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BA - Q4 2014 Boeing Co Earnings Call

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OVERVIEW:

BA reported 2014 revenue of $91b and core EPS of $8.60. 4Q14 revenue was $24.5b and core EPS was $2.31. Expects 2015 revenues to be $94.5-96.5b and core EPS to be $8.20-8.40.

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PRESENTATION

Operator

Good day, everyone, and welcome to the Boeing Company's fourth quarter 2014 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 am turning the call over to Mr. Troy Lahr, Vice President of Investor Relations for the Boeing Company. Mr. Lahr, please go ahead.

Troy Lahr *- Boeing Company - VP of IR*

Thank you, and good morning. Welcome to the Boeing's fourth quarter 2014 earnings call. I am Troy Lahr. And with me today are Jim McNerney, Boeing's Chairman and Chief Executive Officer, and Greg Smith, Boeing's Chief Financial Officer. After comments by Jim and Greg, we'll take your questions.

In fairness to others on the call, we ask that you please limit yourself to one question. As always, we have provided detailed financial information in today's press release, and you can follow this broadcast and slide presentation through our website at Boeing.com.

Before we begin, I need to remind you that any projections and goals included in our discussion this morning are likely to involve risk, which is detailed in our news release and our various SEC filings, and in the forward-looking statement disclaimer at the end of this web presentation. In addition, we refer you to our earnings release and presentation for disclosures and reconciliation of non-GAAP measures that we use when discussing our results and outlook. Now, I'll turn the call over to Jim McNerney.

Jim McNerney *- Boeing Company - Chairman & CEO*

Thank you, Troy, and good morning, everyone. Let me begin today with a brief review of some recent strategic achievements, followed by comments on our strong 2014 operating performance. Then, an overview of the business environment. After that, Greg will walk you through our financial results and outlook in greater detail.

Now, let's move to slide 2, please. Boeing is entering 2015 stronger, healthier and better positioned in its markets than any time in recent memory.

Our strategic accomplishments over the past 24 months alone provide a compelling picture of the progress we've made to enable sustained growth and improving profitability as we near the start of our second century in business. During that timeframe, we captured more than 2,700 net new Commercial Airplane orders, grew our market share and deliveries with 6 successful production rate increases, including reaching our target 10 per month on the 787, with more than 3 per month flowing steadily from our capacity expansion in South Carolina.

We completed a comprehensive refresh of our Commercial Airplane product line, with the highly successful launches of the twin-aisle 787-10 and the 777X, on a combined 400 orders and commitments. And the launch of the single-aisle 737 MAX 200, with a 100 airplane order from Ryanair. Starting with the hard-fought technology gains of the 787, we have built a substantial technological lead in Commercial aviation, particularly in the high-value twin-aisle market.

And by listening to our customers, and applying our proven technologies and lessons learned, in summary, we have de-risked a decade of new product development, while expanding our edge in the performance and efficiency of our airplanes.

Turning to Boeing defense, space and security. Despite a tough domestic budget environment, BDS continued to strengthen its relative market position and competitiveness. We have accomplished this by driving significant new efficiencies in response to the environment, in order to meet government customer needs and fund investments in technology and innovation. Including in space programs, where we have restored our technological lead and market position in satellites, autonomous spacecraft, missile defense and human spaceflight.

To the benefit of both businesses, we also secured unprecedented production continuity and improved economics, with long-term labor agreements at our major production sites in Puget Sound, St. Louis and Philadelphia. And we retired significant and longstanding legal and financial risks from billions in potential liability on matters such as the A-12 program to the short term threat to our balance sheet from defined benefit pensions. As you know, by the end of next year, approximately 90% of our workforce will participate in defined contribution plans, which provide attractive and competitive benefits to employees without the risks to our balance sheet.

Going forward, we remain ever focused on driving productivity and executing on our growth initiatives, which are fundamental to our success. To meet customer demand for our market-leading Commercial Airplanes, we have five more rate increases ahead of us over the remainder of the decade. These higher production volumes will provide additional opportunities for driving step function gains in productivity, for us and our suppliers, through lien plus capturing the value of quality and our partnering for success efforts.

We are equally committed to breaking the cost curve on our new development programs, and delivering them on time with performance, as advertised. To that end, we have focused our engineering teams on designs that are more producible, common systems and parts across airplane families, and our disciplined gated development process. We have also increased our investment in manufacturing and production innovations, including automation, to increase quality and safety in the workplace and reduce flow times.

Overall for 2015, and throughout the remainder of the decade, these recent achievements in the marketplace, in our operations and in our financial performance, set the stage for expected, significant cash generation, the flexibility to invest for growth in support of our customers, and the increasing return of cash to shareholders. With that as perspective, let's discuss our 2014 results on slide 3, please.

Strong fourth-quarter results, driven by higher commercial deliveries and solid operating performance, capped an outstanding year. We continued to deliver on our strategies to convert our backlog and to profitable growth, and to drive productivity and affordability throughout the Company.

For the full year, we reported record revenue and core earnings per share, solid operating margins and strong cash flow, much of which was returned to shareholders. Boeing Commercial Airplanes reported record revenue of $60 billion for the year, on higher production rates and an industry record 723 deliveries, which expanded our global market share leadership in deliveries for the third consecutive year.

2014 was also an exceptional year for new bookings, as we captured commercial gross orders of 1,550 airplanes, and record net orders of 1,432 airplanes, which increased our backlog to nearly 5,800 airplanes. When combined with strong orders from our Defense business, total Company backlog grew to a record $502 billion.

Other commercial airplanes key milestones in 2014 included successfully reaching the 42 per month production rate on the 737, and announcing plans to increase to 52 in 2018. Model certification and delivery of the first 10 787-9s, completing preliminary design review on the 787-10, and breaking ground on the new 777X composite centers in Puget Sound and St. Louis.

