Operator

Thank you for standing by. Good day everyone and welcome to the Boeing Company's First Quarter 2014 Earnings Conference Call. Today's call is being recorded. The management discussion and slide presentation plus the analysts 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

Thank you and good morning. Welcome to Boeing's first 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 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 risk, 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 will turn the call over to Jim McNerney.

W. James McNerney

Thank you, Troy and good morning everybody. Let me begin today by acknowledging the families and loved ones of those aboard Malaysia Airlines flight 370. Our thoughts and sympathies remain with them at this time. In accordance with international protocols, Boeing is serving as a technical advisor to the NTSB and support of Malaysian authorities and we appreciate the ongoing efforts of all parties involved in the investigation.

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

Now let's turn to Slide 2. Building on our momentum from 2013 Boeing delivered strong first quarter financial results including healthy revenue increases solid core operating margins and double-digit growth in core earnings per share. During the quarter we also return significant value to shareholders by repurchasing $2.5 billion of Boeing stock and increasing our dividend pay out to $540 million.

Revenue at Boeing Commercial Airplanes was $12.7 billion and operating margins grew to 11.8% a result of higher volume and a favorable delivery mix. We delivered 161 commercial airplanes in the first quarter including 18 787 Dreamliners and we added the net new orders of 235 airplanes.

Boeing Defense, Space & Security reported revenue in the first quarter of $7.6 billion and also generated solid operating margins. During the quarter BDS captured numerous key contract awards including a $2.4 billion order for U.S. Navy to support full rate production of 16 P-8A Poseidon Aircraft an order from the U.S. Army for 82 Apache Block III helicopters, and in March the Government of Qatar announced its intent to purchase 24 Apache helicopters and three 737 based AEW&C aircraft.

Noteworthy program milestones included the first C-17 delivery to the Kuwait Air Force, the first Peace Eagle delivery to the Turkish Armed Forces and the successful completion of On-Orbit Testing for the first Inmarsat-5 satellite. In summary we delivered another strong quarter of operating performance achieved significant program milestones, captured orders totaling $19 billion and returned significant cash to shareholders. All of which Greg will cover in more detail in just a moment.

With that let's turn the business environment on Slide 3. Global customer demand remains high for our fuel efficient and value creating commercial airplane family as evidenced by our strong orders intake during the quarter. Global passenger traffic trends remains strong and air cargo traffic continues to gradually improve. Despite some variation in emerging market growth rates, we see no softening of demand for our commercial airplanes given the compelling operating economics and increased fuel efficiency that our airplanes provide.

In fact, underpinning the strength of this cycle relative to past ones is a sustained higher level of replacement demand fueled by compelling airplane economics and the rapid return on investment that comes from replacing older less efficient aircraft with a dramatically more efficient new technology airplanes we are building today and will introduce throughout this decade.

Furthermore deferral request from customers are still running well below the historical average, request to accelerate deliveries meanwhile continue at a study an encouraging rate. This ongoing demand coupled with our sizable backlog of more than 5100 airplanes which is balanced geographically and across customer operating models, reinforces our plan production rates and we believe position us for a significant and sustained growth in the years ahead. For the superior commercial airplane product line that provides customers a broadest range of size and range capabilities. In addition to unparallel operating economics we continue to expect a book-to-bill ratio above one for the year.

In the Twin-Aisle segment, we expect 2014 will be a strong order year for both the current 777 family and the new 777X models. All Nippon Airways announced intention to purchase both the 777-9X and additional 777-300ERs, illustrates the value that these airplanes bring to the market and reflects our intended strategy to pair orders when possible to meet customer fleet needs and support the production bridge to the 777X.

Based on 777 proposal the volume, firm orders and options, we've confidence in filling the remaining 2016 production slots and we anticipate active sales campaign currently underway will readily solidify 2017 and 2018. With the firm backlog of nearly 300 current 777 continued strong customer demand and airplane availability this decade, we have high confidence in executing a successful transition to the 777X.

The 787 Dreamliner is operating at our plan production rate of 10 per month. And both our Everett and Charleston facilities have made great stride on rate stabilization and introduction of the 787-9. We delivered 10 787s in March and including April deliveries to-date we have delivered total of 133 787 to 18 customers.

The fleet is flying in average of more than 260 flights per day with overall dispatch reliability trending positively at above 98%. More work to do there for a number of customers, but good progress underway nonetheless. 787-9 flight testing and production are progressing well. And we now have rolled out our 6-9 from final assembly. We remained on track to deliver the first 787-9 to Air New Zealand around the middle of this year.

In the Single-Aisle segment airplane interest – airline interest I should say in our new fuel efficient 737 MAX remains high, cumulative orders have surpassed 1900 to-date. In April, we also delivered the first next generation 737 produced at the increased rate of 42 per month. And we're on-track to further increase 737 production to 47 per month in 2017.

Turning to Defense, Space & Security, The President's FY2015 budget request demonstrated solid support from major Boeing programs including KC-46 Tanker, V-22, Apache, Chinook, GMD, NASA's space launch system and commercial crew along with satellite programs including those in the proprietary area.

Well funding for the FAA team was not included in the budget request may be officials have identified additional Growler models as a top priority for funding consideration by Congress this year. Our FAA team, family provides exceptional value for customers with proven technology for needed missions at affordable costs.

