fleet over what time frame.

And that's ultimately what has informed our production rates that we outlined last week. So our priority there is gather that and continue that dialogue, but gather that input and dialogue from our customer base around the globe. And it does vary obviously with the pandemic and your own situation as an operator, and then adjust the rates accordingly and swiftly and that's what we did last week. And then I'm sure we'll talk further about the actions we take then to size the company accordingly. But as we outlined last week, we see -- and IATA sees, this kind of taking around three years to return to 2019 levels. And that's all been kind of taken again into consideration on our production rates.

We're seeing things at different paces in different regions. Near term and long term. And on the replacement front, there's about 2,500 aircraft out there that were in active service prior to the crisis. And as of right now I think there's about 30 airlines that have announced a thousand early aircraft retirement. So we're continuing to see that pace. But then when you step back and think about the market over the long term, the airplanes that we plan to deliver here and have been delivering are about 25 to 40 percent more fuel efficient than what they're replacing. So the economics tied to these assets continue to be very compelling. So our job, continue to stay engaged with the customer and continue to understand their fleet plans and work with them and then work within our skyline, our production rates to meet that demand. And then immediately, like I said, continue to right-size. And in sizing to the new baseline and we've taken a lot of action in that area, as you know, focused on liquidity and discretionary spending and this is all about cash through this challenging period and managing your cash very closely. At the same time we're not losing sight of the future and the market dynamics as we see them going forward continue to be attractive. So we're continuing to make investments. Last year about $5 billion in Cap Ex and R & D and $2 billion year to date. And have we sharpened our pencil on all that? Absolutely. In delaying some things and refining some of those investments again with a keen eye towards liquidity. But we're continuing to fund the key franchise that we've got in the pipeline: the 777X, 737-10, Starliner and so on, and making the right investments in technology and efficiency and just not losing sight of the long-term attractiveness of this business and the long-term competitive position we want to be in.

So this is about getting through this window and being clear-eyed about the market, being clear-eyed around the risks and how do you get ahead of it and how do you mitigate it and position ourselves for the future to come out of this and come out of this strong. And that's exactly what we're focused on.

SK: Sure. And then on the 737 MAX, you recently completed the FAA cert test flights and there's a public comment period. How do we think about the next major milestones, and when do you expect certification around return to Commercial service?

GS: Yeah. The steps from here. Your point, I mean, the cert flight and certainly the notice of proposed rule-making in that comment period are critical milestones. But like we said on the call, we've got more work in front of us. The really steps from here are the Joint Operation Evaluation Board, the JOEB, where they'll review the proposed training and then the final flight standardization board. And then lastly the final design documentation. And those are kind of the next big milestones. Of course, the timing of all this is ultimately determined by the regulators, and they're doing a tremendous job leading and stepping through this process. And in, let's face it, a very challenging time with the pandemic. And, look, our job is make sure that we are responding in a timely manner and providing them with everything and anything they need to complete their work, and that's going to be the focus from here out and will continue to be until we have full return to service, which again, we're planning on the fourth quarter. But again, they'll ultimately determine that timing.

SK: And then how does all that play into your production rate on the MAX as well as delivery rate? You discussed on the last call you want to deliver a majority of the 450 aircraft out of inventory by the end of 2021.

GS: Uh-huh.

SK: How do you think about accomplishing this, you know, airlines intake, and then additionally, can the market absorb a production rate of 31 aircraft per month in 2022? Your thoughts on how you're managing the backlog given some cancellations we've seen.

GS: Yeah. Yeah. No, it's, again, very topical, as you could imagine. The detailed discussions with the customers on that 450 and how we go about delivering them, the sequencing and then the quantity over a period of time. That's what we laid out last week, was that being informed by our customer. The change that we've made in the delivery profile and the rate ramp is all COVID related. So that's our latest assessment from our customers.

So job one will be first and foremost, help once we get return to service -- help our customers get their fleet up. And then we'll quickly move to the airplanes that are in inventory. And as you said I mentioned last week, we've got a schedule that has the majority of those delivering this -- at first, as a first priority, once we get the grounding lifted and into '21. And that'll continue to be the focus and the priority. I'd say, we've got some flexibility in there. There is -- again, there's 450 aircraft that are complete. And the teams have, again -- in the spirit of risk mitigation and streamlining, have just been practicing bringing airplanes out of storage and simulating deliveries to customers to just work through any potential issues we may have. So I think they've done a great job in coordinating obviously hand in hand with the FAA about how we'll go about that delivery sequence. All of that has been kind of laid into our plans.

