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# EDITED TRANSCRIPT

BA - Boeing Co at Barclays Industrial Select Conference

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## CORPORATE PARTICIPANTS

**Jim McNerney** *Boeing Company - Chairman, President, and CEO*

## CONFERENCE CALL PARTICIPANTS

**Carter Copeland** *Barclays Capital - Analyst*

## PRESENTATION

**Carter Copeland** - *Barclays Capital - Analyst*

All right, good morning everyone. I see a lot of familiar faces out there; very pleased to kick off the aerospace and defense portion of our conference with Jim McNerney, Chairman and CEO of the Boeing Company. Very, very pleased to have him here. It's already a stock that is off to the races this year, so I think a lot of excitement, a lot on people's minds. So we're looking forward to a good discussion.

Just before we get started, as I always do, I like to take the -- to poll the audience and figure out who we have in the room. I want to ask a couple of the audience response questions and just put up the first one about whether or not we currently own the stock. Please go ahead and respond. So this, Jim, is where we will see if we have opportunity.

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

I do, I do.

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**Carter Copeland** - *Barclays Capital - Analyst*

You own it as well, I know.

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

I do.

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**Carter Copeland** - *Barclays Capital - Analyst*

All right, so an okay amount of non-owners. And question number two, so we set the stage as well, general bias towards the stock right now. Please go ahead and respond.

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

This is interesting.

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**Carter Copeland** - *Barclays Capital - Analyst*

All right. So we've got a lot of likers, but not as many owners, so probably a lot of opportunity.

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

A target-rich environment.

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**Carter Copeland** - Barclays Capital - Analyst

Exactly. Thank you for joining us. We really do love having you here.

I want to kick off the discussion and just -- you made some comments on the fourth quarter call regarding how you felt about the Company's position relative to where you've been in the prior years. You talk about completing rate ramps, refreshing the product portfolio, sealing labor agreements. There's a lot that's been going on in the last couple of years.

When you take a step back and say what did that mean for the financial performance of the Company over the coming years and what we should expect from that, I wonder if you might talk to that from a high level?

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

I mean I think some of the building blocks that you mentioned, getting the pension fixed, okay, we'll have close to 90% of our employees on contribution-based pensions; a 10-year agreement with our largest unions, one where we don't. But the vast majority we do.

Our position in widebody airplanes is very strong in terms of how our lineup compares to our competitors. And yes, rate has been taken up significantly. A lot of that risk is behind us, and I think we are flowing a lot of the technology that we've developed over the last decade into the next decade, which is I would characterize as a de-risked environment.

For example the 777X wing will be the fourth composite airfoil that we will have done as opposed to the first composite airfoil that we did on the 87 at the beginning of that program. So we're more surefooted in terms of deploying this technology that is making our airplanes unique. We're ahead competitively there and so I think it bodes well. And I think a lot of the risk on the 87 is behind us in terms of the product development and the R&D associated with it.

And now we're dealing with the normal things we do, which is dispatch reliability on the airplane, maybe even taking rate up higher. We're already at an all-time high, 10 a month. A widebody airplane has never been produced at 10 a month before. So we have plans to go to 12 and possibly higher.

So I think we're in a pretty good position. So it's a stable -- more stable financially and it's good growth prospects on particularly the commercial side of our business.

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**Carter Copeland** - Barclays Capital - Analyst

When you think about what this means, I remember having lunch with you a couple of years ago and we had a conversation about this, and it seems very relevant in a broad industrial conference when you look at how Boeing compares to other industrial companies, and the level of risk that the Company takes in its products and the level of return you get from that.

Obviously the product decisions on a 737 MAX, 777X have been a bit different than what the Company has historically done. When you look out at the end of this decade or into the next decade, how do you think that influences the risk-adjusted return profile of the Company? Are we on a path to record margins at some point? And should we see expect to see the volatility of investments maybe come down? Or how do you think about what this Company will look like?

