

01-Jun-2017

The Boeing Co. (BA)

Sanford C. Bernstein & Co. Strategic Decision Conference

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MANAGEMENT DISCUSSION SECTION

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

Okay. Let's get started. I'm Doug Harned, Bernstein's aerospace and defense analyst. We're very pleased to have with us again Boeing's Chairman and CEO, Dennis Muilenburg. If you have questions, please, you know the procedure. You can put them on cards and get them passed up to me.

Dennis is going to say a few words, and then we're going to do a fireside chat-side format. So, Dennis?

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

All right. Thank you, Doug, and good morning. It's good to be back with you again this year. I appreciate the time. What I'll do is just share a couple of charts to get started on the marketplace and how we see commercial and defense sectors, talk a little bit about our strategy and then, as Doug said, we'll jump into some open Q&A.

And as always, our forward-looking statement. So, let me touch first on [ph] contacts (00:57) mission in a marketplace that we're operating in. But if I take a look at our Boeing mission, as we've refreshed for our second century, our 101st doing business this year, this idea of connect, protect, explore and inspire speaks to the importance of the missions we do and, in fact, that lives depend on it every day, and that drives our sense of excellence in how we're investing for the future.

And the big goal that we set for ourselves as an enterprise as we start our second century is to not only be the best in aerospace, but to step up to this, what we call, global industrial champion level of performance. And you'll see that reflected in our financial targets and our expectations for the future.

On the right-hand side of the chart, you'll see our look at the market, 10-year market, about \$7.5 trillion across the three sectors of interest to us. Commercial airplanes continues to be a very strong marketplace. We're seeing sustained passenger traffic growth, historically, 5% to 6% a year year-to-date. Commercial passenger traffic is growing a little over 8% around the globe with very strong growth continuing in Asia-Pacific and Middle East

regions. We see that global marketplace diversifying. It's a much less cyclical market as a result, a much more globally net worth passenger market. So, we see commercial airplanes as a strong growth market for the future.

We have seen recently some hesitancy in wide-body demand, but we're managing well through that and feel very confident in a longer term cycle including a big wide-body replacement cycle that will begin early in the next decade where our Boeing 777 and Boeing 787 are well aligned to that market opportunity.

Defense and space market is solid. We see some re-strengthening of the U.S. Defense budget. There's still some questions about how much it will strengthen. But generally, that's a neutral to positive market growth area with a lot of focus on affordable solutions and bringing capability to our customers rapidly.

And then, on the services market, we see that as our biggest growth market opportunity, \$2.5 trillion market and we're about a 7% to 9% market share owner today, although we have a much more extensive installed base. So, in terms of headroom in the marketplace, we see that as a big growth opportunity for us. It's one of the reasons we're launching our new Boeing Global Services business here in the third quarter to go capture and increase market share in services.

Now, our strategy to go after that marketplace is a three-fold strategy. First of all, it's around leveraging One Boeing. This is the idea that we have unmatched debt and capability, if you look across commercial, defense and space sectors. And that allows us to manage and share processes and technology and talent in a very unique way and to do it on a global scale.

Our second part of the strategy is around building strength on strength and driving productivity and performance. This includes leveraging the backlog. We have almost \$500 billion of backlog in place today, more than 5,700 commercial airplanes in backlog and a strong defense backlog gives us a great opportunity to drive productivity, performance and execute and deliver on both top and bottom line.

And then, the third part of the strategy is around sharpening and accelerating for the future and investing in innovation and growth. This includes some key initiatives around services ramp-up, digitizing our business, what I call second century design and manufacturing investments that drive efficiency and agility in our operations.

Our goals on the right-hand side of the chart are very clear. Our intent to be a market leader in the commercial, defense and services sectors in which we operate, that includes top-quartile performance and, as I said earlier, this global industrial champion level of performance, moving ourselves to mid-teen, double-digit margins. Our year-over-year cash flow growth is a key element of that.

We are investing heavily in innovation, bringing more innovation to the marketplace than we ever had in the past. New product lineups coming in the commercial airplane marketplace, including the 787 family; the Dash 10 just entering flight test; the MAX – 737 MAX just entering production ramp-up; 777X in the heart of development today; as well as new investments we're making in the defense marketplace like T-X, JSTARS and some of the other new franchise opportunities there.

So, continuing to bring innovation to the marketplace and then also innovating inside our four walls, design and manufacturing technology for the future to make us more agile and to take cyclicity out of the business. All of that will contribute to the financial targets that we've laid out, given the strong marketplace, the backlog position and our production ramp-up in commercial airplanes going from mid-700 deliveries this year to well north of 900 deliveries by the end of the decade. We see this as a growing top line business. Defense will be part of that growth. We also think our services ramp-up will contribute to that.

So, top line growth opportunities. Bottom line growth with our productivity investments will follow. As I said, our target of mid-teen double-digit margins, we're on the path to do that. We're also managing our R&D and our capital investments in a way to augment that and make sure that's stable over time. If we take all of those factors together, we see this as a year-over-year cash growth business for the long term.

