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The Boeing Co. (BA)

Q3 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by. Good day, everyone, and welcome to The Boeing Company's Third Quarter 2015 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'm turning the call over to Mr. Troy Lahr, Vice President of Investor Relations for The Boeing Company. Mr. Lahr, please go ahead.

Troy J. Lahr

Vice President-Investor Relations

Thank you and good morning. Welcome to Boeing's Third Quarter 2015 Earnings Call. I'm Troy Lahr and with me today is Dennis Muilenburg, Boeing's President and Chief Executive Officer; and Greg Smith, Boeing's Chief Financial Officer. After management comments, we'll take your questions. In fairness to others on the call, we ask that you please limit yourself to one question.

We have provided detailed financial information in today's press release and you can follow the broadcast and presentation through our website at boeing.com.

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

Now I'll turn the call over to Dennis.

Dennis A. Muilenburg

President, Chief Executive Officer & Director

Thank you, Troy, and good morning. I'll start with some comments on the quarter and our business environment. After that Greg will walk you through details of our financial results and outlook.

With that, let's move to slide two. Boeing delivered strong third quarter operating performance with 9% revenue growth, 10.2% core operating margins, 18% growth in core earnings per share and operating cash flow of $2.9 billion. Given our operating performance in the quarter, we're raising 2015 guidance for revenue, core EPS and operating cash flow. This performance and confidence in our long-term outlook continues to support our commitment to return cash to shareholders while also making strategic investments to grow our business.

Year-to-date, we have returned nearly $8 billion to shareholders through share repurchase and dividends. This remains a priority under our balanced cash deployment strategy. Revenue at Boeing Commercial Airplanes increased 10% on record deliveries of our industry-leading product family. During the quarter, we delivered our 325th 787. We began final assembly and achieved power on for the 737 MAX, completed firm configuration on the 777X and successfully concluded final testing and began implementing the advanced automated fuselage production technology on the 777 line, which will improve safety, quality and flow time, and ensure a smooth transition to the 777X.

Boeing Defense, Space & Security grew its top line by 6% on higher revenue at Boeing Military Aircraft and Network & Space Systems. Key contract awards during the quarter included an order from India for 22 Apache attack helicopters and 15 Chinook heavy-lift helicopters and a contract from Japan for five V-22 tiltrotor aircraft. We also received a contract from the U.S. Navy for 13 additional P-8A Poseidon aircraft.

Significant defense program milestones included delivery of the first two of 12 EA-18 Growlers to the Royal Australian Air Force and the start of flight testing of the first full-up KC-46A aerial refueling tanker. During the last few weeks, we have successfully deployed the tanker's refueling boom and its centerline and wing refueling drogue systems multiple times over a broad range of flight conditions. While more work remains ahead, these early accomplishments represent significant risk reduction and real progress on the flight test program.

In summary, we had another strong quarter of operating performance and cash generation. With that, let's turn to the business environment on slide three.

The commercial airplane business environment generally remains healthy, driven by improving airline profitability, solid air passenger traffic and meaningful replacement demand. Air cargo traffic remains a watch item for us as the gradual market recovery continues amid modest overall global economic growth rates. Airplane order activity and customer discussions are continuing at a moderated but historically healthy pace. Deferral requests and cancellations remain well below the historical average.

In the Single Aisle segment, demand for our new fuel-efficient 737 MAX remains high with cumulative orders totaling nearly 2,900 airplanes from 58 customers. Given the strong market demand, we continue to see upward pressure on narrow body production rates beyond the announced 52 per month in 2018. However, we remain steadfast in our financial discipline as we assess the market demand for further production rate changes.

During the third quarter, we made the decision to increase the 767 production rate to 2.5 per month, starting in 2017, driven by ongoing strong demand for the 767 freighter on top of the existing planned tanker production base. This is a testament to the compelling value proposition that airplane brings to the market. Demand also remains strong for the 777X with a backlog of 306 aircraft from six customers. On the 777, we have 44 orders and commitments year-to-date, including the two 777-300ERs announced last week for EVA Airways.

Our 777 backlog stands at 235 aircraft with production for 2016 essentially sold out and 2017 production more than half sold. With firm configuration of the 777X complete and our manufacturing advancements taking hold, we are now working to finalize the production plan to phase in this new technology. We will also continue to assess 777 supply and demand to maximize airplane profitability over the transition period.

On the 787 program, EVA's decision last week to also purchase up to 24 787-10s is evidence of continued strong market demand for the Dreamliner. The 787's backlog of nearly 800 orders fully supports our planned production rate increases to 12 per month in 2016 and 14 per month later this decade. We have now delivered more than 330 787s, including more than 50 Dash-9s.

Turning to Defense, Space & Security, we continue to see solid support for our major programs. Congress has been supportive of the president's fiscal year 2016 DoD and NASA budget request increases to core Boeing programs, including the P8-A Poseidon, the F-18 Super Hornet, Apache and Chinook helicopters and the NASA Space Launch System. International demand for our offerings remains strong, particularly in the Middle East and the Asia Pacific region.

During the third quarter, international customers for Defense, Space & Security represented 35% of revenue and 40% of our current backlog. The strength of our Defense and Space business stems from our investments in technology and innovation that have established a portfolio of reliable, proven and affordable products and services. We continue to invest in organic growth areas that are priorities for our customers such as commercial derivatives, space, unmanned systems, intelligence, surveillance and reconnaissance, and the critical few future franchise programs like long-range strike and the T-X trainer. Teams throughout our company also continue to ensure our long-term competitiveness by driving further safety, quality and productivity gains to improve program profitability and fund investment in future growth. In summary, our team is executing on our business strategy by growing revenues, generating solid operating performance and capturing strategic new business.

Now over to Greg for our financial results and our updated guidance. Greg?

Gregory D. Smith

Chief Financial Officer & Executive Vice President

Thanks, Dennis. Good morning, everybody. Let's turn to slide four and we'll discuss our third quarter results. Third quarter revenue increased 9% to $25.8 billion driven by record commercial airplane deliveries. Core operating margins of 10.2% reflect solid execution across both businesses. Core earnings per share for the quarter increased 18% to $2.52 reflecting again continued strong core operating performance on production programs and within our services businesses.