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

I think it bodes well for cash generation and a lower beta on earnings within the context of growth. I mean I think the lumpiness in our results come from new to the world kinds of investments that take a little longer to get done or cost a little more to get finalized. And I think we're now dealing with flowing a lot of those hard-fought technologies into all of our platforms, which is a lower risk proposition.

You're right. In the lead-in to your question, I didn't feel, in our conversation at lunch that day, that we were getting paid for the risk we were taking as a systems integrator. I felt that because integrating the systems is more complicated than it used to be. There's a lot more that goes into integrating a 787 than went into integrating the first 737: the software, the sensing technology, just the seats which are basically in-flight entertainment centers. It's a much more difficult task.

And so, I think we began to work with our suppliers differently, where I felt that the risk we were taking was not commensurate with the return we were getting. And so we began to work with them in different ways, where we were trading volume for margin in deals that we cut with them, and giving them more visibility to a future, and at the same time, paying us for what the risk we were taking. So that's a program, partnering for success, that will continue out over the next decade.

And we have a long product lifecycle. The programs you mentioned, the 737 MAX and the 777X, and I think you mentioned it within the context of derivative programs, flowing technology as opposed to another major 787 kind of development. And that's done by design. A, because we have the technology that we can do it with, and B, we're very cognizant of another 787.

We don't want that in terms of the risk profile. We love the airplane. And customers love -- but the financial characteristics were not fun.

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**Carter Copeland** - Barclays Capital - Analyst

I want to just direct our discussion by asking another question of the audience. If we can pull up question six just to see what's most topical. The question is what do you see as the most significant investment issue for Boeing: core growth, margin performance, capital deployment, execution strategy? Go ahead and vote now.

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

Just so everybody feels better, I worry about all four of those.

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**Carter Copeland** - Barclays Capital - Analyst

That's why we'll talk about all four items. I want to make sure.

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

So does everybody.

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**Carter Copeland** - Barclays Capital - Analyst

Exactly. It's the way it should be. So, obviously, it looks like margins and growth make up a significant portion of that. One of the things we talk about a lot is cycle. You obviously have a very large backlog, and I know you guys -- it's something that makes you feel very comfortable. But we in the investment community tend to focus a lot on the simple changes in that backlog.



What is the prospect for continued growth there? What do you expect, continue to book orders in this kind of oil price environment? I know last year we were very worried about growth carriers in some of those parts of the world and today, at this price, we're worried about replacement orders. How are you thinking about the cycle at this juncture with oil prices where they are?

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

Well, I think the overarching comment is that this cycle is characterized much more than prior cycles by replacement demand. In other words that's the demand that is not tied to GDP growth. I think we all have a scenario that says slow -- moderate slow growth globally, and so you have to be able to innovate and replace current products with new products. That's been Boeing's strategy, and that's what the 87 is all about. That's what 777X is all about.

Roughly half of our demand is replacement, and that has the effect of muting a cycle in the sense that you're not tied to the overall economic, because the new planes they are buying pay back so quickly versus the old technology. So that's the innovator's advantage.

But what we're seeing from customers continues to be strong demand. Maybe you've seen some quotes that I haven't, but all the CEOs that I know who run airlines are saying oil prices, FX makes no difference. We buy these 20-, 25-year assets based on expected global view that isn't today. It's not \$130, nor is it \$50. It's the expected value over time.

We've never -- we went back and did an analysis -- Troy did an analysis on the R squared, R demand, either dollar strengthen, yes or no, or oil price high, yes or no. There was very little correlation. I mean what really correlates is the value that we bring, and we're in a period where our airplanes bring a lot of value versus our competition.

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**Carter Copeland** - Barclays Capital - Analyst

To the extent you -- at the margin -- there's a lot of airlines in the world. To the extent you get a handful of those who do say I've got some older aircraft I can fly and I have the flexibility to push, the flipside I guess of that is there's also some beneficiaries of low oil from a demand standpoint. You have seen a lot of people request -- a lot of airlines request to move up in the backlog. Is that a trend you would expect to continue or even accelerate?

