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The Boeing Co. (BA)

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to The Boeing Company's fourth quarter 2018 earnings conference call. Today's call is being recorded. The management discussion and slide presentation plus the analyst and media question-and-answer sessions are being broadcast live over the Internet.

At this time for opening remarks and introductions, I will turn the call over to Ms. Maurita Sutedja, Vice President of Investor Relations for The Boeing Company. Ms. Sutedja, please go ahead.

Maurita B. Sutedja

Vice President, Investor Relations, The Boeing Co.

Thank you and good morning. Welcome to Boeing's fourth quarter 2018 earnings call. I'm Maurita Sutedja, and with me today is Dennis Muilenburg, Boeing's Chairman, President and Chief Executive Officer, and Greg Smith, Boeing's Chief Financial Officer and Executive Vice President of Enterprise Performance & Strategy. After management's comments, we will take your questions. In fairness to others on the call, we ask that you please limit yourself to one question.

As always, we have provided detailed financial information in our press release issued earlier today. And as a reminder, you can follow today's broadcast and slide presentation through our website at boeing.com.

Before we begin, I need to remind you that any projections and goals we include in our discussions this morning are likely to involve risk, which is detailed in our news release, in our various SEC filings, and in the forward-looking statement disclaimer at the end of this web presentation. In addition, we refer you to our earnings release and presentation for disclosure and reconciliations of non-GAAP measures that we use when discussing our results and outlook.

Now, I will turn the call over to Dennis Muilenburg.

Dennis A. Muilenburg

Chairman, President & Chief Executive Officer, The Boeing Co.

Thank you, Maurita, and good morning. Let me begin today with a brief overview of our 2018 operating performance, followed by an update on the business environment and our expectations going forward. After that, Greg will walk you through the details of our financial results and outlook.

With that, let's move to slide 2. Thanks to the dedicated efforts of our teams across the company, Boeing delivered strong 2018 financial results that included record revenue, earnings per share, and operating cash flow, driven by record commercial aircraft deliveries, higher Defense, Space & Securities and services volume, and strong performance, and all of our three businesses increased their backlog in 2018.

We sharpened our focus on profitable, sustained long-term growth strategies, disciplined execution of our production and development programs, delivering greater life cycle value, including growing our services business, and driving further quality, safety and productivity gains across the enterprise.

For the full year, we generated record operating cash flow of $15.3 billion. We repurchased 26.1 million shares for $9 billion and made dividend payments totaling $3.9 billion in 2018. We continue to deliver on our commitments to returning cash to shareholders while investing in our people, innovation, and future growth. In December, our Board of Directors authorized a new $20 billion share repurchase program and a 20% increase in our quarterly dividend. The increases are part of our balanced cash deployment strategy and reflect the confidence we have in our strong lineup of products and services and our long-term outlook for the business.

Turning to our core operating performance for the year, Boeing Commercial Airplanes [BCA] generated revenue of $60.7 billion, reflecting a record 806 deliveries, including the delivery of the first 787-10 Dreamliner and the first 737 MAX 9. During the year, we delivered 256 MAX airplanes, nearly half of the total 737 deliveries. Continued healthy sales activity contributed to 893 net new airplane orders during the year, adding to our robust backlog that stands at nearly 5,900 airplanes and is worth $412 billion. Our backlog equates to about seven years of production at current rates.

Key Commercial Airplane milestones in 2018 included the delivery of the 787th 787 Dreamliner and the first airplane from the new 737 completion center in China. The 737 program increased its production rate to 52 per month and made good progress on its recovery plans to mitigate supply chain challenges, with 173 aircraft delivered in the fourth quarter. Also in the year, we completed the first flight of the 737 MAX 7 and delivered the first MAX Boeing business jet airplane.

The 777X program achieved a number of key milestones last year, as we rolled out the static test airplane and began production of the flight test airplanes. We recently completed final body join for the first flight test airplane and turned on its electrically powered systems. We plan to start flight testing this year and remain on track for the first 777X delivery in 2020.

Meanwhile, the 787 program further matured its rate readiness. We have started transitioning to 14 per month in our factories and supply chain, as we prepare to begin delivering at this higher rate. We expect to complete the transition in the second quarter.

Now over to Defense, Space & Security, BDS reported revenue of $23.2 billion, 13% growth year on year, reflecting higher volume across its business. BDS booked $36 billion of new orders during the year, including wins on important new franchise opportunities, like the T-X trainer, the MQ-25 unmanned aircraft, and the MH-139 helicopter. More recently in the fourth quarter, BDS was awarded contracts to modernize the entire Spanish Chinook helicopter fleet and a joint ground system to provide tactical satellite communications for the U.S. Air Force.

BDS made progress on a number of critical program milestones, including delivering the first two KC-46 tankers to the U.S. Air Force earlier this month. Two more tankers have been accepted by the Air Force, and we expect to deliver these aircraft imminently. We look forward to working with the Air Force and the Navy during their initial operational tests and evaluation of the KC-46, as we further demonstrate the operational capabilities of this next-generation aircraft across refueling, mobility, and combat weapons systems missions. Additionally, we received a contract to provide a second KC-46 international tanker to Japan. This highlights the broader demand and market opportunity that we see for this program.

Other key operational milestones for BDS included the unveiling of the SB>1 DEFIANT helicopter Boeing and Sikorsky are developing for the U.S. Army's Joint Multi-Role Technology Demonstrator program and completing another Minuteman III flight test.

We continued to ramp up the activities for THE T-X and MQ-25 programs. These wins are the culmination of years of unwavering focus, improving our technology, and derisking the programs. We have developed and flighttested two all-new production-ready T-X jets, with 76 flight tests having being completed to date. We've already seen strong interest as well for the T-X from outside of the U.S. On MQ-25, we have demonstrated deck handling and engine trials. Our MQ-25 prototype aircraft is currently in ground tests and expected to undergo first flight this year.

Now turning to Global Services, BGS reported revenue of $17 billion, representing 17% growth year on year. Since its operations began in July of 2017, BGS growth has consistently outpaced the average for the services market. BGS continues to win new business, highlighting the value we bring to our broad range of commercial and government customers and the strength of our One Boeing offerings. BGS booked new orders totaling approximately $18 billion in 2018. The awards included support services and sustainment contracts for military customers globally, such as the recent C-17, F-18, and F-22 contracts with the U.S. Navy and Air Force and F-15 for Qatar.

In addition to the strong momentum in its parts and supply chain business, BGS continues to expand its market-leading digital solution portfolio and customer base. In the fourth quarter, more than 5,300 commercial and military aircraft were monitored in flight by Airplane Health Management, a cloud-based real-time health monitoring solution.

Adding to the list of our digital analytics customers, Shenzhen Airlines recently signed up for crew pairing and rostering services. Shenzhen will be the first airline in China to use Boeing AnalytX-powered crew management solutions, bringing the most advanced data analytics capabilities to the airlines, allowing them to focus on their core business of serving their customers while improving efficiency and cost.

In the fourth quarter, we also completed acquisition of KLX, a major global provider of aviation parts and services. Boosting our supply chain capability enables us to better serve our customers while profitably and purposefully growing our business. Our integration activities continue to progress well. We've retained top KLX talent and are on track to achieve or exceed our business case synergy value.