Let's now discuss Commercial Airplanes on slide five. For the third quarter, Boeing Commercial Airplanes' revenue increased 10% to $17.7 billion on a record 199 airplane deliveries. BCA operating margin of 10% reflects strong execution offset by the impact of higher planned R&D spending and increased 787 deliveries. Commercial Airplanes captured $13 billion of net orders during the third quarter and backlog remains very strong at $426 billion and nearly 5,700 aircraft equating to more than seven years of production.

Specifically on the 787, we continue to expect the program to be cash positive in the fourth quarter and we still anticipate deferred production to decline shortly after we achieve the 12 per month production rate later in 2016. No change to these fundamental milestones. We continue to see progress in the key operational performance indicators for the 787 program as we implement additional production efficiencies while meaningfully increasing 787-9 production.

As planned, the 787-9 production rate and deliveries are now outpacing 787-8. This is a testament to the team's detailed advanced planning and day-to-day execution to ensure smooth transition and ramp-up of the 787-9. On the 787-8 we have continued to make progress on unit cost reduction where we've now seen a decline of approximately 40% over the last 230 deliveries. We've also made further progress on the 787-9 where we now have had more than 30% cost reduction over the first 50 deliveries. Driven by continued cost reductions, a healthy mix of Dash-9s and a benefit of favorable timing on quarterly spending, 787 deferred production increased $577 million to now a balance of $28.3 billion in the third quarter.

We continue to anticipate 787 deferred production growth to further decline in the fourth quarter. We still have work ahead of us on the 787 as we remain focused on the solid day-to-day execution and risk mitigation while improving the long-term productivity and cash flow going forward. We will continue to manage the smooth ramp-up of the 787-9 production, prepare for the 12 per month introduction and introduce the Dash-10 while again driving efficiencies across all aspects of the program.

Let's now turn to slide six to discuss Defense, Space & Security results. BDS reported strong results in the quarter with revenue increasing 6% to $8.4 billion and operating margins of 12.2% on strong performance and a favorable delivery mix. Boeing military aircraft third quarter revenue increased 15% to $4.1 billion largely driven by F-15 contract negotiations. Operating margins were 12.2% in the quarter reflecting higher volumes and strong performance. Network and space revenue increased 5% to $2.1 billion driven by commercial crew volume.

The segment also generated strong operating margins of 11.5% on favorable mix and productivity improvements. Global services and support revenue declined to $2.2 billion, largely driven by timing of deliveries while operating margins were strong at 12.9%. Defense, Space & Security captured $9 billion of orders during the quarter and reported a solid backlog of $59 billion.

Let's move to cash flow now on slide seven. Operating cash flow for the third quarter was strong at $2.9 billion driven by higher volumes and solid operating performance. With regards to capital deployment, we paid $618 million in dividend and repurchased 11 million shares for $1.5 billion in the third quarter as we continue to deliver on our commitment of returning cash to shareholders. Year-to-date we've returned $8 billion to shareholders through dividend and repurchased 41 million shares. Again, this reflects our commitment and confidence in the long-term outlook for our business. Returning cash to shareholders along with continued investments to support future growth remain high priority for us.

Let's now move to cash and debt balances on slide eight. We ended the quarter with $9.9 billion of cash and marketable securities. Our cash balance continues to provide solid liquidity and positions us well going forward.

Let's now turn to slide nine and I'll discuss our outlook for the balance of 2015. Based on the strong operating performance year-to-date, we've increased our 2015 guidance for revenue, operating margins, core earnings per share and operating cash flow. Core earnings per share guidance for 2015 is increased $0.25 to now be between $7.95 and $8.15 a share on continued solid execution across the business.

The company revenue guidance has increased $500 million, now be between $95 billion and $97 billion on higher commercial airplane deliveries. BCA delivery guidance has increased now five airplanes to be from 755 to 760. Defense, Space & Security operating margin guidance is increased to approximately 10%, again reflecting strong operating efficiencies across the business.

Operating cash flow is increased to approximately $9.5 billion on improved performance across the company, as well as favorable timing of receipts and expenditures. And furthermore we're lowering our R&D guidance $100 million to now be $3.4 billion for the year to reflect timing of spending. In the fourth quarter, we expect BCA margins to be impacted by the strong operating performance, somewhat offset by delivery mix, and higher planned R&D spending on 777X as well as additional investments in productivity initiatives.

So in summary, we generated solid revenue growth and healthy operating margins while generating significant cash flow. We meaningfully returned cash to shareholders and invested in our future.

And with that, I'll turn the call back over to Dennis for closing comments.

Dennis A. Muilenburg

President, Chief Executive Officer & Director

Thank you, Greg. With three solid quarters behind us, we remain focused on disciplined execution, quality and productivity improvements, and meeting customer commitments. Our priorities going forward are clear and consistent. The profitable ramp-up in Commercial Airplane production, delivering on our development programs, continuing to strengthen our Defense and Space business, driving productivity and performance throughout the enterprise to fund our investments innovation, talent and technology, and importantly, providing increasing value to our customers and our shareholders.

Now with that, we'd be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Doug Harned with Bernstein. Please go ahead.

Doug Stuart Harned
Sanford C. Bernstein & Co. LLC Q

Yes. Good morning.

Gregory D. Smith
Chief Financial Officer & Executive Vice President A

Morning.

Dennis A. Muilenburg
President, Chief Executive Officer & Director A

Hey, good morning, Doug.

Doug Stuart Harned
Sanford C. Bernstein & Co. LLC Q

I'm going to probably violate this a little bit because I wanted to get some clarity on the deferred production ramp as part of this question. So when you look forward, you're talking about being cash positive in Q4 on the 787. And my understanding was that would be followed by a plateau in 2016 and then that would ramp down as you took rate out toward the back part of 2016. I just want to make sure that that is still how you're thinking about this.

Gregory D. Smith
Chief Financial Officer & Executive Vice President A

Yes.

Doug Stuart Harned
Sanford C. Bernstein & Co. LLC Q

That is how you are thinking about it?

Gregory D. Smith
Chief Financial Officer & Executive Vice President A

Exactly. Yep.

Dennis A. Muilenburg
President, Chief Executive Officer & Director A

Doug, That's exactly right, and that remains consistent. And we're confident in that profile.

