

Boeing raises 777 production rates starting in 2013

Boeing raises 777 production rate to 8.3/mo in 2013

Boeing announced today that it will raise 777 production rates to 8.3/month, or 100/year starting 1Q13. This is an increase of 16 777s/year from the previously announced 7/month, going into effect mid-2011. As a result we are raising our 777 forecast to 96 deliveries in 2013 and to 100 in 2014. We are also raising our legacy program margins to 22.25% in 2013 and to 23.25% in 2014 from 22% and 23%, respectively. This raises our 2013e to \$7.35 from \$6.90 and 2014e to \$8.20 from \$7.60.

Legacy widebodies filling gap of uncertain new programs

In our view there are several reasons why Boeing likely raised its production rate. With recent 787 issues, potential A350 delays, and the slow ramp of the A380 program, Boeing's increase in 777 rates fills the demand left by flailing new widebody programs. However, we note that according to Ascend there are 260 777s in Boeing's backlog. At a rate of 100 deliveries/year Boeing will quickly deplete its backlog unless the Company generates more orders. However, if BA is planning to replace or upgrade the 777, this might be a prudent move to clear out existing orders to make room for the next 777.

Bolsters Free Cash Flow, masks 787 troubles

Another reason for Boeing's decision to raise rates could be to boost Free Cash Flow. As development programs burn through cash, delivering more legacy program aircraft helps to bolster FCF. In our view, it also generates excitement for Boeing's business model which may mask 787 difficulties. We would expect final resolution of the 787 delay to be announced before year end. Raising 777 rates could temporarily lift BA sentiment.

Raising PO to \$85

We are raising our PO to \$85 based on a DCF analysis that assumes a 2.9% implied growth rate and 10.4% discount rate. In the outyears we lowered our FCF conversion rate as we believe the 787 program's lower margins dilute FCF.

Estimates (Dec)

(US\$)	2008A	2009A	2010E	2011E	2012E
EPS	3.67	1.84	4.00	4.05	5.65
GAAP EPS	3.67	1.84	4.00	4.05	5.65
EPS Change (YoY)	-30.4%	-49.9%	117.4%	1.3%	39.5%
Consensus EPS (Bloomberg)			3.99	4.57	5.50
DPS	1.60	1.68	1.85	2.04	2.24

Valuation (Dec)

	2008A	2009A	2010E	2011E	2012E
P/E	17.7x	35.3x	16.3x	16.1x	11.5x
GAAP P/E	17.7x	35.3x	16.3x	16.1x	11.5x
Dividend Yield	2.5%	2.6%	2.8%	3.1%	3.4%
EV / EBITDA*	12.8x	18.9x	10.3x	10.5x	8.2x
Free Cash Flow Yield*	-4.3%	9.1%	-0.2%	0.3%	8.1%

* For full definitions of *iQmethod*SM measures, see page 2.

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Stock Data

Price	US\$65.03
Price Objective	US\$85.00
Date Established	20-Dec-2010
Investment Opinion	B-1-7
Volatility Risk	MEDIUM
52-Week Range	US\$53.10-76.00
Mrkt Val / Shares Out (mn)	US\$48,321 / 743.1
BofAML Ticker / Exchange	BA / NYS
Bloomberg / Reuters	BA US / BA.N
ROE (2010E)	81.8%
Total Dbt to Cap (Sep-2010A)	96.5%
Est. 5-Yr EPS / DPS Growth	11.0% / 11.0%

Key Changes

(US\$)	Previous	Current
Price Obj.	80.00	85.00
2011E Rev (m)	68,661.3	66,718.5
2012E Rev (m)	76,301.1	73,849.4

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Refer to important disclosures on page 6 to 9. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11004139

iQprofileSM The Boeing Company

iQmethodSM – Bus Performance*

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Return on Capital Employed	10.8%	6.0%	10.6%	9.9%	12.7%
Return on Equity	68.0%	242.3%	81.8%	52.1%	54.0%
Operating Margin	6.5%	3.1%	7.7%	7.3%	9.0%
Free Cash Flow	(2,075)	4,417	(86)	129	3,900

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Cash Realization Ratio	-0.2x	4.3x	0.5x	0.6x	1.3x
Asset Replacement Ratio	1.3x	0.8x	1.1x	1.1x	0.9x
Tax Rate	33.4%	22.9%	35.0%	32.5%	32.5%
Net Debt-to-Equity Ratio	NM	166.7%	220.5%	191.1%	113.0%
Interest Cover	19.6x	6.2x	9.8x	10.6x	14.5x