And my last point on that is around taking cyclical out of the business. I think, in the past, this has been viewed as a cyclical business. We hear a lot of questions about, are we at the peak of the current cycle? We see the marketplace as fundamentally different. As I said earlier, the global marketplace is a much less cyclical market. Passenger traffic patterns today are much different than they've been in the past. We have a backlog that's seven years instead of two years, a backlog that's geographically diversified, not a U.S./Europe-dominated backlog. So, from a market standpoint, it's less cyclical.

But inside our business, we've also changed. And this is how we managed our production rates, keeping supply and demand in balance, the freeze on our pension, long-term labor agreements, a phased R&D plan so we have stable R&D and then designing services growth which, again, tends to be non-cyclical in nature. So, a lot of actions underway that I think are fundamentally changing the nature of this business from one that, in the past, has been cyclical to one that is now a long-term sustained growth business, and one that will produce year-over-year cash growth as a result.

So, that's just a bit of context for what's going on. And, Doug, I'll slide it over, and we'll do some questions.

QUESTION AND ANSWER SECTION

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Great. Thank you. I'd like to start out just following on the comments you just made about the cyclical nature of the business and the change in demand. If you look at Boeing Commercial today, how do you see the demand there [ph] and I'd say that's (08:16) program-by-program? In other words, you've talked about being oversold on Boeing 737 MAX. How long is that the case? I mean, how long [ph] does that order book fill (08:26) out for you?

Dennis A. Muilenburg

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

A

Well, as I said, when you take a look at backlog in place today, total backlog is a little over 5,700 Commercial airplanes, so roughly the equivalent of seven years of production. If you look at Boeing 737, we continue to see very strong demand in single-aisles. We're at 42-a-month production rate right now. We're stepping to 47 a month in the third quarter. We're going to 52 a month next year, 57 a month the year after.

Even against that production profile, we are strongly oversold and market demand signals are telling us, you could go even higher. So, as part of our effort to keep supply and demand in balance, have a long-term growth plan, we settled in at that 57-a-month rate structure. We think that is clearly sustainable out through the end of the decade and beyond. Again, with some market pressure, it can go beyond that.

If you take a look at Boeing 787, right now, we're at – running at 12 a month. We've got almost 700 airplanes in backlog. So, again, we see 12 a month as a very strong, sustainable production rate. We're currently evaluating timing of stepping up to 14 a month. We're – we still see a plan, our path to getting to 14 a month but we want to

be very diligent about keeping supply and demand in balance. But again, it's clear that the demand signals are there and the value that the Boeing 787 is bringing into the marketplace, we can see a path to 14 a month.

On the Boeing 777, we've made the decision to cut back on the production rate as we go to the bridge. We'll be stepping down to five a month this fall, as we've previously announced. And through the bridge, that is, in effect, delivering airplanes to three-and-a-half a month as we ramp over to Boeing 777X.

At that rate, we're about 90% sold out in 2018 and 2019, so we got a few more slots to fill on Boeing 777. But a number of campaigns underway that give us confidence that we'll fill that bridge. So, we see that as the production rate floor for Boeing 777. And then, that will position us to ramp up Boeing 777X as it comes online. We've got about 340 firm backlog on Boeing 777X.

And I think a good reminder is, as we get into the next decade, as we get through that bridge, we see a very big wide-body replacement demand that will occur. 39,000 new airplanes needed over the next 20 years. 9,000 of those are wide-bodies. And a big part of that replacement cycle starts early next decade. Boeing 777X and Boeing 787 are perfectly positioned for that.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And so, just to go into the individual programs a little bit more. If you look at Boeing 777X, a lot of – the majority of your orders, the early orders are coming from the Persian Gulf carriers. And so, when you look at that demand picture...

Dennis A. Muilenburg

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

A

Yeah...

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

There's – I think there's reason to think there may be some risks in there. How do you look at that part of the order book and then the ability to fill that, should you see some cutbacks there?

Dennis A. Muilenburg

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

A

Well, yeah, we're continuing to be mindful of that. And wide-bodies, in general, we've seen some market hesitation over the last year and we've all recognized that. And that's why we're trying to be very diligent about keeping supply and demand in balance.

Now, in the Middle East, we're still seeing passenger traffic grow at double-digit rates. It's still exceeding the global passenger rate growth. We've had some challenges with some airlines in the region. Other airlines are doing exceptionally well. So, it's mixed. And you're right, we've got a fair amount of Boeing 777X orders coming from Middle East carriers, but they're well diversified across those carriers and we're seeing demand for Boeing 777X outside of the Middle East. I think a good example is Singapore's announcement earlier this year of intent to buy 20 Boeing 777-9Xs. We're seeing a lot of Asia-Pacific demand as well.

