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EDITED TRANSCRIPT

BA - Q2 2014 Boeing Co Earnings Call

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OVERVIEW:

Co. reported 2Q14 revenue of $22b and core EPS of $2.42. Expects 2014 core EPS to be $7.90-8.10.

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PRESENTATION

Operator

Thank you for standing by. Good day, everyone, and welcome to the Boeing Company's second quarter 2014 earnings conference call. Today's call is being recorded. The management discussion and slide presentation, plus the analyst and media question and answer sessions, are being broadcast live over the internet.

At this time, for opening remarks and introductions, I am turning the call over to Mr. Troy Lahr, Vice President of Investor Relations for the Boeing Company. Mr. Lahr, please go ahead.

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

Thank you and good morning. Welcome to Boeing's second 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 www.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 risks, which is detailed in our news release and our various SEC filings and in the forward-looking statement disclaimer at the end of this web presentation. In addition, we refer you to our earnings release and presentation for disclosures and reconciliation of non-GAAP measures that we use when discussing our results and outlook.

Now I'll turn the call over to Jim McNerney.

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

Thank you, Troy, and good morning. Let me begin today by acknowledging the families and loved ones of those aboard Malaysia Airlines Flight 17. All of them and everyone affected by this horrific tragedy are in our thoughts and prayers at this time. For the men and women of Boeing and others throughout our industry who are passionately committed to ensuring the safety and security of passengers and aircrews, this is a particularly unsettling and painful moment in the history of civil aviation. We are providing technical assistance to the investigation at the request of the NTSB, which is supporting international authorities in the important work they have underway.

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

Now let's move to slide 2. Boeing delivered strong second-quarter operating performance across our production programs and services business with solid revenue, double-digit core EPS growth and healthy cash generation. Our strong positive performance through the first half of the year has allowed us to continue returning cash to shareholders and increased guidance for our full-year EPS by $0.75, which includes approximately a $0.50 tax benefit. Greg will discuss guidance in more detail in just a couple of minutes. During the second quarter we did record a $272 million after-tax charge on our fixed-price US Air Force Tanker program engineering and manufacturing development contract. The charge was driven by higher spending needed to complete systems installation on the tanker test aircraft and maintain the schedule for delivering this vital capability to the war fighter.

As you may recall, we noted in our investors conference that we were beginning to see some challenges in the building systems installation process. The increased spending is primarily related to additional engineering and systems installation rework required mainly to meet wiring specifications. The issues at hand are well-defined and understood, which in no way mitigates our disappointment in having to take this charge. But the actions we have taken to keep us on path to the next major program milestone, which is to begin test flying fully provisioned tanker our craft in the first part of next year. For the long-term potential market for the KC-46 tanker of up to 400 airplanes worth $80 billion, it remains a franchise program for Boeing and we expect to realize strong returns over decades of production and in-service support.

With that said, let's discuss our core operating performance during the quarter. Revenue at Boeing Commercial Airplanes was $14.3 billion and operating margins increased to 10.8%, a result of both the higher volume and a favorable delivery mix. We delivered 181 commercial airplanes in the second quarter, including 37 787 Dreamliners and we added net new orders of 264 airplanes. So far in July, we have booked another [284 orders] (corrected by company after the call), including those announced by customers at the Farnborough International Air Show, bringing our current net order total to 783 for the year, already a book-to-bill greater than one.

Boeing Defense, Space and Security reported revenue in the second quarter of $7.7 billion. During the period, BDS captured numerous key contract awards including a $1.9 billion order for 44 US Navy and Royal Australian Air Force EA-18G and F/A-18 aircraft. A $700 million order for five years of AEW&C in-service support from the Royal Australian Air Force and a $200 million order for our ninth 702MP Intelsat satellite. Significant program milestones included a successful missile-defense system intercept test, delivery of both the fourth [P-8I] aircraft to India and the hundredth EA-18G Growler to the US Navy.

With that, let's turn to the business environment on slide 3. Global demand remains high for the superior fuel efficiency and economics provided by our family of commercial airplanes as recognized in the order totals I mentioned earlier. Global passenger traffic trends continue to be healthy and air cargo traffic is still gradually improving. In addition to growth driven demand, we continue to experience and foresee sustained high replacement demand where newer more efficient airplanes offer compelling economics and a rapid return on investment compared to keeping older less efficient airplanes in service. Combining growth and replacement needs over the next 20 years, we forecast the global demand for nearly 37,000 commercial airplanes, a 4% increase over last year's forecast. Deferral requests from customers are still running well below the historical average while request to accelerate deliveries remain brisk. This ongoing strong demand, coupled with our already sizable and diverse backlog of more than 5,200 airplanes, reinforces our planned production rates and outlook for sustained growth in the years ahead.

In the twin-aisle segment, we continue to see healthy demand for both the 777 and the 777X, which continue to outsell the competition by a wide margin giving us confidence in our ability to transition between the two airplanes. As part of our focus on net transition, we are looking to maximize production efficiencies with existing best practices from other programs as well as advanced new manufacturing technologies. For example, last week we unveiled a new robotic system for building 777 fuselages. This automated approach will increase first time quality, reduce build times and improve workplace safety for our employees. On the 787 program, we achieved major milestones with certification of 330 minute ETOPS and the on schedule certification and first delivery of the 787-9 to Air New Zealand with element the 787-10 also is progressing to plan with the first delivery in 2018.

