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BA - Q1 2014 The Boeing Company Earnings Conference Call

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OVERVIEW:

Boeing discussed 1Q14 results, reporting core EPS of $1.76 on revenues of $20.5b. Mgt. reaffirmed prior revenue guidance and raised 2014 core EPS guidance to $7.15-7.35.

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PRESENTATION

Operator

Good day, everyone, and welcome to the Boeing Company's first-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'm going to turn this call over to Mr. Troy Lahr, Vice President of Investor Relations for the Boeing Company. Mr. Lahr, please go ahead.

Troy Lahr - *The Boeing Company - VP of IR*

Thank you and good morning. Welcome to Boeing's first-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 will take your questions. In fairness to others on the call, we ask that you please limit yourself to one question. As always, we have provided detailed financial information in 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, in our various SEC filings, and in the forward-looking statement disclaimer at the end of this web presentation. In addition, we refer you to our earnings release and presentation for disclosures and reconciliation of non-GAAP measures that we use when discussing our results and outlook.

Now, I will turn the call over to Jim McNerney.

Jim McNerney - *The Boeing Company - Chairman & CEO*

Thank you, Troy, and good morning, everybody. Let me begin today by acknowledging the families and loved ones of those aboard Malaysia Airlines flight 370. Our thoughts and sympathies remain with them at this time. In accordance with international protocols, Boeing is serving as a technical advisor to the NTSB in support of Malaysian authorities. And we appreciate the ongoing efforts of all parties involved in the investigation.

Turning back to the subject at hand this morning, I'll start with some comments on our first-quarter performance and the business environment. After that Greg will walk you through details of our financial results and outlook.

Now, let's turn to slide 2. Building on our momentum from 2013, Boeing delivered strong first-quarter financial results, including healthy revenue increases, solid core operating margins, and double-digit growth in core earnings per share. During the quarter we also returned significant value to shareholders by repurchasing $2.5 billion of Boeing stock, and increasing our dividend payout to $540 million.

Revenue at Boeing Commercial Airplanes was $12.7 billion, and operating margins grew to 11.8%, a result of higher volume and a favorable delivery mix. We delivered 161 commercial airplanes in the first quarter, including 18 787 Dreamliners. And we added net new orders of 235 airplanes.

Boeing Defense, Space & Security reported revenue in the first quarter of $7.6 billion, and also generated solid operating margins. During the quarter, BDS captured numerous key contract awards, including a $2.4 billion order from the US Navy to support full rate production of 16 P-8A Poseidon aircraft, an order from the US Army for 82 Apache Block III helicopters, and in March the government of Qatar announced its intent to purchase 24 Apache helicopters and three 737-based AEW&C aircraft.

Noteworthy program milestones included the first C-17 delivery to the Kuwait Air Force, the first Peace Eagle delivery to the Turkish Armed Forces, and the successful completion of on-orbit testing for the first MRSAT-5 satellite. In summary, we delivered another strong quarter of operating performance, achieved significant program milestones, captured orders totaling $19 billion, and returned significant cash to shareholders, all of which Greg will cover in more detail in just a moment.

With that, let's turn to the business environment on slide 3. Global customer demand remains high for our fuel-efficient and value-creating commercial airplane family, as evidenced by our strong orders intake during the quarter. Global passenger traffic trends remain strong, and air cargo traffic continues to gradually improve.

Despite some variation in emerging market growth rates, we see no softening of demand for our commercial airplanes, given the compelling operating economics and increased fuel efficiency that our airplanes provide. In fact, underpinning the strength of this cycle relative to the past ones is a sustained high level of replacement demand fueled by compelling airplane economics and the rapid return on investment that comes from replacing older, less efficient aircraft with the dramatically more efficient new technology airplanes we are building today, and we'll introduce throughout this decade.

Furthermore, deferral requests from customers are still running well below the historical average. Requests to accelerate deliveries, meanwhile, continue at a steady and encouraging rate.

This ongoing demand, coupled with our sizable backlog of more than 5,100 airplanes, which is balanced geographically and across customer operating models, reinforces our planned production rates, and we believe positions us for a significant and sustained growth in the years ahead. With a superior commercial airplane product line that provides customers the broadest range of size and range capabilities, in addition to unparalleled operating economics, we continue to expect a book-to-bill ratio above 1 for the year.

In the twin-aisle segment, we expect 2014 will be a strong order year for both the current 777 family and the new 777X models. All Nippon Airways' announced intention to purchase both the 777-9X and additional 777-300ERs illustrates the value that these airplanes bring to the market, and reflects our intended strategy to pair orders when possible to meet customer fleet needs and support the production bridge to the 777X.

Based on 777 proposal volume, firm orders, and options, we have confidence in filling the remaining 2016 production slots. And we anticipate active sales campaigns currently underway will readily solidify 2017 and 2018. With a firm backlog of nearly 300 current 777s, continued strong customer demand, and airplane availability this decade, we have high confidence in executing a successful transition to the 777X.

The 787 Dreamliner is operating at our planned production rate of 10 per month. And both our Everett and Charleston facilities have made great strides on rate stabilization and introduction of the 787-9. We delivered 10 787s in March. And including April deliveries to date, we have delivered a total of 133 787s to 18 customers.