We continue to work with Congress, the Navy and potential international customers to reiterate the aircrafts value proposition. International Defense, Space & Security business represented nearly 30% of BDS revenues during the quarter and remains at 35% of the BDS backlog as we continue to leverage our unique one Boeing global advantage.

We also continue to target organic growth through investments and technology and innovation in areas such as commercial derivatives, space, unmanned systems, intelligent surveillance and reconnaissance, cyber security and a few but critical future large-scale programs as identified as priorities by our customers like Long-Range Strike, new class and the T-X trainer.

The relative strength of our Defense, Space & Security business stems from a portfolio that is reliable, proven and is being delivered on budget and on schedule. Across the enterprise, we remain intensely focused on driving further efficiency, quality and productivity gains to improve program profitability and importantly to fund investment and future growth.

Our market-based affordability initiative within Defense, Space & Security as generated $4 billion of cost reductions over the past three years. And we are on plan to drive out another $2 billion in annual operating costs. We are also seeing early benefits from our partnering for success initiative with our suppliers with further improvements expected to materialize over the next few years as production ramp-ups on our new airplane programs occur.

Before I turn it over Greg. Let me comment briefly on the set of related developments in the first quarter that would materially improve our competitive position enhance workforce stability and reduce business risk for us and our customer. Following completion in January of a long-term contract expansion with our Machinists union in the specific North West we successfully negotiated long-term expansion with our Machinists in Saint Louis. These unprecedented agreements essentially ensure a decade of labor continuity for us at our customer.

With economics and productivity incentives that will improve our global competitiveness, A key feature in those agreements is retirement plan change, which we are also flowing across our non-union population. We started the year with approximately 15% of our workforce our modern define contribution pension plans. After and initial transition period we will now have about 80% of our workforce covered by defined contribution plans.

These changes are strategic and fundamental to the way we are structure in the company to reduce risk ensure the health of our balance sheet and enhance our competitive position, all well providing employees with attractive and competitive benefits and further driving long-term shareholder value.

Now over to Greg for our financial results and our updated guidance. Greg?

Greg Smith

Thanks Jim and good morning. Let's turn to Slide 4 and we will discuss our first quarter results. First quarter revenue increased 8% to $20.5 billion driven by strong commercial airplane deliveries. Core operating margins increased to 10.2% in the quarter primarily driven by solid productivity gains of both businesses and improved commercial delivery mix.

First quarter core earnings per share $1.76 was driven by higher commercial airplane volume and continued strong operating performance. Excluding the $0.19 of research and development tax credits we've receive in the first quarter last year EPS this quarter grew 14%.

At previously announced during the first quarter we recorded GAAP, non-cash pension curtailment charges of approximately $330 million associated with the announced move in the define benefit pension plans to define contribution plans for over a 100,000 of our employees.

These charges did not impact core earnings per share. And as Jim indicated we believe these pension changes in long-term labor agreements further de-risk our business and will improve the company's long-term competitiveness and further drive value for all of our stakeholders going forward.

Let's discuss commercial airplanes on Slide 5. For the first quarter our commercial airplane business increased revenue 19% to $12.7 billion on a 161 airplane deliveries and increased operating margins to 11.8%. Solid performance, higher volume and favorable delivery mix contributed for the strong operating margins in the quarter and our testament to our continued focused on efficiently executing or rate increases and driving productivity.

Commercial airplanes captured $14 billion of net orders during the quarter and backlog remains very strong at $374 billion and over 5100 aircraft equating to approximately seven years of airplane production. Gross inventory for the company included $36 billion related to the 787 program an increase during the first quarter of approximately $2.9 billion; this expected increase was primarily driven by higher planned inventory in support of the production rate increase to 10 per month and the introduction of the 787-9 program.

Included in the working process inventor are deferred production costs, for the first quarter 787 deferred production balance totaled $23.1 billion a $1.5 billion increase from the fourth quarter of last year. The $1.5 billion change in deferred production was driven by the plan transition to 10 per month rate, additional 787-9 in the production system and a one-time IAM contract extension payment.

Excluding the IAM payment a change in deferred production during the quarter was slightly lower than the first quarter level. Based on further production stability, plan contracted supplier step down pricing and continued overall productivity improvements, we expect a quarterly change in deferred production to decline in the second quarter.

We continue to expect 787 deferred production to peak at approximately $25 billion late this year and moderate at that level before beginning to decline shortly after we complete the transition of 12 per month production rate in 2016. We continue to see good progress in key operational performance indicators and unit costs as we further implement production efficiencies and stabilize the overall production system on the 787 program.

While introducing the 787-9 into the production system and increasing production rates by over 40% the teams continued to make good progress on reducing 787-8 unit cost by more than 15% and improved final assembly flow times by more than 10% in the last 12 months. More work to do, but the teams remain focused on improving productivity flow times and quality going forward.

We also continue to see good progress on the 787-9 where we've seen a 30% improvement in unit cost and flow times from the first to sixth aircraft to rollout the factor. We still have work ahead of us in the 787 program and anticipate continue improvement as we further stabilize at the 10 per month rate and increase 787-9 production. We also remain on track to deliver approximately 110 787s in 2014. Again, the team remains focused on execution and improving productivity on the program.