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

It's still happening. It's still happening. People -- more people want to move up in the backlog than want to be pushed back in the backlog in general. You remember the 787 program was approved at \$40 oil. People forget that. So, our view then, and it remains today, is that this asset which has 20%-plus better fuel, 30%-plus better operating economics, which is an amazing step function change, pays back at virtually any expected oil price that an airline executive has. That's what they're saying.

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**Carter Copeland** - Barclays Capital - Analyst

When you look at the profitability of the big programs, obviously you talk of record rates, thinking about going higher. If you look at the margins that, say, BCA has coming out of the commercial aircraft division over the last couple of quarters, I think you mentioned elevated period expenses. Obviously the 787, a little bit more cost there.

When you look at fundamentally where the major programs are 37, 777, 87, what's the long-term directionality and margin outlook that you see for those programs as you look out over the next three to five years?



**Jim McNerney** - Boeing Company - Chairman, President, and CEO

Well, I think the margins are very strong on the 37 and the 777. We have close to -- we have basically executed the transition from the old model to the new model on the 737. The margin outlook remains strong as we've done that. That is not easy to do, but I think we're there.

777 -- I think we're not done with that kind of transition, but I think it is very doable. 777 has a unique place in the marketplace. Our competitor does not have a product that matches up well there. So the transition from the old to the new model I would anticipate would not only happen without a hit to production rates --

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**Carter Copeland** - Barclays Capital - Analyst

You think you can maintain the margin rate --

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

Right, and also I don't want to make any margin prediction but I think -- it's pretty far out there. But I think we have a plan to successfully mitigate margin pressure there. Let's just put it that way.

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**Carter Copeland** - Barclays Capital - Analyst

And is that primarily based on productivity efforts?

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

It's productivity efforts that are happening today. It's the fact that we can get pricing commensurate with value because there is not an immediately ready competitive offering. And, the current 777 airplane is a value proposition versus what's out there, not to mention the next 777. So we're in a very strong position there, whereas the 737 has a direct competitor and we were still able to navigate that transition.

Without as strong a competitive environment, I think the prospects are very strong that we could do the same thing on the 777. And we're off to a good start -- 63 orders last year. As I think you know, we're trying to get between 40 and 60 a year to get the bridge done.

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**Carter Copeland** - Barclays Capital - Analyst

So five last weekend?

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

Yes.

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**Carter Copeland** - Barclays Capital - Analyst

Switching gears, just because I don't want to focus solely on commercial as we often tend to do, Boeing defensive space, obviously the conversation with -- given where the President's budget request was a couple of weeks ago, and given what we widely expect to see in the defense budget that the conversation is one that's shifted to a return to growth in the defense industry.

You've got some pretty high profile programs that are in their later years of maturity and some that are in their early years like the (multiple speakers) tanker. When you look at your defense portfolio and compare it to the peer group over the next, say, three to five years as we return to growth, what is your expectation in terms of the relative growth you expect BDS to generate relative to the peer group?

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

I would choose our position. We have the tanker and the P-8 in place. One is just exiting low rate production into full rate production, P-8, and tanker is on track and is going well. We've already flown the base airplane end of last year. In the first half of this year the militarized version will get in the year and then start delivering in 2017. I think -- and that's going well.

Then I think it gets to -- because that will be replacing C-17 slowdown in some of the fighters, satellites and helos are doing very well. Growth prospects in both satellites and launch, so we're in pretty good shape. All of that should replace the pressure we see on C-17 going away and on fighters.

On top of that there is long-range strike, UCLASS and TX, all of which we have strong offerings in. I have a personal view on where we're strong in those competitions. It will play out. But I think a reasonable yield off those three programs gives us some moderate growth on top of the P-8 tanker replacing C-17 pressure on the fighters, if that all makes sense. I mean I know you know our business well. So I hope anybody out there understood all that math. It adds up to slow moderate growth.