The fleet is flying an average of more than 260 flights per day, with overall dispatch reliability trending positively at above 98%. More work to do there for a number of customers, but good progress underway nonetheless.

787-9 flight testing and production are progressing well. And we now have rolled out our sixth -9 from final assembly. We remain on track to deliver the first 787-9 to Air New Zealand around the middle of this year.

In the single-aisle segment, airline interest in our new fuel-efficient 737 MAX remains high. Cumulative orders have surpassed 1,900 to date. In April we also delivered the first next-generation 737 produced at the increased rate of 42 per month. And we are on track to further increase 737 production to 47 per month in 2017.

Turning to Defense, Space & Security, the President's FY15 budget request demonstrated solid support for major Boeing programs, including KC-46 tanker, B-22 Apache, Chinook, GMD, NASA's space launch system and commercial crew, along with satellite programs, including those in the proprietary area. While funding for the F/A-18 was not included in the budget request, Navy officials have identified additional Growler models as a top priority for funding consideration by Congress this year.

Our F/A-18 family provides exceptional value for customers with proven technology for needed missions at affordable costs. We continue to work with Congress, the Navy and potential international customers to reiterate the aircraft's value proposition. International Defense, Space & Security business represented nearly 30% of BDS revenues during the quarter, and remains at 35% of the BDS backlog as we continue to leverage our unique One Boeing global advantage.

We also continue to target organic growth through investments in technology and innovation in areas such as commercial derivatives, space, unmanned systems, intelligence surveillance and reconnaissance, cyber security, and the few, but critical, future large-scale programs as identified as priorities by our customer, like long-range strike, UCLASS and the TX Trainer. The relative strength of our Defense, Space & Security business stems from a portfolio that is reliable, proven and affordable. And is being delivered on budget and on schedule.

Across the enterprise, we remain intensely focused on driving further efficiency, quality and productivity gains to improve program profitability, and, importantly, to fund investment in future growth. Our market-based affordability initiative within Defense, Space & Security has generated $4 billion of cost reductions over the past three years. And we are on plan to drive out another $2 billion in annual operating costs. We are also seeing early benefits from our Partnering For Success initiative with our suppliers, with further improvements expected to materialize over the next few years as production ramp-ups on our new airplane programs occur.

Before I turn it over to Greg, let me comment briefly on a set of related developments in the first quarter that will materially improve our competitive position, enhance workforce stability, and reduce business risk for us and our customers. Following completion in January of a long-term contract extension with our machinists union in the Pacific Northwest, we successfully negotiated a long-term extension with our machinists in St. Louis. These unprecedented agreements essentially ensure a decade of labor continuity for us and our customer, with economics and productivity incentives that will improve our global competitiveness.

A key feature in those agreements is a retirement plan change which we are also flowing across our non-union population. We started the year with approximately 15% of our workforce on modern defined contribution pension plans. After an initial transition period, we will now have about 80% of our workforce covered by defined contribution plans.

These changes are strategic and fundamental to the way we are structuring the Company to reduce risk, ensure the health of our balance sheet, and enhance our competitive position. All while providing employees with attractive and competitive benefits, and further driving long-term shareholder value.

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

Greg Smith - *The Boeing Company - CFO*

Thanks, Jim. And good morning. Let's turn to slide 4 and we'll discuss our first-quarter results.

First-quarter revenue increased 8% to $20.5 billion, driven by strong commercial airplane deliveries. Core operating margins increased to 10.2% in the quarter, primarily driven by solid productivity gains of both businesses and improved commercial delivery mix. First-quarter core earnings per share of $1.76 was driven by higher commercial airplane volume and continued strong operating performance. Excluding the $0.19 of research and development tax credit we received in the first quarter last year, EPS this quarter grew 14%.

As previously announced, during the first quarter we recorded GAAP non-cash pension curtailment charges of approximately $330 million associated with the announced move from the defined benefit pension plans to defined contribution plans for over 100,000 of our employees. These charges did not impact core earnings per share. And, as Jim indicated, we believe these pension changes and long-term labor agreements further de-risk our business, and will improve the Company's long-term competitiveness and further drive value for all of our stakeholders going forward.

Let's discuss commercial airplanes on slide 5. For the first quarter our commercial airplane business increased revenue 19% to $12.7 billion on 161 airplane deliveries, and increased operating margins to 11.8%. Solid performance, higher volume and favorable delivery mix contributed to the strong operating margins in the quarter, and are a testament to our continued focus on efficiently executing our rate increases and driving productivity.

Commercial airplanes captured $14 billion of net orders during the quarter. And backlog remains very strong at $374 billion and over 5,100 aircraft, equating to approximately seven years of airplane production.

Gross inventory for the Company included $36 billion related to the 787 program, an increase during the first quarter of approximately $2.9 billion. This expected increase was primarily driven by higher planned inventory in support of the production rate increase to 10 per month, and the introduction of the 787-9 program.

Included in the work-in-process inventory are deferred production costs. For the first quarter 787 deferred production balance totaled $23.1 billion, a $1.5 billion increase from the fourth quarter of last year. The $1.5 billion change in deferred production was driven by the planned transition to 10 per month rate, additional 787-9s in the production system, and a one-time IAM contract extension payment. Excluding the IAM payment, the change in deferred production during the quarter was slightly lower than the fourth-quarter level.