So, I don't see it as being over concentrated in the Middle East, but it's one of the reasons we're being very thoughtful about our Boeing 777 production rate. That's why we've decided to step down as we get through the

bridge, make sure we have a smooth transition to the Boeing 777X and I think we've got a good balance of supply and demand going forward. And while there's some risks or things to watch in the Middle East, there are other upside opportunities in the Asia-Pacific region. So, I think, on balance, we feel pretty good about that.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And then, on the 777X, you've talked about entering service at the beginning of...

Dennis A. Muilenburg

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

A

Yes...

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

FY 2020 [indiscernible] (12:58) possibly a little bit earlier. Can you tell us how the program is going?

Dennis A. Muilenburg

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

A

Yeah. Well, Boeing 777X development is right on track. Just had the opportunity to visit our team again in Everett last week and walked through the factory and went through the Composite Wing Center where we're building the fourth-generation composite wing. That is all coming online right on track. We're building initial production parts now. So, our supply chain is energized and running. We're completing the detailed design workup. We still see that airplane entering into final assembly in 2018, enter into service on 2020.

So, we're about midway through the development program, right on track. Weight of the airplane looks good, performance looks good. Production system transformation, and it's probably the most significant piece of this, is going to a modern digital production system. We're getting rid out of the old fixed tooling infrastructure and going to much more agile tooling, low capital investment structure for the future.

So, that production system transition, automation, the fuselage upright build that we're doing on 777 right now to derisk that, all of those production system transformation steps are occurring, too. So, I feel very good about that development program, and we still have work ahead of us. We'll be getting into build an airplane, flight testing, and then deliver on schedule.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Well, and on that program, you've talked in the past that if you look overall that you're actually kind of at a peak CapEx level right now. Could you talk about how that fits with the fact that you're going to be – you're ramping up and how much have you front-loaded your investment on Boeing 777X?

Dennis A. Muilenburg

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

A

Yeah. This year, we're roughly at peak investment on the Boeing 777X. So, when we take a look at our R&D and capital spending profile over the next several years, we expect that to be very stable. We're actually peaked on the capital investment. We're into the heart of the R&D investment. We'll finish that up as we get through flight

test. So, you should expect to see our overall R&D and capital expenditure profile be very level over the next several years.

This is all part of our strategy again to take cyclicity out of the business, to feather in our development programs as we've wrapped up the MAX very successfully, as we're now ramping up production, exiting flight test, entering production. That program was delivered on cost and schedule, Boeing 787-10 just had first flight. Third production unit is now inflow. So, that development program is closing up very nicely.

Boeing 777 is on the back side of that, Boeing 777X. So, this idea of a phased R&D plan looking across the entire enterprise is a key part of how we're managing our efforts. And you should expect to see that kind of stable behavior in our R&D expenditure over the next several years.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Now, on the 737, Airbus has been quite aggressive in selling the A321neo. I think it's been a very successful airplane. You've talked about responding with a slightly larger 737 MAX 10 which would be roughly the same size as the 321neo. Do you need to see to launch that? And if you launch it, is it something that we'll see much investment around it?

Dennis A. Muilenburg

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

A

Yeah. We are continuing – we have very productive conversations with our customers on the MAX 10. We haven't made an official launch decision yet, but things are maturing very nicely. And again, we're going to be very diligent about making sure there's value for the investment to be made. We still see the heart of the market in single aisles in that MAX 8, MAX 9 size category. You see that bearing out in the orders. So, with more than 3,500 orders on the MAX, we feel very strong about the heart of the market.

A MAX 10, as we've been able to configure the airplane, talking with our customers, would be basically the same size as the A321, have about 5% lower operating cost per seat because of the weight advantage of the airplane. So clearly, it could bring value to the marketplace. If we were to proceed with that, it could eventually be 20%, maybe 25% of the sale for the MAX profile and one that would be highly common with the MAX 9 in our production system.

It's not a big R&D expenditure. It's an airplane that would enter into service in the 2020 timeframe, and it's one, if we were to make that investment, would fit within our existing investment profile overall as I just described it. It's not a big investment, but we want to make sure that we're doing the right thing in the marketplace. So, we'll continue those conversations. This is a nearer term decision for us and we'll make the right decision when the timing is right.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And then on 787, what are you looking for to gain confidence to go to 14 a month? And it seems now, I mean our sense is things are fairly in balance at 12 a month for a ways to go, but with weakness in the wide-body market overall, how do you start thinking about 14?

Dennis A. Muilenburg

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

A

Well, first of all, the 787 continues to look very strong in the marketplace. So, as you know, we have almost 700 airplanes in backlog. So, at 12 a month, that is a long term, very solid, sustainable rate. And so, what we're really looking at now is timing of stepping to 14 a month. That's still our plan, but we want to make sure we keep supply and demand in balance. Pricing of the airplane is holding up very well in the marketplace. So, it's not as if we have to rush to make a rate decision. This is a rate decision that's based on keeping supply and demand in the right place in the market.