Doug Stuart Harned
Sanford C. Bernstein & Co. LLC

Q

But – okay. Great. Then the second part is when you look out toward the end of the block when we look at this, the deferred production level suggests to us that when you get in the later portion of the block, you're going to have to have unit cash margins move above 25% for the program. Now that's a pretty good number, and what I'd like to know first, is that correct? And then second, how do you see the path to getting there?

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Well, Doug, I won't get into the specific program by program margin but I will give you a sense of kind of – I'll say the few areas are focused on that have been the path and will be the path forward to continue to drive 787 profitability. Certainly productivity, continuing to come down the learning curve internally. You heard us talk about the progress to date on the 787-9 and the 787-8. So that's got to continue and we got a lot of projects in work. We got to get those matured and we got to get them cut in on line numbers. So there is not a lack of, I'll say, focus and ideas in that area but we got to get them matured and get them in but continuing to execute as we have on the productivity.

Mix plays a big factor in here and so our ability, with a richer mix of Dash-9s and 10s and quite frankly, as you've seen the Dash-9 get entered into the production system as smooth as it is, is another, I think, indicator of that mix coming together and keeping in mind this is all in our backlog. So this is delivering on the backlog but getting that smooth introduction and having that richer mix of Dash-9s and 10s will obviously grow as you get further out into that cost space and deliver on that backlog.

The supply chain, obviously we've got planned step down and contractual step down but we also got initiatives that we're working together across in the company and across the supply chain looking for additional productivity ideas. And keeping in mind, there's only been 300 units built here roughly. And a very steep ramp up and a lot of change in rate break. Having being stable at 10 and now making that transition up to 12, this is when you look historically, this is where you've really been able to capture additional productivity gains. So we're working with the supply chain on that.

And then rate. As you know we're going up in rate and it'll total about 40% going up to 12 a month and 16 and then 14 a month later in 2019 timeframe. So making good progress on getting up to rate within the supply chain as well as getting the factories ready internally. Again this is delivering on the backlog and you know the market, and so that supports these rate increases very much. But again, that'll continue to drive productivity.

And then I guess the only comment I'd make on the margins, I'd say they are similar to what we see today on our wide body programs and what we're achieving. So I'd say good progress to date, lot of work ahead of us to do, team's got good plans in place but we need to keep executing as we have and that'll be the path going forward.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

And, Doug, just to add a little more color to that as Greg said, in each of those dimensions we have real and firm actions underway. I can tell you for myself, Greg, Ray and the whole team, this is a very important, high priority focus area for us and in each of these productivity dimensions that Greg talked about, the advantage we have here goes to the fact that we've got 800 of these aircraft roughly in backlog. So this gives us the opportunity to do that long-term planning and engagement and to drive profitability with that long-term view. And that is what's going to drive us down the learning curve to get to those objectives that Greg mentioned.

Doug Stuart Harned
Sanford C. Bernstein & Co. LLC

Q

As part of that trajectory, then presumably you still have a number of contractual step downs in the supply chain that you're looking forward to and that you know that you have a pretty good handle on I guess.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

We do, Doug, and that includes the overarching Partnering for Success umbrella that we've talked about before that includes committed step downs that are in the plan and a continuing effort to drive value generation. So our value engineering effort that we've talked about before with our supply chain network more than 1,000 ideas in the pipeline right now that we're moving from design stage to implementation stage. So both planned and committed step downs as well as additional value generation beyond that.

Doug Stuart Harned
Sanford C. Bernstein & Co. LLC

Q

Okay. Thank you.

Operator: Our next question is from Howard Rubel with Jefferies. Please go ahead.

Howard Alan Rubel
Jefferies LLC

Q

Thank you very much. Dennis, you recently extended the 787-10 with a new customer and you've done a number of things with the 777 to enhance it as a value proposition. Could you address a little bit the market dynamics you see because of the capabilities these new airplanes offer and how you see the environment for both the 777 demand and also the 9 and the 10?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

You bet. Yeah, thanks, Howard. So yeah, just stepping back and I know there's been a lot of discussion out there about the wide body marketplace and the prospects going forward. And let me paint for you a market outlook there and then hone in on those two specific airplanes in particular. But if you take a look at the overall market, we continue to see a growing healthy marketplace. As we said before, a current market outlook for 38,000 new airplanes over the next 20 years in total. We continue to see strong passenger growth, independent assessments again of 6% year-over-year growth throughout the time period. Cargo growth has been more moderated and has been a bit slow to recover as you know but we are seeing some recovery signs there.

If you take a look at overall market characteristics, we continue to see a strong healthy marketplace, both narrow bodies and wide bodies. If you take a look at replacement demand, it continues to be strong. We expect about 40% of those aircraft in that market outlook to be driven by replacement demand. And as I said, cancellations and deferrals remain below historic levels as well. So the market fundamentals remain strong.

Now when we get to the two products you mentioned, on 787 as noted, with 800 aircraft in backlog and a continuing strong market demand and I think EVA's decision here just in the last couple of weeks to acquire 24 787-10s is just another good sign of the value that that product is bringing to the marketplace. The 787 is delivering value for our customers. The value proposition is clearly a competitive advantage both in terms of operating cost reduction as well as the advantage on revenue and cargo volume and residual value that it brings to the customers. And with the production efficiencies that we're generating, we remain very bullish on 787 and as Greg talked about our plan is to ramp up to 12 a month and then to 14 a month before the end of the decade, all supported by strong market demand and unique value proposition of that airplane.

On the 777 we've been very focused on building out the 777 bridge as we've talked about. We needed to generate about 40 to 60 orders per year on the current 777 to build that bridge year-to-date. We've got 44 orders and commitments so we're continuing to fill out that bridge. In essence the 777 line is sold out through 2016, more than half sold in 2017 and we continue with a number of serious campaigns there all bridging to the 777X. And as you pointed out, the 777X is bringing, again, a unique value proposition to the market. Both today's 777 and the 777X have really no peer competitor and bring unique value to our customers. And 777X, having just completed firm configuration, good solid signs on development program, being executed on plan and we plan to have EIS on that airplane 2020 as scheduled. So in all cases, a strong fundamental market, the right differentiated product line, both 787s and 777, and very mindful right now about building a bridge from the 777 to the 777X.

Howard Alan Rubel
Jefferies LLC
Q

If I just may on the 78, initially had teething pains introducing it into the market. Could you just for a second, and then I'll end here, address sort of both dispatch reliability and how you've improved that and how that's also helped lower both airline costs and your costs?