Based on further production stability, planned contracted supplier step-down pricing, and continued overall productivity improvements, we expect the quarterly change in deferred production to decline in the second quarter. We continue to expect 787 deferred production to peak at approximately

$25 billion late this year, and moderate at that level before beginning to decline shortly after we complete the transition of 12 per month production rate in 2016.

We continue to see good progress in key operational performance indicators and unit costs as we further implement production efficiencies and stabilize the overall production system on the 787 program. While introducing the 787-9 into the production system, and increasing production rates by over 40%, the team continued to make good progress on reducing 787-8 unit costs by more than 15%, and improved the final assembly flow times by more than 10% in the last 12 months. More work to do but the teams remain focused on improving productivity, flow times, and quality going forward.

We also continue to see good progress on the 787-9 where we've seen a 30% improvement in unit costs and flow times from the first to the sixth aircraft to roll out the factory. We still have work ahead of us in the 787 program, and anticipate continued improvement as we further stabilize at the 10 per month rate, and increase 787-9 production. We also remain on track to deliver approximately 110 787s in 2014. Again, the team remains focused on execution and improving productivity on the program.

Let's turn now to slide 6 to discuss Defense, Space & Security results. First-quarter revenue at our defense business was $7.6 billion, and operating margins were 10.2%, largely driven by strong performance and delivery mix.

Boeing military aircraft first-quarter revenue declined to $3.5 billion, reflecting F-15 development milestones achieved in the first quarter of last year. Operating margins of 9.6% in the quarter were due to strong operating performance, which was offset by the first-quarter $48 million C-17 inventory-related charge.

Global services and support increased revenue 6% to $2.3 billion, and reported solid operating margins of 12.1%. Network and space systems reported revenue of $1.9 billion, and generated operating margins of 9% in the quarter, resulting from continued focus on execution and activity. Defense, Space & Security reported a solid backlog of $66 billion, with 35% of our current backlog representing customers outside the United States.

Turning now to slide 7, Boeing Capital's net financing portfolio declined to $3.5 billion on run-off that exceeded new aircraft volume.

Let's turn to cash flow now on slide 8. Operating cash flow for the first quarter was $1.1 billion, driven by solid operating performance and favorable timing of receipts and expenditures.

With regards to capital deployment, we paid $540 million in dividends to shareholders, and repurchased 19.4 million shares for $2.5 billion in the first quarter. We continue to anticipate completing the remaining $8.3 billion of repurchase authorization over the next two to three years. Returning cash to shareholders, along with continued investments to support future growth, remain a top priority for us.

Let's now move to cash and debt balances on slide 9. We ended the quarter with $12 billion of cash and marketable securities. Our cash position continues to provide solid liquidity, and positions us well going forward.

Turning now to slide 10 and we'll discuss our outlook for 2014. We're reaffirming 2014 guidance for revenue, operating margins, deliveries and cash flow. And as a result of a $115 million favorable IRS tax settlement we received early in the second quarter, we're increasing our core earnings-per-share guidance for 2014 by $0.15 to now be $7.15 to $7.35 per share. GAAP earnings-per-share guidance is unchanged as the second-quarter tax benefit offsets the first-quarter pension curtailment charges I discussed earlier.

In summary, first-quarter financial performance reflects the strength of our backlog, the strong demand for our products and services, and our continued focus on driving productivity and execution through the entire enterprise. Furthermore, as evidenced by our meaningful dividend increase and our higher share repurchase activity, we continue to expect to deliver solid growth, productivity and strong cash flows going forward.

With that I'll turn it back over to Jim for some closing comments.

Jim McNerney - *The Boeing Company - Chairman & CEO*

Thanks, Greg. With a strong first quarter behind us we remain focused on disciplined execution, quality and productivity improvements, and meeting customer commitments. Our priorities going forward remain clear -- the profitable ramp-up in production of our commercial airplane programs, executing on our commercial and defense development programs, driving productivity and affordability throughout the enterprise, continuing to strengthen and position our defense business with investments in growth areas amid further international expansion, and, importantly, providing increasing value to both our customers and shareholders.

Now, we would be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Rob Spingarn, Credit Suisse.

Rob Spingarn - *Credit Suisse - Analyst*

A question for Greg on the 787 and the deferred. You talked about the delta from last quarter and we should pull out the $300 million from the IAM. So, thinking about the $2 billion of headroom left to the peak of $25 billion, it sounds, Greg, like year end is the time for that.

Should we consider a curve, perhaps incremental drop, of about $1 billion then maybe $650 million and $350 million, declining like that to get to that target? Is that the right way to think about it or is it steeper or flatter than that?

Greg Smith - *The Boeing Company - CFO*

Just a point of clarity, Rob, not all the $300 million hits the 787s. That was for all IAM members including folks that are on the 787 program.

But I think as you think about deferred going forward, as I mentioned in my remarks, we've got some quarter over quarter, some step down pricing that we have with our supply chain that's already contracted. And at the same time continuing to make progress on unit cost and productivity. And I mentioned the progress that's been made up to now.