Boeing defense, space and security also had a very strong year, with solid revenue, healthy margins and significant new business wins and program milestones. Key contract awards captured during the fourth quarter included an order for two 702 high-power satellites, multiple long-term international service contracts, including a 25-year order from the Australian government to train Rotary Wing aircrews, valued at approximately $500 million, and finalization of the NASA Commercial Crew award announced in the third quarter.

Noteworthy program milestones in the quarter included the first flight of the 767-2C test aircraft for the KC-46 tanker program, the selection of the V-22 by Japan to fulfill their tilt-rotor aircraft requirements, and US government funding for EA-18G Growler production. Finally, our strong operational performance trend, significant cash flow and confidence in the future, all supported by our December announcement of the new share repurchase authorization totaling $12 billion, and a 25% increase in the quarterly dividend.

With that, let's turn to the business environment on slide 4. Our view of the business environment remains positive. Given favorable global air traffic trends, improving airline profitability, and the continuing need for efficient and value-creating products we provide.

Strong growth in the Commercial Airplane market continues to drive demand that supports our planned production rate increases over the remainder of the decade. Net new orders for 2014 that I mentioned earlier were essentially twice our 2014 output. And our record backlog of 5,800 airplanes represents approximately eight years of production at current rates.

The placement demand remains an important market driver, with airlines continuing to introduce newer, more efficient airplanes, with superior economics and a rapid return on investment, in place of older, less efficient models in service. Notwithstanding a fuel price environment today that is well below the 15-year average, the value proposition for our airplanes remains a compelling one.

Historically, we have seen aircraft orders more correlated to airline profits. And as many of you may recall, we closed the business case for, and launched the 787, when oil was at $40 a barrel. Furthermore, based on discussions with our customers, lower oil prices have not substantially changed their views on fleet planning, or their commitment to existing delivery schedules.

Our new technologically advanced airplanes not only have far better fuel efficiency and lower maintenance costs, but also often deliver higher passenger and cargo revenue, increased residual values, a better overall passenger experience, and greater range, allowing for new city pairs and more optimal routes. All of these elements provide significant value to our customers over the life of the aircraft.

Overall, we see low fuel prices and positive traffic trends as beneficial to our industry and growth prospects. Our long-term outlook also remains strong, as we expect the combination of growth and replacement to drive the need for nearly 37,000 aircraft over the next 20 years. In the twin-aisle segment, we continue to see healthy demand for both the 777 and the 777X, which are outselling the competition by a wide margin, giving us confidence in our ability to efficiently transition production between the two airplanes.

In 2014, we captured 63 new orders for current 777 models, giving us [278] (corrected by company after the call) firm orders in backlog. We expect demand for the 777 to remain healthy through the end of this decade, with an anticipated average order capture of around 40 to 60 airplanes per year, to support the transition to the 777X. With the new airplanes -- for the new airplanes scheduled to enter final assembly in the 2018 timeframe, this transition will leverage new manufacturing processes and technologies being proven on the current 777, to optimize the 777X production system.

On the 787 program, which delivered a twin-aisle industry record 114 airplanes in 2014, we remain focused on continued production efficiencies in support of future planned rate increases, to match a strong market demand for the airplane. Since the first customer flight, 787 fleet has now flown -- has now safely flown approximately 30 million passengers, more than 400 million miles, while saving 1 billion pounds of fuel, providing game-changing efficiencies and capabilities to 29 customers worldwide.

In the single-aisle segment, demand for our new, fuel-efficient 737 MAX also remains high, with cumulative orders totaling more than 2,660 airplanes, from 57 customers. Development of the MAX remains on track for the first delivery in 2017.

Turning to defense, space and security, we continue to see solid support among US customers and Congress for our major programs. In addition to the Growler funding I mentioned earlier, the FY15 budget, signed into law in December, fully funds other core Boeing production programs, such as the Apache helicopter and the P-8A Poseidon. Key development programs like tankers and long-range strike also were fully funded, and additional funds were added for the space launch system.

We continue to see strong international demand for our offerings as well, particularly in the Middle East and the Asia-Pacific region. In 2014, international customers for defense, space and security represented 28% of revenue and 36% of our current backlog. While notable alone for its size, the strength of our international defense backlog also comes from its diversity across our product and services portfolio, and the geographic mix of its customer base.

Our investments in technology and innovation for organic growth continue in areas such as commercial derivatives, space, unmanned systems, intelligence surveillance and reconnaissance, and the critical few large-scale future programs that are priorities for our customers like long-range strike, U Class and the TX Trainer. The relative strength of our defense, space and security business stems from a portfolio that is reliable, proven and affordable, supported by our ongoing market-based affordability initiative, which is focused on reducing operating costs by another $2 billion, to ensure competitiveness through the ongoing downturn in domestic defense spending.

In summary, our business strategies are aligned to the realities and opportunities of our markets, and our teams are executing them well to deliver top-line and bottom-line performance, and capture new business to sustain our growth and profitability for the decades to come.

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

Greg Smith - *Boeing Company - CFO*

Thanks, Jim, and good morning. Let's turn to slide 5 to discuss our full-year results.

Revenue for the year was a record $91 billion, reflecting 5% growth from last year, driven by higher deliveries in our Commercial Airplane business. Core earnings per share totaled $8.60 for the year, representing a 22% increase.

The increase in core EPS was driven by strong operational performance across the Company. Adjusting for the tax items in the A-12 litigation settlement in 2013, core earnings per share increased 14%.

Operating cash flow for the year was also very strong at $8.9 billion. The robust cash generation was driven by higher deliveries, solid core operating performance, favorable timing of receipts and expenditures, and capturing the early benefits of our disciplined working capital initiatives.