Let's turn now to Slide 6 to discuss Defense, Space & Security results. First quarter revenue at our Defense business was $7.6 billion and operating margins were 10.2%, largely driven by strong performance and delivery mix. Boeing military aircraft first quarter revenue declined to $3.5 billion reflecting F-15 development milestones achieved in the first quarter of last year.

Operating margins in 9.6% in the quarter were due to strong operating performance, which was offset by the first quarter of $48 million C-17 inventory related charge. Global services and support increased revenue 6% to $2.3 million and reported solid operating margins at 12.1%. Network & Space Systems reported revenue of $1.9 billion and generated operating margin in 9% in the quarter resulting from continued focus on execution and productivity. Defense, Space & Security reported a solid backlog of $66 billion, with 35% of our current backlog representing customers outside the United States.

Turning now to Slide 7. Boeing capital's net financing portfolio decline to $3.5 billion on run-off that exceeded new aircraft volume. Let's turn to cash flow now on Slide 8. Operating cash flow for the first quarter was $1.1 billion driven by solid operating performance and favorable timing of receipts and expenditures. With regards to capital deployment, we paid $540 million in dividends to shareholders, and repurchased 19.4 million shares or $2.5 billion in the first quarter. We continue to anticipate completing the remaining $8.3 billion of repurchase authorization over the next two years to three years. Returning cash to shareholders, along with continued investments to support future growth, remain a top priority for us.

Let's now move to cash and debt balances on Slide 9, we ended the quarter with $12 billion of cash and marketable securities. Our cash position continues to provide solid liquidity, and positions us well going forward. Turning now to Slide 10, and we'll discuss our outlook for 2014. We're reaffirming 2014 guidance for revenue, operating margins, deliveries and cash flow. And as a result of $150 million favorable IRS tax settlement we received early in the second quarter or increasing our core earnings per share guidance for 2014 by $0.15 to now be $7.15 per share to $7.35 per share.

GAAP earnings per share guidance is unchanged as the second quarter tax benefit offsets the first quarter pension curtailment charges I discussed earlier. So in summary, first quarter financial performance reflects the strength of our backlog, the strong demand for our products and services and our continued focus on driving productivity and execution through the entire enterprise. Furthermore is evident by our meaningful dividend increase in our higher share repurchase activity we continue to expect to deliver solid growth productivity and strong cash flows going forward.

So with that I'll turn it back over to Jim for some closing comments.

W. James McNerney

Thanks, Greg. With a strong first quarter behind us, we remained focused on disciplined execution, quality and productivity improvements and meeting customer commitments. Our priority is going forward remained clear, but profitable ramp-up and production of our commercial airplane programs, executing on our commercial and defense development programs driving productivity and affordability throughout the enterprise continuing to strengthen and position our Defense business with investments and growth areas a mid further international expansion and importantly providing increasing value to both our customers and shareholders.

Now we would be happy to take your questions.

Question-and-Answer Session

Operator

(Operator Instructions) First we’ve got Rob Spingarn from Credit Suisse. Please go ahead.

Rob Spingarn – Credit Suisse

Good morning.

W. James McNerney

Morning.

Greg Smith

Morning.

Rob Spingarn – Credit Suisse

A question for Greg on the 787 and the deferred. You talked about the delta from last quarter and we should pull out the $300 million from the IAM. So, thinking about the $2 billion of headroom left to the peak of $25 billion, it sounds Greg like year-end is the time for that. Should we consider a curve perhaps incremental drop of about $1 billion maybe $6.50 million and $3.50 million declining like that to get to that target is that the right way to think about it or is it steeper or flatter? Than that?

Greg Smith

Yes. I mean just to point of clarity, Rob, not all the $300 million hits the 787 that was for all IAM members including folks that are on the 787 program, but I think as you think about deferred going forward as I mentioned in my remarks, we've got some quarter-over-quarter some step down pricing that we have with our supply chain that's already contracted and at the same time continuing to make progress on unit cost and productivity and I mentioned that the progress that's been made up to now.

And I'll tell you there's a lot obviously in work around ahead of improved slow, ahead of improved productivity and just like I think it will be go back in time when we stabilized rate on any program that's were the team to really been able to capture productivity and that's expected here. So quarter-over-quarter we are going to as I said we will see improvement coming of this quarter into second quarter and we still again expect to peek at about $25 billion.

And then you know it will hold flat as I mentioned before relatively flat and then once we hit a 12 a month as where you will start to see as burning that of. So we got to stay focused on productivity we got to stay focused on deliveries as we have and stay focused on rate readiness get into 12 a month. So across the board you know teams to in a very good job staying focusing on those elements…

Rob Spingarn – Credit Suisse

So Greg just to clarify how would we think about the Delta just on 787 deferred when we factor in the IAM what piece was for that?

Greg Smith

It's about $75 million.

Rob Spingarn – Credit Suisse

Okay thank you.

W. James McNerney

You're welcome.

Operator

Our next question is from Cai von Rumohr with Cowen & Company. Please go ahead.

Cai von Rumohr – Cowen & Co. LLC

Yes, thank you very much.

W. James McNerney

Good morning Cai.

Cai von Rumohr – Cowen & Co. LLC

So dig in a little bit on the 787 could you give us some color on how you spend on the Charleston mid-fuselage issue or the Charles behind down, Mitsubishi weighing crack issue and then perhaps give us some color on when we should expect a step down pricing just start to kick in and which quarter?