And I'll tell you, there's a lot, obviously, in work around how to improve flow, how to improve productivity. And just like, I think if you go back in time when we stabilized rate on any program, that's where the teams have really been able to capture productivity. And that's expected here.

So, quarter over quarter we're going, as I said, we'll see improvement coming off this quarter into second quarter. And we still, again, expect to peak at about $25 billion. And then it will hold flat, as I mentioned before, relatively flat. And then once we hit 12 a month is where you'll start to see us burning that off.

We've got to stay focused on productivity, we've got to stay focused on deliveries, as we have, and stay focused on readiness getting to 12 a month. So, across the board teams doing a very good job staying focused on those elements of the production.

Rob Spingarn - *Credit Suisse - Analyst*

So, Greg, just to qualify, how would we think about the delta just on 787 deferred when we factor in the IAM? What piece was for that?

Greg Smith - *The Boeing Company - CFO*

It's about $75 million.

Rob Spingarn - *Credit Suisse - Analyst*

Okay, thank you.

Operator

Cai von Rumohr, Cowen and Company.

Cai von Rumohr - *Cowen and Company - Analyst*

Yes, thank you very much. To dig in a little bit on the 787, could you give us some color on how you stand on the Charleston mid fuselage issue, the jobs behind down, the Mitsubishi wing crack issue? And then perhaps give us some color on when we should expect the step-down pricing to start to kick in and which quarter.

Greg Smith - *The Boeing Company - CFO*

Yes, sure, Cai. Let me address the jobs first. As you know, we put a very concentrated effort into Charleston to focus particularly on the mid body, and the team's making good progress. They have burned down a significant amount of jobs.

Still some work to do but making tremendous progress. And I certainly don't see any impact on our delivery guidance for the year as a result of that. So, right focus, the right people making good progress.

On MHI, we're essentially through all the MHI rework. As of last night we have three airplanes left ago. And, again, the team's executed that flawlessly, and met all the requirements there. So, I'd say that's behind us at this point. All of that, again, playing right into the deferred production and improvement that were expected in unit costs.

On the step down we will start to see some of that in the next quarter as we introduce the next block. So, you'll start to see that. And obviously expect to see that through the balance of the year.

Cai von Rumohr - *Cowen and Company - Analyst*

Thank you. Should we be concerned that you've only done one 787 delivery so far in April?

Greg Smith - *The Boeing Company - CFO*

No. I think I mentioned before, month to month you're going to see variance in deliveries. Certainly what you just described had an initial impact on specific timing. And at the same time we're introducing the airplane to 18 new customers this year.

So, you're going to see a change in cadence month over month. But like I said, when you look at tail number by tail number through the balance of the year, we're comfortable that we can get to the 110 deliveries.

Cai von Rumohr - *Cowen and Company - Analyst*

Thank you.

Operator

Doug Harned, Sanford Bernstein.

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

Good morning. You talked about the 777X transition. I would assume at this point you have a good sense of 777 demand later in the decade as you're working through a lot of the negotiations on combined orders for 300ERs and 777Xs. But do you expect to be able to maintain 300ER production rates through the decade? Could you describe your strategy for the bridge and potentially any need you may have for discounting, given the large production quantities that are planned for the A350, the 87 and potentially the A330?

Jim McNerney - *The Boeing Company - Chairman & CEO*

Doug, I'll take that one. Based on the data we see we do have high confidence in being able to maintain production rates up until the introduction of the 777X. There will obviously be some feathering in at the transition point itself, but by and large maintaining production rates.

Where do we get the confidence? It's in airplanes sold to date. It's in proposals accepted. It's in campaigns that our ongoing today where, as in the case of ANA we're selling both 777 300ERs as well as the new Xs. The requirement versus the alternatives still is favorable.

I think you're right, there will be some pricing pressures associated with that, that we've anticipated in the way we look at this. Which is why the most aggressive productivity program we have right now in our factory is on the 777 model to offset that and more.

But you have to remember the plane that essentially replaces the 777 300ER will be introduced after the first 777X. The first 777X is a 406-, 407-passenger model. The 8X, which will be the one that directly replaces the 300ER, won't come for a couple of years after that.

So, there is plenty of running room where they can reap the economics of the base 777 in conjunction with buying 777Xx. It looks good as we talk to our customers, and we do have a high degree of confidence in being able to do it.

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

When you look at 2017, when things start to fall off, at least when we look at firm orders, are you already pretty comfortable with the discussions you're having, that you can go out into 2018, for example, or maybe even a little longer, and keep this up?

Jim McNerney - *The Boeing Company - Chairman & CEO*

Yes. The pipeline gives us comfort. These are real discussions. You have to remember, the 777 customer base is one of the biggest and most loyal customer bases that we have.

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This is not discussions that are just happening in a vacuum. These are with people who have both additional 777 needs in the medium term, and then longer term would need the new model to significantly increase performance and productivity for themselves. And there's a large overhang of options, there's a large overhang of other forms of commitments, that give us comfort that this will happen. And there is almost ten years from now until when the replacement model will be introduced. So, there's plenty of time to garner the economics of the base 777.

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

Okay, very good. Thank you.