Additionally, last year we started operations for our airplane seat joint venture with Adient and auxiliary power units joint venture with Safran. These partnerships support Boeing's vertical integration strategy to strengthen in-house capabilities and depth in key areas to offer better products that deliver greater value to our customers, grow our services business, and generate greater life cycle value.

We have also made progress in our strategic partnership with Embraer. We've recently received approval by the government of Brazil and signed definitive agreements with Embraer. The Embraer shareholder vote, scheduled for February 26, is the next major milestone. Over the coming months, we'll continue to work with Embraer, global regulators, and other stakeholders to complete the transaction and create the most important strategic partnership in the aerospace industry. Assuming the approvals are received in a timely manner, we expect to close the transaction by the end of this year.

In summary, we delivered another year of strong operating performance, captured noteworthy additions to our large and diverse backlog, returned significant cash to our shareholders, invested in our people and our business to drive innovation and excellence, and complemented our organic growth with planned strategic inorganic investments.

With that, let's turn to the business environment on slide 3. We continue to see healthy global demand for our offerings in commercial, defense, space, and services. These are sizable sectors that are growing and backed by strong fundamentals, with a combined market opportunity of $8.1 trillion over the next 10 years.

I would note that as a global company with customers in 150 countries, we are always mindful of the potential impact of geopolitical and macroeconomic forces. We continue to track a host of near-term issues and mitigate potential risks as appropriate. We value and maintain strong relationships with our customers, suppliers, and other stakeholders around the world, reinforcing the mutual economic benefits of a strong and prosperous aerospace industry.

In commercial aviation, global passenger traffic continues to grow faster than GDP and long-term trends. For 2018, passenger traffic grew 6.6% through November, representing the ninth straight year of above-trend growth. We believe the changing nature of travel with more connected city pairs and a rising middle class has fundamentally expanded traffic patterns and supports sustained growth. At the same time, airlines are maintaining capacity discipline, keeping supply and demand in balance, as industry profitability remains near historic highs.

Meanwhile, air cargo continued its solid momentum in 2018, with traffic increasing nearly 4% through November. Our customers continue to recognize the superior value proposition of our more fuel-efficient airplanes, as reflected in the strong intake of new orders we saw last year. For 2019, we expect to see our new order intake to be moderated but still at a healthy pace.

Our sales expectations are built on the diverse demand that we're seeing around the world and across airline business models. There also is more balance between airplanes purchased for fleet growth and replacement, leading to more stable purchasing patterns. We believe the evolution in these key market dynamics in aggregate continues to drive less cyclicality for our industry.

Over the long term, we remain highly confident in our outlook, which forecasts demand for nearly 43,000 new airplanes over the next 20 years, which will help double the size of the global fleet. These long-term demand fundamentals combined with healthy market conditions and a robust backlog provide a solid foundation for our planned production rates.

Now turning to our product segments, starting with the narrow-body, our current production rate of 52 per month and planned increase to 57 this year is based on our backlog of more than 4,700 aircraft and a production skyline that is sold out into early next decade. The 737 program added 13 new customers during the year, and the MAX family surpassed 5,000 net orders in December. We continue to assess the market upward pressure on the 737 production rate. As with all rate increases, we continue to assess the supply chain readiness as well as the market demand in an integrated manner as part of our disciplined decision-making.

In the wide-body segment, we have seen steady orders for the 787 and the 777 and have high confidence in a meaningful increase in wide-body replacement demand early next decade. The current-generation 777 continued its steady sales momentum with 51 net orders. The 777 program has captured more than 2,000 orders since its launch. These additional orders brought the backlog to 100 aircraft and provide further support for the 777 bridge.

Turning to the 777X, we recently launched our Boeing business jet variant, the longest-range business jet ever that can connect virtually any two cities in the world. We have a strong foundation of 340 orders and commitments for the 777X, which support our plan for ramping up production and delivery of this new aircraft. We are focused on further bolstering the 777X skyline. The combined 777/777X production rate is five per month. As we transition to 777X, we continue to expect the delivery rate to be approximately 3.5 aircraft per month in 2019, and we expect the delivery rate to increase slightly in 2020 as we continue to assess 777 demand as well as 777X timing.

The 787 Dreamliner extended its status as the fastest-selling twin-aisle jet in history, with 109 net orders last year or more than 1,400 since the program launched. Highlights include Hawaiian Airlines and Turkish Airlines becoming new 787 customers. American Airlines and United Airlines added to the growing list of repeat 787 Dreamliner customers, highlighting the strong market preference for the 787 family and its superior value. With more than 600 in the backlog, our plan to increase Dreamliner production to 14 airplanes per month this year is well supported.

Turning to our 747 and 767 programs, with our unmatched freighter product lines, we are well positioned to capture the increased cargo demand. We added four new orders for the 747 in the fourth quarter. And as previously announced, we plan to increase 767 production rate from 2.5 per month to 3 per month in 2020.

At Defense, Space & Security, we continue to see solid demand for our major platforms and programs. The BDS portfolio is well positioned with a mature world-class set of platforms to address current needs and innovative, capable, and affordable new franchise programs to build the future.

We expect to continue to see broad support for our products from the Pentagon and Congress. Fiscal year 2019 Defense bills authorized support, multiyear procurement for the F-18 fighter, added funding for additional rotorcraft, funded the requested quantities of our key programs across our fixed-wing and commercial derivative aircraft portfolios, and supported our missile, space, and satellite products. While the fiscal year 2019 NASA appropriations have not yet been enacted, Congress has also demonstrated robust support for our key space exploration programs. Demand from outside of the U.S. for our Defense and Space offerings also remains high, in particular for rotorcraft, commercial derivatives, fighters, and satellites.

Our investment in future growth and new sales continues in areas that are priorities for our customers. We will continue to leverage capabilities and technologies from across our enterprise to win important opportunities such as the ground-based strategic deterrent.

Turning to the services sector, we see the $2.8 trillion services market over the next 10 years as a significant growth opportunity for our company. BGS provides agile, cost-competitive services to our customers worldwide. We aim to continue growing faster than the average services market growth rate of 3.5%, as we further expand our broad portfolio of services offerings and continue to gain market share.

BGS's 17% year-on-year revenue increase solidifies our confidence in the growth opportunity and our team's ability to capture it. Strong orders of $18 billion in the year reflect our customers' recognition of our value proposition in helping them optimize the performance of their fleets and reduce operational costs through the life cycle.

Our focus for BGS remains on optimizing the business and expanding our portfolio offerings through organic growth investments, such as strengthening our vertical capabilities complemented by strategic acquisitions and partnerships, position BGS for sustained long-term and profitable growth. Our expertise, the global reach of our business, and our strong customer partnerships have us well positioned to compete and win in this important sector.

In summary, with growing markets and opportunities ahead, our team remains intensely focused on growth, innovation, and accelerating productivity improvements to fuel our investments in the future. For example, the first test flight of our autonomous passenger air vehicle prototype last week shows our efforts to continue to lead with a safe, innovative, and responsible approach to new mobility solutions. Our One Boeing strategy and offerings across our three businesses are key differentiators that help cement our position as the world's leading aerospace company.