It's not a big capital investment. So, it's not something what we have to make a decision on a particular date that demand is a big investment to prepare the path. In fact, we've been making incremental investments with our supply chain all along to protect the 14 a month and it's a relatively small capital investment to take that next incremental step. That's the beauty of it. So, this is really about just keeping supply and demand in balance. The marketplace signals still tell us that we can step-up to 14 a month. We're just going to do that in a very diligent manner.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Q

So, when you look at that whole landscape, you all have talked about potentially building a middle-of-the-market airplane or a number of different names for this have come up. But how are you thinking about that right now?

Dennis A. Muilenburg

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

A

Well, that's another area where we're having good productive conversations with our customers. It's a little earlier phase, just understanding the marketplace and potential customer demand, something that would be positioned between the 737 family and the 787 family, notionally, an airplane that's a little larger and longer range than the 757. A lot inputs from customers right now indicating market interest. But we want to go through all of our due diligence to make sure if we decide to go down that path, we've got the right airplane and the right business case.

Again, this isn't something we need to rush to do. Entering the service would be 2024, 2025 kind of timeframe. If we decide to launch and go down that path, it's not something that will significantly change our R&D profile over the next year. In fact, timing, again, fits very well with our phased R&D. If we were to do this airplane, it would be on the backside of 777X and would be the next thing that would fit within that phased R&D profile that I talked about. So, timing makes sense. Customers are indicating some interest. We're having productive conversations. But this is a decision still a little out ahead of us.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Q

And your expectation is then that in terms of R&D and CapEx requirements for an airplane like this, that would come sort of start 2020-2021, that timeframe?

Dennis A. Muilenburg

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

A

Yeah. Late this decade, you'd start to fill it in and then you'd get up to peak R&D early in the next decade. As I said, from a phasing standpoint, it would fit very nicely on the backside of Boeing 777X. So, it's not something where you're going to see a spike in R&D or capital requirements over the next several years. It will be something that will fit very neatly into a level-loaded R&D profile.

Douglas S. Hamed
Analyst, Sanford C. Bernstein & Co. LLC

Q

Now, you've spoken in the past about the goal of being at mid-teens margins for BCA at the end of the decade. So, we're getting closer.

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

A

Yes.

Douglas S. Hamed
Analyst, Sanford C. Bernstein & Co. LLC

Q

And how do you look at that now and how do you get there?

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

A

Well, one, we're very committed to that target. That's a serious goal and it is a high bar goal. It's one that we're stretching our teams on, but we're very committed to getting there. I do see us making progress in that direction. This is why we're investing in our Partnering for Success initiative with our supply chain. And the second wave of that program and working our supply chain architecture and competitive structure for the future is already paying dividends. But there's a lot more benefits still to be gained from our Partnering for Success initiative. It's our lean initiative and first-time quality initiative inside our own four walls. It's how we're managing our R&D to have that stable profile for the future.

The second century design and manufacturing work that I talked about, digitizing our design to manufacturing to support lifecycle value stream, and using that to take cost out of our structure. We're just beginning to see some of the opportunities there come to fruition on things like automation investment, what we're doing modularity in our production lines, on-demand customization using things like additive manufacturing. All of those things will also help us take out cost structure over time.

So, we're committed to that target. I think it's a reasonable target and expectation for us. And I can tell you, our leadership team, Kevin McAllister and his business; Stan Deal, who've ramped up the Services business; Leanne and the Defense business; and our functional leaders, all committed to achieving that goal.

Douglas S. Hamed
Analyst, Sanford C. Bernstein & Co. LLC

Q

And should we see this – should we expect to see this as steady progress toward 2020 that...

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

A

You should. Yeah. You should expect to see incremental steady progress towards that goal. This is not something where we'll be satisfied with flat performance and then a sudden step-up at the end of the decade. My expectation and the expectation we're working through is incremental steady performance against that goal. And while we're doing that, that margin accretion, you're going to see year-over-year cash growth. And we remain very confident in our ability to deliver that.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And that was actually the next question I wanted to ask you, with respect to BCA. So, in terms of delivering growing cash from commercial, 787 is a big part of this. Now, you've gotten to a point now where you are cash positive on the program. When you look forward, can you talk about what are the levers that are going to increase your cash performance on that program? Price, supply chain, internal, how would you parse that?

Dennis A. Muilenburg

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

A

It's a combination of all of those factors, but when you take a look at the cash performance opportunity, 787 is clearly one of the biggest levers and opportunities we have. And just to look at the deferred inventory balance, for example, turning that into cash, just to give you a feel for what the levers look like, on the deferred production inventory, about 70% of that will be transitioned into cash because of favorable mix and pricing going forward. This is the fact that we're going from -8s to -9s and -10s.