In the single-aisle segment demand for our new fuel-efficient 737 MAX remains high with cumulative orders exceeding 2,100 airplanes from 43 customers. The production bridge from today's 737 to the MAX remains solid with the first MAX delivery in 2017.

Turning to Defence, Space and Security, we continue to see solid support for our major programs in the FY15 budget process. We are encouraged by the actions taken in both the House and Senate appropriations committees with regard to additional P-8s, Apaches and EA-18G aircraft. International Defense, Space and Security business represented nearly 30% of BDS revenues during the quarter and remains at approximately 35% of the BDS backlog as we continue to leverage our unique one Boeing global advantage. Our investments in technology and innovation for organic growth continue in areas such as commercial derivatives, space, unmanned systems, intelligent surveillance and reconnaissance, cyber security and the few but critical future large-scale programs identified as priorities by our customer like long-range strike, new class, and the T-X trainer. The relative strength of our Defense, Space and Security business stems from a portfolio that is reliable, proven and affordable and is being delivered on budget and on schedule. We remain intensely focused on driving further efficiency, quality and productivity gains to improve program profitability and fund investment in future growth. Defense, Space and Security continues to make great progress on our market-based affordability initiative as we strive to take out another $2 billion in operating costs.

Along those lines, benefits from our enterprise partnering for success approach with suppliers continue to accrue. For example, in collaboration with our partner Japanese Aircraft Industries, we are reducing the cost of producing various 777 parts through value engineering, a great joint effort that will help ensure that continued competitiveness of the 777 airplanes in the marketplace.

In summary, notwithstanding our disappointment over the charge on tanker, our team delivered another strong quarter of core operating performance, captured meaningful growth through new business and made great progress on further improving productivity and achieving important program milestones for us and our customers.

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 to discuss our second quarter results.

Second quarter revenue of $22 billion was driven by a 7% increase in commercial airplane deliveries and higher commercial services volume. Core operating margins in 9% reflect solid productivity gains on production programs and across the services businesses, offset by the impact of the tanker charge. Second quarter core earnings per share increased 45% to $2.42 a share on additional tax adjustments, higher commercial volume and continued strong operating performance on core production programs.

During the quarter, we recorded a tax benefit of $116 million for the 2007 and 2008 tax settlements that we discussed in April as well as an additional $408 million tax benefit related to the 2009/2010 tax settlement and a tax basis restoration. The $425 million pre-tax charge, or $272 million on an after-tax basis for the tanker program, largely relates to additional engineering and manufacturing labor associated with the challenges we encountered in the wire installation as we moved into the systems integration stage of final assembly on the initial test aircraft. As we said before, given the significant long-term tanker market opportunity that Jim discussed, we bid the EMD phase with the tanker program aggressively at zero margin with plan profitability generated during the production phase.

Looking at our overall performance to date on the program, we have met all customer milestones and are proceeding with functional testing to be followed by the start of initial tanker flight testing in early part of next year. As Jim noted, despite our disappointment in encountering these challenges, the issues are well understood. No new technology is required to resolve them and we believe the program is sufficiently provisioned and has a solid path forward. We are confident we are taking the right steps to fulfill our promises to our customers. Excluding the tanker performance encountered in the quarter, we continued to make great progress across other areas of the business.

Let's now turn to Commercial Airplanes on slide 5. For the second quarter our Commercial Airplane business increased revenue 5% to $14.3 billion on 181 aircraft deliveries, including a record 124 737s and 30 787's. The business also increased operating margins in the quarter to 10.8%. Higher volume and our focus on efficiently executing on our rate increases and continuously driving productivity led to strong operating performance during the quarter that more than offset the $238 million pre-tax charge related to the EMD Tanker contract at BCA. Commercial Airplanes captured $17 billion of net orders during the quarter and backlog remains very strong at a new record of $377 billion, over 5,200 aircraft, equating to approximately 7 years of production.

In a second quarter, while at a declining rate, 787 deferred production increased $1.1 billion to $24.2 billion, largely driven by increase in our rate of production on the 787-9 and inventory pull-ahead to efficiently optimize our production and minimize [787-9] (corrected by company after the call) disruption as we introduced the aircraft into our production system. Based on further production stability, planned contracted supplier step-down pricing and continued overall productivity improvements, we expect a quarterly change in deferred to improve over the remainder of the year. The [cash flow] profile of the 787 continues to improve as we drive productivity throughout the production system. We continue to see good progress on key operational performance indicators and unit costs as we further implement production efficiencies and increased 787-9 production. As we continue our efforts to optimize the production system and maximize efficiencies at the 10-per-month rate, team continues to make progress in reducing 787-8 unit cost by approximately 13% and improved final assembly flow times by more than 10% over the past year.

Travel work has also been significantly reduced, declining by greater than 30% since this time last quarter. We're also continuing to see good progress in the 787-9 productivity where we've seen 50% improvement in unit cost and a 25% improvement of flow time from the first aircraft to the seventh aircraft to roll out the factory. Overall, we've made solid improvement on the 787 program; however, a great deal of work ahead of us as we increase 787-9 production, introduce the 787-10 into early stages of our production system and continue to optimize to drive further productivity and profitability on the program, remain on track to deliver approximately 110 787s in 2014 and, again, the team remains focused on day-to-day execution and improving long-term productivity and profitability on the program.