Operator

Joe Nadol, JPMorgan.

Joe Nadol - *JPMorgan Chase & Co. - Analyst*

Good morning. Just back to the 787, thinking through the next couple of years, your rate is going to be flat out 10 a month. But you're going to have a mix shift, through, from -8 to -9s. -8s are actually going to come down in rate, while the -9s are coming up. Your margins are higher right now, where your cash burn is lower per unit by far on -8s.

There's a lot of moving parts here as we think about the deferred profile. The question is, on the -9, when do the margins or the cash, the unit margins, on -9s get better than they are on -8s?

Greg Smith - *The Boeing Company - CFO*

Certainly when you look at the mix there's still going to be a lot of -8s. And that will be the predominance of the deliveries for the next little while here, next couple years really. They'll still be dominated by -8.

We're obviously still expecting improvement on the -9, as I mentioned, Joe. Even on the first six units we're seeing the unit costs coming down. So, we've anticipated that in the current booking rate.

I think mix really starts to come into play when you get much further out in the blocks, when you see the mix of -10, -9 and -8s in there. I think you're still going to see some, as we move further into the skyline, you're going to see more people converting from -8s to -9s and potentially -9 to -10s just because it fulfills their mission more efficiently. So that mix, again, will have more impact later in the blocks than near term.

Joe Nadol - *JPMorgan Chase & Co. - Analyst*

Can you compare the -9 to the -8 in terms of just early learning here, what you're seeing? You've given us a few different numbers but it's hard to string them altogether. Just compare and contrast a little bit.

Greg Smith - *The Boeing Company - CFO*

It's very hard, obviously, to compare the first -8s to the first -9s considering where we are. But I'd say they are coming down the learning curve, as we would expect them to. So, I think they're making good progress.

At the same time they are incorporating production efficiencies that we've realized on the -8. They're getting into the -9 and also working anywhere where they had opportunity to work any commonality on manufacturing processes, and so on. Again, hard to compare tail number to tail number at this point because it's so early on in the program. But we're seeing the improvements that we'd expect there. Have certainly got more work to do but off to a good start.

Joe Nadol - *JPMorgan Chase & Co. - Analyst*

Thank you.

Operator

Carter Copeland, Barclays.

Carter Copeland - *Barclays Capital - Analyst*

Good morning. Just a quick revocation on a disclosure and a question. Greg, with respect to the unit versus program differences, which were 1.8 versus the 1.5 in deferred production on the 87, I wonder if you could tell us what program that pertained to.

And then, additionally, a question. I just wanted to address BCA absolute profit dollars and the guidance. It looks like, if you look at what you did in op profit in the first quarter, and where the guidance is for BCA for the year in absolute dollars, on a run rate basis it would imply that the op profit is down in the remaining three quarters just by the fact that deliveries will be up, and even on some profitable platforms like the 37, not just the 87. So, I wondered if you could help reconcile that and tell us how to think about what might be driving that, or whether you've got some conservatism in there.

Greg Smith - *The Boeing Company - CFO*

Sure. To start with, first, on a unit versus program, almost 85% of that was 787. As you look at it, Carter, you will see unit improvement quarter over quarter there. I've always got to caution you that that may not be the case every time because of the mix of deliveries through EMC, Charleston and - 9s now in Everett. But, again, we're seeing the right level of improvement unit over unit there. So, continue to focus in that area.

On the guidance, certainly off to a good start. Early. There's a lot of things, obviously, we've got to work through, through the balance of the year. I think we've got good plans in place to do that.

We are making some investments -- continuing to make investments -- in efficiency in the production system. So, you'll see some of those investments be hitting more later in the year that we'll certainly benefit from, from years to come, that we don't have early on. And then some mix and volume differences between what we're seeing in the services business in the first quarter through the balance.

We're going to continue to focus on execution, continue to focus on productivity. And if we continue to do that we'll update you going forward. But we're obviously focused on, like I said, those basic elements to continue to drive the production system and capture as much of the efficiencies as we can.

Carter Copeland - *Barclays Capital - Analyst*

On that unit versus program number there wasn't a negative delta of any significance for any of the other programs?

Greg Smith - *The Boeing Company - CFO*

No.

Carter Copeland - *Barclays Capital - Analyst*

Okay, thank you.

Operator

Sam Pearlstein, Wells Fargo.

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

Good morning. If I look, it looks like starting in 2014 a significant portion of long-term incentive comp now seems to be tied directly to total shareholder return. I'm just trying to think about what does that make you do differently? How does that make you think about M&A, the returning 80%, 85% of cash to shareholders, and even dipping further into the cash balance? How do you get that stock to move the way you want it?

Jim McNerney - *The Boeing Company - Chairman & CEO*

I don't think the incentive program is designed to change behavior. I think it's designed to reinforce the behavior that I think we've been talking about, which is to balance innovation, productivity, customer satisfaction, and shareholder returns.

I wouldn't characterize it as a seismic shift in our program. We've moved more of it toward what you would refer to as performance-based pay where there is a TSR measurement that keeps us focused on our relative stock price, which is the expression of all those things. We're just trying to tighten up and focus our management on the things that are important. We're not trying to say different things are important.