At the backlog, we have, on 787, 85% of it are -9 and -10 models. The third -10 airplane in our factory is already showing learning curve performances on top of the -9. So, commonality is paying off. Also, we don't have – we haven't given up any pricing on those future airplanes for early settlement for late airplanes. So, all of that, that 70% of it is mixed in pricing that's in hand.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And that presumably – when you talk about your outlook going forward, it's in hand. In other words, that's very predictable without any assumptions.

Dennis A. Muilenburg

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

A

That's firm backlog and we just have to execute the plan and the learning curves are telling us we're executing the plan. So, that's 70% of it. Another 25% is in the supply chain and these are step-down pricing in supplier agreements, 80% of which are already in place and so, you'll see those show up as those agreements' timing take hold. And then, the remaining 5% are additional work that we're doing inside our own factory space.

So, we could see very clear line to driving productivity and cash performance of 787. And the data says we're making good, steady, solid progress on that. That is one of the biggest cash generation levers that we have, and this is operating on nearly 700 airplanes in backlog. That, combined with 737 ramp-up, just go into a volume ramp-up of 57 a month. Those two things are the cash generators in the company, the additional cash generators over the next five years.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Now, I've got a question here which relates to Spirit. And so, clearly, the two companies had negotiations going on for some time. But in the context of what you've just spoke about, when you think of the changes that need to happen in the supply chain, some of which have been negotiated, some of which haven't, the bulk have been, does the Spirit situation fall into the potential upside if you get a more favorable agreement or is it assumed to all that you have to negotiate it? How do you say what's done and what's not done?

Dennis A. Muilenburg

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

A

Well, on Spirit, obviously, one of our big industrial partners, we're not all the way to the finish line on our agreement, so we've got some in place on some programs. Others are still in work. And so, I won't get into the specifics of the negotiations. But program by program, we're working through our plans there. And we're making progress, but we still have work to do.

And as I said, our partner for success arrangements and creating value for the future are really important to us. And these are not things that we're going to take lightly or rush to get to a deal. We need to have a good long-term deal and one that generates value. And that's certainly the case with Spirit.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

But when you talk about 80% of supply chain agreements are done, would that refer to – with Spirit as an example, that would refer to the part that's already agreed and then...

Dennis A. Muilenburg

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

A

A portion of their agreement is done, and it's in that 80%. A portion of the agreement is still in negotiation.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And in the 20%.

Dennis A. Muilenburg

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

A

In the 20%. Yeah. But we're going to be very diligent about making sure we're creating value for the long run.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

One other question here, which is if you had a different view of the market, in other words, if you started to be concerned that there might be an economic downturn, that there could be some weakness out there, how would you manage the business differently?

Dennis A. Muilenburg

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

A

Well, that's the key on the investments we're making to reduce the cyclicity of the business. Now, as I said earlier, the fundamental marketplace has changed. And the fact that it's no longer U.S., European airline-dominated with heavy backlog concentration just in U.S. and Europe, it's much more global backlog, much more diversified. And traffic patterns have fundamentally changed. The new technology we've brought to the marketplace that's allowing point-to-point connectivity around the world has fundamentally changed traffic patterns forever.

We've got, in Asia alone, 100 million people that are entering the traveling public for the first time every year. So, you realize that that's fundamentally changing the business and traffic continues to outpace global GDP. So, market strength and diversification helps. And then inside our four walls, this is where it gets to being able to read

and react in the marketplace. So, how we're managing our production rates, keeping supply and demand in balance, and then making our production rates less capital sensitive.

In the past, what has happened is if you've changed production rates, you had big expenditures to go with that. In this new digitized manufacturing facilities, low-tooling facilities, the capital expenditure to go up and down is muted. That gives us more flexibility. And then having long-term labor agreements, pension freeze, phased R&D, really thinking about keeping a level-loaded R&D plan and phasing it across products, and then growing services which tends to be a stable growing business, not cyclical in nature at all or in sometimes offsetting the platform business.

All of those business investments are making us less cyclical as well. So those are all tools we have in hand. And if we see the marketplace changing, those are tools that we can use now that we didn't always have in place in the past.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

I want to switch over to defense. We've looked at BDS as being somewhat stable outlook, flat but you've been getting a lot of traction it seems recently on a number of programs. Where do you see the growth trajectory now, looking like in defense over the next five years?

Dennis A. Muilenburg

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

A

We see our defense business strengthening. We still see it as a modest growth business going forward. We see some fundamentals strengthening in the U.S. Defense budget. As you well know, there's still uncertainty on exactly where the fiscal year 2018 budget will come out, what the five-year plan looks like. But generally, that's a neutral to up market in the U.S.

We're continuing to see a lot of strength in the Middle East and the Asia Pacific region. I just had the opportunity to spend some time in Riyadh as the King and President Trump were meeting and there were a lot defense deals associated with that visit. And Boeing had a very significant share of that. So, we continue to see strong international demand. About a third of our defense backlog is outside of the U.S.