Let's turn now to Defend, Space and Security results on slide 6. Second quarter revenue for our Defense business was $7.7 billion and operating margins were 7.5%, a strong performance on production programs and favorable delivery mix offset by the $187 million pre-tax charge on the EMD Tanker contract. Boeing Military Aircraft second quarter revenue declined to $3.5 billion reflecting delivery mix and operating margins of 4.7% in the quarter, again, impacted by the tanker charge. Global Services and Support revenue of $2.3 billion reflects slightly lower volume in the maintenance [mod] and upgrade business and strong operating performance across that business drove operating margins to 11.6%. Network and Space Systems reported revenue of $1.9 billion on lower commercial satellite volume and generated operating margins of 7.8% in the quarter. Defense, Space and Security reported a solid backlog of $63 billion with 36% of our current backlog now from international customers.

Now turn to slide 7. Boeing capital's net financing portfolio declined at $3.4 billion on runoff that exceeded new aircraft volume.

Now look at cash flow on slide 8. Operating cash flow for the second quarter was $1.8 billion driven by solid operating performance and timing of receipts and expenditures. With regards to capital deployment, we've paid $530 million in dividends to shareholders and repurchased 11.4 million shares for $1.5 billion in the second quarter. We continue to anticipate completing the remainder $6.8 billion repurchased authorization over approximately the next two years. Returning cash to shareholders along with continued investment to support future growth remains a top priority for us.

Moving now to cash and debt balance on slide 9. We ended the quarter with $11 billion of cash and marketable securities and our cash position continues to provide solid liquidity and positions us very well going forward.

Turning now to slide 10 to discuss our outlook for 2014. We are increasing our core earnings-per-share guidance for 2014 by $0.75 to now be $7.90 to $8.10 a share, reflecting the $408 million tax benefit and strong core operating performance that more than offset the impact of the tanker charge. Guidance for revenue operating cash flow and delivery remain unchanged. Commercial airplane operating margin guidance for 2014 is increased to now be greater than 10% on continued strong operating performance. Over the remainder of the year, we anticipate BCA margins to be impacted by higher 787 deliveries, some additional fleet support and additional investments in productivity initiatives. Defense, Space and Security operating margin guidance for 2014 is unchanged at approximately 9.5% with lower margin guidance in BMA, offset by higher guidance into the GS&S business.

In summary, second quarter performance reflects the strength of our backlog, the strong demand for our products and services and our continued focus on driving productivity throughout the entire enterprise. And furthermore, as evidenced by the meaningful dividend increase and the 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 to Jim for some closing comments.

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

Thanks, Greg. With a strong first half behind us and a team that is focused on sustained strong business performance, we are ready and committed to deliver on our strengthened outlook for the remainder of 2014. Our priorities remain clear: the profitable ramp up in production on our commercial airplane programs; executing on our commercial and defense development programs with the emphasis on tanker; 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 all the while providing increasing value to both our customers and shareholders.

With that said, we'd now be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Howard Rubel, Jefferies.

Howard Rubel - *Jefferies & Company - Analyst*

Despite the admonition, it's going to be sort of a two part question and part of its -- so there's two parts to it. If we think about it, the tanker -- you probably missed the program cost by about 10%. Can you help us understand why you've killed all the bugs in the program? And then second, if we adjust margins for R&D and maybe exclude what appears to be 787 revenues, your margins on the core business continue to improve. So the question really is, with that kind of improvement, why aren't we seeing some of that translate into even better numbers on the 787? Because if you are getting the core business there, some should spill into the other business. Thank you.

Greg Smith - *The Boeing Company - CFO*

Thanks, Howard. Let me address your second question first on margin improvement. You're right. I think, again, the continuous focus on productivity, whether it's within our four walls or through the partnering for success initiative, is driving a lot of that. And there has been improvement on the

787. We are certainly not at the levels that we expect. So we have high expectations on driving margins further on that program but we have seen improvements on that program as well as, I'd say, on the core programs, in particularly the 37 and the 777. So continuing to focus their, Howard, big priority for us -- big priority within partnering for success certainly is 787.

With regards to the tanker program, certainly as we worked our way through the integration on that first aircraft and learning from that and understanding some of the challenges we were faced with, we certainly understand the scope of work that needs to be done on the balance of that aircraft as well as aircraft 2 through 4. And that's giving us the confidence to understand, again, how to get the completion. This is not new technology or innovation. This is basic kind of blocking and tackling as we work through the redesign on the engineering effort, primarily around the wire harnesses, and then the manufacturing labor to work through installing those. So we've got some of that activity completed on the first aircraft, enough to move into first flight, which will be late in the third quarter this year. And then the balance will obviously be scoped that will be applied on those other airplanes.

If you look at some of the things that are done on this program maybe versus some of the others, labs -- so we have a wet fuel lab, we have a lighting lab and those are all been put in place and right from the beginning of the program to derisk the program. So we have a very functional wet labware were we're actually running fuel through pumps and valves to validate that on the ground so when we get in the air that minimizes that risk. And so there's things like that, Howard, that have been put in place that we're continuing to make our way making progress on as well is working our way through the functional testing on that first airplane. So that's kind of how we are thinking about it. Again, we are comfortable about the path forward. We're committed to meeting the customer milestones through the balance of this contract. And that's what the team has been focused on. And the long-term profitability, I should also mention, on this program and that objective is unchanged as we work into the production phase of the contract.