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**Carter Copeland** - Barclays Capital - Analyst

And you feel good about your chances on the bomber?

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

Yes. Very good, very good. But the customer decides. We don't.

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**Carter Copeland** - Barclays Capital - Analyst

That's correct. Just kind of shifting gears a little bit, if you go back to the 787, obviously last quarter the target for deferred production cost -- for those who don't know, the capitalized cost on that program went up a little bit. But I wondered if you might expand a little bit and help us to understand what's going on in that program and driving that. Is that more heads on the program? Is it high staffing levels or is there some level of disruption or (multiple speakers)

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

First of all, overall, the amount that that deferred production represents given the unprecedented demand for this product over time, that I don't see it as an issue over time. I think it's more an issue of quarter by quarter timing. And I would say somewhat more than half of that quarter by quarter pressure relates to investments we're making that make economic sense, that have a chance to improve productivity in Charleston, a chance to improve productivity in Everett. Spend \$75 million to do that. It pays back handsomely. We make those investments; puts a little pressure on that balance.

But there's also some manning and productivity that -- manning in particular coming down more slowly than we'd anticipated as we ramped this program up so fast that we had to keep manning on a little bit longer than we'd anticipated. But we have good plans to get that down. And the trajectory that Greg mentioned on the last call I think remains solid.



**Carter Copeland** - *Barclays Capital - Analyst*

Is a lot of that improvement in the cost of the airplane and the profitability of the airline embedded in that forecast based on simple learning curve concepts? Or is it really based more on mix, and we think about shifting more to 787-9, -10?

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

It's both. It's both. I think there will be a mix up even in the current backlog. Most people have agreements that they can mix up from the -8 to the -9 or the -10 even in their base orders, but certainly in their options. And I think there will be more -9s and -10s sold on this program when we look back 25 years from now, and that's all good news on a mix standpoint in terms of those airplanes create more value. We get more price for that value, and at the same time, learning curve productivity bringing some activities back in-house where we can get a better return and a more surefooted control over delivery and cost.

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**Carter Copeland** - *Barclays Capital - Analyst*

So despite the fact there is an adjustment in the short-term in terms of --

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Yes, it doesn't change our view, doesn't change our view longer-term --

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**Carter Copeland** - *Barclays Capital - Analyst*

About the profitability of the program, you still see the potential for margin expansion on that program over time?

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Yes, absolutely.

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**Carter Copeland** - *Barclays Capital - Analyst*

I just want to hit on the cash topics since I know that got considerable response. Obviously you've guided to a level of a little bit more than \$6 billion of free cash flow this year. Obviously last year was a very strong year, really outperformed our expectations and seemingly your own expectations.

When you look at the cash generation of the Company, how much of last year's performance or even the year before where you were very, very strong at the end of the year, it's just based on timing and maybe a little bit of luck in how this all works out? Or how much of it is just prudence in planning when you guys set out a cash flow guide or an outlook for the year? When we look at this year's guide, is it similar and how you set the prior couple years or is there anything different moving parts?

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Our headset is I think the same every year. We're not trying to be overly conservative, nor are we overly lucky in the fourth quarter every year. I think we're in a business where cash flow can be a little lumpy. The numbers are big and they can move around.

If you don't get a progress payment from some country that has bought 45 of something and the progress payment slips from quarter to quarter, that can be a very big number. So we have some prudence in our guidance, only because -- not because we're trying to be sandbaggers but because



we just live in a world where things move around a little bit. And so -- and then we spend all year trying to execute like hell and try to make all of those come home. Last few years, a lot -- not all of them, but a lot have come home and that's the way we run the Company.

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**Carter Copeland** - *Barclays Capital - Analyst*

So with respect to the cash you're generating, with respect to \$8 billion of repurchases and dividends over a three-year time frame, that would imply reducing the share count and market capitalization of the Company 20%, 25% over that time period. Is that a deployment profile that's sustainable while still being able to invest in whatever the next opportunity is? How do you think about the sustainability of that? And are those reasonable numbers to think about the sustainability of that and are those reasonable numbers to think about?