W. James McNerney

Yes, sure Cai. Let me address the jobs for so as you know we could a very concentrated effort into Charleston to focus on in particularly in the midbody and the teams making good progress. So they have burned down a significant amount of job still some work to do, but making tremendous progress and I certainly don't see any impact on our delivery guidance for the year as a result to that, so right focused, the right people making good progress.

On MHI were essentially through all the MHI rework as of last night we have three airplanes left to go and again the teams executed that flawlessly and met all the requirements there is so I would say that that behind us at this point. So, all of that, again playing rate into the deferred production and improvement that were expecting in unit cost. On the step down we will start to see some of that in the next quarter. As we introduce the next block. So you will start to see that and obviously expect to see that through the balance of the year.

Cai von Rumohr – Cowen & Co. LLC

Thank you. Should we be concerned that you only done one 787 delivery so far in April?

W. James McNerney

No, I think I mentioned before month-to-month you are going to see variance and deliveries certainly what you just describe had an initial impact on specific timing and at the same time we are introduce in the airplanes to 18 new customers this year. So you are going to see a change in cadence month-over-month, but like I said when you look at tail number by tail number through the balance of the year we are comfortable that we can get to the 110 deliveries.

Cai von Rumohr – Cowen & Co. LLC

Thank you.

W. James McNerney

You are welcome.

Operator

Our next is from Doug Harned with Sanford Bernstein. Please go ahead.

Doug Stuart Harned – Sanford C. Bernstein & Co. LLC

Good morning.

W. James McNerney

Good morning Doug.

Greg Smith

Good morning.

Doug Stuart Harned – Sanford C. Bernstein & Co. LLC

You talked about 777X transition and I would assume at this point you have a good sense of 777 demand later in the decade as you are working through a lot of the negotiations on combined orders for 300ERs and 777Xs, but do you expect to be able to maintain 300ER production rates through the decade, I mean could you describe your strategy just for the bridge and potentially any need you may have for discounting given the large production quantities that are planned for the A350, the A7 and potentially the A330.

Greg Smith

Doug, I'll take that one. I think the – based on the data we see, we do have high confidence in being able to maintain production rates up until the introduction of the 777X, there will obviously be some feathering in at the transition pint itself, but by and large maintaining production rates. Where do we get that confidence, its in airplanes sold to-date, its in proposals accepted, its in campaigns that are ongoing today where as in the case of A&A we are selling both 777-300ERs as well as the new Xs, the requirement versus the alternatives still is favorable.

I think you are right, there will be some pricing pressures associated with that that we've anticipated and the way we look at this, which is why the most aggressive productivity program we have right now in our factories is on the 777 model to offset that and more, but its – you have to remember the plane that essentially replaces the 777-300ER will be introduced after the first 777X.

The first 777X is a 467 passenger model, the 8X which will be the one that directly replaces the 300ER wont come for a couple of years after that. So there is plenty of running room where they can reap the economics of the base 777 in conjunction with buying 777Xs, so it looks good as we talk to our customers and we do have a high degree of confidence in being able to do it.

Doug Stuart Harned – Sanford C. Bernstein & Co. LLC

So when you look at 2017 when things start to fall off at least when we look at firm orders, are you already pretty comfortable with the discussions you're having that you can go out into 2018, for example, maybe even a little longer and keep this up?

Greg Smith

Yes, I mean the pipeline gives us comfort and these are real discussions with – you have to remember the 777 customer base is one of the biggest and most loyal customer bases that we have. So this is not discussions that are just happening in a vacuum, these are with people who have both additional 777 needs in the medium term and then longer term would need the new model to significantly increase performance and productivity for themselves and there's a large overhang of options, there's a large overhang of other forms of commitments that give us comfort that this will happen and there is almost 10 years from now until when the replacement model will be introduced so there's plenty of time to garner the economics of the base of 777.

Doug Stuart Harned – Sanford C. Bernstein & Co. LLC

Okay, very good. Thank you.

Greg Smith

Yep, you are welcome.

Operator

And next going to Joe Nadol with J.P. Morgan. Please go ahead.

Joseph B. Nadol – J.P. Morgan

Good morning.

Greg Smith

Good morning.

W. James McNerney

Good morning Joe.

Joseph B. Nadol – J.P. Morgan

Just on the back to the 787 thinking through the next couple of years, your rate is going to be flat at 10 a month. You're going to have a mixed shift though from Dash 8 to Dash 9. And so Dash 8s are actually going to come down in rate, while the Dash 9s are coming up. Your margins are higher right now, your cash burn is lower per unit by far on Dash 8s, but there is a lot of moving parts here as we think about the deferred profile.

W. James McNerney

Yes.

Joseph B. Nadol – J.P. Morgan

The question is, when – on the Dash 9 when do the margins or the cash, the unit margins on Dash 9s get better than they are in Dash 8?

Greg Smith

Well, certainly when you look at the mix there is still going to be a lot of Dash 8s and that will be in the predominance of the deliveries for the next – a little while here, next couple of years, really, they will still be dominated by Dash 8s. So, we're obviously still expecting improvement on the Dash 9 and as I mentioned, Joe even on the first six units we're seeing the unit costs coming down.