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

And if I can follow that up, based on your buyback pace in the first quarter, it seems like with the dividend you'll already have returned 85% of your free cash this year to shareholders. Can we expect to see that going up?

Greg Smith - *The Boeing Company - CFO*

Yes. As I said, Sam, we're committed to deploying our cash efficiently. And obviously off to a strong start in the first quarter. We had $8.3 billion still under authorization that we plan to use over the next two to three years. So, we'll continue to focus in that area.

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

Great, thanks.

Operator

Howard Rubel, Jefferies.

Howard Rubel - *Jefferies & Company - Analyst*

Thank you very much. I have a two-part question, maybe half for Jim and half for Greg. To go back to the end of your opening comments about improved labor stability and more manageable benefit costs going forward, how does that cause you to think about make versus buy, comparing market-based rates versus what you can potentially do internally? And then I have a follow-up to that.

Jim McNerney - *The Boeing Company - Chairman & CEO*

I'll swing at that one, Howard. I think it's a very important point you're raising with that question. I think we have a highly valued workforce, a number of whom are unionized. We now have a much more stable, visible set of outcomes in front of us with them, which I do think, coming out of an era where we may have on the margin relied too much on some outside work, I think this gives us the option, where it's smart, to do some of the work inside.

And I'm not trying to imply a big seismic shift. I'm trying to say it gives us the option. And given that it's a highly valued workforce that has some new economics associated with it, which is what we accomplished with the agreements, I think it gives us the option to use the best mix of inside/outside toward the end of delivering reliably, on time, highly valued products to our customers. So, I think it's another arrow in the quiver as we strive to remain the world's best aerospace company.

Howard Rubel - *Jefferies & Company - Analyst*

And then to follow that up, if I add back R&D in the quarter to the operating margins at commercial, and compare it with a year ago, and maybe even adjust for 78 deliveries where there were 18 versus 1, you're on the order of almost a 500 basis point improvement in profitability, Greg. Is there one or two things that you can point to? This did absorb some of the changes in the benefit costs so it's a pretty notable statement.

Greg Smith - *The Boeing Company - CFO*

Howard, I would say predominantly improved performance on 737 and 777, I'd say were the biggest drivers in there. But, as I mentioned earlier, and Jim's mentioned many times, we're really focused on productivity across all cost elements. Certainly continuing to work, Partnering for Success, but at the same time challenging our sales internally on any and all forms of costs- -- period costs, productivity.

The 777 is a great example. 8,000 airplanes, best-selling aircraft ever, and we're still able to capture additional productivity gains there. So, it's a great testament to the team's focus on that. And that's really where you're seeing the improvement. And obviously we're staying focused on that to continue to improve that going forward on all programs.

Howard Rubel - *Jefferies & Company - Analyst*

Thank you, gentlemen.

Operator

Ron Epstein, Bank of America Merrill Lynch.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Good morning. Maybe just changing gears a little bit to the military side of the business. When you think about the BMA portfolio and South Korea's decision, and then the Brazilians decision to buy the Gripen, C-17 winding down, you've got Tanker, you've got P-8, Jim, can you tell us what's your broad strategy on that portfolio and how do you sustain it?

I hear you that the Navy wants some F18Gs to get put back in the budget. And that probably will, would be my guess, but it's a fight now. It seems like it's a bigger fight now to keep those programs alive than it was before. How do you think about that down the road?

Jim McNerney - *The Boeing Company - Chairman & CEO*

There's no question that the budget discussion is getting more difficult. Every program is fighting for inclusion. We're fortunate that a lot of our programs are in the budget, come hell or high water. But you do point out correctly that there's some moving pieces that we're going to have to manage.

I suspect that that F-18 line will remain open due to some possible orders from the US government, which you characterize as probable. I would tend to agree but we'll see. There's a number of international campaigns that will supplement that.

But C-17 is going away. Tanker and P-8 will more than replace the C-17 when you look at the longer term. And there are some other big programs that are high priority for our country -- long-range strike, UCLASS, TX Trainer -- that I think will survive any budget scenario. And Boeing is very well-positioned on all three of those.

Will we win all three of them? Hard to predict, but winning one or two of them keeps the business intact, and the industrial base intact, even in a scenario where the fighters are winding down. Remember, the helos are growing and in high demand around the world. The satellites are growing, in high demand around the world. Space is growing. We've got the major program there on SLS.

So, the core is growing. The stuff that's immediately going away is being replaced by more than it represents today. And the longer-range programs, a betting man would say, will more than replace some of the tactical air pressure that we would see in the medium term. The whole equation, near term, flat; longer term, slow growth. And very responsible management of margins all the way along. That's the role of that business in our portfolio.

Ron Epstein - *BofA Merrill Lynch - Analyst*

May I ask a follow-on to that? When you think about that business, when we think about capital deployment, is there anything in that military portfolio, or areas in that military portfolio, that you would like to add onto from an M&A perspective, maybe bolt-ons or --? When you think about capital deployment into the military business, how do you think about investing in growth?

Jim McNerney - *The Boeing Company - Chairman & CEO*

I think about it in two dimensions. Smaller bolt-on deals that provide vertical strength. And that's ISR, that's cyber, that's all the things that make platforms strong or make networks more secure. They're either part of a platform we sell or something we can sell on its own. So vertical strength.

