

Boeing Company

Q1 Encouraging on Several Fronts; Raising Estimates and Price Target

Q1 contained several positive developments: 1) core BCA margins are expanding at an increasing pace, a continuation of a trend that we have highlighted in recent quarters; 2) 787 deferred production growth of \$1.5 bn was in line with our estimate, and it is our impression that management is growing more confident about achieving its target for a ~\$25 bn peak late this year; 3) free cash flow exceeded our forecast, reinforcing our view that 2014 FCF will materially exceed guidance; and 4) management aggressively bought back stock. We continue to see significant cash flow growth in 2015 and beyond as 787 cash burn reverses, and we are raising our EPS estimates as well. As a result, our Dec 2014 price target, which is based on both our cash flow and EPS expectations, is up by \$5 to \$167, for 25-30% upside. A key potential catalyst in the next 3-6 months would be significant declines in 787 unit costs, which would shore up confidence in our cash flow outlook. We continue to forecast ~\$12 of FCF in 2015, so the stock trades at only 10-11x.

- **Core BCA margin is expanding at an increasing rate.** We estimate that the core commercial margin (excluding 787, 747-8, and █████) expanded 250 bps y/y to 19.5% in Q1, following up 100 bps of expansion in 3Q13 and 200 bps in 4Q13. We now assume it remains ~19.5% going forward (with a seasonal step down in Q4) but some of the key performance drivers, including Partnering for Success and internal cost takeout efforts, still have room to run, creating potential for further expansion. Management highlighted Partnering for Success nearly a year ago at its investor meeting, and the performance since then has been impressive.

Overweight

BA, BA US

Price: \$130.63

▲ **Price Target: \$167.00**
Previous: \$162.00

Aerospace/Defense

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Price Performance



The Boeing Company (BA;BA US)

FYE Dec	2011A	2012A	2013A	2014E (Prev)	2014E (Curr)	2015E (Prev)	2015E (Curr)
EPS - Recurring (\$)							
Q1 (Mar)	-	-	1.73	1.63	1.76A	-	-
Q2 (Jun)	-	-	1.67	1.91	2.02	-	-
Q3 (Sep)	-	-	1.80	1.98	1.94	-	-
Q4 (Dec)	-	-	1.88	2.02	2.18	-	-
FY	5.74	5.88	7.08	7.55	7.90	8.20	8.60
Bloomberg EPS FY (\$)	4.51	5.01	6.74	-	7.32	-	8.17

Source: Company data, Bloomberg, █████ Morgan estimates. Our EPS estimates for Boeing are consistent with the company's core EPS, which excludes certain pension and post-retirement expenses. GAAP EPS was \$5.11 in 2012 and \$5.96 in 2013. Our estimates for 2014, and 2015 are \$6.79, and \$7.67, respectively.

Company Data

Price (\$)	130.63
Date Of Price	23 Apr 14
Price Target (\$)	167.00
Price Target End Date	31-Dec-14
52-week Range (\$)	144.57-87.20
Market Cap (\$ mn)	100,467.50
Shares O/S (mn)	769

See page 6 for analyst certification and important disclosures.

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- **787 deferred production growth should begin to step down.** While forecasting 787 unit costs is difficult given the number of variables and lack of data, we see a path to management's deferred production peak target of ~\$25 bn late this year. The current balance is \$23.1 bn, and growth has been running at ~\$1.5 bn per quarter. Management committed to a smaller increase in Q2, and we believe this is the first time Boeing has committed to a near-term decline in a specific quarter, which we view as a sign of confidence. We are forecasting an increase of \$1.1 bn for Q2, followed by ~\$700 mn in Q3, and then ~\$400 mn in Q4 to reach \$25.3 bn, and we assume the balance remains in the mid \$25 bn range through 2015 before starting to decline in 2016, consistent with guidance. We see potential drivers of near-term improvement beyond the higher productivity that typically kicks in when aircraft program volumes stabilize at a good rate. One is the transition to new "block" (a block within the accounting quantity for estimating costs) at unit 200 around mid year, which should incorporate lower overhead rates due to the higher production rate for aircraft 201-300 relative to aircraft 101-200. Boeing should complete this third block in about 10 months compared to the 15 months it will have taken to complete the second block. Another driver is a pricing step down for key structural suppliers that was contractually established many years ago, and we believe this alone could drive double-digit cost improvement. A key issue that is hard to model is that Boeing will need to materially reduce unit costs on the 787-9, since this variant should begin to constitute the majority of production by late 2015, up from its current production rate of less than 1/month. The mix shift from -8 to -9 over time should be a clear positive for margins, but it represents another learning curve that the company needs to come down, and therefore we see this as more of an intermediate term risk since it lowers visibility.
- **We continue to forecast FCF of ~\$6 bn in 2014 and ~\$9bn in 2015.** Our 2014 forecast is well above guidance for \$3.75 bn, and we don't think we are crazy as Boeing has exceeded its initial cash flow guidance by \$2-3 bn in each of the past three years. Q1 FCF was \$615 mn, and while this was only 10% of our forecast for the year, it was well above our estimate for breakeven in the quarter and even further above other Street estimates that had looked for a material cash burn. FCF was \$6 bn last year with no contribution from Q1. Looking to 2015, we see 787 as the major source of cash flow improvement as it moves from a ~\$3.4 bn use of cash to \$1.6 bn source, driven by deferred production no longer being a major use of cash and the delivery of some planes from inventory.
- **Another solid quarter for BDS, but risks lurk in the out years.** In a replay of 2012 and 2013, BDS results were stronger than expected and we boosted estimates for the year after sales and margins came in ahead of our forecasts. We are now \$170 mn above the midpoint of EBIT guidance, which equates to 15 cents of EPS. With a headwind coming for C-17 in 2015 and 2016, however, as well as risk for the Super Hornet and an overall environment that remains challenging, we continue to look for declines beyond this year and we are modeling \$2.8 bn of defense EBIT in 2016, down from \$3.1 bn this year. We would also point out that Boeing programs were hit hard in the report DoD published last week regarding the potential impact of sequestration on specific programs, with cuts across the FYDP for Apache (\$1.2 bn), tanker (\$1.1 bn), Chinook (\$1.0 bn), and P-8 (\$1.0 bn). There is still much uncertainty regarding future budgets and the DoD document is no doubt intended to some degree as a device for generating opposition to budget cuts, but the situation bears watching.