But like I said, there's flexibility in there if we need to move customers around or need to revise the quantity. We can do that with that parked fleet. How successful we are with that will ultimately inform our rate ramp. So we've got a baseline schedule in there, as you said. The environment will certainly be the first thing that'll inform the rate increase, but then it'll be how we're doing on depleting the inventory off that ramp. We don't want to put more product on the ramp. So how successful we are in doing that and our customers' ability to take the aircraft and then how they see their fleet plans from there, again, that'll continue to inform our rate increases from here forward. And look, while we've been down, I think I've mentioned it before, we've had a real focused effort in the factory to really look for opportunities to enhance the system overall from a productivity perspective and a productivity perspective and eliminate traveled work and increase first-time quality and predictability that we feel really good about. It's going to serve us well on the ramp-up and ultimately serve our customers very well as we deliver the airplanes to them.

SK: And then just on that last topic, with regards to the supply chain flexing up and down.

GS: Uh-huh.

SK: How much does the supply chain play into your rate-setting, and is there a minimum rate where you can achieve the most productivity while keeping the supply chain healthy from a work perspective? Maybe that's most relevant for the MAX. And then additionally, given your current production rates, it seems like production for all of BCA has exceeded deliveries of late and that will continue throughout most of 2020. How do we think about the total number of aircraft in inventory across platforms, and is there a crossover point where those aircraft will be delivered and deliveries and production align?

GS: Okay. I'll try to answer the first one, and then if I forget what your second one was you can remind me. But I think on the supply chain, absolutely big focus. They're an extension of our factory. Let's face it. The market has had a real sharp turn here. And we've all adjusted on the production rate side, including the supply chain. So keeping them informed of how we're seeing the market and how we're adjusting and again, trying to get ahead of it with them and trying to help them get sized accordingly will continue to be a big focus for us.

With regards to inventory -- and particularly on the MAX, as you know, there's plenty of supply chain inventory out there. So that will not be a constraint as we come up. It'll be burning off that inventory. The focus for us has been and will continue to be supply chain health. Through COVID, through the reduction of the production rates and, how do we help and support them to allow for smooth recovery on the other side. We've got roughly 12,000 suppliers. For every dollar we spend, 70 cents goes to the supply chain, and we've continued to fund the supply chain through this pandemic to keep them healthy. At the same time help them with third-party financing or any other financial support or government aid that may be available to them to help bridge them. That I think ultimately will be critically important to our industry and to our economy that they're prepared on the other side and we get them through this period. So supply chain health, supply chain liquidity, and I'll say adjusting to the new rates will continue to be a big focus area for us with that long-term objective, keeping that in mind.

SK: And then just on the second part, when do deliveries and inventory align on the remaining platforms?

GS: Yeah. Yeah. So you're right. I mean, we talked last week that we've got a little bit of a mismatch as we're helping customers navigate through COVID and moving deliveries off of what the baseline schedule was and having completed airplanes and then -- but the production rate continuing. So you're going to see that continue into this year and then a little bit into next year, and then it'll start to, I'll say, true up a little bit more in '21.

SK: Great. And then on the MAX unit margin going forward, how do we think about that?

GS: Uh-huh.

SK: There's a few cash impacts with the customer concessions, around 6.7 billion. And then abnormal production costs adding up to 3.5 in total.

GS: Yeah. Look, the biggest enabler there is deliveries and rate associated with it. So as you know, we deliver those inventoried aircraft and then start to move up production again it'll be very methodical and slow at -- with a keen eye towards stability and health. We'll continue to do that. And all of that is ultimately going to bring that unit margin or cash profile of the 737 MAX back up. So it's purely, I'll say again, delivery and rate related. And then there's a burn-off of progress payments that we've talked about that we have at the higher rate. But then as you move into '22 and '23 time frame, the progress payments start to be more normalized tied to rate increases. But essentially those are the key drivers of MAX unit margin and ultimately MAX cash flow.

SK: Great. And then I just want to step back more broadly within BCA. You had a good margin trajectory prior to COVID and some of the MAX issues with margins close to 15 percent. How do we think about the ability to drive productivity going forward, and what are the keys to getting back to that point and pushing margins higher?

GS: Yeah.

SK: And I guess what are new normalized margins that we should think about?

GS: Yeah. I think certainly this is -- MAX and then now COVID has certainly made it a lot more challenging for us but we're facing into it. And it really gets to getting the right production rates aligned and moving swiftly with those and then getting sized appropriately. And that's all going to contribute to the overall cash profile. BCA keeping a close handle on the period expense. And again, all elements of spending.

But I would say the biggest driver going forward is once again MAX. Getting MAX back up and then that rate increase. Getting 777X transitioning from development to production and positive cash flow, that'll begin in '22, will also be a key enabler. And then on the 787, like I mentioned on the call, despite a significantly lower rate on a unit margin perspective, ultimately cash, the program is maintaining a very healthy rate through that period considering that drop in volume. And that just really goes to a lot of the hard work that's been done by the collected team between Seattle and Charleston of focusing on efficiency on the program and then the supplier participation in that and certainly the model mix. But again, those are really, I'd say, the key drivers or key elements to get us to, what I would consider a more normalized margin rate coming out of COVID.