Howard Rubel - *Jefferies & Company - Analyst*

Thank you very much.

Greg Smith - *The Boeing Company - CFO*

You're welcome.

Operator

Carter Copeland, Barclays.

Carter Copeland - *Barclays Capital - Analyst*

Greg, just a question on the BCA margins, which X the charge look like they were very strong at 12.5. Given the 787 mix, that's a pretty high number and I wondered if you could help us with that a little bit. The Universe's program differences were about $2 billion. And I wondered if you might give us some color on that and let us know if there's any -- were there negative differences on any of the mature production programs? And did those programs on the 73 and 777, you mentioned they were better, but were those at record margin levels or was there something else going on in terms of period expenses? I know the R&D was a little bit lower but any color you can provide on how those margins compared to the historical trend?

Greg Smith - *The Boeing Company - CFO*

Yes. Program to program they varied slightly. Certainly 37 and 777 continue to have solid margins. We did have a slight increase on the 787 as well. And the team is doing a very good job managing the period expense, whether it's the G&A or the R&D or the fleet support. Now when you look in the back half, obviously we got more 787's in there. So we'll have some dilution on the margin from that perspective and a little bit higher period expenses I talked about, I think, on the last call where we got more new customer introductions going on so we're going to spend a little bit more in fleet support to ensure that our customers have a smooth transition of entering that airplane into service. But that's predominantly what's driving the back half. But again, we're staying very laser focused on looking for further opportunities there and continuing to drive productivity. But I would tell you the BCA programs are running very well and they are doing a very good job executing on these rate breaks, at the same time continuously focus on productivity.

Carter Copeland - *Barclays Capital - Analyst*

And were the 37 and 777 differences negative?

Greg Smith - *The Boeing Company - CFO*

Negative? I'm sorry. I don't quite understand.

Carter Copeland - *Barclays Capital - Analyst*

Meaning were they -- did you subtract from those programs -- meaning was their unit profitability better than their program probability in the quarter?

Greg Smith - *The Boeing Company - CFO*

Yes.

Carter Copeland - *Barclays Capital - Analyst*

Okay. And you.

Operator

Doug Harned, Sanford Bernstein.

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

When you look forward over the next, I would say, 4 to 5 years and think about how your investing in BCA and you go through completing the 787 and MAX models and then you're moving toward the 777X, how should we expect R&D and CapEx to go over that time period? What's the trajectory we should think about for those?

Greg Smith - *The Boeing Company - CFO*

Well let me -- maybe I'll start with CapEx and then we can talk more about R&D collectively. But certainly on CapEx I think for next year you're going to see levels similar to this year and that's predominantly, almost all of it, really investing in the future. So this is all about the additional rate breaks coming up along with productivity. Jim talked about the 777 automation so we are making some investments in the production system as well. But again, a lot of that is driven on the growth. So after that, Doug, I think we'll start to see the CapEx moderate at, I'll say, more normal levels at a stable production rate going forward.

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On the R&D, certainly on -- we'll peak out here on R&D on the MAX in about 2015. Obviously 787-9 ramping down but 787-10 ramping up and then feathering in 777X and then 787-10 in there. So we are continuing to look at those profiles over the next couple of years and how they will play out in meeting our entry into service dates. But we'll see slight increases into next year but, again, we're managing it very tightly. And I know Jim's talked a lot about how we're managing development and we talked a lot -- that a lot at the investor conference and we're continuing to do that to optimize our spending.

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

But should we think about it as these sort of ebb-and-flow here that things should be somewhat flat but then when we expect with the 777X, as we've seen in programs in the past, some kind of a ramp up out in the 2018, 2019 time frame? Is that -- are we looking at that type of a typical trajectory?

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

I'll jump in here. Greg is tired, Doug.

Greg Smith - *The Boeing Company - CFO*

(laughter)

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

(laughter) Okay.

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

No. Listen, this development program -- the two design pillars of the remaining part of the decade were aborting major pileups of engineering with concurrent work being done. And the second pillar was not absorbing as much risk in each development. In other words, capitalizing on some of the hard fought technology gains we've had and not adding risk to that. And so I think what you -- I think that -- those comments imply a design of some upward pressure but nothing like your question implied. Our plans do not have big pileups in R&D along the way. It's more characterized by very manageable, no major year-over-year spikes. Now we'll report on that as we get closer to these but the design of this is -- moderation would be a word that I'd use rather than precipitous in any given year.

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

Okay. Thank you.

Operator

John Godyn, Morgan Stanley.

John Godyn - *Morgan Stanley - Analyst*

Jim and Ray, I was hoping you guys could maybe reflect a little bit on Farnborough and what transpired there, particularly just given the A330 Neo announcement and how you think it might affect the competitive balance a bit and as well as 777. I think some of us had hoped to see a little bit more order activity there. But I understand that these campaigns can take a while to pull off.