And then services capability. We have, by far, the largest base out there, as you know, you've heard me say it. We have a very large services business. I think the services business can even get bigger.

And, of course, international -- you don't want to leave international out of the discussion because Boeing has a unique advantage. We have a unique industrial base and engineering base around the world, and affiliations, because of our commercial business, which is a leverageable thing when we start offset programs in support of military business. Capital in support of those initiatives, on top of what I mentioned before, which is more of a portfolio of products, I think those are the strategies that will sustain this business and enable us to sustain margins in a slow-growth environment.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Okay, thank you.

Operator

John Godyn, Morgan Stanley.

John Godyn - *Morgan Stanley - Analyst*

Great, thank you for taking my question. I was hoping the team could give an update on Partnering for Success. I think the analyst community realizes this is a big opportunity but has a lot of trouble translating it into the model. Is there anything that you could offer in terms of the percentage of contracts that have been successfully negotiated? Have they been negotiated on track? What on track means. And any other granularity you're willing to offer.

Jim McNerney - *The Boeing Company - Chairman & CEO*

Yes. Again, our assumption is a more-for-less world over the next couple of decades. And the Partnering for Success program offers a win-win to the suppliers that we do business with. As I've characterized it before, we're in the early innings of this game. And I would say 25% to 30% of our base has reached some form of agreement with us on how to go forward.

I would say another third we're in deep discussions, we're close to coming to some agreements -- which are characterized by mutual benefit. This is not just -- we want your margin, and be nice to us from now on. This is a broader business arrangement that does reflect the more-for-less world that I see out in front of Boeing.

These arrangements often do have price reductions associated with them, significant price reductions associated with them, but also have benefits to our partners. We have already baked in substantial money into our EACs based on the agreements we've reached so far.

Now, look, this isn't pure gravy. The reason we're doing this is we have a world out there that's putting price pressure on us, that is putting cash pressure on us, and we're trying to respond to that. And, so, you see our margins steadily improving. That remains our objective.

And, by the way, we're working as hard on our internal costs, if not harder, than we're working on costs in our supply base. I feel quite proud and credible standing in front of the supply base and telling them that I expect the same from them that I'm expecting from my team. This is not a zero-sum game. This is a how-do-we-win-together game.

The financial impact of improvements we make in our business relationship will increase over time over the next decade, because a lot of these arrangements involve technology and procurement for things that will flow out and are growing over the next decade. That's when you'll begin to see the impact. But it's already in the order of billions of dollars over a medium and long term, and there's more where that came from.

John Godyn - *Morgan Stanley - Analyst*

Very thorough, very helpful. Thank you

Operator

Jason Gursky, Citi.

Jason Gursky - *Citigroup - Analyst*

Good morning, everyone. Greg, I just wanted to ask you a quick question on the outlook and where the BDS business is global services and support. You've had nice margin performance there for the last several years. And yet what you're suggesting over the next couple of quarters is the deceleration in the margin outlook. I was wondering if you could just talk a little bit about the dynamic that might be going on there, to help us understand why we would see a deceleration there.

Greg Smith - *The Boeing Company - CFO*

Jason, as you know, especially when it comes to services and the thousands of contracts that exist in any services organization, mix really comes into play here. So, we're not anticipating any performance degradation at all. It's just purely mix quarter over quarter or through the balance of the year that is driving that.

But, at the same time, very focused on performance. There's no question there's DoD budget pressure that's out there that we continue to face day in and day out, and manage our way through that. But, again, the team is focused on executing flawlessly on the contracts they have, and focused on productivity through the Partnering for Success and the market-based affordability initiatives that Jim described. So I wouldn't read any more into that other than what I just described.

Jason Gursky - *Citigroup - Analyst*

Okay, that's helpful. Thank you.

Operator

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

(Operator Instructions)

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

Tom Downey - *The Boeing Company - SVP Corporate 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 are ready for the first question. And in the interests of time we ask that you limit everyone to just one question, please.

Operator

Jon Ostrower, Wall Street Journal.

Jon Ostrower - *Wall Street Journal - Media*

Good morning, guys. Just a follow-on question about Partnering for Success. You had, last September, announced the Heroux-Devtek order for the 777X landing gear. That seemed to be reflective of a sea change in how Boeing was communicating about Partner for Success as far as its seriousness with the supply chain, that this effort was going to continue whether they were onboard were not.

As you look at the current state of both your supplier management organization with the new leader there, and also getting companies like Spirit to form up a final long-term contract, as well as the absence of talking about the Japanese as far as their role in 777X, how do you see the relationship with those key players moving forward in the context of Partnering for Success, and whether or not there is room to be essentially maneuvered to get the kind of cost-cutting that you guys are looking for on both sides?

Jim McNerney - *The Boeing Company - Chairman & CEO*

I think I would characterize the progress as good so far. I think we are finding deals that have mutual benefit, significant benefit, for our customers and us, as well as benefit for our partners. And it sometimes takes time to find that, to find those deals. And, as you've noted, there's been a couple of events along the way that do reflect the seriousness of the discussions. But we're making good progress.