SK: I want to delve into that a little bit more in terms of the cash profile on the wide body so a few-part question.

GS: Uh-huh.

SK: First let's start on the 777X. I think we have about a billion dollars of cash usage this year. You talked about it being cash positive in '22. So at a lower rate, how do we think about the 777X cash profile?

GS: Yeah. So that's all been kind of factored into our dialogue. And again, it's more of a drag on cash flow that we outlined with the lower production rate and move EIS than it was prior quarter. But when I talked about a path to positive cash, that's all taken into consideration. And so we've got that all kind of laying in there at those lower rates. But to your point, the big movement on X is going to be, getting it certified and then moving out of development and into production and then starting to bring that rate up. That'll ultimately -- all those things will be ultimately the key drivers on cash on the wide-body side. And then I talked about the 87. Not to say there isn't more opportunity and more work to do. There certainly is. But you know, one of the things that we talked last week is going through the evaluation on sites, and we'll continue to do that. And again, put that all under the umbrella of needing to size yourself to the new rate. But also not losing sight of the fact that the rate as the market will demand and certainly indicates, the rates will come back up. So don't lose sight of that while we're trying to optimize the program.

And you're going to see more of this Sheila, as we talked about on the call around positioning ourselves for the future. We're just trying again to be very clear-eyed around infrastructure and sites and looking for opportunities to be more efficient and up our utilization. Overhead and org structure. I know we talked earlier on G&A and others, but we're again reassessing all of that. Our portfolio. What portfolio do we have today that we're offering, and how do we see that post-COVID, and how do we be sharper, I'll say, and focused on our investments in that area. And then supply chain health we talked about on stability and then operational excellence. So this is just blocking and tackling. This is like I talked about on the 737. Not having traveled work, first-time quality. First-time quality in the supply chain. Looking for opportunities to streamline, enhance kitting. Enhance standard work in the factories. And ultimately, again, all falling under the umbrella, first-time quality in all elements of what we do.

Operational excellence will continue to be a big lever in our company. And sharing best practices. Taking things off F-18, bringing them to 787 and vice versa. We're seeing that and seeing really good indications of that. And there's some great work going on around the company that I would consider top quartile that we haven't fully capitalized on yet across the company. And we're going to double down on that, as well. So it's a full-court press that is certainly focused on cash but continuing to make solid investments in the future and really, again, positioning ourselves to come out of this healthy and really position us for the marketplace of the future.

SK: And just putting all that together on the 787 specifically, outside of advances --

GS: Uh-huh.

SK: -- given rates going from 14 at a peak down to 6, how do these offsets factor into the cash profile of the aircraft?

GS: Sorry. I wasn't quite tracking. What do you mean by offsets?

SK: You talked about operational excellence.

GS: Yeah.

SK: So is that what helps drive your cash profile to, you know, potentially be --

GS: Sure.

SK: -- similar to when you were at a 14 production rate.

GS: Yeah. Yeah. Certainly it does, yeah. We've got a productivity element laid into our plans that we're solidifying across the organization that will play into that. But look, the objective is to advance as much of that as possible. But be prudent about it, but also be strategic about it as you think about the long-term kind of marketplace that we still see as attractive and we want to make sure again we're positioned for that. But all this operational excellence or infrastructure overhead, we're looking for sustainable change there. And across the board. And this is an opportunity to challenge all aspects of the the business and ask ourselves are these -- is there a better way to do this? Is there a more efficient way to do it? Keeping a keen eye on the competitive environment and the world post-COVID. Again, we want to be positioned for strength coming out of this. Right now it's getting through this period, and cash will continue to be king, and we'll manage that very tightly but smartly, as well, and stay ahead of it on liquidity actions.

SK: Great. And then just switching gears a little bit, how do we think about the market changes and how BA shifts its investment in terms of the Next Generation aircraft. It seems a lot of the focus has always been on safety but is more focused on safety now versus new platforms, which is quite understandable. You spent a lot of time on the NMA.

GS: Yeah.

SK: What's next for BA in terms of balancing your portfolio in a fairly constrained spending environment?

GS: Yeah. No, look, we've not lost sight on the importance of making investments that are critical to the future of the business, for sure. That certainly includes investments in safety and quality and the operational excellence and aspects around our people and key technologies. You know, whether -- and factory enhancements and end products.