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

Well we did have 150 777X orders the week before Farnborough. (laughter) But look, the competitive question, and I know that's what you're really driving at here -- one way to look at the A330 Neo is that it replaces and ambition to have a second A350 800 model. So in some respects, it's a trade of older technology re-engined for newer technology. And I'm not sitting with the Airbus guys as they make these calls but that's one way to look at it -- old technology for new. And whereas we've got in the wide-body space 5 new airplanes, all of which exceed the competitive performance of what we've seen from our competitor. And the -- and so I really like that line the. And I think if you look at year-to-date orders, wide-bodies for example, I think you'll see a very healthy dose of -- I forget exactly -- somewhere in the mid-200's wide-bodies and I think with the Emirates cancellation, our competitor may be negative for the year.

So that is a more strategic time frame than what happened during three days at Farnborough. But I really like the relative strength of our wide-body offerings. Those 5 airplanes, all new, all selling briskly, with a -- sort of a mix of new technology and re-engined old technology that our competitor has.

John Godyn - *Morgan Stanley - Analyst*

There's a little bit of a concern among investors that book-to-bill might start to slip. I was hoping that you could offer a little bit of perspective on that just given your comments there.

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

Yes. I mean, I think -- we continue to see brisk demand, as we've said. As I mentioned in my remarks, deferral requests are well below historical averages for our Company. Hey, move the airplane up. Accelerate the delivery far above what we have historically had. And the reason for that is this new technology that we're offering pays back so quickly, even when compared to airplanes that haven't reached their full life out there. I mean, you can -- for the lease rate you have to pay or for the incremental capital you have to deploy, the payback is so quick with oil prices that don't promise to come down, with the geopolitical world that we're in -- payback so quickly that this replacement demand is half, or in some segments more than half of the demand, not just growth -- underlying GDP growth or growth in air traffic. So it's -- and our book-to-bill, for example, in July is already above 1 to 1 and we are halfway through the year. So we haven't seen signs of it yet. I realize that it is a professional sport to call the cycle in this industry that we're in. But this industry has not seen this kind of replacement economics since the 707, and that was in the mid-1950s where the payback was so dramatic and the performance was so different. And so we're seeing no signs of it yet.

John Godyn - *Morgan Stanley - Analyst*

That's a lot of great color. Thanks a lot.

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

You're welcome.

Operator

Cai von Rumohr, Cowen & Co.

Cai von Rumohr - *Cowen and Company - Analyst*

So your deferreds on the 787 went up by $1.1 billion. Maybe give us some color on how much of that was the rate increase and how much was the inventory pull-forward, which is essentially discretionary move on your part to improve? And give us some color on the pattern in the third and fourth quarter. Are we going to get to zero? And the impact on the deferreds from the fact that while the A330 Neo is probably not as efficient as the 787, it certainly is priced lower given the orders they've received. And what response are you going to make and what impact does that have on 787 deferreds? Thanks.

Greg Smith - *The Boeing Company - CFO*

Okay. Let me -- I'll talk about the deferred and then I'll hand it over to Jim and we can talk more about pricing on the 787. But you're right, our airplane is much more efficient.

So on the 787, on deferred, Cai, about a third of that growth we saw there was inventory pull ahead to support 787-9. And as I talked about in my opening remarks, I mean 7 airplanes and we've seen a 50% increase in unit costs. So it really gives you a sense of the cadence and the work that people are focused on to improve productivity on the program. As you think about the path forward to the end of the year -- certainly learning curve. We've got to continue to come down the learning curve as we have and that includes, obviously, on the 787-8 but, obviously, with more 787-9s in the flow. So got to continue to work that. We do have some supplier step down through the balance of the year. There's some model mix movement that will take place in the balance of the year that should be favorable for deferred. And then as you mentioned, I mean quarter-over-quarter, I'd say month-over-month, we are making inventory decisions to pull forward components if they're ready, get them into the fixtures and do as much pre-work as we can. And frankly, that's why you've seen us being able to stabilize that production system.

So that's kind of the give and take that's going to take place through the balance of the year. At the same time, we're not doing as much pull ahead as we have because we are more stable at 10 per month. It's really, really around 787-9. And then, again, continuing to focus on stabilizing the production system in all positions of assembly. So that's kind of -- I'll say the moving pieces as you look through the (inaudible - background noise) end of the year, Cai. As I said to you, certainly this is a big focus area for us but the day-to-day focus on that program is on unit costs and cash. That's the focus, which ultimately I recognize in deferred, but that's what that team is executing to. Again, good progress but, again, we've got to continue to come down that learning curve through the balance of the year and going forward to drive profitability and ultimately impact deferred.

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

Yes. Cai, your question about A330 Neo as compared to the most comparable airplane would be the 787-10 in terms of remission. The -- look, our strategy is to produce the most capable airplane and then share the value with our customers that that value produces. Obviously the value is two components. One is efficiency. That's all about fueled, big advantage, 787-10, compared to the A330 Neo -- in the neighborhood of mid-double-digit kind of advantage. And also performance. I mean I think the reach of the airplane is a little greater. And so we feel very comfortable even under scenarios where, as your question applies, they'd have to accept less price for less capable airplane. We feel very comfortable when we sort of model that all out that our returns are good and the capability of our airplane sustains value for both us and our customers. And so I think I understand why they made this decision. It's a far less capable airplane. And they'll have to make decisions on how to price it and how they marketed. But it's -- these aren't pancakes we're dealing with. These are airplanes -- major investments that produce a lot of value when they are good.

Cai von Rumohr - *Cowen and Company - Analyst*

Thank you.

Operator

Joe Nadol, JPMorgan.