Let's now move to our quarterly results in slide 6. Fourth-quarter revenue increased 3% to $24.5 billion, driven by strong commercial airplane deliveries. Core operating margins increased to 9.6%, reflecting solid productivity gains in both businesses.

Fourth-quarter core earnings per share increased 23% to $2.31, on higher volume and continued strong operating performance. Fourth-quarter 2013 included, again, $0.34 for the A-12 litigation settlement.

Let's now discuss commercial airplanes on slide 7. For the fourth quarter, our Commercial Airplane business increased revenue 15% to $16.8 billion, on a record 195 airplane deliveries, and solid operating margins of 9.3%. The margin benefit from the higher volume and mature programs was offset by the impact of higher 787 deliveries, and the anticipated increase in period costs, primarily for investments, to support future growth and productivity.

Commercial airplanes revenue for the year was a record $60 billion, an increase of 13%, as we successfully executed on our planned production rate increases, resulting again in record deliveries, totaling 723 aircraft. Commercial airplanes captured $27 billion of net orders during the quarter, and backlog grew to a new record of $440 billion and nearly 5,800 aircraft. Specifically on the 787, we exceeded our delivery guidance for the full year, as the team worked hard to deliver 114 787's. And in total, we have now delivered 228 787's to 29 customers, 14 of which were new customers in 2014.

We continue to see progress in key operational performance indicators, as we further implement production efficiencies and stabilize the overall 787 production system. On the 787-8, we've seen a decline in unit costs of approximately 30% over the last 175 deliveries. And on 787-9, we've seen declines of 20% since the first delivery. Based on this progress, our production schedule and planned productivity investments, we continue to expect the 787 to be cash-positive during 2015, and we still anticipate deferred production to decline shortly after we've achieved the 12 per month production rate in 2016. No change to these fundamental milestones.

In the fourth quarter, the 787 deferred production increased $960 million to $26.1 billion, and we now anticipate 787 deferred production to grow at moderate levels for the next several quarters, as productivity improvements on both models offset timing of supplier negotiations, further investments to optimize the production system, and our decision to maintain higher employment levels to ensure the continued smooth introduction of the 787-9, and further incorporate additional productivity and reliability investments. These focused decisions and efforts are expected to continue to drive long-term efficiencies, margin improvement, and cash generation on the 787 program.

Overall, our focus and priorities remain unchanged for the 787 program. Solid, day-to-day execution, risk reduction, and improving long-term productivity and cash flow going forward, while continuing to have smooth ramp up on the 787-9 production, prepare for the 12 per month rate introducing the 787-10, while again driving efficiencies across all aspects of the program.

Let's turn now to defense, space and security results on slide 8. Fourth-quarter revenue for our defense business was $7.6 billion, and operating margins increased to 12.1%, due to strong business across the portfolio.

Revenue for Boeing Military Aircraft declined by -- to $3 billion in the fourth quarter, resulting from lower planned C-17 and F-15 deliveries. Operating margins increased to 12.3% in the quarter, driven by solid operating performance.

Network and space systems revenue declined to $2.2 billion in the fourth quarter, on lower government satellite volume. Operating margin at NS&S was 8.8% in the quarter.

Global services and support reported a 2% increase in the fourth quarter revenue, to $2.4 billion, on higher MM&U volume, and generated strong operating margins of 14.9%, driven by a higher operating performance. Defense, space and security reported a solid backlog of $62 billion, with 36% of our current backlog now representing from customers outside the United States.

Let's now turn to slide 9. Operating cash flow for the fourth quarter was $5 billion. The strength of our cash flow was driven by higher volume, strong operating performance, favorable timing of receipts and expenditures, and again, early benefits of our disciplined working capital initiatives. With regard to capital deployment, we paid $519 million in dividends to shareholders, and repurchased 7.8 million shares for $1 billion in the fourth quarter, bringing our total 2014 repurchase activity to 47 million shares, or $6 billion.

And as Jim mentioned earlier, we announced in December that our Board of Directors increased the share repurchase authorization to $12 billion, and increased the dividend 25%, up 88% in the last two years. We expect to complete the repurchase authorization over approximately the next two to three years.

Our capital deployment to date continues to demonstrate the strength of our portfolio and backlog, and our commitment and confidence in the business performing well going forward. Returning cash to shareholders, along with continued investment to support future growth, remains priorities for us.

Let's now move to cash and debt balances on slide 10. We ended the quarter with $13.1 billion of cash and marketable securities, and our cash position continues to provide solid liquidity, and positions us well going forward. Again, our financial strength allows us to continue to invest in key growth areas of the business, return cash to shareholders, and execute our cash deployment strategies going forward.

Turn now to slide 11, and we will discuss our outlook for 2015. Our guidance for 2015 reflect solid core operating performance, higher deliveries at commercial airplanes business, while reflecting the near-term investments needed to support our efforts to drive long-term growth and productivity.

Core earnings per share guidance for 2015 is set to be between $8.20 and $8.40 per share. And excluding the 2014 tax settlements totaling $0.71 per share, 2015 earnings per share is expected to grow between 4% and 6%.

Revenue for 2015 is forecast to increase to be between $94.5 billion and $96.5 billion, representing growth of between 4% and 6%. Our 2015 commercial airplane revenue guidance is between $64.5 billion and $65.5 billion, reflecting 8% to 9% growth, as we execute on our record backlog.

The 2015 commercial delivery forecast is now between 750 and 755 airplanes, and 787 deliveries for 2015 are expected to be essentially in line with the 10 per month production rate, plus a few early build deliveries. Commercial airplanes operating margin guidance is set to be between 9.5% and 10% on improved operating performance, offset by greater dilution impact of higher planned research and development spending, higher 787 deliveries and further investments to support future growth. Defense, space and security revenue guidance for 2015 is between $29.5 billion and $30.5 billion, reflecting the continued, challenging defense environment, partially offset by the ongoing international growth.