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

You bet. And we continue to see strong progress. And you're right. We had some challenges as we introduced that airplane into our customer fleets and we've been very focused on reliability improvements both in the field and in the production line. We've seen steadily improving dispatch reliability across our customer set so we're pleased with the progress there. That said, more work to go so we're not done and we're going to continue to drive dispatch reliability there for our customers until we achieve the objectives that we have. So more work to go.

I will say that reliability improvements that we've delivered to date in the field and then it back driven into production line are really taking hold. And the best sign of that is with the roughly 50 Dash-9s that we delivered. As they're hitting the fleets, they're coming in at a much higher dispatch reliability than the original Dash-8s. So just further proof that the investments we're making are delivering value for our customers. We're going to stay very focused on getting to the finish line there.

Howard Alan Rubel
Jefferies LLC
Q

Thank you.

Operator: Our next question's from Myles Walton with Deutsche Bank. Please go ahead.

Myles Alexander Walton
Deutsche Bank Securities, Inc.
Q

Thanks. Good morning.

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

Morning.

Myles Alexander Walton
Deutsche Bank Securities, Inc.

Q

Hey, Greg, maybe one for you. I know timing around advances is something that's generally hard to predict. You put out there kind of a placeholder of $3 billion for 2015.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yeah.

Myles Alexander Walton
Deutsche Bank Securities, Inc.

Q

And year-to-date that hasn't really contributed much.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yep.

Myles Alexander Walton
Deutsche Bank Securities, Inc.

Q

And if you look at the fourth quarter, obviously if that came through, it's hard for me to not think you'd be running $1 billion plus ahead of your revised guidance. So can you help give either the offset or if that is more or less just conservatism around not knowing when that $3 billion is going to tick?

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yeah, no, I mean, you said it, Myles. They certainly, they do move around. I still expect it to be a positive contributor to 2015. But timing does factor in. So we should have more in the fourth quarter. But I think stepping back from that, you can see, it's about the strength of the cash engine here. And not the reliance on the advances. Obviously advances are important, but when you look into the core of the company, you're seeing strong cash flow generation, and that's the big focus area for us. And as you said, advances, they're going to move around quarter to quarter, and we'll have a few more here in the fourth quarter than we have in the third quarter.

Myles Alexander Walton
Deutsche Bank Securities, Inc.

Q

And even with the tick up in the revised cash guidance for this year, the outlook is still for growth into 2016 from the new level?

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yeah. I mean, as you step back and you look at kind of the long-term profile of the company, we still see the same opportunity to have strong cash flow growth going forward. It really plays into certainly the production rates, increases that we've talked about on the 37, the 67 and as well on the 87 over the long term, and obviously 787 improving through that period. So over the long term, we're confident in the long-term cash flow growth, I'll say, story that we have in place. And I think it's a unique one when I compare us to other industrials.

Myles Alexander Walton
Deutsche Bank Securities, Inc.

Q

Great. Thanks.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Thanks.

Operator: And we'll go to Sam Pearlstein with Wells Fargo. Please go ahead.

Samuel J. Pearlstein
Wells Fargo Securities LLC

Q

Good morning.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Morning.

Samuel J. Pearlstein
Wells Fargo Securities LLC

Q

Dennis, you've talked about in the past being able to get mid-teens margins within the BCA business. And I guess I'm wondering how comfortable you are still with that? And how do things like the 777 transition and volume and actually lower commodity prices, which should be lower escalation, how does that play into it? What does it take to get those kind of margins in BCA?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yeah, hey, Sam. Good morning. Yeah, we remain focused on that aspirational target as we've talked about before. We see margin growth in BCA as an important priority for us. You're seeing it in the data and the results that we're producing. The productivity actions that Greg described earlier are all part of doing that. Part of it is productivity efficiency inside our own factories. Another key portion of that is within our supply chain through our Partnering for Success effort. But if we take the longer term view of what our company can and should be, getting to that mid-teens margin range is an expectation and aspiration that we set for ourselves. And I think that's a smart and aggressive target for the long-term. We're going to stay very focused on it.

As Greg had said, with the backlog that we have and the product line that we have, our opportunity to generate long-term cash growth and long-term margin accretion is very strong. And we are taking the right productivity actions both internally and externally to do that. And that will result in increased return to our shareholders, and it will allow us to fund and invest in our future innovation and talent. So we are very focused on doing that and remain steadfast on that longer term target.

Now regarding your question around 777 as we think about that transition, obviously a key topic for us here as the 777X will begin coming into the production system in the 2018 timeframe leading to EIS in 2020. As I mentioned earlier, we're building the 777 bridge with today's current product line, leveraging the fact that that airplane does provide a unique value proposition in the marketplace. We're thinking carefully through exactly how we do that transition and the timing of it.

As we've talked about before, it's important that we do that efficiently. We're trying to pull ahead some of the technology investment in the line, like automation in the fuselage line, to de-risk that transition. And as I mentioned earlier, we've already implemented that automation here in the 777 line on the fuselage upright build, and that's going well. So that's another way to de-risk that transition and ensure profitability through it.

There's been a lot of conversations out there about exactly what the shape of that transition might be. And we're factoring in market demand; as I said, some uncertainty around cargo recovery; frankly, some uncertainty around Ex-Im Bank reauthorization. Those are factors that could cause some customers to delay decisions around wide bodies, so we're being mindful of that. We want to make sure we maintain a highly profitable line through the transition. All of those factors are going into our planning right now. Frankly, with that, we don't see any scenarios where we'd come down below a seven a month production rate during the transition.

Important again to remind ourselves that 2016 is essentially sold out; 2017 is more than half sold out. So this transition that we're talking about is a 2017 and beyond transition. And through all of that, we're going to drive this in a way that maximizes profitability at the line, through the transition, allows us to continue to invest in the future and my broader comments about continued cash growth and margin accretion over the long-term all account for that 777 transition. So that's all factored into our bigger game plan.

Samuel J. Pearlstein
Wells Fargo Securities LLC
Q

Thanks. And, Greg, I don't know if you can mention anything about commodity costs and how that affects the escalation and your assumptions in the program accounting. Did it have any effect this quarter?

Gregory D. Smith
Chief Financial Officer & Executive Vice President
A

No, no. It didn't. It didn't, Sam. It didn't have much impact at all.