With that, Greg, over to you for the financial results.

Gregory D. Smith

Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

Great. Thanks, Dennis. Good morning, everybody. Let's turn to slide 4 and we'll discuss our full-year results.

We booked record revenue of $101 billion in 2018, exceeding $100 billion for the first time in the company's history. This was driven by record commercial aircraft deliveries, higher Defense, Space & Security volume, and continued growth in Services. Core earnings per share totaled $16.01 for the full year, another record, reflecting higher volume, improved mix, and solid execution across the company. Operating cash flow for the year was also a record at $15.3 billion. The robust cash generation was largely driven by higher volume and strong operating performance across the businesses.

Let's move now to our quarterly results on slide 5. Fourth quarter revenue increased to $28.3 billion, driven by growth in all three businesses, while core earnings per share grew to $5.48, driven by higher volume and strong operating performance across the portfolio, which outweighed the favorable tax reform impact in the fourth quarter of last year.

Now let's discuss Commercial Airplanes on slide 6. Our Commercial Airplane business revenue of $17.3 billion during the quarter reflected higher deliveries and favorable mix. BCA operating margins increased to 15.6%, driven by higher 737 volume and strong operating performance on production programs, including higher 787 margins.

BCA captured $16 billion in net orders during the fourth quarter, and the backlog remains strong at $412 billion with nearly 5,900 aircraft, representing approximately seven years of production. We delivered 238 aircraft in the quarter, including 173 737s. And as we've discussed, the 737 deliveries for the year were back-loaded due to production and supply chain recovery efforts.

Let's now turn to Defense, Space & Security results on slide 7. Fourth quarter revenue increased to $6.1 billion, driven by higher volume across the BDS portfolio, including F-18, satellites, and weapons. BDS margins increased to 10.9%, reflecting solid performance and favorable mix. BDS added $5 billion of new orders in the quarter, bringing its backlog to $57 billion, with 30% of that from outside the United States.

Turning now to Global Services results on slide 8, in the fourth quarter, Global Services revenue increased to $4.9 billion, reflecting higher volume, predominantly driven by increased sales of parts and supply chain solutions. Year-over-year growth of 17% for the full year, which was predominantly driven by organically, more than meets our objective to outpace the average annual service market growth rate of 3.5%.

BGS operating margins were strong at 15%, reflecting the mix of products and services in the quarter as well as improved performance, partially offset by higher period costs for investments focused on expanding our portfolio of offerings going forward.

During the quarter, BGS won key contract awards worth approximately $6 billion, bringing our backlog to $21 billion. These wins underscore the strength of our One Boeing offerings to our customers.

Let's turn now to cash flow on slide 9. Operating cash flow for the quarter and full year was strong at $2.9 billion and $15.3 billion respectively. These results were driven by planned higher volumes, strong operating performance across the business, and some timing of receipts and expenditures.

We remain focused and on track with our balanced cash deployment strategy. In 2018, we invested $5 billion in R&D and CapEx, repurchased $9 billion of Boeing stock, and paid $3.9 billion in dividends, reflecting a 20% increase in dividend per share from last year. And we also completed the KLX acquisition in the fourth quarter.

The strength of our business and our confidence in the sustainable long-term outlook are powering investments in productivity, innovation, and growth, while delivering on our commitments to return cash to shareholders.

As Dennis mentioned earlier, in December last year, we reinforced our commitment to returning value to shareholders, as our Board of Directors authorized a new $20 billion share repurchase program and a 20% increase in our quarterly dividend. Over the last five years, we've repurchased more than 205 million shares and increased our dividend by more than 180%. At the same time, we've invested nearly $35 billion in key strategic areas of our business to support long-term growth sustainability for Boeing, for our customers, and our shareholders. We remain committed to continue to execute on our balanced cash deployment strategy going forward.

Let's move now to cash and debt balances on slide 10. We ended the quarter with $8.6 billion of cash and marketable securities, $13.8 billion of debt, and stable credit ratings. Our cash and debt position reflects the acquisition of KLX in the fourth quarter, and our balance sheet position continues to provide us with flexibility to invest in innovation and profitable growth opportunities, while again returning value back to shareholders.

Turning now to slide 11 to discuss our outlook for 2019, building on the strong performance in 2018, our guidance for 2019 reflects higher volume, improved core operating performance, additional productivity capture, and continued focus and effort to drive growing cash flows.

Total company revenue for 2019 is forecasted to be between $109.5 billion and $111.5 billion, largely reflecting higher planned 737 and 787 production rates and growth in both services as well as Defense, Space & Security.

Core earnings per share guidance for 2019 is set to be between $19.90 and $20.10 per share on higher volume, favorable mix, and improved productivity and affordability.

Operating cash flow for 2019 is forecasted to increase by $2 billion to be between $17 billion and $17.5 billion. This is largely driven by improved 787 cash generation in 2019, higher overall volume, including 737 and 787 production, and improving tanker cash profile. That's partially offset by increased planned 777X inventory related to test aircraft and early build units and higher cash taxes, primarily due to improved unit profitability, as well as higher planned R&D spending in 2019.

Capital spending is forecast to be approximately $2.3 billion and includes the timing shift of some expenditures that were expected in 2018. Our investments align with our long-term growth and productivity strategy that supports core programs, innovation, productivity, verticals, and services.

And before we discuss the business unit guidance, I'd like to highlight at the beginning in January of 2019, we are changing the realignment of our military derivative aircraft contracts, such as the KC-46 tanker, P-8 Poseidon, VC25 Air Force One between BCA and BDS. This change is to better reflect the contractual relationship with the end customers, as BDS holds the prime contracts. This accounting realignment does not change how BCA and

BDS execute together on these contracts. Also, it does not affect total Boeing sales, earnings, cash flow, assets or liabilities.

Our 2019 segment guidance includes the impact of this realignment. And beginning in January 2019, the revenue and costs associated with military derivative aircraft that was previously reported in both BCA and BDS will now be 100% reported in the BDS segment. And for comparison purposes, as part of this earnings release, we've provided restated 2018 and 2017 financial information incorporating this accounting change.

Now for 2019 Commercial Airplane revenue guidance, it is set to be between $64.5 billion and $65.5 billion. And as we've discussed, this is largely driven on the higher deliveries of 737 and 787 program, partially offset by the impact of the military derivative aircraft realignment to BDS.

The ramp-up on the 737 MAX production continues, and we expect 737 MAX to account for approximately 90% of total 737 deliveries in 2019. In all, BCA is expected to deliver between 895 and 905 airplanes for the full year. Incorporated in this delivery guidance assumption are planned 737 and 787 production rate increases and the intercompany deliveries of the military aircraft from BCA to BDS.

Commercial Airplane operating margin guidance is set to be between 14.5% and 15% on higher 737 volume and improved operating performance, which more than offset the higher period costs, including R&D. The margin guidance also reflects all planned production rate increases.

Defense, Space & Security revenue guidance for 2019 is between $26.5 billion and $27.5 billion, reflecting the higher volume on new programs, strong backlog on core programs, and the impact of the military derivative aircraft realignment from BCA. Operating margin guidance for Defense business is greater than 11%, based on continued productivity efforts across the portfolio, offset by less favorable mix.