Operating margin guidance at the defense business is now between 9.75% and 10%, reflecting continued productivity efforts, offset by the impact of lower volume and delivery mix. Supporting our long-term growth plans, we expect research and development spending for 2015 to be approximately $3.5 billion, with about 70% related to [BCA] (corrected by company after the call), particularly driven by the planned increase in 777X and 787-10 development. While at BDS, we continue to invest in key strategic growth opportunities going forward.

We expect operating cash flow for 2015 to be greater than $9 billion, reflecting higher deliveries, strong operating performance, continued 787 productivity, and capturing final C-17 orders. This is somewhat offset by higher cash tax payments and favorable timing of receipts and expenditures that benefited 2014 results.

As we look forward, we expect further growth in operating cash flow in 2016, as we continue to execute on our backlog, capture additional productivity gains, and improve 787 cash performance. Capital spent in guidance for 2015 is approximately $2.8 billion, driven by the new 777X facilities and equipment, Charleston expansion to support the 787 rate increase, and other investments to support continued growth in productivity.

Our required pension contributions in 2015 will be minimal. As a result of legislative pension changes, we are now foregoing discretionary pension funding in 2015.

As we look into the next quarter, we expect first-quarter revenue, core EPS and cash flow to be the lowest during the year, based on timing of deliveries, phasing the expenditures and advances. First-quarter EPS is estimated to be approximately 20% of our full earnings.

So in summary, Boeing's 2014 financial performance and the 2015 financial guidance reflects the strong demand for our products and services, the strength of our backlog, and our continued focus on driving productivity throughout the entire enterprise.

With that, I will now turn it back over to Jim for some final thoughts.

Jim McNerney - *Boeing Company - Chairman & CEO*

Thank you, Greg. 2014 was another year of strong operating performance and significant cash generation, as we successfully executed on our record backlog that allowed us to return cash to our shareholders, while still prudently investing to sustain our growth and competitive advantage. Built upon an underlying foundation, 2014 was a very strong year for Boeing, as we continued to deliver on the significant and sustained growth, and increasing profitability and cash flow, that our strategies were designed to produce.

Thanks to the tremendous efforts of our employees, our partners, and customers around the world, we achieved critical strategic milestones in both businesses. Continued focus and execution on production and development programs that are important to our customers, and maintain our relentless focus on productivity to enable continued investment in our future. All of which sets the stage for further growth and sustained business performance for customers and shareholders in the years ahead.

Now, we'd be delighted to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Carter Copeland, Barclays.

Carter Copeland - *Barclays Capital - Analyst*

Good morning, gentlemen.

Jim McNerney - *Boeing Company - Chairman & CEO*

Morning, Carter.

Carter Copeland - *Barclays Capital - Analyst*

Just some quick clarifications about your comments on deferred production, Greg, and a question. Did that change result in any negative margin impact on the program? And how far rightward did it shift the cash breakeven point you had talked about in the past?

And then just from a high level, has is changed -- does the difference in the profile and deferred production here represent a change in how you're managing the program or thinking about the long-term risk profile or return profile on the program? Is it reactive in any way? Just from a high level, is there something more we should read into that? And how you're approaching risk and return there?

Greg Smith - *Boeing Company - CFO*

Yes -- no. I would say that it -- there's -- you shouldn't look at it any differently, Carter. I think when you step back, and you look at how this program has performed, it's performed very well. 114 deliveries last year. And obviously, we've reached a record production rate, higher than any wide body in (technical difficulty) aviation history, and we're planning to go up.

The fundamental milestones that you talked about, where they're -- with regards to cash positive, we still expect that in 2015. And we still expect deferred to decline shortly after we hit that 12 a month that we're planning for in 2016. So those things have not changed. We obviously -- we, as I discussed, we see the next two to three quarters, similar growth than what we've seen. And later in 2015, to decline at a healthier rate.

But all of that is anticipated in the guidance we gave on cash flow. And at the end of the day, that's what matters. You've seen our results in 2014, you see our guidance for 2015 on cash. All of that is, again, taken into consideration.

Carter Copeland - *Barclays Capital - Analyst*

And the program margin?

Greg Smith - *Boeing Company - CFO*

Program margin was just down slightly in the quarter, but not significant.

Carter Copeland - *Barclays Capital - Analyst*

Okay. Thanks.

Greg Smith - *Boeing Company - CFO*

You're welcome.

Operator

Doug Harned, Sanford Bernstein.

Doug Harned - *Sanford C. Bernstein & Company, Inc. - Analyst*

Good morning.

Jim McNerney - *Boeing Company - Chairman & CEO*

Morning.

Doug Harned - *Sanford C. Bernstein & Company, Inc. - Analyst*

I'm interested. You've got -- I mean you had very strong cash in Q4. So if we're looking at more than $9 billion in operating cash in 2015. And then, I was surprised to see, in the deferred, continuing to rise. Could you walk through -- really two things here - the puts and takes of getting -- of your cash -- operating cash flow in 2014 to 2015?

And then, when you look at how much you've got in the balance sheet, you've got now cash and STI of over $13 billion. And you're going to generate more than $6 billion in free cash flow. How do you expect to deploy that? You should have declining risk here. This is a lot of cash. And it seems like it is a lot more than you would really need to manage the Company on the balance sheet today.

Jim McNerney - *Boeing Company - Chairman & CEO*

As you know, Doug, one of the strategies we had in place was to de-risk the decade, and we've certainly done that. And the risk profile going forward is very different than it was in the past. And so continuing to execute on delivering on the backlog, focusing on the core operating performance, again, improving the 787 cash profile. And of course, capturing those final C-17 orders. That's the biggest driver from 2014 to 2015.