Samuel J. Pearlstein
Wells Fargo Securities LLC
Q

Thank you.

Gregory D. Smith
Chief Financial Officer & Executive Vice President
A

Thanks.

Operator: Our next question is from Cai von Rumohr with Cowen & Company. Please go ahead.

Cai von Rumohr
Cowen & Co. LLC
Q

Yes. Thank you very much. So could you comment whether there were any adjustments to commercial blocks or accrual rates? And then kind of relatedly, Dennis, you talked about moderated kind of quarter strength. Are you still looking for book-to-bill to get to 1.0 for the year because it looks like you're going to have to move pretty quickly to get there? And if so, how does the Chinese order play into that and what are the implications of kind of getting there or not getting there in terms of potential profitability looking forward? Thank you.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Cai, let me take the second part and then I'll flip it to Greg for your first question.

Cai von Rumohr
Cowen & Co. LLC

Q

Yep, okay.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

So regarding book-to-bill for the year, again, we continue to see book-to-bill of approximately 1 for the end of the year. As I mentioned, we have some hesitancy right now in the wide body marketplace around cargo recovery and uncertainty with the Ex-Im Bank. That's causing some customers to pause a bit on decision-making so it's more of a timing issue rather than a volume issue. So we still anticipate book-to-bill to be roughly 1 by the end of the year. Some decisions could slide into the early part of the new year. Frankly, with about 5,700 aircraft in backlog, annual book-to-bill ratios are not that important to us. We're continuing to generate orders pipeline, but timing quarter-to-quarter, if it happens to shift a bit, with the kind of backlog we have, we remain very confident in the long-term plan.

Now as you mentioned the recent announcement by our customers in China was very positive for us. We were honored to host President Xi at our factory in Everett a couple of weeks ago, amongst a number of agreements that included an announcement around 300 aircraft, 250 narrow bodies and 50 wide bodies. Some of those are airplanes that were already in backlog but unidentified. Others are incremental new commitments. And we'll be working through the specific deals on those airplanes with our customers over the next many months. And we'll announce those as they come to fruition. But that will generally create upside to our book-to-bill posture for the end of the year. Greg, you want to take the first part of the question?

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Sure. Yeah, Cai, on block extensions we extended the 737 by 200 aircraft, so one block extension there. And then with the increased demand and outlook on the 767, we increased that as well by 34 units. As far as changing in booking rates by program, no significant changes I'd say, Cai, across the board.

Cai von Rumohr
Cowen & Co. LLC

Q

Thank you very much.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

You're welcome.

Operator: Our next question is from Jason Gursky with Citi. Please go ahead.

Jason M. Gursky
Citigroup Global Markets, Inc. (Broker)

Q

Yeah, one quick clarification question and then the [indiscernible] (37:57) one. Dennis, you mentioned a rate of 7 a month on the 777. Would you be firing blanks in that environment? That's the clarification question. And then the [indiscernible] (38:07) question one for Greg on CapEx out into the future. Can you talk about the puts and takes that you're likely to see over the next couple of years on CapEx?

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

Yep. Yeah. Hey, Jason, on the first question there, yeah, that will be factored into the overall transition plan. And as you're well aware, that's a very common practice for us as we transition model mixes in our high volume lines. As we go from 777 to 777X where we can pull technology and implementation ahead as we're doing with automation we will. That'll make the transition even smoother. In some cases we will fire selected blanks down the production line. That again will help us smooth out implementation and ensure lean implementation.

Note that we'll also have some 777 flight test – excuse me, 777X flight test aircraft that will flow through the production system in that same timeframe. So all of that will be factored into the production profile and the transition plan. But again as I said, we look through all the options and variables here both from a market demand standpoint, from a production efficiency standpoint, we don't see any scenarios that would take us below a 7 a month production rate. And we're very confident that we can achieve that implementation, remain very profitable on that line while we do it, and successfully bring the 777X to the marketplace.

Gregory D. Smith
Chief Financial Officer & Executive Vice President
A

And, Jason, on CapEx, we'll expect to go up slightly next year from our levels this year. And again that's supporting the growth in the production rates we talked about and further investments in the Defense business, as well as some of the productivity initiatives. So further implementation of the automation activity on the 37 and the 87 will also be put into play there. And again supporting 777X, as well as the planned production rates. And then I would say past 2016, then we start to come down and moderate from there as really, again, linked to our growth and linked to our investment profile.

Jason M. Gursky
Citigroup Global Markets, Inc. (Broker)
Q

Okay. That's helpful. Thanks, guys.

Gregory D. Smith
Chief Financial Officer & Executive Vice President
A

Okay. You're welcome.

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

Yep. Thanks, Jason.

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

Ronald Jay Epstein
Bank of America Merrill Lynch
Q

Yeah, hey. Good morning, guys.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Morning.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Morning, Ron.

Ronald Jay Epstein
Bank of America Merrill Lynch

Q

Quick question for you, for Greg. When you think about balancing near term capital returns to shareholders versus long-term value, and kind of in the context of this is I'm thinking about the share buybacks, year-to-date you guys bought back, if I did the math right, 41.5 million shares for about $6 billion. Right?

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yeah.

Ronald Jay Epstein
Bank of America Merrill Lynch

Q

That implies an average cost of maybe $144 to $145 per share.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yeah.

Ronald Jay Epstein
Bank of America Merrill Lynch

Q

That's within about 10% of the historical highs of the stock. How do you think about that?

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Well, we think the stock is still undervalued. And again, I think it goes to the marketplace that Dennis talked about. It goes to the strength of the backlog which then links rate to the production rates that we have announced that are again delivering on that backlog. So it's that profile along with the productivity expectations year-over-year. So we obviously see a lot of value still left in this stock. That's why we bought back $20 billion in the last three years and remain committed to that. At the same time, remain committed to the dividend to ensure that we're competitive from the dividend perspective as well as investing in the business.

Then that's been first and foremost for us, investing in things like 777X, like the MAX, like 787-9 and 10 and these rate increases along with, again, efficiencies, automation that we're putting in on 777, we're putting in on 37 and then additional investments we're making down in Charleston to support, again, productivity and rate increases. So that's the kind of profile we see that gives us the confidence to continue to buy back these shares, but have a balanced deployment plan to meet all our objectives.