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

I'm not exactly sure how that equates with our guidance on 80% return to shareholders, but I think it's roughly in line. I see that as very doable and consistent with R&D levels to get the new airplanes out, consistent with the CapEx required to facilitate 777 in Charleston in support of the 87. So we feel comfortable with that level if I'm understanding -- Troy can talk to you if I'm misunderstanding. But I think those levels are sustainable and I think the cash opportunity for this Company remains strong and has an opportunity to strengthen.

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**Carter Copeland** - *Barclays Capital - Analyst*

Well, I guess at the core of the question, you've been higher than that 80% recently. Obviously very strong levels of repurchases last year. I think Greg said multiple times on calls that the Company probably has a little bit more cash than it needs, to the tune of a few billion dollars. So that 80%, it seems clearly sustainable. But is there something you see in terms of your deployment above that level as well as the balance sheet room that's there that implies that it might be more than that?

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

I think we'll have to make those specific decisions as we get there. But I think I'll just leave the statement highly confident on the 80%, and realize that there is cash strength that could lead people to conclude there's opportunity beyond that. I see some of that same cash strength. But we'll deploy that cash -- we're very mindful of shareholders. And -- as you've seen over the last couple of years. And that headset won't change.

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**Carter Copeland** - *Barclays Capital - Analyst*

Great. Before we finish up with cash, I do want to ask the cash question, which is number four, which is in your opinion what should Boeing do with excess cash: bolt-on M&A, larger M&A, repurchases, dividends. I'll be amazed if anybody -- debt paydown and internal investment. Please go ahead and answer. Okay, so almost 70% of respondents like share repurchases.

So let's play devil's advocate and say what are the pros and cons of inorganic investment and not doing share repurchases? And you've talked about M&A expansion into services, trying to position the portfolio for even more growth, capitalize on your position. Maybe speak to the benefits of being a little bit more balanced than just focused solely and share repurchases.

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Yes, if I could just paint the picture, we are the largest and most broadly based aerospace Company in the world, as you know. So we already have the benefit of diversification -- classical strategic diversification. So there's no big rush for us to go fill some big hole on some strategic matrix.

So, basically, given that our stance is already where we want it to be, my focus is on organic growth and I don't want to buy things to replace my inability to grow organically. So organic growth is going to be our first, second and third priorities.

Now that doesn't mean bolt-on acquisitions that sort of complement some of the capabilities we need in some vertical space, or some services opportunity which complements the organic growth story will not be part of our plan. It is part of our plan and you've seen it over the last few years. But much more of an organic growth focus, smaller bolt-on opportunities that complement that, much less of a headset even with cash to jump into some big acquisition that gets us into a new space.

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**Carter Copeland** - *Barclays Capital - Analyst*

How do you feel about the valuations you see out there for the stuff that does (multiple speakers)

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

It's ridiculously high, with the possible exception of my share price. But the numbers are hard to make work without significant bolt-on kinds of synergies.

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**Carter Copeland** - *Barclays Capital - Analyst*

Very good. Something we only seem to touch on once every few years -- I know this was something we talked about a lot in 2009/2010 with the euro. Obviously you guys don't have any direct exposure to changes there, but your principal competitor does. What do you see is the potential impacts on your business in terms of the risks of the pricing environment, how that influences the competitive landscape? How are you thinking about that, because it's a big move?

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Yes. I think as I mentioned earlier we've done some analysis over time. And there's a very low R squared between where the dollar is and demand for our products. And I think that's because -- some of the same logic around oil price. It's because people look at an expected value of where an exchange rate is over time, and so it's not a point in time kind of look. Because when you buy an airplane, a lot of the cost is after you buy it, and a lot of that cost has some of those same exchange rate characteristics. So very low R squared.