We are going to have higher cash taxes, because we are improving unit cost on 787. And we have, again, slightly higher R&D all planned out, 777X and 10-X. So those the moving pieces from 2014 to 2015. With regards to deployment, you've seen what we did last year. You see the authorization we have in place. It's in place to utilize it, and we plan to do that.

Operator

Howard Rubel, Jefferies.

Howard Rubel - *Jefferies & Company - Analyst*

Thank you very much. Nice numbers.

Jim McNerney - *Boeing Company - Chairman & CEO*

Thank you.

Howard Rubel - *Jefferies & Company - Analyst*

One question related to the 787, and orders related. As I look at it, this year is more of a year to fill in some holes and demonstrate that the products you have have extended legs. Could you address some of the opportunities, with some specificity on 777? And then also, on what you're finding from customer feedback on the 787? And what kind of movement there is to 787-9's?

Jim McNerney - *Boeing Company - Chairman & CEO*

Let me take swing at that one, Howard. On the 777, the gut issue there, obviously, is the bridge -- transition to the bridge. Because I think the market has spoken on the launch of the 777X, a very robust launch. As to the bridge, the 63 orders this year that Ray and his team secured, bodes well for the 40 to 60 we need over the next few years, to get to the bridge. So I'm feeling increasingly comfortable there.

Long-term demand for the airplane, there is no I'm competition for the airplane. So I feel very good about the long-term demand for the airplane. I think on the 787, I think what you're going to see is a mix from 787-8's to 787-9's to 787-10's. And then we still have moving around the skyline, as that's accommodated. That's all goodness for the Boeing Company, in the sense that we are usually selling more capability for a higher price. And that dynamic, I don't see changing.

I think we're still -- we're a little bit hampered by the number of orders we have. I mean it's -- we're out to 20, 21-ish. I would anticipate, toward the end of this year and into next year, a rekindling of orders on the 87. As we get a little closer to the end of the decade, people begin to pick up options. The moving around of the skyline will have subsided a little bit.

An the airplane's performance, quite frankly, I cited it in my remarks, the airplane's performance, to be candid, is better, I think, by and large, than we sold it at. And we're very pleased with the operating costs, the fuel savings, obviously.

And the thing that is often left unnoticed here is that this grows the market. This airplane enables wide body, or any kind of body, quite frankly, city pairs that have never been enabled before. And so, I'm sort of making up the number, but it's 20% of demand for this thing is opening up capacity between city pairs that was not available before, because of the performance of the airplane. So a little bit longer answer than you wanted, but that's my dump on the subject.

Howard Rubel - *Jefferies & Company - Analyst*

Thank you very much.

Jim McNerney - *Boeing Company - Chairman & CEO*

Thanks.

Operator

Joe Nadol, JPMorgan.

Joe Nadol - *JPMorgan - Analyst*

Thanks, good morning, everyone. Greg, I had a couple for you on just deferred. I was wondering if you could, as you've done the last couple quarters, quantify if there was any pull-forward from building 787-9 inventory? If you could give us a sense, sequentially, if 787-8 and 787-9 unit costs declined? And if this was just mix related, that you didn't see any deferred reduction, sequentially?

Greg Smith - *Boeing Company - CFO*

Yes, there was no pull-forward in the quarter, Joe. There was more 787-9. It was about 30% more 787-9 mix in third quarter versus fourth quarter. So that obviously had an impact.

And then we had more reliability enhancements in the fourth quarter than we did in the third. And again, that is something that we're really trying to be proactive and get those embedded into the production system, so they are there when we deliver the airplane. But those are really the big moving pieces between 3Q and 4Q.

Joe Nadol - *JPMorgan - Analyst*

Unit costs on both models did decline sequentially? Or they were flat?

Greg Smith - *Boeing Company - CFO*

They did come down in the quarter.

Joe Nadol - *JPMorgan - Analyst*

Okay. And then just one final clarification. When you say you expect the program to be cash flow positive in 2015, that's deferred building. But you deliver a few of the early production aircraft, and you're also including advances, in advance of that production rate increase, to help get you to cash flow positive. Is that right?

Greg Smith - *Boeing Company - CFO*

Yes. That's right, Joe, no change.

Joe Nadol - *JPMorgan - Analyst*

Okay, thank you.

Greg Smith - *Boeing Company - CFO*

You're welcome.

Operator

Cai von Rumohr, Cowen and Company.

Cai von Rumohr - *Cowen and Company - Analyst*

Yes, thanks so much. So, you're talking about the deferred going up another -- sounds like $2.5 billion over the next three quarters. That's a pretty big change. Could you give us a little bit more granularity, in terms of how much of that is inventory pull-forward? How much of that is buffer stock? And how much of that is other items?

Greg Smith - *Boeing Company - CFO*

Yes. I guess, Cai, I'd put it into three categories. First of all, let me just back up. The things we're doing on this program every day are all about driving cash and profitability over the long term. So there's going to be decisions we make quarter over quarter, or frankly, between last year and this year and forward, that are enhancements to the production system over the long term that are proven. We've done them on other programs. And now, it's about implementing them on the 787. So there's some of that in there that is really, again, focused on investments over the long term of the program.

On -- as far as labor, we are coming down on unit costs, but we're coming down at a lower rate than what we expected or anticipated. And again, we're doing that at these higher label levels to really achieve the stability, incorporate those reliability enhancements I talked about.

And then these productivity initiatives, again, they're going to take folks to work through each one of those at every sequence of the build. And we're working that, and we're working it at an enterprise level. We're leveraging across Boeing. So we know where the bottlenecks are, or some of the challenges are. So now it's about reaching -- when we reach the 10 a month, capturing that and improving upon that.

On the supply chain side, we've talked about the timing of some of our discussions and negotiations. And some of those have moved out to the right. And I think I mentioned before that we've seen a benefit in doing that. These guys are still coming down a learning curve. We are helping them encapsulate productivity enhancements that we're seeing, or able to achieve in Charleston and Everett. And we want to get that back into the supply chain. And then from there, we'll mature our negotiations. So again, a near-term sacrifice, but much long-term benefit, frankly, for us and our supplier.