And then, our product mix, even domestically, is regaining some energy. I see some new energy in our fighter lines, for example. Demand for the F-18 is returning and we see the five-year plans that have just been launched and the fiscal year 2018 budget request. Those all include Super Hornets when, in the past, they did not. So, that creates some opportunity for the future.

Helicopters are very strong, Apache, V-22, Chinook, the P-8 as it comes on line is proving itself around the world. We see domestic and international demand for that, satellite services. So, all of that gives us a more bullish view of the defense business going forward.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Well, on the Saudi deal, can you comment anymore on what some of the opportunities are that you've got coming out of that?

Dennis A. Muilenburg

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

A

Yeah. Well, if you look in total, out of the entire package, we had a little north of \$50 billion of deals in that package, and those ranged from commercial airplane deals to defense product deals. Defense products included Chinooks and weapons which were part of the public announcement. Also, a standup of the rotorcraft support center in Saudi Arabia, a joint venture around military sustainment that's going to grow jobs in Saudi Arabia and in the U.S. So, those are all examples on the defense side.

Also, as announced, the Saudi Gulf Airlines indicated interest in 16 wide-body aircraft, which was part of the discussions as well. So, we saw a broad-based interest across our commercial and defense product lines, a great diversity of interest and substantial volume.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Q

Now, you mentioned the F-18, there's some renewed interest in F-18, F-15. Going forward, what do you see those rates going at now given that these are seemed to be strengthening programs?

Dennis A. Muilenburg

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

A

Yeah. Well, we see a sustainable rate on the F-18 line that we were running at about two a month kind of rate, so some opportunity to fill in and sustain beyond that with the Navy's plans for domestic procurement and also the midlife upgrades that they're looking at for the existing Super Hornet fleet. And we see continuing interest in the Growler electronic attack variant domestically. All of that tells us that line could very well be strong and healthy through the next decade, not just through this decade, but well into the next decade.

We also see continuing international interest, Kuwait interest in F-18s. As you recently saw the signing of the agreements or approval of the agreements in Qatar for 36 F-15s with an option for another 36; Canadian interest in the Super Hornets. And we have continuing international interest in several places. So, we can see both the F-18 line and the F-15 line being extended in a strong way well into the next decade.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Q

And on the helicopter side, Apache and Chinook, those seemed to just keep moving along at a steady pace.

Dennis A. Muilenburg

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

A

Very strong. And again international and domestic capacity and interest in both of those products remains very solid. Domestically, the recent decision on the Apache multiyear is just another good sign. So, that's another at least 268 airplanes in that multiyear procurement that just adds strength to the Apache line going forward. And the fact that those production lines are long and stable is allowing us to continue to invest to keep the technology current inside of those airplanes. So, things like Block II upgrades to the Chinook line is just another good example that's being enabled because of the longevity of the production line.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Q

Within Boeing military airplanes, if you put all these together, you've got a number of mature programs that are extending. You've had challenging development program on the KC-46 Tanker, but that will go into full rate production. The P-8A is now maturing. What should we expect from margins there? I mean, it seems like it's an area where we should see some very attractive margin improvement over time.

Dennis A. Muilenburg

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

A

Yeah. And that's why that shared goal of getting to the double-digit, mid-teen margins is shared with our Defense business and Leanne and her team have been driving market-based affordability, reducing cost structure, winning new business, driving productivity in our factories. You see that in the margin accretion that's already happened over the last couple of years in our Defense business, but that's one again where we're looking for continued incremental performance improvement. And the fact that we've got these sustained, mature production lines adds capability there.

Tanker, while it's been a challenging development program, we're clearly closing in on the finish line. We'll start delivering airplanes to our customer later this year, well, the first 18 delivered by early next year. We still see that production run on at least 400 airplanes as an opportunity there. And as we get into a mature production program, it's going to be profitable for Boeing. It's going to be high value for our customer. And in addition to that production run, the in-field support and training will be significant. So, we've got a solid lineup for the future.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And on support and training, so Global Services & Support you've got – that unit has performed very well. How much of that now is tied to international situations where obviously there's a need in many of them for a lot of support work?

Dennis A. Muilenburg

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

A

Well, it's similar. As I said, our Defense business is about a third outside of the U.S. today. It's even a little more heavily weighted on Defense Services. And what we find a lot with our international customers that may not have as much defense infrastructure, support infrastructure, they tend to be more inclined to have these larger performance-based logistics deals where we can provide power by the hour, if you will, a full set of performance capability, similar to what we do with GoldCare on the commercial airplane side. And so, those holistic services solutions really work well for many of our international customers. That's one of the areas where we see continued future growth.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Now, there are three big new defense programs coming up.

Dennis A. Muilenburg

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

A

Yeah.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

So, Ground Based Strategic Deterrent, T-X, JSTARS [ph] replacement, (38:27) and all of those I know are important to you. But first, on T-X, a lot of people will argue that cost is so important now that using an already existing platform like the Lockheed and Korean platform [ph] that that would be of advantage. (38:44) What's your response to that?