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

I was intrigued with the comment that you increased by a small amount the accrual rate for 787. I think that's, if I'm not mistaken, the first time you've done that except for the time that you extended the accounting quantity by quite a bit. And I was just wondering if you could give us any detail on what gave you the confidence to do that.

Greg Smith - *The Boeing Company - CFO*

Well certainly, again, coming back to partnering for success, that was one of the bigger elements of the movement within the quarter, Joe. And like we talked in the past, on the partnering for success efforts, 787 is the big -- our number one priority. So started to see some of that come together with our suppliers and reach an agreement and we booked it. And that's essentially what drove the change quarter-over-quarter.

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

Greg, do you feel like that there's room for small steps if things keep going in that direction in the coming periods? Or that 787 margin is something we are going to have to wait a while for or is this something that -- how do you feel about, I guess, the prospects?

Greg Smith - *The Boeing Company - CFO*

Yes. I mean I think it's going to take time, Joe. There's no question about it. Quarter-over-quarter, I wouldn't expect a lot of movement but we have a plan by supplier, by component and working with those folks. So it really kind of gets to how we can accelerate those discussions or negotiations and reach an agreement. Certainly the more time we spend on partnering success, the more mature we are getting with those discussions and we expect to do that. But it's going to take some time. But clearly, again, it's a number one priority and focus and we have a plan. And so we've got to continue to execute with that and work with our partners because the long-term certainly prospects of this program are extremely beneficial to everybody including our suppliers. So we'll continue on the journey that we started here.

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

Thanks.

Operator

Myles Walton, Deutsche Bank.

Myles Walton - *Deutsche Bank - Analyst*

Greg, maybe a question for you on cash flow. It's been pretty strong year-to-date when you consider the headwinds form the 67 and the union bonus. And I look at the full year and there's been no raise there and I'm assuming the tax benefits are no cash. But it still would imply the second half of 2014 cash flow is half of what it was in the second half last year despite lower deferred production growth. So maybe can you just walk us through how much conservatism is there or other puts and takes?

Greg Smith - *The Boeing Company - CFO*

Yes. Remember last year, too, we had a lot of timing benefits very late in the fourth quarter, which I don't expect at the same level as we are going to experience this year. We got more cash taxes by close to $1 billion this year compared to last year. And again, some of that is back-loaded when you compare it. But, Myles, I would just tell you very focused, obviously, on generating cash. We're comfortable with our approximate $7 billion of cash flow. And if we see that improving through the next quarter, then we'll update our guidance going forward. But at the same time, when you look at the long-term prospects on cash for the Company, that is unchanged. I mean delivering on this backlog and executing to our plans is going to generate a significant amount of operating cash going forward and we're going to deploy that in the most efficient and effective way possible. So continue to focus on it, Myles. Again, hard to compare last fourth quarter or third quarter of this one because there's a lot of moving pieces within the quarter. But again, if we see opportunities to improve that, we will. But we're comfortable with where we are right now.

Myles Walton - *Deutsche Bank - Analyst*

Okay. All right, thanks. I'll stick to one.

Operator

Peter Arment, Sterne Agee.

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

Jim, just maybe you could just give us some thoughts on the outlook at BDS. I mean your backlog continues to be very strong. Book-to-bill was a little under one but you gave some comments in your opening remarks about the longer-term outlook there. I mean do you think that we're going to be able to sustain kind of this $30 billion-plus revenue number given your outlook?

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

Yes. Yes, I do. I mean, I think the math of for that business is over time tanker replaces C-17 -- actually a little more when you look at the numbers. There's a couple of big development programs coming up. Three that I mentioned in my remarks. There's a couple other ones. Our opportunity to win those -- a couple of those, is good, which would mitigate risk on the fighter side as the F/A-18 and the F-15 over the next decade face some sunsetting. And then the upside is international. One of the unique things Boeing has is strong Company-to-country relationships built over the years, largely in our Commercial business, that has broadened us real base and cooperation in many of the world's key countries that help us in campaigns, both on the BDS and the Commercial side. And there's a lot of action out there. I mentioned the 35% of our backlog. I would probably say somewhat more than that as a percentage of our discussions or of the pipeline out there. And historically we've done well.

So that adds up to an equation with the helicopters and space and some of the other things staying flat or slightly up -- that adds up to an equation of flattish growth with may be some upside. But with the US Defense market being what it is, I think we want to keep our feet underneath us, our costs under control, because there's and unpredictability about that. We think we've got that risk covered. We think we understand it. But it remains a bit of a wildcard and we want to be ready if there is a wildcard. And I think we will be.

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

That's helpful. I'll stick to one. Thanks.

Operator

David Strauss, UBS.

David Strauss - *UBS - Analyst*

Greg, you talked about improvement on the 787-9 in terms of the unit cost. As you look out, when would you -- I think you talked about the 787-9 being better from a cash perspective long-term than the 787-8. When do you see the 787-9 catching the 787-8 from a cash perspective? And what are you assuming in terms of the 787-9 as a percentage of the production mix over the next 12 to 18 months?

Greg Smith - *The Boeing Company - CFO*

I would say, David, you'll see that probably around the 2016 time frame when you look at what's in the production flow in the mix between 787-8 and 787-9. That's probably where you really start to see the benefit of the 787-9 in the system. I'm sorry. I lost you on the second question.