But those are really the three main categories that we're faced with over the next year -- and to the end of 2015. But very focused, again, on the long term. And very focused on improving cash in the program. And none of those fundamentals have changed.

Cai von Rumohr - *Cowen and Company - Analyst*

Can you quantify any of those three items?

Greg Smith - *Boeing Company - CFO*

No, I can't, Cai. Those are the main three categories. And like I said, those are the ones we're working on. There's no -- I see significant splits between the three of them.

Cai von Rumohr - *Cowen and Company - Analyst*

Thank you very much.

Greg Smith - *Boeing Company - CFO*

You're welcome.

Operator

Sam Pearlstein, Wells Fargo.

Sam Pearlstein - *Wells Fargo Securities, LLC - Analyst*

Good morning.

Jim McNerney - *Boeing Company - Chairman & CEO*

Morning, Sam.

Sam Pearlstein - *Wells Fargo Securities, LLC - Analyst*

I just wanted to see if you could help me out on two things. One is, on the C-17, can you talk about how many were on the balance sheet at the end of the year of 2014? And how many are you assuming will be there at the end of 2015?

And then just looking at this share count assumption you have embedded in your guidance, that would seem to imply a pretty sizable buyback, in order to get 40 million shares down, on average, over the course of the year. Can you try and size, at all, your thinking around that?

Greg Smith - *Boeing Company - CFO*

On C-17, we've got seven that remain unsold, Sam. We delivered seven last year, we'll deliver four in 2015, and then four in 2016, and then probably about two in 2017. So we're in active discussions with customers for the balance of those aircraft remaining, and we're highly confident that we'll sell those and be able to deliver them over that timeframe.

On the share count, like I said earlier, you saw what we did in 2014. We upped the reauthorization. So we're very focused on that, and we'll continue to execute and utilize that authorization.

Sam Pearlstein - *Wells Fargo Securities, LLC - Analyst*

Thank you.

Greg Smith - *Boeing Company - CFO*

You're welcome.

Operator

Myles Walton, Deutsche Bank.

Myles Walton - *Deutsche Bank - Analyst*

Thanks, good morning. Greg, if I look at the last three years, you've been running, if you correct for the 787 after tax, $14 a share pretty consistently over that period of time, or about $10 billion. As you level off on the 787, any reason we shouldn't think about that as a starting point of discussion?

Greg Smith - *Boeing Company - CFO*

I'm sorry, Myles. I wasn't tracking exactly what you were focused on.

Myles Walton - *Deutsche Bank - Analyst*

If over the last three years, you correct for all the 787 inventory build, you've been doing a consistent level of $10 billion, or about $14 a share, in free cash flow. Any reason that shouldn't be the starting point of the discussion, once you do level out on the 787 inventory?

Greg Smith - *Boeing Company - CFO*

No, I think that's fair.

Myles Walton - *Deutsche Bank - Analyst*

Okay.

Greg Smith - *Boeing Company - CFO*

That's fair. Obviously, you've seen it. It's a significant focus area for us. And any -- all elements around working capital. And we're going to continue that effort, going forward.

Myles Walton - *Deutsche Bank - Analyst*

Just one clarification. Were there any adjustments on the accounting blocks in the quarter?

Greg Smith - *Boeing Company - CFO*

Yes. 737, an increase of 200, all of which were MAX airplanes.

Myles Walton - *Deutsche Bank - Analyst*

Okay. Thanks.

Greg Smith - *Boeing Company - CFO*

You're welcome.

Operator

Jason Gursky, Citi.

Jason Gursky - *Citigroup - Analyst*

Good morning, everyone.

Jim McNerney - *Boeing Company - Chairman & CEO*

Morning.

Jason Gursky - *Citigroup - Analyst*

Greg, I was wondering if you could just talk a little bit about the trajectory of CapEx and R&D, as we move out into 2016, 2017, maybe even into 2018? Just relative to where we are going to be in 2015? Going up, down, sideways on those items?

Greg Smith - *Boeing Company - CFO*

CapEx, this year, obviously is just tied to the growth, right? It's on the successful launch of the 777X, the 787-10. And then of course, 787 rate, combined with 737. So those are the real, I'll say, fundamental drivers of the growth in CapEx.

This year will be increased, because of preparing for the entry into service of those aircraft. And we'll probably have a similar year next year. And then it will start to decline from there. And again, it's all tied to growth, all tied to the successful launches of those programs, combined with productivity. We've got additional productivity initiatives in here, including that automation that Jim talked about. And so, that's kind of a profile on CapEx.

For R&D, again, 777X and 10X, as 787-9 certainly winds down. And 37 -- I'll say MAX continues at a similar spend rate. If you look at the entry into service on 777X, you are going to see a profile from here. But again, you're going to see 10X declining. So we're continuing to manage it, and look at further ways to optimize the R&D spend, as Jim has talked about a lot. But for this year, we are seeing it at about $3.5 billion, and I think managing it very efficiently. And taking advantage of a lot of things, again, that Jim highlighted, and doing it in a more efficient and effective manner.

Jason Gursky - *Citigroup - Analyst*

And just one quick follow-up on the triple 777. Can you talk a little bit about what the impact is going to be on your ability to deliver aircraft late in the decade, as you feather in the 777X? Will that be coming in at a slower flow time? And will your ability to deliver come under some pressure as we move out late in the decade?

Greg Smith - *Boeing Company - CFO*

I don't think out ability to deliver will come under pressure. But you will have -- very similar to what you're seeing on the 787, you'll have some additional flow time associated with those early introductory units. And that will get feathered into the current 777's, as we deliver those. So I'd say that it is a well planned out phasing in strategy, that was really leveraged off the success of the 787. And that's the plan going forward.