Ronald Jay Epstein
Bank of America Merrill Lynch

Q

Great. Super. And if I may just a follow-on, be it that everybody else asked about five questions. How do you guys think about the middle of the market airplane? That's something we've been thinking about a lot, and there's been a lot of chatter about that in the industry. How do you think about it as a potential market opportunity and what investment would be required?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yeah, we still see that as a niche market, but an important one, and we're having conversations with our customers. We see today that that market space is largely served by our 737 MAX 8 and 9 family and on the upper end, by the 787, and we think that in large part serves that market space. It's important that a lot of our customers, their buying behavior and their needs are related to families of aircraft. And we still see, in that narrow body marketplace, the MAX 8 as being right at the heart of the market, augmented with the MAX 9 to serve some of those needs that are in that, more the middle of the market segment. So for the near term, we see our current product line as being the right answer for that segment.

That said, we're continuing to have conversations with our customers, and if we need to respond with a new airplane in that marketplace, that would be something that would be more towards the middle of the next decade. It's not something that would dramatically affect our R&D profiles over the next four to five years. We think those profiles are very solid with our current development programs, but it is something we're keeping an eye on, continuing to talk with our customers. Understand their needs. And if the market demands a response, we'll be ready.

Ronald Jay Epstein
Bank of America Merrill Lynch

Q

Great. Thanks a lot.

Operator: Our next question's from Seth Seifman with JPMorgan. Please go ahead.

Seth M. Seifman
JPMorgan Securities LLC

Q

Hi. Thanks very much, and good morning.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Morning, Seth.

Seth M. Seifman
JPMorgan Securities LLC

Q

Morning. Digging in on the 787 a little bit more and what to expect in Q4, not to nitpick too much, but you've talked in the past about a healthy decline in the deferred growth in Q4. But now we're starting from a lower level, so just maybe a little more color on how to think about that? And then if you could explain a little bit about the dynamics as we head into 2016 and kind of why it plateaus for a little while before coming down at that [indiscernible] (44:35)?

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Sure. Yeah, no. We'll see a decline in deferred in the fourth quarter, I'd say similar to the rate of decline you've seen in this quarter, and Q3 certainly was helped by strong performance, but we did have some timing of expenditures as well. So we had a little bit of, I'll say, favorable pick-up in the third quarter. But again, I think when you step back and look at the overall profile or deferred to-date, it's better than what we originally projected.

And then as you move into 2016, Seth, as I said, you'll start to see that turn once you hit the 12 a month. So the growth will moderate obviously into the fourth quarter and then through into 2016 until you hit that rate, and then that's when we would expect it to turn. And that turn down, again, is driven by the rate as well as the step-down on the supply chain, the contracted step-down pricing, and the continued productivity, but also that mix. I mean, ensuring that we've got that Dash-9 continues to come into the production system as it has. So those are kind of, I'd say, the key indicators or key levers as we move into 2016.

Seth M. Seifman
JPMorgan Securities LLC

Q

Thanks very much.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

You're welcome.

Operator: And next we'll go to Carter Copeland with Barclays. Please go ahead.

Carter Copeland
Barclays Capital, Inc.

Q

Good morning, Dennis and Greg.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Morning.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Good morning, Carter.

Carter Copeland
Barclays Capital, Inc.

Q

Greg, I wondered if we could go back to the margins for a second. Just I noted you extended the block 200 units on the 37, but no material margin increase there. I wondered why that was. I assume that would be all MAXs. And then on the 777, Dennis, your comments about trying to maintain that margin rate to the extent possible. You obviously have some pretty significant extra cost there when you transition over the surge line from the 87 to the 777. Is it that that cost is in the 777X block, or it's called R&D? How should we think about how you manage the two different programs going down the same line? Because there's obviously significant cost there. So any color would be much appreciated.

Gregory D. Smith
Chief Financial Officer & Executive Vice President
A

Yeah, let me – If you're all right, I'll answer the MAX question.

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

Go ahead, Greg. Yep.

Gregory D. Smith
Chief Financial Officer & Executive Vice President
A

It was a slight pickup, Carter, but again, 200 units on a large block. So there's a lot of moving pieces in there. There's some investment in there for additional rate increases and productivity. So when you net that all out, again, not a significant change on overall booking rates for the quarter.

Carter Copeland
Barclays Capital, Inc.
Q

But positive? Okay.

Gregory D. Smith
Chief Financial Officer & Executive Vice President
A

Yep. Yep.

Carter Copeland
Barclays Capital, Inc.
Q

And on 777?

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

And to your second question on 777, so as you noted, the R&D investments, the CapEx investments we're making to bring 777X online are all part of the profile that we've shared with you in terms of our total R&D and CapEx investment. Where we can pull those forward and pre-implement on the 777 line to reduce risk, like the fuselage upright build, we are doing that, but all of that is included in our total investment profile for 777X.

Carter Copeland
Barclays Capital, Inc.
Q

All right. Thanks, guys.

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

You're welcome.

Operator: Our next question is from Steve Levenson with Stifel. Please go ahead.

Stephen E. Levenson
Stifel, Nicolaus & Co., Inc.

Q

Thanks. Good morning, everybody.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Morning.

Stephen E. Levenson
Stifel, Nicolaus & Co., Inc.

Q

Could you please expand your comments on the upward pressure on single isle rates and can you let us know if there's push back from supply chain particularly on engines?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yeah, we take a look at the market there, Steve. It continues to show signs of strength and growth. What we're seeing from customers in terms of market demand, especially from 737 MAX continues to be a positive sign for us. As we've told you, we're at 42 a month now, we're ramping to 47 a month and 52 a month by 2018. Those are committed plans that we have in place. We continue to do studies on possibilities of ramping up beyond that. As I said earlier, we're going to maintain very strict financial discipline as we do those studies being very mindful about it. We are still in a slightly over booked position in terms of our order profile for the 737 and all of that just creates general upward pressure to production rates. We're going to be very fiscally responsible as we consider those options. Again our committed plan takes us out through 2018 so we have time to consider these alternatives beyond that.

The other thing that I'd like to factor in is the 737 MAX development; the fact that we've achieved power-on on the first airplane, that final assembly is on or ahead of schedule also gives us confidence in terms of the airplane coming together and being ready for EIS with our customer. So both the development program progress as well as the market demand signals show us that narrow bodies are a very robust market for us both short and long-term.