Secondly, and you'd have to ask the Airbus guys this, but they according to their public statements they have a very aggressive hedging program that -- I think I've seen some statements from Tom that say lessons learned from the late 2008s and 2009s where they were naked and got burned a little bit. I don't want to put words in his mouth, but their aggressive hedging program is something that their public statements say they are committed to, which would give them less of an opportunity on the cost side if they are doing it that way.

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**Carter Copeland** - *Barclays Capital - Analyst*

When you think about the implications for cost, so you take two products, one principal, the A330neo which is a product that's pretty openly based on a value proposition of being significantly cheaper than a 787, and you look at the flexibility that a lower euro may give Airbus to sell that product that an even more -- an even cheaper price relative to your product, how much incremental pressure does that put on you guys from a cost standpoint on the 87 to get that much better?



**Jim McNerney** - Boeing Company - Chairman, President, and CEO

Well, it obviously gives them some tailwind, although again, I go back to their public statements which is get more of their procurement in dollars and have a pretty aggressive hedging program to mute the impact of exchange going one way or the other. Having said that, there will obviously be some opportunity and they will have to make up their own minds.

But I think it's overwhelmed by the value proposition that our competitive airplanes have. I mean the A330neo, the example you used, is a 1970s design with new engines. And our analysis shows many tens of millions of dollars of value of difference between that airplane and the model of the 787 that they may sell against it. So I think the value we bring overwhelms any sort of incremental benefit they can get on where the dollar is today, and who knows where it will be tomorrow. But we are not deeply concerned about that.

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**Carter Copeland** - Barclays Capital - Analyst

Before we close, I want to ask about the BDS margins before we close on this topic. But I do want to ask another question of the audience because we've talked about a lot of the elements of growth, margin and that's question number three. In your opinion, through cycle EPS growth for Boeing should be above peers, in line with peers and below peers. Obviously a lot --

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

There we go.

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**Carter Copeland** - Barclays Capital - Analyst

Go ahead and answer and I'll talk while you get the chance. Obviously a lot that goes into that, much of which we addressed -- the growth in BCA, the growth in BDS. One thing we didn't talk about, and I think it's been -- there we go; above peers. That's always a comforting answer.

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

Yes.

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**Carter Copeland** - Barclays Capital - Analyst

One thing we didn't talk about, but is important because it seems like it's a big focus for the management team, is profitability at BDS.

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

Yes.

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**Carter Copeland** - Barclays Capital - Analyst

Obviously you've taken a significant amount of cost out of that business. The numbers you have cited in terms of reduction in annual costs are pretty sizable. How do you think about the margin profile of that business and its sustainability or expandability from here, especially given the mix changes you expect with some of the new programs as well as some of the sunseting older programs?



**Jim McNerney** - Boeing Company - Chairman, President, and CEO

I think you're right. The implication of your question is right Carter. I think our view is that the defense budget of the United States, which represents a challenge right now, and the international opportunity which represents an opportunity, the net of which is sort of flattish, that's our view of the world today. And so margins is our number one priority.

So the top line is in large part under our control in terms of how we execute our programs, but there's a big macro pressure on the top line. And we want to keep margins while maintaining our investment in research and development. That's kind of the way we're running the business right now.

So we're not going to eat our seed corn but we're going to keep the margins at that low double digit place it's been. And now that gives us upside if the macro environment improves. Everybody in Washington seems to agree that we ought to get rid of sequestration, but the dynamics of the two political parties hold each other hostage for how exactly it's done. So that has yet to play out.

But I think a lot of people are betting on defense beginning to grow again. It's hard for me to predict. I think it will grow again, but when is a bigger question. I think the responsible thing to do is hold our margins, hold our investment in research and development, come hell or high water right now execute our programs well, win a couple of these new programs and off to the races.

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**Carter Copeland** - Barclays Capital - Analyst

If you look -- and I'm not sure the number -- the year over year change in investment that you expect in BDS, obviously a lot of your peers are talking about those numbers going up pretty significantly.