Jason Gursky - *Citigroup - Analyst*

Okay. Thank you.

Greg Smith - *Boeing Company - CFO*

You're welcome.

Operator

Peter Arment, Sterne Agee.

Peter Arment - *Sterne, Agee & Leach, Inc. - Analyst*

Yes, good morning.

Jim McNerney - *Boeing Company - Chairman & CEO*

Good morning.

Peter Arment - *Sterne, Agee & Leach, Inc. - Analyst*

Jim, Greg is getting all the work here. Let me give you one. Jim, does book to bill ever go down again? It's another strong year. How are you thinking about 2015? And your comment on the 777 bridge, you're getting increasingly comfortable there. The 63 new, would you characterize that as just replacement for the Dash 200's? Or could you give a little more color there? Thanks.

Jim McNerney - *Boeing Company - Chairman & CEO*

No, I think the -- two examples would be A&A and Qatar, where there was a blended order of both the new airplane, the X, as well as one of the current models. And I think in both cases, the 300 ER's -- I may be forgetting exactly the model type in one of those cases. But the -- I think it is a sign that the capability is an enduring capability. And the competition is -- you hate to say it this way, but there is not much competition for this capability.

So versus any alternative, both the old and the new, makes sense. And it's more a matter of satisfying demand, and running a competitive airline, that drives them to buy both types. And so we're in a fortunate position here, and it's one that we will shamelessly take advantage of.

Peter Arment - *Sterne, Agee & Leach, Inc. - Analyst*

And on book to bill for 2015?

Jim McNerney - *Boeing Company - Chairman & CEO*

Book to bill. It's early in the year. I think it will at least be -- one-to-one would be -- is the way it looks now. And we'll see as the year goes forward.

Peter Arment - *Sterne, Agee & Leach, Inc. - Analyst*

Okay, thank you.

Jim McNerney - *Boeing Company - Chairman & CEO*

Yes.

Operator

Ron Epstein, Bank of America Merrill Lynch.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Good morning, guys.

Jim McNerney - *Boeing Company - Chairman & CEO*

Morning.

Ron Epstein - *BofA Merrill Lynch - Analyst*

You've obviously done a fantastic job getting airplanes out the door. I just wanted to follow up on profitability, however. One would think, unless I'm thinking about it wrong, that given the volume of airplanes that the Company has delivered, that profitability in the quarter would have been better at Boeing commercial. Defense seemed to do wonderful. And then as we go into next year, with that volume of airplanes going out the door, and given the overhead absorption that, again, margins would be higher than what you guys are projecting them to be?

Jim McNerney - *Boeing Company - Chairman & CEO*

Yes, I mean in the quarter, Ron, 37 and 777, unchanged from quarter over quarter. So no change in margins there. And as I mentioned, we did have a block extension on the 37 -- this is really associated with period costs. As you know, we're seasonably high in fourth quarter, around taxes and fleet support, and just the amount of deliveries we have.

And then some investments we've made across the business, whether it's an 87 reliability, or in some of the fleet management efforts. So, like I say, high in the quarter, but not something that it would take forward from here.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Okay, okay. And then one follow-on, if I may. In the defense business -- we haven't talked a heck of a lot about that. Were there any contract closeout, one-time types of things in the quarter that boosted margins there?

Jim McNerney - *Boeing Company - Chairman & CEO*

Nothing significant.

Greg Smith - *Boeing Company - CFO*

No.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Okay, great. Thank you.

Troy Lahr - *Boeing Company - VP of IR*

Operator, we have time for one more question.

Operator

Rob Spingarn, Credit Suisse.

Rob Spingarn - *Credit Suisse - Analyst*

Good morning.

Jim McNerney - *Boeing Company - Chairman & CEO*

Morning.

Rob Spingarn - *Credit Suisse - Analyst*

Greg, just on the improvement cost on the 87, I think you said that you took cost down about 30%, over the last 170-odd airplanes? Something like that?

Greg Smith - *Boeing Company - CFO*

Yes. 175.

Rob Spingarn - *Credit Suisse - Analyst*

Right. So now, I'm guessing, with the unit deferred as it stands, at a little over $30 million -- and I know there's some puts and takes, and some things in that number that probably aren't aircraft specific. But I'm guessing airplanes are costing you, these days, somewhere around $130 million.

To get down to a breakeven level, I would imagine you need about another 20% cost reduction from here, give or take, back of the envelope. Can that be done inside of a year, with the volume of airplanes we're talking about?

Greg Smith - *Boeing Company - CFO*

We continue to have plans to reduce the unit costs on the program, Ron. Whether it's through, our own internal efforts or working with the supply chain. So those initiatives are all laid out, and now we've got to go execute those. And we have plans in place to do them. Again, this is stuff we know how to do. We've done it on other programs. And we're putting, obviously, additional focus on that. And this, again, remains a priority for us.

So, at the same time, we're continuing to invest in productivity, as I talked about. As we get more mature with the production system, we see more opportunities to do things better and more efficiently, but they take an investment. It's short-term investment, or a short-term challenge. But long term, significant gains for the program. And that's really where we've got everybody focused.

Rob Spingarn - *Credit Suisse - Analyst*

Okay. And then just a clarification from earlier. The guidance embeds the buyback that you've talked about?

Greg Smith - *Boeing Company - CFO*

Yes. It embeds some form of buyback, yes.

Rob Spingarn - *Credit Suisse - Analyst*

Okay. Okay. Thank you very much.

Greg Smith - *Boeing Company - CFO*

You're welcome.

Operator

Ladies and gentlemen, that completes the analyst question and answer session.

(Operator Instructions)

I will now return you to the Boeing Company for introductory remarks by Mr. Tom Downey, Senior Vice President of Corporate Communications. Mr. Downey, please go ahead.