As you know, we've got a lot in the pipeline on current development around the X and then the 737-10 and the Starliner. And with regards to I'd say a future product strategy, we're continuing to reprioritize and streamline our investments on R & D and Cap Ex as I mentioned. But we've asked the team to step back and reassess our Commercial product development strategy and determine a family of airplanes that we think will be needed in the future. And the team has been building on the work through NMA and the whole production system that we've talked about in that analysis. But look, we'll continue to evaluate the product strategy in this obviously very dynamic environment and remain mindful what's happening on the competitive landscape. So like I said, we haven't lost sight of it and we won't. And we'll make the right investments at the right time to maintain a competitive advantage with the product offerings that we have.

SK: And then I wanted to touch upon the Services portfolio. How do we think about the impact of COVID on Services? Does it drive more power by the hour, or are there more notable shifts given airlines are in cash conservation mode?

GS: Yeah. Well, look, this is -- this is where you certainly appreciate a balanced portfolio and within the growth that we have on the government side of the business and all aspects whether support international customers or domestic and training, logistics, supply chain and so on. But on the near term it has just been about focusing on adjusting to the new market realities. And as you know, Services is usually, the first thing to be impacted when an airline is -- whether they're grounding fleet or slowing down their gross trajectory it services. So you've got to act fast.

And the team's acted fast to face into what they think is the near-term market, but also again, not losing sight on the long term. So Ted and the team have been doing a great job of providing Dave and I weekly updates on what they're seeing in the market and how they're adjusting accordingly. And that's part of our operating rhythm. But like I said, we get that sized right. On the other side of it, we've got to continue to support, the growth on the government side of the business which we're continuing to do. So we'll see how it all plays out, Sheila, on the Commercial side.

But, we're taking the lead in the customer and being, again, clear-eyed on what they're telling us and what we think, how long it'll take to kind of bring fleets back up and how many of those will be an opportunity on the Services side of the business and how many of those essentially were retired. So we're continuing to assess that on a regular basis.

SK: And then just moving on to free cash flow, you know, 2021 free cash flow, in my view, is driven largely by inventory unwind on the MAX and the 787s.

GS: Uh-huh.

SK: How do we think about a relatively cleaner 2022 free cash flow profile with that inventory unwound and out of the way?

GS: Yeah. It's certainly 777X EIS and that delivery profile that we talked about that'll be a driver from '20 to '21. The 37 profile we discussed will be another element. And then we're projecting slight improvement on the Commercial Services side.

And then I think of Defense as moderate growth with a conversion rate essentially equal to earnings. So that's kind of what we see as the path. Obviously as we sit here today it's dynamic, to say the least, and we're continuing to really carefully monitor cash and perform scenarios. So we've got the baseline plan we talked about last week. But we are running scenarios and have for quite some time on a more severe downside or stress case. And just again, this has treated us well, this discipline. Getting ahead of it. And not just looking at a baseline plan and an improved plan, but looking at more dire situations and what would you do and how would you get ahead of it and really, again, proactive management around ultimately what is liquidity . So that's kind of how we see the path from '20 to '21, ultimately '22. But again, it's dynamic. We'll continue to keep you up to speed, and we'll continue to face into the market with a clear line of sight. And then all full court press on positioning ourselves for the future.

SK: And just one last quick one for you in terms of debt. You most recently took on an additional 25 billion.

GS: Uh-huh.

SK: Whether it's capital deployment priorities or -- what's the proper level of deleveraging before returning back to the markets, in your view?

GS: Yeah. Well, look, as you said, in mid March, we advanced our bank loan of 13.8, which some would have at the time maybe viewed early. We viewed it as trying to be prudent. And then issuing the 25 billion to ensure that we had appropriate liquidity to get through this period. And I give tremendous credit to the administration and to Treasury, to the feds for opening up the debt market. This wouldn't have been possible without that. So the fact that they did, we were able to successfully go in, certainly gave us a strong foundation.

As you see it kind of -- as I mentioned last week, we don't see a need at this time to obtain more liquidity through additional debt offering. But we're continuing to keep all our options open. And will through this. Just due to the fact that it is dynamic. When we come out the other side, as I mentioned, priority one, pay down the debt. And continue to make the investments, pay down the debt. That will remain our priority. As we continue to make progress and ultimately see how we are with cash generation, what's the market telling us at this time? That'll ultimately inform our longer-term, I'll say, leverage, as well as deployment.

We've not certainly lost sight on our long-term objectives around a balanced deployment. But we're a ways away from that. So if we can accelerate that or the market frankly dictates that we can accelerate that, we'll certainly readdress how we deploy. But job one will be, we've gotta get the balance sheet back in order as soon as we can, and that really, again, plays into this whole positioning for the future. All those actions I mentioned combined with the day-to-day, I'll say cash management, all of those is ultimately trying to get us to a better position on the rate of return on cash and then focus on getting balance sheet back in order and then deploy from there.

SK: That's perfect. Thank you so much.

(CONCLUSION OF SESSION)

Transcribed by: slw/slw