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

This is investment in --

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**Carter Copeland** - Barclays Capital - Analyst

This is investment in R&D.

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

CapEx and R&D?

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**Carter Copeland** - Barclays Capital - Analyst

CapEx and really Company-funded R&Ds (multiple speakers). How do you think your investment level compares to that? Is that of a flat or maintaining a flat profile, or is that actually going to see --

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**Jim McNerney** - Boeing Company - Chairman, President, and CEO

I think is flattish but off a higher level. I think Troy will have to clean me up on this because I don't have the competitors' R&D levels in front of me. Maybe you do. But I think our Company-funded number has tended to be higher than our competitors, and so it's more a matter of them trying to catch up with us rather than us continuing to grow dramatically more than they are.

**Carter Copeland** - *Barclays Capital - Analyst*

I want to ask a couple product development kind of questions, and the biggest one is there's a lot of chatter around potential 757 replacement at some point and whether or not that aircraft is needed. Obviously we think a lot about these investments because they're big investments. How do you think about that product segment, whether an investment there is needed, how that might be able to be absorbed in the R&D profile of the Company. How should we think about how you think about -- (multiple speakers)

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

We don't think it's needed short or medium-term based on discussions with our customers. Longer-term we'll keep talking to them. But if you go back to the 757 mission, 80% of that mission now is handled by the bigger longer-ranged narrowbodies -- the bigger longer-range 737s, for example.

So there is -- people argue a niche mission over water. That's a pretty small niche right now. I don't know how many 57s are flying right now over water, but it's not very many. Our discussions with customers seem to imply that a slightly bigger airplane may be needed at some point.

So the way to think about it it's not necessarily a 75 replacement but it's where the 75 goes as the world grows and as the missions change. And so it's not very clear in our minds right now. I think at some point that niche will clarify and it will become something above the narrowbody and below the smaller widebodies. I think that will be a niche that clarifies. But it hasn't to date.

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**Carter Copeland** - *Barclays Capital - Analyst*

So if we take it back to where we started our discussion in terms of being appropriately compensated for the investment that you make, it sounds like your view is that might be too much of a niche market. That requirement might not warrant (multiple speakers)

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

That's our view today. No business case would close today as we look at it, which doesn't mean pretty far into the future it might not. But right now it doesn't.

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**Carter Copeland** - *Barclays Capital - Analyst*

A couple on productivity. Obviously a year ago this time, one of the big focuses of a lot of the suppliers we heard from at this conference was partnering for success. And that initiative, we have not heard as much about it lately, and not sure why, but maybe you can tell us what inning you're in there in terms of that or whether it even has a defined set of innings or this is a cultural change -- (multiple speakers)

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Yes, I'm the one who began the inning vocabulary. But look, there is no -- you make a good point. There really is no end to it. We're well into it now. It's favorably impacting our financials. I think you've seen that.

There is a lot of value to keep harvesting as we find the right places with our suppliers, where the amount of business we can bring them is taken into account as we negotiate and work together. It pays them well for their value, but also compensates us for the risk we take and the volume we bring them. So we'll always be working that.

I think we have a current round of discussions that started a couple of years ago and we're sort of 40% of the way through those, and there's a backlog of that discussion. And guess what's going to happen when that ends four to five, six years from now? We're just going to do it again and we'll just keep working it.

It's more of a headset based on the strategic realization that you pointed out, which is that, as the systems integrator, we were taking, in my view, more risk than we were getting compensated for. And I don't think that dynamic is going to change. Large-scale systems integration is a tougher business than it was 20 years ago, and to be successful at it -- we're committed to being successful at it. I think there are fewer and fewer people that can do it. We're one of them and we just want it to be a good business for us, for our customers and our shareholders.