Tom Downey - *Boeing Company - SVP of Communications*

Thank you. We will continue with the questions for Jim 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're ready for the first question. In the interest of time, we ask that you limit everyone to just one question, please.

Operator

Jon Ostrower, Wall Street Journal.

Jon Ostrower - *Wall Street Journal - Analyst*

Good morning, guys. Just a bit of clarity on the math that you guys presented on the 787 deferred production. Obviously, you're passing $26 billion on deferred costs, with 100 airplanes to go in your accounting block. So you're booking a positive margin on each 787, just really flat out. To zero out those deferred costs, just really simple, back of the envelope, you need to be generating $25 million in profits per plane, starting today. And I -- obviously, there's a curve in there. And you guys haven't hit the unit breakeven yet. So the $25 million figure is even higher than that.

So at what point are the assumptions that you're putting into your accounting estimates that are generating your record earnings? Ultimately, do they reflect the reality of the 787's program cost reductions, while ultimately keeping the program stable?

Greg Smith - *Boeing Company - CFO*

Jon, I guess I would start with, as I said, the fundamental milestones around the 787 being cash positive, and the deferred [declining] after we reach 12 a month, 2016, haven't changed. And the focus on the program hasn't changed. It's all around, again, being more efficient on each unit, and capturing additional unit cost.

There is initiatives within the supply chain. Obviously, there's initiatives within our factory. And we're working to capture those, and continue the journey on the successful productivity we've had in the program to date. That's what everybody is focused on, ultimately leading to, again, cash positive in 2015.

Operator

Julie Johnsson, Bloomberg News.

Julie Johnsson - *Bloomberg News - Analyst*

Hi, all. Congrats on a great quarter.

Jim McNerney - *Boeing Company - Chairman & CEO*

Thank you.

Julie Johnsson - *Bloomberg News - Analyst*

I just wanted to follow up on something that we saw late in 2014. Zodiac had some issues with seat deliveries and certification, and I know it affected some 787 deliveries. And they had cautioned that it's taking longer than they had anticipated to straighten some of those issues out. Just wondering if you see any trickle over into Q1? And if this is a potential warning sign or red flag, as you prepare to ramp up 737 and 787 production?

Jim McNerney - *Boeing Company - Chairman & CEO*

I think that there is no question that seat supply did impact some deliveries, and some fall in our production system. We are working through it now. We see it being resolved this year. The -- we regret any impact it has had on our customers, but it's all been within our plans, and within our guidance, as we work through it. I think the supply days is adjusting to these higher volumes at both 787, and anticipated higher volumes in other programs. And I think they'll be ready.

Operator

Doug Cameron, Wall Street Journal.

Doug Cameron - *Wall Street Journal - Analyst*

Hi, good morning, everyone. The quarterly defense question, Jim. You got some -- you got funding for some old Growlers in the 2015 budget. What are your thoughts of the timing for the future of the St. Louis line? And does it depend at all on what happens with the long-range strike contest, which is upcoming?

Jim McNerney - *Boeing Company - Chairman & CEO*

Yes, I think the status is, we're through close to the end of the decade on F-15's, which is a big piece of St. Louis. We've regained momentum on F-18s. I think in the minds of many, there remains a need beyond that order. So there is a good chance that that line could continue, at least to the end of the decade. Although we do not yet have firm orders, that's an assessment.

And there is no my question that, when we win on long-range strike -- and I'm sounding as confident as I can, because I do believe we will -- that it will solidify the future of St. Louis for many, many years to come.

Operator

Dominic Gates, Seattle Times.

Dominic Gates - *Seattle Times - Analyst*

Hello, gentlemen. This question is for Greg. You mentioned delivering some early 787's this year -- early build 787's. There are something like 11 airplanes, usually -- mostly, the terrible teens, as they are called, that have been sitting there for four years and more. And about a year ago, a couple of customers that those were earmarked for pulled out. Trans Arrow was one of them. So two questions about -- or two parts to the question about that.

First of all, is there any chance those have to be written off or sold so cheaply that it is almost the same thing, and we get some accounting charges for those planes? And then secondly, it looks like you want to deliver maybe three this year, maybe three next year? Very slow output. Is that a deliberate strategy, because of the hit to unit costs every time one of them enters the delivery stream?

Greg Smith - *Boeing Company - CFO*

Not at all. The timing of the deliveries is really solely tied to when we finish the work on the aircraft. And frankly, it's a matter of prioritizing the teams, of taking them off the production line, and moving them over on the early builds. So that is the only things tied into that. It's really just about finishing up the aircraft for the customers.

With regards to the aircraft themselves, we continue to see a viable market, and we're in active discussions with many customers, related to those airplanes. So that is fundamentally how we're handling the EMC airplanes. And you're right, we're working through them in a prudent fashion, and we do expect to deliver three or four this year.

Tom Downey - *Boeing Company - SVP of Communications*

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

Operator

Christopher Drew, New York Times.

Christopher Drew - *New York Times - Analyst*

Good morning. Jim, you mentioned space. And I was just wondering if you could talk us -- a minute about what it is like to compete with SpaceX, with their lower cost and aggressive lobbying and political clout in Washington? And various ways that you, Boeing, and the United Launch Alliance compete with them? And what you see happening, in the long run, in some of these areas?

Jim McNerney - *Boeing Company - Chairman & CEO*

I have respect for space X. I think they offer more limited mission types that we do at this stage. And -- but their combination of focus on gaining capability at improved cost is going to benefit the market. It will make us a better competitor in some segments, where cost is -- has become more important. I suspect that we will retain the lead in those segments where often, manned type missions that go a long way, and to many places we've never been before. I see the advantage we have there will sustain itself for a long period of time.

Tom Downey - *Boeing Company - SVP of Communications*

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