- **Management got after it on share repurchase.** Management showed its commitment to returning cash to shareholders by taking advantage of the selloff in the stock last quarter to invest \$2.5 bn buying back nearly 20 mn shares, or 2.5% of diluted shares outstanding. This buyback volume combined with the 50% dividend hike last December are evidence that management has been increasingly willing to act aggressively to return cash after holding back for roughly four years as it worked through 787 development. We expect the repurchase pace to moderate somewhat, but management intends to continue buying back stock and we are looking for ~\$800 mn per quarter the remainder of the year. This would mean returning ~120% of FCF to shareholders on our estimates, well above management's commitment to 80% and our prior estimate of ~100%. There is \$8.3 bn remaining on the current repurchase authorization, which management has said it will use over 2-3 years. We assume it is done by early 2016 with the potential for it to be consumed faster, and we would expect another authorization to follow.
- **Raising estimates.** Our 2014 core EPS estimate is up 35 cents to \$7.90. The increase comes from a tax benefit now expected in Q2 (~15 cents), a lower sharecount (10-15 cents), and BDS upside in Q1 (~10 cents). For 2015, our core EPS estimate is up 40 cents to \$8.60 driven primarily by sharecount and BCA margins.

Investment Thesis, Valuation and Risks

Boeing Company (*Overweight; Price Target: \$167.00*)

Investment Thesis

We rate Boeing Overweight based on expectations for improving FCF as 787 cash burn falls, rising repurchases and dividends, and favorable conditions for new aircraft production.

Valuation

The stock trades at 15.2x our estimate for 2015 core EPS, a 5% premium to our coverage universe. We are raising our December 2014 price target by \$5 to \$167 to reflect higher estimates. Our target represents 16x the average of our 2015 core EPS and 2015 free cash flow estimates.

Risks to Rating and Price Target

Risks to our rating include a failure to lower 787 unit costs, a decline in demand for aircraft, worse than expected execution on core commercial programs, and a greater than expected decline in defense earnings.