Global Services revenue guidance is set to be between $18.5 billion and $19 billion, with operating margins of greater than 15%. BGS margin guidance reflects solid performance, mix of products and services, as well as investments to expand our portfolio of offerings. And as we've discussed, we aim to grow faster than the average service market growth rate of 3.5%, as we expand our broad service offerings and gain market share while maintaining and growing margins.

We expect research and development spending to increase to approximately $4.1 billion in 2019, with approximately 60% related to BCA as we invest in future growth. BDS and BGS also continue to invest in key strategic growth opportunities and productivity enablers. In addition, we will continue to make investments at the corporate level for technology and innovation with enterprise applicability. This 2019 R&D forecast also includes some timing shifts of some expenditures previously planned in 2018.

Our R&D funding will continue to be focused on our core programs, key future franchises, productivity enablers such as automation, prototyping and capabilities to further our vertical content life cycle capture, and other key growth areas such as autonomy and mobility solutions. We will continue to make the required investment in innovation and technology to ensure our products and services continue to win in the marketplace. And going forward, we expect our overall R&D spending as a percentage of revenue to be relatively stable.

While organic investment remains the primary engine for growth, we may partner with other industry players in investments that accelerate our life cycle value strategy and strengthen our vertical capabilities and content, as demonstrated by the proposed strategic partnership with Embraer, which assuming all approvals are received in a timely manner, we expect to close by the end of the year.

Now, consistent with prior years and given the seasonality of our business, as we look into the next quarter, we expect first quarter to be the lowest quarter of the year for revenue. With the relatively light Commercial Airplane deliveries, January is expected to have slow delivery activity, consistent with prior-year trends and reflects the supply chain recovery plans.

Core EPS is estimated to be approximately 20% of the full-year earnings and first quarter operating cash is forecast to be approximately 10% to 15%, again, driven by lower volume and the timing of receipts and expenditures.

As we look towards the remainder of the year, our key focus areas are continuing to manage the 737 recovery progress within our factory and throughout our supply chain, including assuring rate readiness for a smooth transition to 57 a month; also, working together with our U.S. Air Force customer delivering additional KC-46 tankers, continuing healthy order momentum, especially on new programs such as the 777X, as well as strong execution across the portfolio, including T-X and MQ-25 development.

So in summary, our core operating engine continues to deliver strong results. We continue to use our three business unit strategy as a key differentiator to win in the marketplace, make prudent strategic investments, and leverage the talent and innovation from across the company. At the same time, we will set challenging goals and objectives around elements of operations and support functions, guide to profitability and efficiency to generate cash, improve working capital, while driving value to our customers. All these will help us achieve our goal to grow year-over-year revenue, margins, and cash flow.

With that, I'll turn it back to Dennis for some closing comments

Dennis A. Muilenburg

Chairman, President & Chief Executive Officer, The Boeing Co.

All right. Thanks, Greg.

2018 was a year of strong performance and record results on many different fronts operationally and financially, a demonstration of how our team remains focused on further driving both growth and productivity. These results were achieved through the hard work and dedication of our employees and the great partnerships that we have with our customers and suppliers.

In addition to the strong commercial airplane market dynamics I mentioned earlier in my remarks, we have taken our own actions to reduce cyclicality in our business. This includes remaining disciplined in our production rate decisions, derisking our pension liabilities, strategically phasing our research and development spending, creating labor stability with long-term contracts, and expanding our services business, which is also less cyclical.

We have executed on our long-term strategy of robust and continuing organic growth investment and returning value to our shareholders, complemented by strategic acquisitions of partnerships that enhance and accelerate our growth plans. The planned strategic partnership with Embraer, the recent KLX acquisition, and the seats and APU joint ventures are entirely consistent with this strategy.

Our priorities going forward are to leverage our unique One Boeing advantages, continue building strength on strength to deliver and improve on our commitments, and to stretch beyond those plans, and sharpen and accelerate our pace of progress on key enterprise growth and productivity efforts. As always, we'll continue to keep a close eye on the geopolitical and macroeconomic forces and prudently manage risks.

Achieving these objectives will require a clear and consistent focus on: the profitable ramp up in Commercial Airplane production; continuing to strengthen our Defense Space & Security business; growing our integrated Services business and leveraging the power of our three business unit strategy; delivering on our development programs; driving world-class levels of productivity and performance throughout the enterprise to fund our investments in innovation and growth; disciplined leading-edge investments and a balanced, value-creating cash deployment strategy; and continuing to develop and maintain the best team and talent in the industry. All of which position Boeing for continued market leadership, sustained top and bottom line growth, and increasing value for our customers, shareholders, employees, and other stakeholders.

With that, we'll be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Rajeev Lalwani with Morgan Stanley. Please go ahead.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

Good morning, Dennis. Good morning, Greg.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

Good morning.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Good morning, Rajeev.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

On the 737, at what point do you expect to be caught up on deliveries, and where have the pressure points been of late? Also, how does that inform the latest thinking and timeline on a decision beyond 57 a month?

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Yes, Rajeev, good question. Certainly, 737 production system health remains a key focus for us. As you can see by the fourth quarter deliveries with 173 in the quarter and 69 in December, good signs of recovering to our production plan. You can also see the increased rates reflected in our total year guidance for deliveries for 2019 as we continue to ramp up.

I would say we still have more work to do on the recovery efforts. We've seen some good, solid progress. We still have work to do inside our own factories and in our supply chain, and that is a daily and weekly focus for us, very intense effort. I'll say within the supply chain, we've seen some solid recovery in several areas. We still have some areas that need work, including engines. And we're doing some additional work with CFM including deploying some additional Boeing personnel to their factories and to their sub-tier suppliers. So that's one area that will have some additional focus for us in the first quarter.

And as Greg mentioned, just in terms of production profile for the year, we expect the first quarter to be the lightest quarter of the year, and we expect January to be the lightest month within that quarter. So we're going to continue to work hard on production system health and recovery.

And then as you alluded to, at the same time we're moving forward on our plans to ramp up to 57 a month during the year. Some elements of the supply chain have already moved to that position. We still have some work to do before we move the entire line to 57 a month, and we're going to be very, very disciplined in that process. Again, we're making good progress. We know exactly what needs to be done, but we're going to just look at this through very clear eyes and step through it day by day, week by week, and make sure that we in a very disciplined and smooth way move to 57 a month. I think we learned some lessons from the 52 a month step that we did last year, and those lessons are certainly being applied this year on the 57 a month rate range. But you see all of that, again, reflected in our plans and our guidance for 2019.

Operator: Our next question is from Myles Walton with UBS. Please go ahead.

Myles Walton
Analyst, UBS Securities LLC
Q

Thanks, good morning.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Good morning.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

Hi, Myles.

Myles Walton
Analyst, UBS Securities LLC
Q

Could you catch us up on your latest thinking on the NMA [New Mid-market Airplane] and maybe tie that to your view on moderating demand? I guess demand would obviously fluctuate a bit if you had chosen to launch the aircraft with a pile of launch customers, I'd imagine. So maybe just juxtapose those two different points.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Myles, I'd say first of all, if you take a look at NMA, we're still working through that same disciplined decision process that we talked about previously. We're making progress on that. We've had very productive conversations with customers. We understand the market. It's clear that there's a market need, but we're working through the details of the business case. And as we said, we're going to be very disciplined on how we do that. And while we're making progress, we're not up to our decision point yet.