Dennis A. Muilenburg

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

A

Well, I would argue the opposite. I believe what we have is a tailor-made, tailor-designed airplane for the requirements of the customer [ph] set for (38:55) T-X. So, we're not trying to take an off-the-shelf airplane and adjust it or modify it to make it fit. Our Air Force customers' requirements, we started with the requirements, clean sheet design, designed an airplane with new digital technology that's designed for future production and support.

And I believe that's ultimately going to be a lower cost solution for our customer both in terms of operating cost and delivery. And our confidence in that is based on the fact that we've built two airplanes to that system. They're flying. They performed exceptionally well, and that's part of the proposal that we've just presented to the Air Force. And so, that gives us a very strong confidence that we can build the airplane and do it affordably.

So, yeah, our future in our defense business is not dependent on any one program. The T-X is important, and we're putting forward a very strong bid. I think it's a great value solution for our customers, and we'll see how the competition plays out.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

How about JSTARS?

Dennis A. Muilenburg

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

A

Well, JSTARS is another important one for us. We've taken, again, a different approach on that one where we're using the Boeing 737-based platform. We believe that provides the size, weight, power, cooling growth that our customers will need for the future. These surveillance airplanes, [ph] situational awareness assets, (40:14) tend to have mission growth over time, as the missions get tougher and tougher. So, we're presenting an option to our customers there that provides a growth capacity for the future.

And while the Boeing 737 is a bigger platform than what some of our competitors have offered, that bigger platform has some interesting advantages. One, the mission capacity and having the crews onboard, obviously, the footprint advantage but even in that bigger airplane, an operating cost advantage because, by leveraging the Boeing 737 and the commercial infrastructure around the world, you can get a bigger airplane with more capability for less operating cost. And that's a fundamental advantage of our One Boeing approach. And again, that's the offer we've put forward, and we're looking forward to supporting our customers there.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Now, in T-X and JSTARS, can you give us a sense of what you see as the time line for decisions and...

Dennis A. Muilenburg

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

A

Yeah. It's – we've submitted both proposals. We've also submitted our GBSD proposals. So, all three are in evaluation now. We'll go through the normal evaluation cycle. We could potentially see awards towards the end of this year or in 2018...

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

For all three...

Dennis A. Muilenburg

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

A

But it's that kind of timeframe.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

For all three...

Dennis A. Muilenburg

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

A

Yeah.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

You can see awards by the end of this year...

Dennis A. Muilenburg

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

A

Potentially or early 2018. It's a little hard to predict, but it's something that will occur over the next 6 to 12 months.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Space, this is one you and I were talking a little bit before. A concern that we would have is, with all of these [ph] draws (41:52) in the Air Force budget, that could squeeze space at a time when you've actually got some very serious risks out there. How are you approaching space? Do you see that as a growth area for Boeing?

Dennis A. Muilenburg

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

A

Well, we do, and we see it in a couple of different areas. One, the satellite business, and this again is a marketplace that has both commercial and defense interest. Clearly, as you said, the interest in satellite infrastructure secure infrastructure for the future, but also an intense, almost insatiable demand for commercial communications bandwidth. So, we've used that as our investment target for our satellite business, ranging all the way from the mid-power bus, the 702MP, to the small 702SP to all electric satellites that we now are the first to have on orbit. So, we see the satellite business as a growth business.

Part of that will be dependent on a strong defense budget for the future. As we said, getting off in sequestration and getting to a planned sustainable defense budget for the country is an important part of that. In addition to

satellites, we have a lot of interest in human space exploration. So, our work on Commercial Crew for NASA and work on the new Space Launch System, mission to Mars for NASA are also important elements for the future.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

So, Q3, you're going to [ph] stand up the services... (43:18)

Dennis A. Muilenburg

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

A

Yeah.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

If I look at the Commercial side, historically, this all – this has seemed for many years to be a challenging thing for Boeing to really get the service value...

Dennis A. Muilenburg

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

A

Yeah...

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Out of that, kind of, commercial airplane business. It seems like you are getting more – some more traction now. Can you talk about what's different today? Why we should expect this to work and grow?

Dennis A. Muilenburg

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

A

Well, a couple of factors. One is I think the business is now positioned to do this. Two, and perhaps more importantly, is just our sheer focus and leadership on this. We've decided that services is a big growth market for us, as I said, a \$2.5 trillion market. We have 7% to 9% share today on the services market, where our installed base is 30% to 50% of the installed base. So, we got plenty of headroom to grow, leveraging our OEM knowledge base and that we have made the deliberate decision now to launch an integrated services business at the Boeing level. And so, that should convey our intent and focus.

It's different than what has been in the past. Our services business can't be something we think about after we do the platform business. It has to be done together and in a lifecycle value sense. And we're putting in a services leadership team [indiscernible] (44:37) that, every day, their job is to grow services and satisfy our customers. That's a big change for us.