Income Statement Data (Dec)

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Sales	60,909	68,281	65,446	66,718	73,849
% Change	-8.3%	12.1%	-4.2%	1.9%	10.7%
Gross Profit	10,780	11,916	12,762	13,010	14,401
% Change	-18.8%	10.5%	7.1%	1.9%	10.7%
EBITDA	5,275	3,555	6,555	6,421	8,229
% Change	-26.4%	-32.6%	84.4%	-2.0%	28.1%
Net Interest & Other Income	63	(365)	(490)	(430)	(410)
Net Income (Adjusted)	2,672	1,312	2,970	3,009	4,217
% Change	-34.4%	-50.9%	126.4%	1.3%	40.1%

Free Cash Flow Data (Dec)

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Net Income from Cont Operations (GAAP)	2,672	1,335	2,970	3,009	4,217
Depreciation & Amortization	1,325	1,459	1,495	1,533	1,571
Change in Working Capital	(5,646)	1,303	(4,599)	(3,048)	(813)
Deferred Taxation Charge	744	607	1,118	71	170
Other Adjustments, Net	504	899	534	231	231
Capital Expenditure	(1,674)	(1,186)	(1,603)	(1,668)	(1,477)
Free Cash Flow	-2,075	4,417	-86	129	3,900
% Change	NM	NM	NM	NM	NM

Balance Sheet Data (Dec)

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Cash & Equivalents	3,268	9,215	1,435	549	2,552
Trade Receivables	5,602	5,785	7,115	6,215	6,677
Other Current Assets	17,094	20,275	32,052	33,211	34,516
Property, Plant & Equipment	8,762	8,784	8,892	9,027	8,933
Other Non-Current Assets	19,053	17,994	16,492	16,667	16,359
Total Assets	53,779	62,053	65,986	65,669	69,037
Short-Term Debt	560	707	953	560	560
Other Current Liabilities	30,213	32,176	33,454	31,142	32,190
Long-Term Debt	6,952	12,217	11,580	12,470	12,245
Other Non-Current Liabilities	17,196	14,728	14,966	14,966	14,966
Total Liabilities	54,921	59,828	60,953	59,138	59,961
Total Equity	(1,142)	2,225	5,033	6,530	9,076
Total Equity & Liabilities	53,779	62,053	65,986	65,669	69,037

* For full definitions of iQmethodSM measures, see page 2.

Company Description

Boeing is the world's leading aerospace company and the largest manufacturer of commercial jetliners and military aircraft combined. The different segments in the company are: Commercial Airplanes, Integrated Defence Systems, and Boeing Capital Corporation, which provides financial solutions facilitating sale and delivery of Boeing commercial and military aircraft, satellites, and launch vehicles. BA is based in Chicago, Illinois.

Investment Thesis

BA is changing the face of commercial aerospace with the 787, the product development, however, has been fraught with risk and poor execution. We firmly believe that the use of composites as the primary structure on the 787 marks a fundamental shift in the industry. With the recent economic downturn, we believe aircraft deliveries will plateau over the next few years as production slows down to match anticipated increased deferrals and cancellations.

Stock Data

Average Daily Volume 6,508,794

Quarterly Earnings Estimates

	2009	2010
Q1	0.86A	0.66A
Q2	1.41A	1.06A
Q3	-2.23A	1.12A
Q4	1.75A	1.15E

Price objective basis & risk

Boeing (BA)

Our PO of \$85 is derived from a DCF analysis based on a 10.4% cost of equity and an implied growth rate of 2.9%. We use a DCF as it better reflects the value in long term commercial aircraft development programs.

Risks to our price objective are: A sharp and prolonged surge in oil prices to well above \$100/bbl would be negative to aircraft demand but moderately higher oil prices at about \$85/bbl, as BofAML forecasts would probably not affect demand. A downturn in commercial aviation, due to an exogenous factor, could adversely affect Boeing's financial results. Given the number of new systems, materials and construction techniques, Boeing would be materially affected if there were additional problems with the development or manufacturing of the plane. Given that aircraft are priced in dollars, an unexpected rapid revaluation in the dollar could significantly affect order activity. Execution risk on defense programs could result in cost overruns and margin contractions. We view the current Presidential administration as a potential ceiling to defense stocks as political control, in our view, is a key driver of defense spending. Our analysis suggests that the Democrat-led administration in the White House could lead to a decline in defense spending authorization (a leading indicator) in the FY11 timeframe, which in turn could affect outlays (a coincident indicator) in the FY12/FY13 timeframe.

