

Boeing

Will the production freeze impact MAX-7 & -10 certification process?

Maintain Rating: NEUTRAL | PO: 225.00 USD | Price: 205.47 USD

Chris Brady on MAX -7 & -10 certification process

We hosted Chris Brady, author of *The Boeing 737 Technical Guide*, for a conference call to discuss the FAA's mandatory production freeze of Boeing (BA) 737 MAX aircraft and the possible implications for MAX -7 and MAX-10 certification process. Brady applauded the FAA's decision to freeze production rates and noted that an alternative (such as slowing down rates) could have been much worse for Boeing. The increased scrutiny surrounding Boeing following the door plug incident makes us more cautious on the probability of the -7 and -10 aircraft being allowed Time Limit Exceptions (TLE).

-7 & -10 delays necessitate TLE for certification

The ongoing uncertainty surrounding the -7 & -10 certification process stems back to the 2018/2019 MAX aircraft disasters related to the MCAS feature. Following the crashes, all MAX aircraft were grounded and work on certifying the -7 & -10 was effectively paused. At the same time, the FAA was putting in place more rigorous certification standards. Due to the delays incurred, the -7 & -10 did not meet the certification timeline before new rules came into place. As a work around, TLEs can be put in place to allow for certification despite certain deficiencies or non-compliance with new rules. The current deficiency at hand is the engine anti-ice system which has been demonstrated to cause damage to the engine's nacelle if left on for too long. Prior to the Alaska Airline incident, Brady believes the FAA would have granted the TLE. However, increased scrutiny of the FAA may lead the agency to take a tougher view and demand the company fix the problem before granting certification.

Fix will take until 2026, customers likely frustrated

Boeing's published timeline highlights June 2026 as a reasonable timeframe for fixing the anti-ice system. In our view, if certification is delayed until then, there is the risk that customers may begin to turn to other aircraft producers. United Airlines has already announced that they are starting to look outward to make up for the shortfall in MAX -10 deliveries. We think it is unlikely that customers will break their contracts and cancel orders (as this would result in a charge to the customer); however, we do think that these customers may use the delay as a reason to look elsewhere for future aircraft needs. Another risk may be if, under the FAA mandated rate freeze, Boeing is not able to meet its production and delivery commitments. This would free customers (at no cost to them) from their contract and allow customers to turn to other aircraft producers.

Congress likely to be supportive of BA

It is important to note that the decision to grant the TLE comes down to Congress. In Brady's view, given Boeing's position as a massive US exporter and employer, he does not see it as likely for many representatives to take an active stance against the company. Brady believes that the few calls for non-certification in Congress have been in the vast minority and that Boeing ultimately will be granted a TLE. We reiterate our Neutral on Boeing as we think despite current challenges, Boeing will ultimately be able to come out of the production slowdown with a more robust production and quality control system.

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Stock Data

Price	205.47 USD
Price Objective	225.00 USD
Date Established	25-Jan-2024
Investment Opinion	B-2-9
52-Week Range	176.25 USD - 267.54 USD
Mkt Val (mn) / Shares Out (mn)	124,305 USD / 605.0
Free Float	99.9%
Average Daily Value (mn)	2362.81 USD
BofA Ticker / Exchange	BA / NYS
Bloomberg / Reuters	BA US / BAN
ROE (2023E)	NA
Net Dbt to Eqty (Dec-2022A)	NA
ESGMeter™	High

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FAA: Federal Aviation Administration

MCAS: Maneuvering Characteristics Augmentation System

Price objective basis & risk

Boeing (BA)

Our PO of \$225 is based on the 2026e FCF of \$13/share and relative discount to the S&P500 of 0.8x (about half standard deviation above historical average). In our view, a multiple roughly in line with the historical average fairly reflects the looming aerospace recovery, strong demand for commercial jets, defense opportunities, and the lack of dividend.

Upside risks to our PO are the possible involvement of an activist shareholder, better-than-expected cash margins at 787 and/or MAX programs, the company's ability to sustain 777 delivery rates through the bridge to 777X, lower-than-expected 777X, future single-aisle and middle-of-the-market aircraft development costs.

Downside risks to our PO are as follows: Tight competition for engineering talent in the current labor market could make new product development more challenging. Execution risk on new programs and production ramp-ups (737MAX, 777X, KC-46) could result in cost overruns and margin contractions. Changes in trade policy that end in a trade war. A sharp and prolonged surge in oil prices to above \$100/bbl would be negative to aircraft demand. A downturn in commercial aviation, due to an exogenous factor, could adversely affect financial results. As aircraft are priced in USD, an unexpected rapid revaluation in the dollar could significantly affect order activity. Also, a strong dollar could improve Airbus' competitive advantage. 787 fixes could take longer than expected.

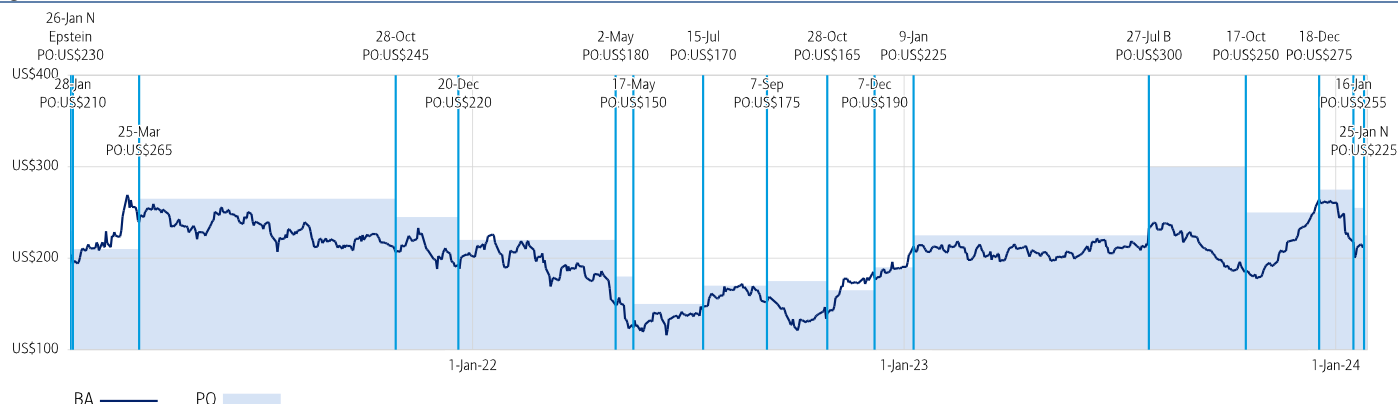
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Boeing (BA) Price Chart



BA — PO
B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	31	62.00%	Buy	23	74.19%
Hold	11	22.00%	Hold	9	81.82%
Sell	8	16.00%	Sell	6	75.00%

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Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
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Sell	807	22.84%	Sell	383	47.46%

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Underperform	N/A	≥ 20%

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