And just to provide clarity on that, as we've mentioned before, we do see a decision point this year, and that is a decision of whether we would offer the airplane in the market. And we need to complete the business case analysis before we arrive at that decision, but that is one that's for this year. And then assuming a positive market response or depending on the market response, we'll make the final launch decision next year. So it's a two-step decision process, as we've always done with Commercial Airplanes, and a very disciplined process.

All of that, we're continuing to work our development program work and maturing the technologies, reducing risk in parallel to protect a 2025 EIS, or entry into service. We think that remains important to our customers, so we're working all of that in parallel. And again, we'll march in a disciplined way through our decision process. Our assessment of the market and the size of that market hasn't changed.

Now to your broader question on orders and how the market is looking, again, we continue to see strong demand signals. I think you see that reflected in the orders volume for this past year with 806 deliveries and 893 orders. And while, as I said, we expect some moderation or timing on orders going forward, we have a very robust backlog position with about seven years of backlog, equivalent backlog in position now.

If you look at the stats on traffic growth, cargo, global expansion of route structures, all the fundamentals remain very strong, and we're encouraged by that. So we expect to see continuing steady orders volume. I wouldn't expect that to change significantly depending on the NMA decision. So we're going to be in the marketplace continuing to compete and win.

I guess one other reminder on NMA. If we do decide to proceed with the authority to offer, don't expect a big change in the R&D profile. This is all part of our planned R&D profile. As Greg said earlier, we expect R&D to continue to be roughly the same in terms of percentage of revenue going forward. So as revenue grows, you'll see some R&D growth that will be at the same percent. And if we launch NMA, it will feather in on the backside of 777X. So from a profile standpoint, it fits very nicely. Greg, anything you want to add on that?

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

No, I think you got it.

Operator: The next question is from Rob Spingarn with Credit Suisse. Please go ahead.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC
Q

Good morning, gentlemen.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Good morning.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

Hey, Rob.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC
Q

So margins at BCA are now in your targeted area of the mid-teens with the 2019 guidance where it is. And you're still not fully ramped with production rates, there's more upside there. And you've built the higher R&D into the 2019 forecast. So I wanted to ask how much of this 2019 improvement in margins is volume versus mix versus productivity. And with the supply chain initiatives still ongoing, what is your longer-term margin potential now? How much further can you go? I was going to ask you how much that differs with and without a new airplane, but I think you just answered that part. So the components of the improvement in 2019 and then what the potential is long term now that you've gotten this far.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

It's a great question, Rob. I would say it's all the above. Certainly, the increased volume is a big driver to that, but the mix of that volume is important. And we've talked about in particular 787, executing on bringing in the 787-9 and 787-10 flawlessly into the market and meeting the commitments to our customers there and ensuring that happens smoothly while going up in rate. You saw that in 2018 and you're going to see that in 2019 as we look to go to 14 a month there.

But the productivity engine, so I'll say the targets that we've set for ourselves is the same playbook that we put in place for the last number of years of really just looking where we have opportunity, where we can leverage best practices. We've talked a lot about this whole One Boeing effort, but there's a lot behind that in leveraging things that are going on an F-18 on 787 and leveraging things on 787 over onto Chinook and vice-versa. That's now part of our operating rhythm, and certainly it's how we're all rewarded and ultimately how the company is rewarded. So there's complete alignment to leverage these practices.

Same in the supply chain, so the whole Partnering for Success effort, some of that is also where we've had productivity gains. How do we take those back in the supply chain, frankly, make the supply chain even better, but come up with ways where we can both take that to the bottom line and reinvest in growth for the future. So I'd say it plays into all three. But, Rob, I would think about the playbook, the same playbook you saw for the last couple years. That's the playbook.

And I'd add to that benchmarking ourselves outside. This whole global industrial champion effort that you can imagine, that target keeps moving. So when we look at a cost of a function, what's it cost us to run a function or how efficient are we with our capital and with our R&D? And what are some best practices within industrials, outside the industrials, how we bring them back into Boeing, make it part of our operating rhythm, and hold ourselves to a standard that is not necessarily industry. It's best in class. And then again, holding ourselves accountable and targeting ourselves to go achieve all that.

So I'd say same playbook, so we don't really have a cap, I think I would say. It's really just continuing to look for opportunities, then compete and win, use some of that...

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

But is there a pace of improvement? Because you've hit your target, or at least you will in 2019 based on the guidance, and again you're not done improving the organization. So is there a new target?

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

Rob, we're not slowing down. So as we said, we set a target, and we've been aggressively pursuing that. We've made some great progress and I'm proud of the team's efforts there, but the competition is only getting tougher and we're not going to slow down. So the pace of progress you've seen is the pace of progress we aim to sustain, and what we're looking for is continued year-over-year margin and cash flow growth. That's part of our planning. That's the framework that we've set up for the team, and we're going to continue to push with that pace.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay, thank you very much. Very well done, guys.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

Thanks, Rob.

Operator: Our next question is from Carter Copeland with Melius Research. Please go ahead.

Carter Copeland
Analyst, Melius Research LLC
Q

A good and frosty morning to you, guys.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

Good morning.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Carter, you got half of that right.

Carter Copeland
Analyst, Melius Research LLC
Q

I'm sure you're freezing out there. Greg, I wonder if I can just get a couple of clarifications on the quarter and then a question about the guidance. With respect to what you printed, I just wanted to check on the unit earnings that it looks like the 737 is still unit below your program margin but not by much. And then with respect to the 787 deferred, it looks like you had a margin expansion there that kept the deferred down. I just wondered if that was correct.

And then just building on Rob's question and what's built into your 2019 plan, do you have any material difference in period expenses outside of R&D that you envision for next year that we should be considering? And if so, can you help us quantify how to think about that? Thanks.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

I'd say outside of R&D, we've definitely got some investments around productivity and systems that we're making, again, thinking about long-term competitiveness. So we've got some money put aside in there and budgeted for the year.

Carter Copeland
Analyst, Melius Research LLC
Q

That's up year on year?

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

Pardon me? Yes.

Carter Copeland
Analyst, Melius Research LLC
Q

Okay.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

So obviously we'll manage that extremely tight as we always do, but we've got budgets in place there and clear initiatives and business cases to go drive that that are a little over and above what we were spending in 2018.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

All included in the budget.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

Yes, all included, absolutely, yes. And your units to program, you've got it. You're right on 737 but increase in 787, and we had a block extension in the quarter that was a big driver of that unit – or sorry, of that program margin increase.

Carter Copeland
Analyst, Melius Research LLC
Q

Okay, great. Thank you.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.
A

You're welcome. Thanks.

Operator: And next we'll go to Doug Harned with Bernstein. Please go ahead.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC
Q

Thank you, good morning.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Good morning, Doug.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

I wanted to continue on the 787 and just to understand a little bit better how you're looking at this longer term in terms of cash margin improvement. You're at a point now where you don't have that many 787-8s in the mix anymore, you're going to have more 787-10s. And then if I look at pricing, at this stage, at least I wouldn't expect you to get a lot more from there. So can you talk about as you look at the next few years, how you see that cash margin trajectory evolving and what's likely to drive it?