We've also brought in a set of leaders who understand the importance of the services business. As mentioned earlier, Kevin McAllister, running our commercial airplane business, also has a deep experience in services. Leanne is running our defense business. She ran our defense services business before that. I ran our defense services for a while back a few years.

So, we have a leadership team that understands the value of services both to our business and to our customers. And I think, by consolidating into this integrated business, we now can coalesce our investments, we can leverage

our cost structure, we'll be in a position to compete in the marketplace at a competitive cost structure. And all of those factors are things that we've made investments with the intent to grow both top and bottom line in services.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

How large is this – how large will this services business be when it's formed? Can you give us a sense for that?

Dennis A. Muilenburg

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

A

Well, we'll roll out the financials in third quarter. So, I don't want to preview that...

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay...

Dennis A. Muilenburg

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

A

Because we're going through our due diligence right now, but we will begin reporting at that segment level in our third quarter reporting, so about a quarter from now. But we've set a longer-term target to grow that to be about a \$50 billion a year business, top line. And while that's a stretched target, I think it's an achievable one and it's one where organic investments in our parts business, low-cost mods and upgrades will be fundamental to that.

But there are also significant opportunity in information-based services. Again, as we digitize the lifecycle of our airplanes, the amount of value we can provide for customers on things like health monitoring and fleet optimization and fuel optimization, those are low-capital investments that create tremendous value and our whole digital aviation initiative around that. There's great substance there for future growth.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And when you talk about \$50 billion, is that – long term, is that 10 years? Is that five years or is that...

Dennis A. Muilenburg

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

A

Sooner is better.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay.

Dennis A. Muilenburg

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

A

I'd put a...

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

But it's not 30 years?

Dennis A. Muilenburg

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

A

Yeah. We're pushing the team to get there in five years.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay.

Dennis A. Muilenburg

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

A

Now, admittedly, again, that's a stretched target and we're not going to make bad decisions just to meet a particular time line. But this is a relatively near-term target. This is a growth opportunity that's right in front of us, and it's not one that requires investments now that take 10 years to play out. These are things that we can do now to rapidly grow the business. So, that's [indiscernible] (47:20)

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

So, from where you sit today, you're – you've been [ph] delivering – increasing (47:27) a lot of cash and you're projecting steady cash flow – free cash flow growth ahead. How are you viewing cash deployment at this stage?

Dennis A. Muilenburg

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

A

Consistent with the strategy we've talked about before, we do see – fundamentally, this is a year-over-year steady cash growth business, and we're going to continue to return value to our shareholders, as part of that. We see three priorities on cash deployment.

First priority continues to be organic investment. This is bringing innovation for the future. These are the product – new products that I've already talked about, as well as the investments we're making to create second century design, manufacturing and support systems.

Second priority is returning value to shareholders, and we're committed to returning roughly 100% free cash flow to our shareholders. That comes in the forms of both repurchase – share repurchase and dividend increases. And as you're well aware, I think our dividend increases over the last three years has been about 190%, and we've also repurchased about \$25 billion or 189 million shares of stock over that time period. So, a balanced approach to returning value to shareholders.

And then, our third priority is in – is M&A. And again, we're looking primarily at targeted acquisitions that fill out our strategy. We still see our primary growth mechanism is organic investment complemented with selective acquisitions.

Douglas S. Hamed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And the acquisitions that fill out your strategy, I'm guessing, services would be a priority?

Dennis A. Muilenburg

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

A

Yes. If I look at the targeted areas – and you've seen us acting in this way recently. It's in services, building out key vertical capabilities in selected areas and autonomous capabilities. We see those as three areas of interest for acquisition.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Q

We're about out of time. So, to wrap up – thanks. I think we're going to have to wrap here. But maybe you could just say a few words about what you see now as your one or two biggest opportunities and challenges.

Dennis A. Muilenburg

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

A

Yeah. Well, maybe just first very tactically – but I look at second quarter, as we're thinking through this year and performance this year, we're going to be a little lighter on revenue in the second quarter just on timing as we look at commercial deliveries. Tanker deliveries are back-loaded in the year. Some of our key defense deliveries are back-loaded in the year. So, just shaping up this year tends to be more back-loaded in terms of top line. So, yeah, we're working through those deliveries.

Strategically, big opportunities on ramping up the Boeing 737 and the entry of the MAX into our production system is going very well, but we've got to keep that on track. Boeing 787 productivity, so I said that is a cash-generation opportunity that we're very focused on, filling out the Boeing 777 bridge, winning a few of these key defense competitions and then launching our services business in the third quarter. Those are our big focus areas. This is a long-term sustained growth business, top and bottom line.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Well, great. Well, Dennis, thank you very much.

Dennis A. Muilenburg

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

Thanks, Doug. Appreciate it. Thank you.

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