David Strauss - *UBS - Analyst*

Just what you're assuming when you talk about deferred coming down per quarter. What you're assuming for the 787-9 as a percentage of the production mix over the next 12 to 18 months.

Greg Smith - *The Boeing Company - CFO*

Yes. Well I can tell you over the cost base, you're looking at more about a 40% of that cost base is assumed to be about that 787-9. Now some of that, obviously, is already done and then there's some assumptions in there about key customers that we will convert from 787-8 to 787-9. But generally, that's kind of the profile you see over the entire cost base.

David Strauss - *UBS - Analyst*

Okay. Great. Thank you.

Operator

Sam Pearlstein, Wells Fargo.

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

I was wondering if you could just address the situation that got a lot of press around the Ex-Im Bank and the financing. I'm just time to think about if that were not to get renewed, should we start to see BCC's portfolio start to turn in the other direction? Or what would it take for BCC's assets to start to go back up?

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

Well first of all, Sam, I think the chances are good. My assessment is that the -- that the bank will be reauthorized. Now there's risk it won't. Okay? But I just want to give you my view. And so addressing that risk -- the Ex-Im Bank has come down as a percentage of our customer base in terms of what percentage relies on them. And that has reflected a lot of liquidity in the capital markets but there are times when the markets are less friendly that the Ex-Im Bank does go up and becomes a significant percentage. The -- I think the issue is more about level playing field with our competition than it is Boeing goes under without the Ex-Im Bank. Okay? I think this idea of unilaterally disarming US manufacturers while European manufacturers continue to get copious kinds of Ex-Im type support is something that -- and that traces back to -- I don't think our -- the political infrastructure will do that. So it's more an issue of that, of losing some campaigns out there where that is important. If we didn't have the Ex-Im Bank -- scrambling using our balance sheet somewhat more. And we've worked the net earning assets in BCC down significantly over the last few years so there's some room there. But it would be more an issue of competitiveness than it would be an issue -- and that's a big issue. Okay? It's a huge issue -- than it would be the balance sheet of Boeing and the credit rating of Boeing being threatened.

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

Thank you.

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

Operator, we have time for were one more question.

Operator

Jason Gursky, Citi.

Jason Gursky - *Citigroup - Analyst*

Jim, I was wondering if you wouldn't mind just talking a little bit more about the cycle itself.

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

Yes.

Jason Gursky - *Citigroup - Analyst*

And your view on how this cycle plays out. We don't have any production rate increases, per se, in front of us for a couple of years. Can you -- how long do you think we can sustain production rates over the course of the rest of this decade? What other growth drivers might you have if we are plateauing in production, per se? And are there plenty of opportunities out there to drive earnings growth through margin expansion if you have plateaued from a production perspective?

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

Yes. Just starting at the highest possible level, one of the reasons we like being the world largest aerospace Company participating in many sectors, some commercial, some defense, some space, is there obviously is some risk mitigation of value and diversification -- some things are up, some things are down. So that's an overall thought and we still like that thought. But I know you're question is more centered on the commercial part of our Company. And again, we are in a -- driven by Boeing -- in a big technology change-out cycle here that has -- is responding to oil prices. You and I could argue whether it will be $90 or $130. These airplanes payback at any conceivable oil price in this unfriendly world we all live in. So starting with the 787 and it's now flowing through the rest of our widebody product line, promises to flow into our narrowbody product line some time in the next decade -- end of next decade. We don't know yet. These offer huge efficiency and maintenance advantages that do encourage people to retire planes earlier than they would were these alternatives not available to them and they payback.

So every sign I see is that this technology change-out is going to -- just look at our airplanes -- 777X -- is going to keep going over the next decade or so that I can see right now. And so that's the difference compared to normal, quote, cycles. So that supports the argument that says it's extended and it's really hard to call. And we have a lot of confidence in our production rates. They do go up a little bit in 2017 and 2018 and in the 37 and in the 87, that we've talked about. So we see it -- we see an extended growth market here.

Jason Gursky - *Citigroup - Analyst*

Okay. And then on the earnings growth side in that context, in the focus on margins -- just maybe a little bit about the big drivers you see there.

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

Well I think the big drivers are going to be -- in our commercial business, we tend to have lumpy earnings when we take too much risk in development. And I think -- which is why the mantra of de-risking the decade in front of us has been something that we've all, after having gone through the 787 experience, we've all thought a lot about. And so flowing the right amount of technology into the 787-9, the 787-10, the 737 MAX, the 777X 8 and 9 -- enough to capture enough of this technology advantage but not more than people are willing to pay for or more than would drive risks that we are not willing to absorb. We've tried to think a lot about that. And as I implied, and I think it was -- I forgot who asked the question -- it might have been Doug on R&D, we -- by design, we've sort of got stability both in our research and development spending and in the amount of risk -- associated risk we're taking during that. And when you have stability in this business and you get these programs driving margins, you can -- as we, I think, demonstrated over the last three or four years, you can make money in this business. And I think you're going to see more of that.

Jason Gursky - *Citigroup - Analyst*

That's helpful. Thank you.

Operator

That completes the analyst question-and-answer session.

(Operator Instructions)

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

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 after the session ends, please call our media relations team at 312-544-2002. Operator, we are ready for the first question. And in the interest of time, we ask that you limit everyone to just one question please.

Operator

Julie Johnsson, Bloomberg News.