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

It is going to continue to grow, Doug. And as Dennis said, the team has done a great job executing to our commitments, our rate breaks. I know I keep going on about this. But bringing two derivatives in while going up in rate is no small task, and they've done it extremely well, and then at the same time, leveraging the best practices. So that's all going to continue to play out.

As you go forward here, you're right, bringing in more 787-10s, the mix of the higher 787-9s and 787-10s. Right now, it's predominantly 787-9. And 787-10 you're going to see the benefit of that over that longer-term period from a cash perspective, and then going up in rate. So you'll see the cash associated with those advances as well as with that higher rate, but again at the same time, bringing down the expenditures.

Don't forget we've got step-down pricing as well on the supply chain that will play into that along with our own productivity. So it probably fits into about six categories of things that need to happen or things that are just going to happen through time as we execute through each of these blocks and having a more favorable mix combined with continuing to have the step-down in the supply chain. So again, we see growing cash flow on the 787. They've done a great job in delivering on their commitments to shareholders but also to customers, and now we're moving into the next phase of moving up into 14 per month and continuing to capture productivity gains.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

And then just on the 787-10, you delivered, I think, nine of them in Q4. So would it be fair to say that your 787-10 margins were probably a little less mature in the quarter we just saw and you should get some improvement out of that as well? Is that fair?

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

To your point, it's still relatively early in the production system and in the supply chain. So as that becomes more mature, just like we would normally, we'll come down that learning curve as the supply chain will and we'll capture the benefit of that.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

And to that, Doug, there's also a big benefit from the high level of manufacturing commonality between the 787-10 and 787-9 which accelerates and reinforces what Greg said. And then the value proposition for that airplane in the market with our customers is very clear that it's generating value and it's winning in the marketplace. So on the pricing side, it's holding up well there as well just because of the value it's creating for our customers.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay, very good. Thank you.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

You're welcome.

Operator: The next question is from Seth Seifman with JPMorgan. Please go ahead.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Thanks very much and good morning.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

Good morning, Seth.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Good morning, Seth.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

So you mentioned the idea of I think trying to bolster the backlog for 777 and 777X, and you talked a lot in the past about wide-body replacement orders coming in the early part of the next decade. Does that mean in the near term, are there 777X order opportunities, or does the order opportunity in the near term focus on more the classic and the freighters and we wait until we get into the early part of the next decade to see the orders for the 777X come through?

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Seth, we're working both in parallel. Certainly, during the last year we've seen some great progress on the 777 with 51 net orders in the year. And that's really strengthened the bridge that we're building 777 to 777X. We still have some work to do to fill out the remainder of the bridge, but our confidence continues to grow in our ability to do that. And as we've made that progress, we're now shifting our teams more and more to 777X opportunities.

As you said, we do see a high wave of replacement demand early in the next decade, but that means those sales campaigns are underway now. So those are very active. We're very engaged with a number of customers around the world. The 777X clearly is bringing a value proposition to the market that's attractive, and you'll see us focusing more and more on those 777X campaigns here during this coming year, so that's a very near-term effort as well. And all of that is consistent with the investment profile and the production system ramp and transition that we talked about earlier.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great, thanks very much.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

You bet.

Operator: Next we'll go to David Strauss with Barclays. Please go ahead.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Thanks, good morning.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

Good morning.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Good morning, David.

David Strauss
Analyst, Barclays Capital, Inc.

Q

In the free cash flow walk that you provided, you highlighted the headwind from 777X in 2019. Could you maybe talk about, is 2019 going to be the peak year for 777X investment? I'm thinking mainly working capital. And how many airplanes do you plan on having in flow before you actually start making deliveries?

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

The profile, David, certainly for the reasons you described, building inventory and the test aircraft and so on. So this year, there's more headwind, and then as we move into 2020, that headwind will moderate. So we'll start to have some more positive cash flow with the combination of 777X moving into production and then into delivery. So this is a peak year for us on, I'll say, cash usage on 777 combined with 777X.

So as Dennis said, transitioning the airplane today in the factory and moving through and building up that move from development to production will be key and obviously a big driver on the cash flow, and things are going well out there today. So we've got very good early signs that the aircraft is moving into the production system smoothly, and any challenges we're having we're working through and we know what they are, but so far so good. So that will be a big driver of cash flow going forward.

David Strauss
Analyst, Barclays Capital, Inc.

Q

And did I hear you say that 777 deliveries in 2020 would actually step up a bit? Is that just the legacy 777 rate holding and 777X starting to deliver?

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

It's really the combined of the two. So it's the 777X and the 777. Now having said that, as Dennis indicated, we're still seeing a lot of demand for the 777, in particular in the area of freight. So we're feathering all this together and making sure that we're in the marketplace and we're meeting the demands of the customers in the near term, but at the same time feathering in the 777X. So that' key in 2020. But we're seeing good demand there on the 777. So that will be a combined production rate on those two programs.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Just for clarity, the 2020 production system will be operating at five a month. So when you look at that delivery rate slightly increasing over the current 3.5 a month delivery rate, that's the combination of 777s and 777Xs that Greg mentioned.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

Yes.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Great, thanks very much.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

You're welcome.

Operator: Next we'll go to Sheila Kahyaoglu with Jefferies. Please go ahead.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Hi. Good morning and thank you.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Hi, Sheila.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

Hi, Sheila.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Hi. Going back to Commercial profitability just because it was such a standout, how sustainable is the 100 bps of margin improvement? Are there any mix impacts we should be thinking about with the 777 coming in or just changing customer dynamics or any pricing dynamic that would alter that trajectory?

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

You're thinking beyond 2019?

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Yes.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

To your point, there are a lot of moving pieces. Obviously, when you get into 2019, we're more stable at the 14 a month and we're more stable at the 57. So again, we should be able to capture productivity, and we're expecting to capture productivity in that. And there's some mix movement certainly between the 777 ramping down and the 777X moving in. So there are a lot of moving pieces.

But I'd say, Sheila, and I'll let Dennis comment here, but the objective we have in place is the same one as I addressed on a prior question. We're looking for opportunities where we can to derisk the production system and bring in automation where we can bring in automation and bring in best practices with an overall objective to grow margins and fund our future and return cash to shareholders. So that playbook, you should just think of that as the same no matter what the mix. So we don't let mix be the deciding factor. Mix is mix. It's our job to try to offset that or use that to our advantage in the best way possible.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

And just to reinforce that, Sheila, as Greg said, a lot of moving parts here. But the sustained margin growth trend is one that's long term. So we expect to continue to see year-over-year margin growth in 2019 and further growth in 2020 and beyond. So this is all about long-term sustained top and bottom line growth, and the game book that we're operating here will drive that year over year.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Thank you.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

You're welcome.

Operator: The next question is from Hunter Keay with Wolfe Research. Please go ahead.

Hunter Keay
Analyst, Wolfe Research LLC

Q

Hey, thank you for getting me on and good morning. I'd like to go back to NMA for a second. I don't want to nitpick a little bit, but, Dennis, you did mention that NMA was going to be a two-step decision process with the final decision coming in 2020. Are you saying that you would make the announcement for the public, so to speak, in 2020 after talking to your customers in 2019? So if you could, just clarify that announcement.