So, we've anticipated that in the current booking rates, but I think mix really starts to come into play when you get much further out in the blocks and when you see the mix of Dash 10, Dash 9 and Dash 8s in there. I think you're still going to see some as we move further into the skyline you're going to see more people converting from Dash 8 to Dash 9 and potentially Dash 9 to Dash 10 just because of it fulfills their mission more efficiently so that mix will impact later in the block the near-term.

Joseph B. Nadol- J.P. Morgan

Can you compare the Dash 9 to the Dash 9 in terms of just early learning here what you're seeing? I mean you have given us a few different numbers, but it's hard to string them all together. Just compare and contrast a little bit?

Greg Smith

Yes. I mean it's very hard obviously to compare the Dash 8s to the first Dash 9s considering where we are, but I would say they are coming down the learning curve as we would expect them to, so I think they are making good progress. At the same time, they are incorporating production efficiencies that we've realized on the Dash 8, they're getting into the Dash 9 and also working anywhere were they had opportunity to work any commonality on manufacturing processes and so on. So again, hard to compare tail number to tail number at this point, because it's so early on the program, but we're seeing the improvements that we would expect there, we've certainly got more work to do, but off to a good start.

Joseph B. Nadol- J.P. Morgan

Thank you.

Greg Smith

You are welcome.

Operator

We will go to Carter Copeland with Barclays. Please go ahead.

Carter Copeland – Barclays Capital, Inc.

Hey, good morning, guys.

Greg Smith

Good morning.

W. James McNerney

Hey carter.

Carter Copeland – Barclays Capital, Inc.

Just a quick clarification on a disclosure and a question. Greg, with respect to the Universe's program differences which were 1.8 versus the 1.5 in deferred production on the 87, I wondered if you could tell us what program that pertain to? And then additionally a question, I just wanted to address kind of BCA absolute profit dollars and the guidance, it looks like if you look at what you did in the – profit in the first quarter and were the guidance is for BCA for the year in absolute dollars.

On a kind of run rate basis, it would imply the profit is down and the remaining three quarters just by the fact that the deliveries will be up and even on some profitable platforms like the 37 not just the 87. So I wondered if you could help reconcile that and tell us how to think about what might be driving that or whether you got some conservatism there.

Greg Smith

Sure. to start with first – on the Universe's program almost 85% of that was 787, so as you look at it Carter, you will see unit improvement quarter-over-quarter there and I always got to caution you that may not be the case every time because of the mix of deliveries through EMC, Charleston and Dash 9s now and Everett, but again we're seen in the right level of improvement unit-over-unit there, so continue to focus in that area.

On the guidance, certainly off to a good start early, there's a lot of things obviously we've got to work through the balance of the year. I think we've got good plans in place to do that. We are making in some investments, continuing to make investments in efficiency and the production system, so you'll see some of those investments be hitting more later in the year that we will certainly benefit from years to come. That we don't have early on. And then some mix in volumes differences between what were see in the service business in the first quarter through the balance.

So we are going to continue to focus on execution, continue to focus on productivity and if we continue to do that will update you going forward, but we are obviously focused on like I said those basic elements to continue to drive the production system and capture as much should be efficiency as we can.

Carter Copeland – Barclays Capital, Inc.

On that unit versus program number there wasn't a negative delta of any significance for any of the other programs? – See more at:

W. James McNerney

No.

Carter Copeland – Barclays Capital, Inc.

Okay, thank you.

W. James McNerney

You're welcome.

Operator

Our next question is from Sam pearlstein with Well Fargo. Please go ahead.

Samuel J. Pearlstein – Wells Fargo Securities, LLC,

Good morning.

W. James McNerney

Good morning.

Samuel J. Pearlstein – Wells Fargo Securities, LLC,

Good morning. If I look, it looks like starting in 2014 a significant portion of long-term incentive comp now seems to be tied directly to total shareholder return. I'm just trying to think about what does that make you do differently? How does that make you think about M&A, the returning 80%, 85% of cash to shareholders, and even dipping further into the cash balance? How do you get that stock to move the way you want it?

W. James McNerney

Well, I don't see incentive program well is designed to change behavior I think is design to reinforce today that I think we have been talking about which is the balance innovation productivity customer satisfaction and shareholder returns. I mean its and I wouldn't characterize it has a seismic shift in our program we moved more of it toward what you would refer to its performance based if there is a TSR measurement that keeps us focused on relative stock price which sort of the question of all of those things. And so we are just trying to tighten up and focus our management on the things that are important. We are not trying to say different things are important.

Samuel J. Pearlstein – Wells Fargo Securities, LLC,

And if I can follow that up, based on your buyback pace in the first quarter, it seems like with the dividend you'll already have returned 85% of your free cash this year to shareholders. Can we expect to see that going up?.

W. James McNerney

Yes, yes, I would say we are committed to deploying our cash efficiently and obviously up to a strong start in the first quarter. We had 8.3 billion still under authorization that we planned use over the next two to three years, so we will continue to focus in that area.

Samuel J. Pearlstein – Wells Fargo Securities, LLC,

Great thanks.

W. James McNerney

Welcome.

Operator

Our next question is from Howard Rubel with Jefferies. Please go ahead.

Howard A. Rubel – Jefferies LLC

Thank you very much, I have a two part question, may half for Jim and half for Greg. To go back to end of your opening comments about improved labor stability and more manageable benefit cost going forward. How does that cause you to think about make versus buy, comparing market based rates versus what you can potentially do internally and then I have a follow-up to that?