Link to Definitions

Industrials

Click [here](#) for definitions of commonly used terms.

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Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Boeing	BA	BA US	Ronald J. Epstein
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	CAE Inc.	YCAE	CAE CN	Ronald J. Epstein
	Crane Co	CR	CR US	Ronald J. Epstein
	Embraer	ERJ	ERJ US	Ronald J. Epstein
	General Dynamics	GD	GD US	Ronald J. Epstein
	Moog Inc.	MOGA	MOG/A US	Ronald J. Epstein
	Precision Cast	PCP	PCP US	Ronald J. Epstein
	Rockwell Collins	COL	COL US	Ronald J. Epstein
	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein
	Textron	TXT	TXT US	Ronald J. Epstein
	TransDigm Group Inc.	TDG	TDG US	Ronald J. Epstein
	Triumph Group	TGI	TGI US	Ronald J. Epstein
	United Tech	UTX	UTX US	Ronald J. Epstein
NEUTRAL				
	Goodrich	GR	GR US	Ronald J. Epstein
	Hexcel Corporation	HXL	HXL US	Ronald J. Epstein
	L-3 Comm	LLL	LLL US	Ronald J. Epstein
	Northrop Grumman	NOC	NOC US	Ronald J. Epstein

US-Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
	Raytheon Co.	RTN	RTN US	Ronald J. Epstein
UNDERPERFORM				
	DigitalGlobe Inc	DGI	DGI US	Ronald J. Epstein
	Lockheed Martin	LMT	LMT US	Ronald J. Epstein
	ViaSat	VSAT	VSAT US	Ronald J. Epstein
RVV				
	Zoltek Cos	ZOLT	ZOLT US	Ronald J. Epstein

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

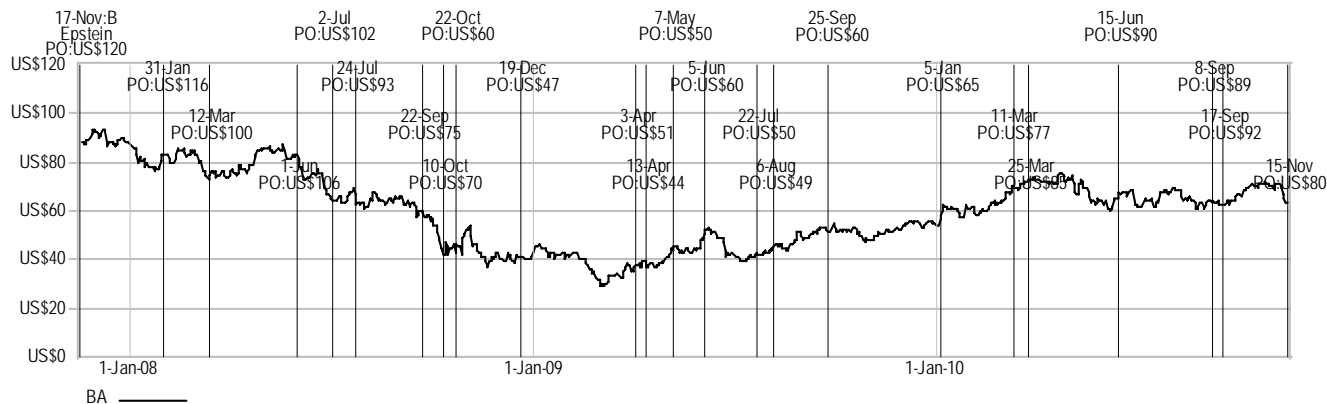
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BA Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of November 30, 2010 or such later date as indicated. BofA Merrill Lynch price charts do not reflect analysts' coverage of the stock at prior firms.

Investment Rating Distribution: Aerospace/Defense Electronics Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	18	50.00%	Buy	14	77.78%
Neutral	14	38.89%	Neutral	9	75.00%
Sell	4	11.11%	Sell	2	50.00%

Investment Rating Distribution: Global Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1948	54.31%	Buy	821	46.73%
Neutral	891	24.84%	Neutral	397	49.07%
Sell	748	20.85%	Sell	259	37.16%

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Underperform	N/A	≥ 20%

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