Julie Johnsson - *Bloomberg News - Analyst*

Jim you have got a big birthday coming up next month. And can you just walk us through what we can expect on August 23? Will you be at your desk and has the Board approved you staying on past age 65?

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

Yes. The heart will still be beating. The employees will still be cowering. (laughter) I'll be working hard. Yes. I'll -- there's no end in sight. We're continuing to build the succession plan and alternatives to succeed me eventually. But there's no discussion of it yet. So we're -- so you'll still be asking questions of me.

Operator

Christopher Drew, the New York Times.

Christopher Drew - *New York Times - Analyst*

Jim and Greg, can you talk a little bit more just in simple terms on the tanker of how the design went off in terms of the wiring harnesses? And it seems like a pretty straightforward problem. What caused the issue?

Greg Smith - *The Boeing Company - CFO*

Yes. Well just like I say, any develop program -- once you've reached the point of integration, whether you're integrating a structure or the systems or wiring, that's where you really see that capability of how things are coming together and the efficiency. The structure of all those airplanes came together extremely well. Where the challenges lie were really around the wiring and the wire harnesses themselves. And the redesigning effort to either move those wires or do whatever rework was required is really what we were dealing with. We started experiencing that on the -- when we started the integration on that first airplane and that continued, which really we required us, again, to put some additional effort in place to go back and do redesign on those harnesses and along with that system installation and the manufacturing labor associated with it.

That's basically what it is. And again, it's well understood, as I mentioned prior to one of the questions. It's not a technology leap. We know how to do it. We've done some of it already on that first airplane, so we're building off of that experience. And again, we're looking -- continue to derisk the program and drive performance through the balance, which is, again, a reason why we put those labs or made the investment in some of those technology labs and we're already seeing the benefit of making that investment today. So the teams are very focused. They know what needs to get done and it's all about focusing on meeting our customer commitments and that is our priority at this point. And we've got a plan to go execute to do that. And it's day-to-day, hour-by-hour and the team is very focused on, again, the task at hand.

Operator

Doug Cameron, Wall Street Journal.

Doug Cameron - *Wall Street Journal - Analyst*

Going back to the Ex-Im issue -- you seemed to imply a little bit that the you might be prepared to use the balance sheet but -- if you had to. But given that we know the arguments on both sides, Jim, would you be prepared to support some reform of Ex-Im going forward that perhaps restricted or limited the either the type of aircraft or the type of customer that had availability to it? Which would at least preserve the broader competitive position even if perhaps Ex-Im fell a bit behind what the ECAs offer. But would you support some sort of reform?

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

Well I think we have been supportive of reform over the last number of cycles. As you know, the terms and conditions are a function of a treaty that basically the OECD nations debate and sign. And we have supported over the last couple of cycles increasing rates, increasing fees, making both of those more commercial term in nature. So that -- and do it in concert with the other ECAs around the world. And we will continue to support this move toward more close alignment with commercial terms. And so we're -- we'll continue to support all kinds of efforts like that done in concert within the treaty.

I think where we get uncomfortable is when we say, oh, tractors -- you can't lend against tractors or gas turbines or widebodied airplanes. I mean, why are we -- why do we pick certain elements that some raise as not needing -- not in need of support where the rest of the economy is? I support none of that.

Operator

Steve Wilhelm, Puget Sound Business Journal.

Steve Wilhelm - *Puget Sound Business Journal - Analyst*

In terms of the robotization of the 777X line, I wondered if you could talk about plans to expand that throughout other production lines in the future and also what that has to do with a competitiveness in terms of Europe and maybe China way in the future?

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

Well I think automation is -- and I know you're aware -- is we are starting with the 777 fuselage. A lot of good work being done. Hope of expanding it to both improve the quality of our airplanes, the cost of which we produce them and the safety for our work -- and safety for our workforce. And, yes, I think it is fair to say that over time, we would anticipate expanding that capability. There are other examples besides automation of the fuselage. There's the paint shop -- 777 wing. I was out in Seattle recently and toured that. A terrific job being done using automation to paint major structures. So we are focused on that to improve our cost quality and the lives of our workers and we will expand it over time.

Tom Downey - *The Boeing Company - SVP Corporate Communications*

Operator, we have time for one last question please.

Operator

Stephen Trimble, Flight Global.

Stephen Trimble - *Flight Global - Analyst*

On the tanker issue, we have seen a couple of warnings from [DOCD] and the DAO that the program could run 6 to 12 month late. And they haven't said anything about wiring harnesses or problems with the wiring, they've talked more about concerns about software and the aggressive flight test rates. Can you address those issues and are those things under control? Or is there a risk of further delays and further cost increases?

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

We don't see that today. I think on the flight test, we have, from the very beginning, as part of the fixed-price development contract, proposed a more commercial-like flight test program. Our customer has agreed with us. When viewed parametrically, it seems shorter than other flight tests that are done in other ways -- not as efficiently. So we disagree with that assessment. And other than the problems that Greg described on the wiring, wiring separation, wiring bundles, some of that detailed design, the rest of the program is moving along well in part because of these laboratories we have set up at our own cost to derisk systems, particularly the fuel system before installing it on the airplane. So it doesn't mean that something cannot crop up in the future but we don't see it now.

Tom Downey - *The Boeing Company - SVP Corporate Communications*

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