Boeing Company: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14E	3Q14E	4Q14E
Revenues	86,623	89,657	94,151		- Revenues	20,465A	22,010	23,203	23,978
Operating expenses	(80,061)	(82,164)	(85,746)		- Operating expenses	(18,923)A	(20,089)	(21,200)	(21,953)
Operating income	6,562	7,493	8,405		- Operating income	1,542A	1,922	2,004	2,026
D&A	1,844	1,938	1,977		- D&A	448A	461	483	546
EBITDA	8,406	9,431	10,382		- EBITDA	1,990A	2,383	2,487	2,572
Net interest income / (expense)	(330)	(332)	(328)		- Net interest income / (expense)	(83)A	(83)	(83)	(83)
Other income / (expense)	-	-	-		- Other income / (expense)	-	-	-	-
Pre-tax income	6,232	7,161	8,077		- Pre-tax income	1,459A	1,839	1,920	1,943
Income taxes	(1,646)	(2,105)	(2,506)		- Income taxes	(494)A	(492)	(634)	(486)
Minority Interest	-	-	-		- Minority Interest	-	-	-	-
Net income - GAAP	4,586	5,056	5,571		- Net income - GAAP	965A	1,347	1,287	1,457
Preferred dividends/convertible	-	-	-		- Preferred dividends/convertible	-	-	-	-
Diluted shares outstanding	770	745	727		- Diluted shares outstanding	754A	745	742	740
EPS - recurring	7.08	7.90	8.60		- EPS - recurring	1.76A	2.02	1.94	2.18
EPS - GAAP	5.96	6.79	7.67		- EPS - GAAP	1.28A	1.81	1.73	1.97
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	15,258	13,367	14,949		- Sales growth	6.0%	3.5%	5.0%	-
Short Term Investments					- EBITDA growth	3.5%	12.2%	10.1%	-
Accounts receivable	6,546	7,049	7,549		- EPS growth - recurring	20.5%	11.5%	8.9%	-
Inventory	42,912	46,348	44,715		- EBIT margin	7.6%	8.4%	8.9%	-
Other current assets	358	271	271		- EBITDA margin	9.7%	10.5%	11.0%	-
Current assets	65,074	67,035	67,484		- Tax rate	26.4%	29.4%	31.0%	-
PP&E	10,224	10,691	10,914		- Net margin	5.3%	5.6%	5.9%	-
Total assets	92,663	94,211	94,804		- Net Debt / EBITDA	(66.9%)	(47.0%)	(57.9%)	-
Total ST Debt	1,563	1,660	1,660		- Net Debt / capital (book)	(60.8%)	(43.6%)	(85.9%)	-
Total LT Debt	8,072	7,275	7,275		- Return on assets (ROA)	6.0%	6.3%	6.6%	-
Net debt	(5,623)	(4,432)	(6,014)		- Return on equity (ROE)	52.5%	39.9%	45.3%	-
Total current liabilities	51,486	53,650	54,440		- Free cash flow / share	7.79	7.98	12.32	-
Total liabilities	77,788	79,610	81,789		- P / E	21.9	19.3	17.0	-
Shareholders' equity	14,875	14,601	13,016		- EV / EBITDA	11.4	9.8	8.6	-
Cash flow from operations	8,179	8,342	11,149						
Capex	(2,187)	(2,400)	(2,200)						
FCF (to firm)	5,992	5,942	8,949						
Net (decrease) increase in cash/equivalents	(1,253)	(1,003)	1,582						
DPS	1.93	2.92	3.37						

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

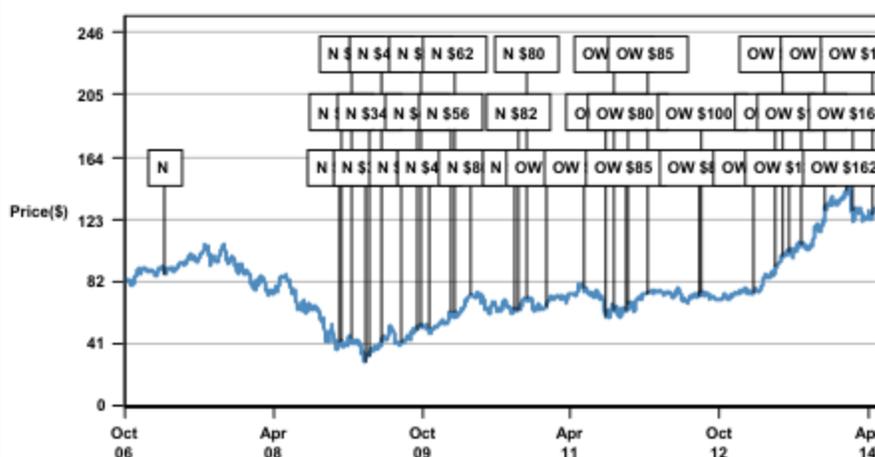
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Boeing Company (BA, BA US) Price Chart



Source: Bloomberg and [REDACTED] Morgan; price data adjusted for stock splits and dividends.
Break in coverage Feb 28, 2007 - Dec 01, 2008.

Date	Rating	Share Price (\$)	Price Target (\$)
28-Feb-07	N	87.20	--
01-Dec-08	N	42.63	46.00
08-Dec-08	N	42.85	42.00
12-Jan-09	N	44.45	44.00
02-Mar-09	N	29.51	36.00
19-Mar-09	N	33.19	34.00
04-May-09	N	42.18	40.00
16-Jul-09	N	42.05	37.00
08-Sep-09	N	49.50	41.00
24-Sep-09	N	52.37	50.00
22-Oct-09	N	51.07	47.00
11-Jan-10	N	61.60	56.00
28-Jan-10	N	62.56	62.00
29-Mar-10	N	74.11	80.00
07-Sep-10	N	63.42	89.00
20-Sep-10	N	63.72	82.00
21-Oct-10	N	71.50	80.00
03-Jan-11	OW	65.26	83.00
20-May-11	OW	78.02	85.00
09-Aug-11	OW	58.71	81.00

07-Sep-11	OW	62.77	89.00
18-Oct-11	OW	63.47	85.00
27-Oct-11	OW	66.56	80.00
06-Jan-12	OW	73.53	85.00
16-Jul-12	OW	72.97	80.00
26-Jul-12	OW	74.91	100.00
31-Jan-13	OW	74.59	94.00
25-Apr-13	OW	91.67	98.00
20-May-13	OW	98.72	105.00
11-Jun-13	OW	101.75	133.00
25-Jul-13	OW	106.95	135.00
24-Oct-13	OW	128.98	138.00
09-Jan-14	OW	142.13	162.00
30-Jan-14	OW	129.78	165.00
17-Apr-14	OW	126.04	162.00

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