Greg Smith

Well I'll swing at that one Howard, I mean I think it's a very important point, you are raising with that question. I think we have a highly valued workforce a number of whom are unionized; we now have a much more stable visible set of outcomes in front of us with them. And which I do think coming out of an era where we may have on the margin relied too much on some outside work, I think this gives us the option where its smart to do some of the work inside and I'm not trying to acquire big seismic shift.

I'm trying to say it gives us the option and given that it's a highly valued workforce that has some new economics associated with it which is what we accomplished with the agreements, I think it gives us the option to use the best mix of inside outside toward the end of the delivering reliably on-time highly valued products to our customers. So I think its another arrow in the quiver as we strive to remain the world's best aerospace company.

Howard A. Rubel – Jefferies LLC

And then to follow that up, I mean if I add back R&D in the quarter to the operating margins at commercial and compare it with the year ago and maybe even adjust for 78 deliveries where there were 18 versus one. You are on the order of almost 500 basis point improvement in profitability Greg, I mean is there one or two things that you can point to, I mean this did absorb some of the changes in the benefit class, so it’s a pretty notable statement.

Greg Smith

Yes, Howard I would say predominantly improved performance on 737 and 777. I would say were the biggest drivers in there, but as I mentioned earlier and Jim has mentioned many times we're really focused on productivity across all cost elements, certainly continue to work partnering for success, but at but at the same time challenging our sales internally on any – all forms of costs, period costs, productivity and the 777 is a great example right 8,000 airplanes, best selling aircraft ever and we’re still able to capture additional productivity gains there and so it's a great testament to the team's focus on that, and that's really where you're seeing the improvement and obviously we’re trying – we are staying focused on that to continue to improve that going forward on all programs.

Howard A. Rubel – Jefferies LLC

Thank you, gentlemen.

Greg Smith

You’re welcome.

W. James McNerney

Thank you.

Operator

Next we go to Ron Epstein with Bank of America Merrill Lynch. Please go ahead.

Ron Epstein – Bank of America Merrill Lynch

Yes hey, Good morning.

W. James McNerney

Good morning Ron.

Ron Epstein – Bank of America Merrill Lynch

Maybe just changing gears a little bit to the military side of the business. When you think about the BMA portfolio and South Korea's decision, and then the Brazilians’ decision to buy the Gripen, C-17 winding down, you've got Tanker, you've got P-8. Jim can you tell us maybe what's your broad strategy on a portfolio and how do you sustain it? I mean I hear you that the Navy wants some F-18G to get put back in the budget. And that probably will, would be my guess, but it's a fight now right, I mean it seems like it's a bigger fight now to keep those programs alive than it was before and how do you think about that down the road?

W. James McNerney

Yes, I mean there is no question that the budget discussion is getting more difficult and so every program is fighting for inclusion. We're fortunate that a lot of our programs are in the budget come hell or high water, but you do point out correctly that there are some moving pieces that we're going to have to manage and I suspect that they F-18 will – that F-18 line will remain open due to some possible orders from U.S. Government, which you characterize as probable, I would tend to agree, but we'll see.

There's a number of International campaigns that will supplement that but C-17 is going away, Tanker and P-8 will more than replace the C-17 when you look at the longer-term and there are some other big programs that are high priority for our country Long-Range Strike, UCLASS, T-X Trainer that I think will survive any budget scenario and Boeing is very well positioned on all three of those, will we win all three of them, hard to predict, but winning one or two of them keeps the business intact and the industrial base intact even in a scenario where the fighters are winding down.

Remember the helos [ph] are growing and high demand around the world, the satellites are growing in high demand around the world, space is growing, we've got the major program there on SLS. So the core is growing, the stuff that's immediately going away is being replaced by more than it represents today and the longer-range programs a betting man would say will more than replace some of the tactical air pressure that we would see in the medium-term. So whole equations near-term flat, longer-term slow growth and very responsible management of margins all the way along that's the role of that business in our portfolio.

Ron Epstein – Bank of America Merrill Lynch

May I ask a follow on to that?

W. James McNerney

Sure.

Ron Epstein – Bank of America Merrill Lynch

Yes. So when think about that business are there any – when we think about capital deployment, I mean are there sort of anything in that military portfolio or area in that luxury portfolio that you would like to add onto from an M&A perspective maybe bolt-ons or when you think about capital deployment into the military business how do you think about it and about investing in growth?

W. James McNerney

I think about it in two dimensions, smaller bolt on deals that provide vertical strength and that's ISR, that's cyber, that's all the things that make platforms strong or make networks more secure. There are either part of the platform we sell or something we can sell on its own, the vertical strength and then services capability. We have by far the largest base out there as you know; we've heard me say it, we have a very large services business.

I think the services business can even get bigger and of course International you don't leave International out of the discussion, because Boeing has a unique advantage, we have a unique industrial base and engineering base around the world and affiliations, because of our commercial business, which is a leverageable thing when we start offset programs in support of military business. So those capital in support of those initiatives on top of what I mentioned before which is more of a portfolio of products I think those are the strategies that will sustain this business and enable us to sustain margins and a slow growth environment.