And the benefit, the beneficiary of progress here, will be the customers of Boeing and the employees of Boeing because it's going to create a stronger company. So, I feel good about the progress, while still at the same time recognizing that the discussions are not always easy. They are difficult. But the ultimate strength we have here is that Boeing's prospective success is based on our product lines and our people, something that people want to be part of. And, so, ultimately that's what's bringing people together.

Operator

Julie Johnsson, Bloomberg.

Julie Johnsson - *Bloomberg - Media*

Hi, Jim. A quick question. I'm just wondering if you could walk us through a little bit your thinking on how to approach Russia and Ukraine, what Boeing's exposure is at this point? And if you see any risk to deliveries for titanium this year.

Jim McNerney - *The Boeing Company - Chairman & CEO*

Managing a global supply chain is what we do. It's what we do every day. And there are potential disruptions in many places around the world. Right now everybody's focused on Russia, as we are. And we have good contingency plans in place if some unlikely but possible outcomes occur there.

Operator

Alwyn Scott, Reuters.

Alwyn Scott - *Reuters - Analyst*

I wondered if you could talk about how does this effort to move engineering talent around help you. And don't you need your engineers in the place where the products are built in order to have the best efficiency there? So, how is moving them more efficient? And, also, don't you risk losing engineers in Washington, say, by these kinds of moves? Those are concerns obviously that have been raised locally in Washington state, and I just wanted to hear how you might address that.

Jim McNerney - *The Boeing Company - Chairman & CEO*

The fundamental principle here is, as the world's largest aerospace company, that has been put together out of the cloth of a number of different acquisitions over the years, we have engineering talent around the Company that is extraordinary. And where we place work, there is a tension between engineering work being done right next to the product, on one hand. And, on the other, doing it in the place that has the best engineers for the task at hand, or so-called centers of excellence. And there will always be a balance there.

What we're trying to do is achieve the right balance between centers of excellence and proximity that leaves us with the strongest company that will take us from the $50 billion in sales we were a decade ago to numbers that are much bigger than that, that we're headed towards. It's an equation that we're balancing all the time. What I do know is it will mean that we will not only be St. Louis-centric for certain kinds of engineers, or Seattle-centric for other kinds of engineers, or Huntsville-centric for other kinds of engineers, it will be a blend, all in the name of creating the strongest possible Boeing.

Operator

Dominic Gates, Seattle Times.

Dominic Gates - *Seattle Times - Media*

Good morning, Jim. I'd actually like to follow-up on Al's question about the transfer of engineering work, because it is top of mind with people here. If we look at something like BR&T shift to St. Louis, Charleston, Huntsville out of Puget Sound, whatever the business and strategic rationale, it seems like there are two possible negative impacts. One is that, because the growth elsewhere is less than the jobs eliminated here, there is a net reduction in engineering productions. And then, secondly, there is a terrible hit to morale among the engineers here, not just the ones who are now tagged for moving but everybody else here. So, how do you address this concern about losing capability and the hit to morale among your workforce here?

Jim McNerney - *The Boeing Company - Chairman & CEO*

In the minds of most of us, these moves strengthen our Company, strengthen our engineering capability. These are not designed in any way, shape or form to weaken our Company. It's this tension between proximity and centers of excellence, that I mentioned in answering Al's question, that we're trying to balance.

Listen, I realize that moving work around a very large corporation can be controversial at the local level. I understand that. But I think we eventually have to come together as a team and keep making progress. This Company is making progress.

And I think, as we see further success in the future, we'll fight through the dislocations that happened, not only in Seattle but in a lot of other places around Boeing, as we try to optimize the right work placement for our engineering capability. So, we'll keep working it.

Operator

Steve Wilhelm, Puget Sound Business Journal.

Steve Wilhelm - *Puget Sound Business Journal - Media*

Hi, Jim. Thanks for taking this one. I wonder if you could talk a little bit about, in terms of the 777X assembly, what kind of robotization and automation are you planning, both in terms of the wing assembly but also final assembly? And how is that going to look different from the current system?

Jim McNerney - *The Boeing Company - Chairman & CEO*

We're always trying to improve our manufacturing processes. And a lot of our advanced work is looking at some different forms of automation.

THOMSON REUTERS

We have not yet made the decision which specifically to deploy where and when. But you will continue to see us make progress on productivity and automation beyond where we are today. It will play a role. And it's very important that we do that to maintain our competitiveness.

Operator

Dan Catchpole, Everett Herald.

Dan Catchpole - *Everett Herald - Media*

Hi, good morning. I was wondering if you could talk about the water quality rule that Washington is considering? The Company's raised its concerns with the states that could affect the Company's future in the states. I was wondering if you could put any finer point on that and give us an idea of what your concerns are about some of the possible unintended consequences of a stricter rule.

Jim McNerney - *The Boeing Company - Chairman & CEO*

Listen, I think this is one where we have been working very closely with the legislative and political leadership in the state of Washington. We're very sensitive to both sides of this question. Obviously we want to find our way through this issue in a way that allows us to keep developing and manufacturing the world's best airplanes, but still be sensitive to some of the local sensitivities. I'm highly confident that we can find a solution here.

Operator

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.