And then the second part of the NMA question is, how are these conversations going with your customers around this plane being used as a replacement aircraft versus opening up new markets maybe relative to new designs in the path? Thanks.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Let me take on the first one there. The process we're talking about here, the decision process is identical to what we've used on all of our previous programs. So this year's decision is what we call authority to offer. That's based on a business case and our ability to go and have deep detailed discussions with customers. That will be something that will be publicly announced once we make our decision around that. So that will be the information that you'll see, and that will initiate deep and meaningful customer conversations. And then depending on market response and our ability to build the right kind of group of launch customers, then we get to an official launch or authority to launch decision next year. So both of those steps are typically public steps and ones that you would see.

Again, I want to reemphasize the discipline that we're putting into these. These are not only decisions related to the airplane and that market; they're also decisions related to the enterprise transformation objectives that we have in terms of production system for the future. So we're looking at this as a total enterprise effort and really being very disciplined in our business case analysis. And then your second question, Hunter?

Hunter Keay
Analyst, Wolfe Research LLC
Q

It was just how the conversation is going with your customers, preliminarily at least, around this plane being used as an enabler of opening up new point-to-point markets versus replacement relative to say, really, I was thinking the 787 specifically, but just broader in general. Thanks.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

We've talked extensively with customers here, more than 60 customers, and very consistent feedback. And we do see several different market segments and potential applications for this airplane. We do see a market need here that's in between today's narrow-body and wide-body families. It's a market area that really cannot be addressed by modifying those existing platforms and aircraft. Some of that is medium haul, medium-range segments that today are being served by I'll say inefficient use of wide-bodies. And we see that as an opportunity for airline customers to gain efficiency.

But a good portion of this is also a creation of new medium-range route structures. And just as we saw with the introduction of the 787, where we saw roughly already 200 new city pairs emerge because of the capability of the airplane, in the medium-range marketplace, again, 4,000 to 5,000 mile range, we see an opportunity for significant regional city pair growth from this airplane. And that's another area where we're gaining customer feedback.

So there are multiple segments of applicability, significant customer interest. The key here is for us to build a business case that's going to create value for our customers as well as value for our company and our shareholders, and that's the work we still need to finish.

Hunter Keay
Analyst, Wolfe Research LLC

Q

Thank you.

Operator: Next we'll go to Ron Epstein with Bank of America Merrill Lynch. Please go ahead.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Hey. Good afternoon, guys.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Hey.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Just a question and maybe a follow-up. How do we think about the 900 airplanes? Where do you have to transition on 737 and 787 to get to 900? That's a lot of airplanes. That's like 75 a month on average.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

Ron, you've made the right calculation there.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Right.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

So as I mentioned, we are well into the 14 a month rate step on 787, and we expect to complete that transition in the second quarter. So that's moving forward very briskly and on track.

On the 737, we've already moved parts of the supply chain to 57 a month. But we still have work to do on some elements of the supply chain; in particular with engines and CFM. And we're not going to make that full transition to 57 a month until we're very confident that we're ready. And it's important that we do that in a very disciplined way.

So you can back into the number mathematically with about 900 deliveries for the year. Note that that 900 roughly deliveries for the year also includes the military derivatives, so P-8, tankers are all included in that number, just for clarity.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Okay, great. Great. And then maybe just one follow-on on the NMA question. In the business case when you think about NMA, how do you think about it and the potential relationship it could have with a future family of narrow-bodies?

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

It's one of the parameters that we think through anytime we're thinking about investments for the future. And I think as we relayed earlier, we fundamentally have changed our R&D investment strategy for the company so that it's feathered over the long term where we can sequence development programs so that we gain the benefits of continuous development and lessons learned program to program, rather than stacking multiple development programs on top of each other. And that's the way we're thinking through NMA as well.

So not only the development program for that particular airplane and the market it will serve but also how do we sequence it? How do we leverage learnings from 777X? How do we leverage what we're learning from things like T-X and roll that into NMA? And then how could we use an NMA investment to think about leverage and creating the production system for the even more distant future, whether that be some future narrow-body airplane or other alternatives that we might invest in.

But think of this as a continuum of R&D efforts. This again is all key to creating a sustained growth business where top and bottom line are both long-term sustained growth models. That is our approach here. And so we're thinking about NMA in that multi-program context.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Got you. And may I ask one more at the tail-end here?

Maurita B. Sutedja
Vice President, Investor Relations, The Boeing Co.

A

I think we're...

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Can I ask just a quick one, just for Greg? Greg, when we think about the 737NG versus the MAX, and just for modeling purposes because we're going to be at 90% MAXs this year, how do we think about the margin profile of one variant versus the other?

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

You're still early introduction, so you take that into account. But net-net, you're in a similar margin profile as you are on the 737NG. It's really just more around timing from a unit perspective and how they're feathered in. So I wouldn't think of it any different. It's really just, again, more timing.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Okay, great. Thank you.

Gregory D. Smith
Chief Financial Officer & Executive Vice President-Enterprise Performance & Strategy, The Boeing Co.

A

Yes, thank you.

Maurita B. Sutedja
Vice President, Investor Relations, The Boeing Co.

A

Okay. So, operator, we have time for just one more analyst question.

Operator: Great, that will be from Peter Arment with Baird. Please go ahead.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.

Q

Thanks. Good morning, Dennis, Greg.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Hi, Peter.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.

Q

Nice results. Hey, Dennis, just maybe an easier one on book-to-bill expectations in 2019, and I guess specifically around 737 MAX orders. You mentioned you had 13 new customers in 2018 and you've had really I think 5,000 aircraft since the launch. So that's close to 68%, I think, of the coverage of NGs. Just how are you thinking about the order momentum with that program? Thanks.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Peter, we continue to see strong order momentum there. I think just another sign of it, this week earlier you saw ANA's announcement about their intent to buy the MAX, and that's another addition to the fleet there. So you see continued momentum on the MAX sales front.

That airplane is creating value in the market for our customers, and we are oversold against our production profile. We talked earlier about ramping up to 57 a month. We are oversold against that profile. We're filling skyline slots way out in 2023. We continue to see upward market pressure overall on the production rate as a result. And we think the demand for that airplane continues to be sustained.

So while we had great orders, volume, and momentum this year, and I mentioned we might see some moderation in that demand this coming year, we still expect book-to-bill to be in that one-to-one range. And there's always timing variability, but in terms of the MAX, the demand signals in the marketplace continue to be very strong.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.

Q

Perfect, thanks.

Operator: Ladies and gentlemen, that completes the analyst question-and-answer session. [Operator Instructions] I will now return you to The Boeing Company for introductory remarks by Ms. Anne Toulouse, interim Vice President of Communications. Ms. Toulouse, please go ahead.

Anne C. Toulouse
Senior Vice President, Communications (interim), The Boeing Co.

A

Thank you. We will now continue the call with media questions for Dennis and Greg. And if you have additional queries following this session, please call our media relations team at 312-544-2002. Operator, we're ready for that first question. And in the interest of time, we ask that you limit everyone to one question, please.