Stephen E. Levenson
Stifel, Nicolaus & Co., Inc.

Q

And again, any pushback from suppliers?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Well, we continue to talk to our supply chain. Certainly ramping up to the degree we're ramping up is something that we have to pay attention to. And our supply chain is letting us know where they see pressure points and where we need to work together. Nothing that I would say is out of the ordinary. These are normal ramp-up pressures and we know how to do these rate ramp ups. We've done more than a dozen over the last few years. We've got a few more important ones ahead of us during the next five years.

But working across the integrated supply chain and making sure they have the capacity and the capability to deliver on our needs is an important part of the equation. That's one of the things we factor into our committed plans. We remain very confident that our supply chain can meet our ramp up to 52 a month on the MAX. If we were to go beyond that, factoring in supply chain capability is a key component of that decision. Again, we have plenty of time to make that decision with the committed plans we already have in place.

Stephen E. Levenson
Stifel, Nicolaus & Co., Inc.
Q

Got it. Thank you very much.

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

You're welcome.

Troy J. Lahr
Vice President-Investor Relations
A

Operator, we have time for one more question.

Operator: And that will be from Rob Spingarn with Credit Suisse. Please go ahead.

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

Thank you. Good morning.

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

Morning.

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

Dennis, I wanted to ask you on the buyback, but before I get to that, just a quick question for Greg on the F-15 and then I think there were some C-17s that were pre-built but delivered in the quarter. So, Greg, the question there is how much cash did the F-15 deal, I think it's about $700 million contribution to revenue, but those two items, how much unusual cash did those provide in the quarter? And then, Dennis, for you, given that you have pretty good visibility into what your program investment looks like over let's say the next half decade with the MAX, the 777X, and it sounds like 757 replacements in the plan but doesn't really ramp until after that. Given that, can we expect that your buyback at the current levels should continue unabated going forward at roughly those levels?

Dennis A. Muilenburg
President, Chief Executive Officer & Director
A

Greg, why don't you take the first one.

Gregory D. Smith
Chief Financial Officer & Executive Vice President
A

Yeah, I mean no impact on cash on the F-15, Rob and then I'd say very insignificant on the C-17.

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

Okay.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

And to your go-forward question, Rob, again as we look at priorities for cash deployment over the next several years, top priority remains organic investment and this is delivering on our development programs like the 777X, the MAX, and the 787-10. We're confident in that and as we said before with the phasing of those programs, our R&D profile year to year we expect to remain consistent. And so that should give you confidence that our R&D foundation is not going to vary significantly year to year. That'll be a foundational investment that's built into the plan over the next five years.

Second priority, as we said, is returning strong value to our shareholders both in the form of dividends and share repurchase. We expect that to continue to be a strong component of our overall cash deployment over the next many years. And then thirdly, any targeted actions we might take in the M&A arena, acquisition arena. That would be a third priority in that list.

So we're going remain very focused on those priorities and the fact that we expect long-term cash growth will allow us to fuel both those future investments and things like share repurchase.

Robert M. Spingarn
Credit Suisse Securities (USA) LLC (Broker)

Q

So, Dennis, to just close the kind of loop on that, barring big M&A, forward years should really not look any different than now from a buyback perspective, or perhaps higher, given that you're ramping?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yeah, I'm not going to give you guidance to specific numbers, Rob, but share repurchase and dividend strength over the long term will continue to be a high priority for us on cash deployment.

Robert M. Spingarn
Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. Thank you.

Operator: Ladies and gentlemen, that completes the analyst question-and-answer session. [Operator Instructions] I'll now return you to The Boeing Company for introductory remarks by Mr. Tom Downey, Senior Vice President of Corporate Communications. Mr. Downey, please go ahead.

Thomas J. Downey
Senior Vice President-Communications

Thank you. We will continue with the questions for Dennis and Greg. If you have any questions following this part of the session, please call our Media Relations team at 312-544-2002.

Operator, we are ready for the first question, and in the interest of time, we ask that you limit everyone to just one question, please.

QUESTION AND ANSWER SECTION

Operator: And we'll go to Julie Johnsson with Bloomberg News. Please go ahead.

Julie Johnsson
Bloomberg News

Q

Oh hi, all. I just wanted to circle back on 777 rate and follow up with a 747 rate question. I just want to make sure I understand this. Are you studying taking the rate to seven a month or planning to? And would this be effective in 2017? Or are we looking more at like at 2018 for the triple? And on 74, obviously, the cargo market is not helping order activity with that plane. Are we potentially looking at taking the rate below one a month?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yeah, let me field the first one there, and then, Greg, I'll ask you to touch on the second one.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yeah, sure.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yeah, Julie, regarding 777, as I said, we're doing our scenario planning right now that includes market demand and feedback we're hearing from our customers. It includes the value proposition of the 777 and the 777X, and I want to stress again that that airplane is providing an absolutely unique value proposition in the marketplace. It's differentiated and our customers see it, and then also doing an efficient and profitable transition from 777 to 777X. So those are all things that we're factoring into our plan. We haven't finalized that plan yet. We're working through a variety of options.

But as we look through all of those options, we don't see any scenarios that would take us below a seven a month production rate. So we wanted to make sure that was clear, as there's been speculation about what option range we might look at. We see that as a floor for our planning given all the scenarios we're looking at. Specific timing, implementation is yet to be finalized. We're working our way through those details. Those will be decisions we'll have to make in the first part of next year. But I'll stress again that we are sold out essentially through 2016; more than half sold out through 2017. So what we're talking about here is a transition that's out 2017 and beyond. And we would get into the meat of that in the 2018 timeframe. So more details to be worked through, but we remain confident that, considering all the factors I talked about, that we'll be able to profitably go through that transition and bring the 777X to the marketplace.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yeah, Julie, on 747, as you know, this has been a challenging marketplace recently, and we took the – we announced taking the rate down from 1.3 to 1 a month early in 2016. So we continue to monitor that marketplace. It is challenging right now. It is driven by the market. It's a great airplane. It's an airplane that sits in a class within itself, whether it's an I or a freighter. So this is certainly market dynamics. We've got a pipeline of customers we're looking at. But again, having said that, it's a challenging marketplace for the airplane. So we continue to watch it and at the same time, focus on productivity within the factories and the supply chain. And we'll likely take another look at the rate here early next year and see where we are on orders and backlog and move forward from there, but right now, the plan is to hold at one a month.