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**Carter Copeland** - *Barclays Capital - Analyst*

So, to that end, something you mentioned at the Investor Day last May as a new initiative was this value of quality initiative, which was about improving first pass yield and all the savings associated with that. We haven't heard much about that in the last --

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Yes, we've been working that. That's all of about -- if you look at any process, say a manufacturing process, and if you had a roll throughput yield of 100, in other words you did it perfectly, what is that number? So I wanted to change the headset in the Company from 7%, 8% better every year to -- there's this number out there if you did it -- (multiple speakers)

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**Carter Copeland** - *Barclays Capital - Analyst*

It was perfect.

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Well, yes, if you did perfect, that's like a 60% opportunity. So how many years will it take you to do that? And get them focused on that kind of vision rather than the improvement, sort of a step beyond continuous improvement. In a couple of places it's really made a difference in our Company. But it's still, at the risk of setting this up again, early innings on that one. But it's catching fire in our Company.

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**Carter Copeland** - *Barclays Capital - Analyst*

But it sounds like it could have a material impact -- (multiple speakers)

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

It does.

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**Carter Copeland** - *Barclays Capital - Analyst*

On the markets over the next five to ten years.

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Part of it goes to margin. Part of it goes to pricing. Part of it goes to R&D. You know how it works. I just want to make sure that Boeing controls its own destiny with its productivity. Our productivity number each year is slightly bigger than our R&D number and I want to make sure it stays that way. I don't want to have to depend on anybody else for our organic growth other than us.

**Carter Copeland** - *Barclays Capital - Analyst*

So we're running a little bit low on time but I do want to ask a question. I've heard a lot about Boeing's first hundred years as a Company. We're coming up on that here in a year's time.

And as you think about all of the changes we've seen over the last five years under your tenure, and beyond five years, and you think about the future leaders of this Company and the ramifications for them, can you speak to what sort of underlying trajectories of change are actually occurring at Boeing and what those will mean for your predecessors when we enter the next century of Boeing?

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Well, obviously, the underlying productivity culture that funds our own growth, that's a fundamental way of looking at the Company. I think that was a bit of a change from the way the Company had been run before. But that's a good foundation I think can be built on.

I think the commercial airplanes product lineup is strong particularly in widebodies. I think the developments are derivative developments, not from scratch, risky, completely new to the world, and yet still bring a lot of value versus our competition. So I think is a pretty good lineup. I think we have a culture of leadership development in the Company now that has produced people that you know and have met, Carter, that will come after me.

And so I think there's a pretty good -- I mean you're always tempted as you near the end of your career to declare everything perfect. But we spent a decade trying to get the business fundamentals of this Company as strong as the technical and product fundamentals. So that will be the balance that has to be maintained by whoever comes after me.

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**Carter Copeland** - *Barclays Capital - Analyst*

That's great. Not to put you on the spot on that, not implying anything about resignations or anything. I want to -- (multiple speakers)

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

It's the Company that's 100 years old, just to make sure that everybody got that.

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**Carter Copeland** - *Barclays Capital - Analyst*

You look great. Don't worry about it. I do want to ask one last question, just because this is always a fun one. It's number five. In your opinion, what multiple of 2015 earnings should Boeing shares trade? I don't expect anyone to answer number one.

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

I hope not.

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**Carter Copeland** - *Barclays Capital - Analyst*

10 to 12, 13 to 15, 16 to 18, higher than 21, do you remember that?

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

I'd be impressed.

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**Carter Copeland** - *Barclays Capital - Analyst*

Do you remember those days?

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

I do.

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**Carter Copeland** - *Barclays Capital - Analyst*

All right. So 16 to 18, which is just about where the stock trades, so definitely an optimistic tone about the Company's direction and making it better than where you found it, and hopefully we'll skew that higher next year. But we really appreciate you joining us. We appreciate you all joining us, and Jim, thank you very much for taking the time.

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

Thank you, Carter. I enjoyed it.

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**Carter Copeland** - *Barclays Capital - Analyst*

Thank you.

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**Jim McNerney** - *Boeing Company - Chairman, President, and CEO*

All the best.

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