Operator: And first go to the line of Andrew Tangel with The Wall Street Journal. Please go ahead.

Andrew Tangel
Aviation Reporter, The Wall Street Journal

Q

Good morning. Some other manufacturers have reported some economic weakness in China as a major headwind. What are you all seeing? And are the orders from China steady, slowing, picking up? And overall, where do you expect to see that moderating order intake coming from around the world? And where is either demand slowing a bit or growth slowing a bit from your seat?

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Andrew, let me touch on the China question first. We continue to see strong demand in China overall in terms of market dynamics. As I said earlier, over the 20 years, we see a world that needs about 43,000 new commercial airplanes. We remain very confident in that outlook. And about 7,700 of those 43,000 are in China, and that remains solid. Traffic patterns in China continue to progress. We're seeing passenger growth there that exceeds the overall market growth around the world, and we also see passenger traffic growth there continuing to exceed GDP growth. So those market fundamentals remain strongly in place.

In terms of orders volume in China, that's typically paced by timing of their five-year planning, so it tends to come in waves. So that's why, again, as we look to the future, we expect to see some timing adjustments on orders, but overall volume over the long term remains very strong. And that really applies to my broader comment too about moderation of orders in 2019.

As we look to the long term, the market fundamentals are very strong, and we see long-term volume of orders continuing to grow and adding to backlog. It just gets into a question of local timing quarter to quarter and year to year as our customers meet their fleet needs. So nothing here that I would say is a macro trend or a substantial change. We just see fundamental aerospace growth and air traffic growth as a long-term sustainable trend. And with the backlog of about 5,900 aircraft or roughly seven years of production, that gives us the ability to weather any local variations and maintain a long-term view in terms of sustained growth.

Operator: Our next question is from Julie Johnsson with Bloomberg. Please go ahead.

Julie Johnsson
Aerospace Reporter, Bloomberg LP

Q

So I just wanted to make sure that I understood the point you're making on China, Dennis. Do you potentially see a lull in orders this year because the next five-year plan is looming in the headlights?

And then a totally unrelated question, and apologies for that. But where does CFM stand on its catchup plan for the LEAP? How unusual is it for Boeing to embed your people in their supply chain?

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Julie, on your first question regarding China, that was exactly my point earlier. Given the five-year planning cycle there, we're having ongoing discussions with our customers in China, the Chinese government, the U.S. government. This also factors into the trade dialogue between the U.S. and China. So these are all factors that we're very much engaged in. Again, we expect China is a long-term growth market for us, but exactly how those efforts play out over the next quarter or two is still an open question as we proceed with trade discussions.

I can tell you having been intimately involved in the discussions and engagement with the governments both in the U.S. and China, we see progress on that front. We see convergence, and we also see that there's clearly a mutual benefit to having a healthy aerospace industry for both the U.S. and China. China needs the airplanes for growth to fuel their economy and to meet their passenger growth and cargo growth needs.

And here in the U.S., our aerospace business is a tremendous U.S. jobs generator, manufacturing jobs. We hired 34,000 people last year. And we as an aerospace industry here in the U.S. create about an $80 billion a year trade surplus for the country. So there's mutual interest in a healthy aerospace business. We expect that to lead the productive trade discussions between the U.S. and China or at least be part of that. And then that will factor into the ultimate orders volume and timing with China. So that's just a little additional context there.

Regarding your CFM question, it's not unusual for us to have Boeing personnel at our suppliers' sites and down into their supply chain. That's a very typical process that we would have. But I will say again as it goes to the 737, one of the supply chain health issues that we're spending a lot of time on right now is engines and our work with CFM. So we are deploying additional resources with them into their factories and supply chain. We do expect to recover. We're seeing signs of recovery, but we still have work to go. And deeply engaged in our supply chain is part of how we do business.

Operator: Our next question is from Sylvia Pfeifer with The Financial Times. Please go ahead.

Sylvia Pfeifer
Energy Editor, The Financial Times (United States)

Q

Hi, good morning. Sorry, I had the China question, which was one of my main ones. Can I just ask you about Brexit then? I know you're in a very different position to Airbus here in the UK. But I just wondered whether you saw any risks to your own operations in the UK in the event of a hard Brexit with just a few weeks to go before the 29th of March.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.

A

Sylvia, we're continuing to keep a very close eye on that, as you might guess. Again, we're very involved in the discussions. We're committed to our operations in the UK. We've ramped up significantly over the last many years, roughly doubling the size of our operations, roughly tripling the size of our supply chain in the UK, and those are long-term sustained investments. And we don't expect that to change based on the outcome of Brexit. That said, we're keeping a very close eye on it and making sure it doesn't impact our operations.

I think just as a further sign of our commitment in the UK, you'll note that during the last year we opened our new operation in Sheffield, where we're doing some advanced manufacturing work. And it's also helping us to build out our actuation vertical capability. So just another example of our long-term commitment to the UK and the investments that we'll continue to make.

Anne C. Toulouse
Senior Vice President, Communications (interim), The Boeing Co.
A

Okay. Operator, we have time for one last question from the media.

Operator: And that will be from Dominic Gates with The Seattle Times. Please go ahead.

Dominic Gates
Reporter, The Seattle Times Co.
Q

Hey, good morning.

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Hi, Dominic.

Dominic Gates
Reporter, The Seattle Times Co.
Q

Going back to the 737 MAX situation and CFM, in December with the delivery of 69 airplanes, it did seem like you had almost fully recovered. Has there been some further setback? And is the need to send people to CFM, is that because there's a problem with the ramp-up of the engine production, or is there some configuration change that's become necessary? Can you just tell us a bit more? Also, what's the timeline you expect to be back to normal, let's say?

Dennis A. Muilenburg
Chairman, President & Chief Executive Officer, The Boeing Co.
A

Dominic, first of all, as you saw in our December deliveries, as you alluded to, we did see some recovery across our supply chain, including engine supply, and that enabled us to drive those December deliveries of 69 aircraft, but we were not yet fully recovered at that point. So we've continued to work supply chain recovery, and there's still work to go there.

There's nothing here that I would say is an issue associated with having to change a configuration or make that kind of alteration to the engine. This is really about just ramping up production and doing it efficiently and being able to get a linear profile of engine deliveries that matches up with our factory production rate for the airplane and synchronizing those production systems. That's what we're focused on.

We still have work to go to get CFM to be supporting our 52 a month production rate and having those systems synchronized, and then even more work to go yet to get them ramped up to 57 a month. And that's really what we're focused on. This is about production system ramp-up and synchronization. And by us getting deeper into their factories, it's going to give us better insights on long lead items, and frankly, it will I think help us do best practice sharing between Boeing and CFM, which is part of how we operate that will make us better and it will make CFM better. And that's work that we plan to be very focused on in the first quarter, and timing of that is reflected in our overall delivery guidance for the year, so you can see that factored in. But we're going to be very, very disciplined about ensuring supply chain health before we fully move to the 57 a month production rate.

Anne C. Toulouse

Senior Vice President, Communications (interim), The Boeing Co.

Okay, that concludes our earnings call. Again, for members of the media, if you have further questions, please call our team at 312-544-2002. Thank you.