Operator: Our next question's from Doug Cameron with The Wall Street Journal. Please go ahead.

Doug Cameron
The Wall Street Journal

Q

Hi. Good morning, everyone. I know you must be pretty exhausted after that defense question at the end of the analyst call, but hopefully you'll indulge me. Given the amount of portfolio shaping that's going on amongst the primes now, Dennis, how comfortable are you with the shape of the BDS right now, particularly on military aircraft and space? And are you comfortable with that regardless of what happens with some big upcoming contests?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yeah, Doug, we are. And as I said before, we have a strong, robust healthy Defense business. Now it's a tough marketplace, and we've acknowledged that. We're dealing with realities of sequestration in the U.S. defense budget, somewhat offset by what we've seen as international defense growth, especially in the Middle East and Asia-Pacific regions. But our Defense business overall is a healthy portfolio. We like the program structures we have. We're growing internationally and we're investing for the long run. That marketplace is somewhat muted so we expect that business to be relatively flat to slight growth top line.

In parallel with that, we're continuing to drive bottom line performance, and you saw it in the results here with a 12.2% margin quarter in our defense business. So that's a robust, important part of our portfolio. We have differentiated product lines on things like commercial derivatives, the P-8 and the tanker which present us for opportunities for longer term growth and leverage the one Boeing value, if you will, across commercial and defense sectors. We're continuing to invest in future product lines around human space exploration, satellites. We're investing in unmanned systems and ISR capabilities. And importantly we are investing for some critical franchise programs for the future.

You alluded to that. But programs like long range strike, the new T-X trainer are important and one of the reasons we continue to drive productivity is so we can invest in those future product lines. And we don't see a need to significantly change the structure of our Defense business. We're going to stay very focused on executing the business, investing organically, and where we can make targeted acquisitions to round out our portfolio, we'll continue to do that.

Operator: Our next question's from Dominic Gates with The Seattle Times. Please go ahead.

Dominic Gates
The Seattle Times Co.

Q

Good morning, Dennis, and Greg.

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Morning, Dominic.

Dominic Gates
The Seattle Times Co.

Q

I just wanted to clarify a couple of things about the 777 rate question. The EIS for 777X is 2020. But presumably that's going to ramp up over several years. So the first question about the bridge is, how far beyond 2020 are you still having to fill a bridge for the current 777 model? And then secondly, you gave us some reassurance that the floor for the production rate in the bridge is seven a month, but you've also mentioned firing blanks in that. Can you give us some idea, like how many blanks are we talking about? If it was one a month, that's very different from one or two a year. So give us some guidance there?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yeah, hey Dominic, to the first part of your question. When you look at the duration of the bridge, you're right 777X EIS is in 2020. As we said the bridge we're trying to build with the current 777 is roughly a five-year bridge, so it takes us to that same timeframe. The depth of that bridge is most significant in the 2018, 2019 timeframe. So we're very focused on filling that out. And we need about 40 to 60 aircraft per year over that five years to fill that bridge. So that effort continues to press ahead.

Now when you think about the transition production rate, the fact that we'll fire some selective blanks through the line, that is not a high volume decision, to your point. This is something that we'll do selectively as we bring lean implementation online in the new production rate. We haven't finalized exactly how many that will be, but those are incrementals, not a sustained activity. And then also mindful that we will have some 777X flight test aircraft, typical numbers of flight test aircraft, principally in the 2018, 2019 timeframe that'll be within that production line as well. So both of those are being factored into the profile.

Operator: And our next question's from Alwyn Scott with Reuters. Please go ahead.

Alwyn Scott
Thomson Reuters

Q

Hi. Can you hear me?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yep.

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yep.

Alwyn Scott
Thomson Reuters

Q

Okay. So I wanted to come back to the 787, Dennis, and ask, and also Greg, how far do you think you can keep increasing the deferred production costs? Are we nearing the upper limit of what you can reasonably defer without taking a charge? And if we're nearing that, how do you think about whether you need to increase the accounting block? Or at what point you may need to take a reach forward loss?

Gregory D. Smith
Chief Financial Officer & Executive Vice President

A

Yeah, on the deferred I would say, Alwyn, that the profile hasn't changed. The key milestones haven't changed. The growth will start to moderate again in the fourth quarter and as I've indicated, once we hit 12 a month that's when the deferred will start to turn, I'd say, all the key contributors to that unit cost mix. And again, getting to the 12 a month which, again, we're making good progress in that area. So those are all the key items I'll say the contributors to that, but the fundamental milestones in the profile, that has not changed from what we discussed probably a year and a half ago.

Thomas J. Downey
Senior Vice President-Communications

A

Operator, we have time for one final media question.

Operator: And that'll be from Micah Maidenberg with Crain's Chicago Business. Please go ahead.

Micah Maidenberg
Crain's Chicago Business

Q

Hi. Good morning. Dennis or Greg, Delta Air Lines has continued to push this idea that there's a bubble in the wide body aircraft market. They compared that segment to the pre-recession real estate market. Any comment on this take from Delta?

Dennis A. Muilenburg
President, Chief Executive Officer & Director

A

Yeah, Micah, I'll go back to my earlier comments about our broader look at the wide body market. We continue to see a very healthy overall marketplace both narrow bodies and wide bodies. As I said, traffic growth is sustained. Replacement demand is sustained. Deferrals, cancellations below historic levels. We recognize some of the comments that have come out recently and believe you're referencing the note around $10 million 777s that might be available.

I'll say just based on our understanding of the marketplace and what we understand from our customers, that number is the wrong order of magnitude. And, frankly, the value of the 777 is holding up very well in the marketplace. It is a unique airplane. In that 365-seat category, there is no competing aircraft out there. It's a unique value proposition for our customers. So values are holding up well in the marketplace.

We are mindful that the cargo market has been a bit slow to return. We're mindful of the fact that lack of Ex-Im Bank reauthorization is creating some uncertainty and some delays in customer decisions. And so we're considering that. But if you step back from it, the overall health of the marketplace and the unique value proposition of our airplanes is very clear and we remain confident in that.

Thomas J. Downey
Senior Vice President-Communications

That concludes our earnings call. Again, for members of the media, if you have additional questions, please call our Media Relations team at 312-544-2002. Thank you.