Ron Epstein – Bank of America Merrill Lynch

Okay thank you.

W. James McNerney

Yes.

Operator

Our next question from John Godyn with Morgan Stanley. Please go ahead.

John D. Godyn – Morgan Stanley & Co.

Great, thank you for taking my question. I was hoping the team could give an update on partnering for success. I think the analyst community realizes this is a big opportunity but has a lot of trouble translating it into the model. Is there anything that you could offer in terms of the percentage of contracts that have been successfully negotiated? Have they been negotiated on track what on track means in any other granularity you are willing to offer?

W. James McNerney

Yes, I mean again our assumption is a more for less world over the next couple of decades. Okay and the partnering for success program offers a win-win to the suppliers that we do business with and the – and as I characterize before we are in the early innings of this game and I would say 25% to 30% of our base has reach some form agreement with us on how do go forward I would say another third we are in deep discussion we are close to coming to some agreements, which are characterize by mutual benefit.

I mean this is not just we want share margin and be nice to us from that this is a broader business arrangement that does reflect the more for less world that I see out in front of Boeing. And so these arrangements often do have price reduction associated with a significant price reduction associated with, but also have benefits to our partners.

And so its we have already baked in substantial money into our EACs based on the agreements we've reached so far. Now look this is a pure gravy, I mean this the reason we are doing this as we have world out there is putting pressure on us that is putting cash pressure on us. And we are trying to respond to that. And so you see our margins sort of steadily improving that remains our objective.

And by the way we are working as hard in our internal costs if not harder then we are working on costs in our supply base I mean I feel quite proud and incredible standing in front of the supply base and telling them that I expect the same from them that I'm expecting from my team and so this is not a zero sum game, this is a how do we win together game and the – you will – the financial impact of improvement we make in our business relationships, we'll be seeing will increase overtime over the next decade, because a lot of these arrangements involve technology and procurement or things that will flow out and are growing over the next decade, that's when you will begin to see the impact, but its already in the order of billion of dollars over a medium and long-term and there is more where that came from.

John D. Godyn – Morgan Stanley & Co.

Its very thorough, very helpful. Thank you.

Greg Smith

You are welcome.

W. James McNerney

Operator we have time for one more question.

Operator

And that will be Jason Gursky with Citi. Please go ahead.

Jason M. Gursky – Citigroup Global Markets Inc.

Good morning everyone. Greg I just wanted to ask you a quick question on the outlook in one of the BDS business is global services and support.

Greg Smith

Yes.

Jason M. Gursky – Citigroup Global Markets Inc.

You had nice margin performance there for the last several years and yet what you are suggesting over the next couple of quarters is a deceleration in the margin outlook. I was wondering if you could just talk a little bit about the dynamic that might be going on there to help us understand why we would see a deceleration throughputs there.

Greg Smith

Yes. Well I mean Jason as you know especially when it comes to services and the thousands of contracts that exist any services organization mix really comes into play here. So we are not anticipating any performance derogation at all, its just purely mix quarter-over-quarter or through the balance of the year that is driving that but at the same time very focused on performance.

There is no question there is EOD budget pressure that's out there that we continue to face day-in and day-out and manage our way through that but again the team is focused on executing flawlessly on the contracts they have and focused on productivity through the partnering for success and the market based affordability initiatives that Jim described. So I wouldn't read anymore into that other than what I just described.

Jason M. Gursky – Citigroup Global Markets Inc.

Okay, that's helpful. Thank you.

Greg Smith

You are welcome.

Operator

Ladies and gentlemen 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 and Corporate Communications. Please go ahead.

Thomas J. Downey

Thank you, we will continue with the questions for Jim and Greg, if you have any questions following this part of the session, 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

And we'll go to Alwyn Scott with Reuters. Please go ahead. And they have dropped out of queue. We'll go to Jon Ostrower with Wall Street Journal. Please go ahead.

Jon Ostrower – Wall Street Journal

Hey, Good morning guys

W. James McNerney

Good morning, Jon.

Greg Smith

Good morning.

Jon Ostrower – Wall Street Journal

Just a follow-on question about partnering for success so you had last September announced the Heroux-Devtek order for the 777X landing gear. That seems to be reflective of a few change in how Boeing was communicating about partner for success as far as its seriousness with the supply chain that this effort was going to continue whether they were on board were not.

As you kind of look at the current state of both side your supplier management organization with a new leader there and also getting companies like spirit to form up a final long-term contract as well as the absence of time with the Japanese as far as their role in 777X. How do you see the relationship with those key players moving forward in the context of partnering for success and whether or not there is room to be essentially maneuvered to get the kind of cost-cutting that you guys are looking for on both sides?

W. James McNerney

I think I would characterize the progress is good so far. I think we're finding yields that have mutual benefit, significant benefit for our customers and as well as benefit for our partners and it sometimes takes time to find that – to find those deals as you've noted there's been a couple of events along the way that to reflect the seriousness of the discussions, but we're making good progress and the benefit – the beneficiary of progress here will be the customers of the Boeing and the employees of Boeing.

Because it's going to create a stronger company and, so I feel good about the progress while still at the same time recognizing that the discussions are not always easy. They are difficult, but Boeing's the ultimate strength we have here is that Boeing's perspective success is some based on our product lines and are people something that people want to be part of and so ultimately that what's bringing people together.

Operator

Next we'll go to Julie Johnsson with Bloomberg. Please go ahead.

Julie Johnsson – Bloomberg LP

Hi Jim.

W. James McNerney

Good morning.

Julie Johnsson – Bloomberg LP

Quick question, I'm just wondering if you could walk us through a little bit you're thinking on how to approach Russia and Ukraine what Boeing's exposure is at this point? And if you see any risk to deliveries or titanium this year?

Greg Smith

Yes. I mean the managing a global supply chain is chain is what we do, its what we do every day and there are potential disruptions in many places around the world. Right now everybody is focused on Russia as we are and we have good contingency plans in place if some unlikely but possible outcomes occur there.

Operator

And well to Alwyn Scott with Reuters. Please go ahead.

Alwyn Scott – Thomson Reuters Corp

Hi, thanks. Can you hear me all right?

Greg Smith

Yes, yes we can hear you. Go ahead.

Alwyn Scott – Thomson Reuters Corp

Okay, I tried to pick up my handset last time, so apologizes.

Greg Smith

Coming through loud and clear.

Alwyn Scott – Thomson Reuters Corp

Okay. I wondered if you could talk about how does this effort to move engineering talent around help you. And don't you need your engineers in the place where the products are built in order to have the best efficiency there? So, how is moving them more efficient? And, also, don't you risk losing engineers in Washington, say, by these kinds of moves? Those are concerns obviously that have been raised locally in Washington state, and I just wanted to hear how you might address that.

Greg Smith

Yes. I mean I think there is – the fundamental principle here is as the world's largest aerospace company that has been put together out of the path of a number of different – a number of different acquisitions over the years. We have engineering talent around the company that is extraordinary. And where we place work there is tension between engineering work being done right next to the product on one hand and on the other doing it in the place that has the best engineers for the task at hand or so-called centers of excellence and there will always be a balance there.

And what we're trying is achieve the right balance between centers of excellence and proximity that leaves us with the strongest company that will take us from $50 billion in sales we were a decade ago to numbers that are much bigger than that that we're headed towards and so it's an equation we're balancing all the time and what I do know is it will mean that we will not only be St. Louis centric for certain kinds of engineers or Seattle centric for other kinds f engineers or Huntsville centric for other kinds of engineers, it will be a blend all in the name of creating the strongest possible Boeing.

Operator

Our next question is from Dominic Gates, The Seattle Times. Please go ahead.

Dominic Gates – The Seattle Times

Good morning Jim.

W. James McNerney

Hi, Dominic.

Dominic Gates – The Seattle Times

Hi, I actually like to follow up on Al's question.

W. James McNerney

Sure.

Dominic Gates – The Seattle Times

About the transfer of engineering work because it is top of mind with people here. If we look at something like BR&T shift to St. Louis, Charleston, Huntsville out of Puget Sound, whatever the business and strategic rational it seems like there are two possible negative impacts.

One is that there is because the growth elsewhere is less than the job eliminated here there is a net reduction and engineering positions. And then secondly, there is a terrible hit the morale among engineers here not just the ones who are not tagged for moving but everybody else here. So are you – how do you address this concern about losing capability and hit to morale among your workforce here.

W. James McNerney

Well, in the mines of most of us, these moves strength in our company. Strength in our engineering capability these are not designed in anyway say perform to week in our company is this pension between proximity and centers of excellence that I mentioned in answering Al's question that were trying to balance.

Listen I realize that moving work around a very large corporation can be controversial at the local level, I understand that and its but I think we eventually have to come together as a team and keep making progress this company is making progress and I think as we see further success in the future we will fight through the dislocations that happen not only in Seattle but in a lot of other places around Boeing as we try to optimize the right work placement for our engineering capability. So we will keep working it.

Operator

Next go to Steve Wilhelm with Puget Sound Business Journal. Please go ahead.

Steve Wilhelm – Puget Sound Business Journal

Hi, Jim thanks for taking this one.

W. James McNerney

Sure.

Steve Wilhelm – Puget Sound Business Journal

I wonder if you could talk a little bit about in terms of the 777X assembly. What kind of robotization in automation are you planning both in terms of the wing assembly but also final assembly and how that going to look different from the current system.

W. James McNerney

We are always trying to move improve our manufacturing processes and a lot of our advance work is looking at some different forms of automation and we have not yet made the decision which specifically to deploy where and when, but you will continue to see us make progress on productivity and automation beyond where we are today will play a role and it's very important that we do that to maintain our competitiveness.

Thomas J. Downey

Operator we have time for one last question from the media.

Operator

And that will be Dan Catchpole with Herald. Please go ahead.

Dan Catchpole – Herald Writer

Hi, good morning.

Greg Smith

Good morning.

Dan Catchpole – Herald Writer

I was wondering if you could talk about the water quality rule that Washington is considering the company has raised its concerns with the dates that could affect company's future in the state. I was wondering if you could put any final point on that and give us an idea of what your concerns are about some of the possible unintended consequences of a stricter rule.

Greg Smith

Listen I think this is one where we have been working very closely with the legislative and political leadership in the state of Washington, we are very sensitive to both sides of this question, obviously we want to find our way though this issue in a way that allows us to keep developing and manufacturing the world's best airplanes, but still be sensitive to some of the local sensitives. I'm highly confident that we can find a solution here.