Operator

Thank you for standing by. Good day, everyone, and welcome to the Boeing Company's Fourth Quarter and Full Year 2011 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'm turning the call over to Mr. Scott Fitterer, Vice President of Investor Relations for the Boeing Company. Mr. Fitterer, please go ahead.

Scott Fitterer

Thank you, and good morning. Welcome to Boeing's Fourth Quarter and Full Year 2011 Earnings Call. I'm Scott Fitterer and with me today are Jim McNerney, Boeing's Chairman, President and Chief Executive Officer; and Greg Smith, Boeing's Chief Financial Officer Elect.

After comments by Jim and Greg, we'll 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 our press release issued earlier today. And as a reminder, you can follow today's broadcast and slide presentation through our website at boeing.com.

Before we begin, I need to remind you that any projections and goals we may include in our discussions this morning are likely to involve risks, which are detailed in our news release and our various SEC filings and in the forward-looking disclaimers at the end of the web presentation.

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

W. James McNerney

Thanks, Scott, and good morning, everybody. I'll begin with a few brief comments on the business environment, followed by some thoughts on our strong performance during 2011. After that, Greg will walk through our financial results and our 2012 outlook. And then we'd be glad, as always, to take your questions.

Starting with the business environment on Slide 2. While global economic growth slowed during 2011, air transportation remained notably resilient on balance, adjusting to various regional economic impacts throughout the year. Passenger traffic grew at a pace slightly above the long-term average, while cargo traffic was flat for the year and even saw declines in recent months. With load factors at record highs and utilization rates near prior peak levels, we expect passenger growth rates to remain in line with historical trends during 2012.

Growth in cargo traffic is expected to trend below the historical average, although we expect to see improvement in the second half of this year. Emerging markets continue to fuel worldwide airline fleet expansion. Demand in developed markets also remains high, driven by retirement and replacement of older, less efficient airplanes.

The combination of strong demand and our customer-preferred line of more fuel-efficient products and services generated orders in 2011 that significantly exceeded our initial expectations. Our orders were balanced across programs, geographic regions and airplane business models.

Twin-aisle demand was exceptionally strong, with the 777 reaffirming its market leadership with a record 200 net orders across both passenger and freighter models. The 767 program also had a big year, extending its production well into the next decade with the U.S. Air Force tanker contract and signing an important order for new freighters with FedEx.

On the single-aisle side, we capped the year and a series of major wins with our largest Commercial Airplane order ever: the $19 billion deal with Southwest Airlines for 208 737NG and MAX airplanes.

Customer response to the 737 MAX accelerated rapidly through the fall, and orders and commitments now total more than 1,000 airplanes from 15 customers. We anticipate finalizing most of these arrangements this year.

The rapid uptake on the MAX since its August launch has validated our decision to address this important market segment with the solution our customers want along with the time line they need, and an airplane that maintains a sizeable economic advantage over its competitors.

With $75 billion in new orders for the year, Commercial Airplanes' backlog grew by $40 billion to a record $296 billion, further solidifying the unprecedented growth opportunity we have in front of us. While we continue to monitor the European debt crisis, we foresee a manageable situation for aircraft financing in 2012. Boeing airplanes are attractive, value-creating assets, and sources of financing for them remain broad and diverse.

Turning to Defense, Space & Security. Despite growing constraints on U.S. government spending plans, we were pleased with the results of the fiscal year 2012 budget process and the level of funding approved for Boeing programs. Our portfolio of proven, affordable and reliable systems and services continues to advantage us in U.S. and international markets.

While tough contracting conditions and flat to declining budgets will continue to characterize the U.S. defense budget -- the U.S. defense market, we foresee significant upside potential in international markets, which we expect will generate 25% to 30% of revenues within just a few years and offer an opportunity to offset domestic reductions.

Our core strategies for Defense, Space & Security are as I've described them before: extend our existing programs by bringing capability and affordability to our customers; capture a growing share of international opportunities; and continue investments in expanding target markets such as unmanned systems, cybersecurity and intelligence, surveillance and reconnaissance. These strategies along with a relentless effort to maximize efficiencies and reduce infrastructure costs in support of the Defense Department's affordability initiatives will ensure continued success in the current environment and maintain our ability to invest in the future and respond to customer needs.

In summary, despite pockets of economic uncertainty and defense budget pressures, our markets remain large and growing in the aggregate. We are exceptionally well positioned for growth in the expanding commercial airplane market, and we are taking the right steps to maintain a competitive advantage in our Defense, Space & Security segment.

Turning to the fourth quarter and overall 2011 highlights on Slide 3. 2011 was a pivotal year for our company where we made substantial progress on our business strategies and delivered strong operating performance across our core production and services programs. Commercial Airplanes generated 9.7% margins, delivered 477 airplanes and recorded net orders for 805 airplanes.

It also retired key technical and business risks for the certification and initial deliveries of the 787 and 747-8. It was a long, tough road on both of those programs, but we got there. And thanks to the relentless determination and ingenuity of our people and the support of our program partners, we have created 2 new airplanes that will deliver significant value to our customers and company for decades to come.

The 787s in service with launch customer ANA are performing well, with high dispatch liability rates and a favorable passenger response to the features and capabilities of the airplane. Our priority on the 787 now is to ensure a disciplined ramp-up in production and to increase deliveries to our consumers. Although we fell short of our targeted 87 deliveries for 2011, transition to a production rate of 2.5 per month has been successfully implemented. Condition of assembly is improving with each airplane, and we are closely monitoring the entire supply chain to ensure operational stability as we systematically ramp up to higher rates. We plan to complete the next production system rate increase to 3.5 airplanes per month in the second quarter, tracking as expected to the planned 10 per month production rate and final assembly by late 2013.

With the airplane design stabilized and out-of-sequence work being reduced as planned, we expect change incorporation requirements to decrease progressively with each airplane moving through production in the first half of the year. The first non-change incorporation airplane will be a line number in the mid-60s coming out of the factory this summer.

Final assembly of the first 787 built in South Carolina also is progressing to plan, with weight on wheels achieved in December. First delivery from our new customer delivery center in Charleston is expected mid-year.

The first 787 powered by GE engines is on track to deliver later this quarter. We also continue to make steady progress on 787-9 development, with first flight scheduled for 2013 in support of the first customer delivery in early 2014.

Moving to the 747-8 program. During the fourth quarter, we delivered 9 747-8 freighters to 3 customers. The airplane is performing well in revenue service. In December, the intercontinental passenger model received its type certification and is scheduled for first delivery later this quarter. Production system rate increases on the 747 are underway and also tracking to plan.

In addition to managing to ramp-ups on the 87 and the 47-8, we continue to implement planned production rate increases on both the 737 and 777 in order to meet market demand. The 737 program has successfully increased its production rate to 35 airplanes per month, with the next planned increase to 38 per month in the second quarter of 2013, and then up to 42 per month in the first half of 2014.

The 777 has successfully increased rate to 7 airplanes per month, with the next planned increased to 8.3 per month in the first quarter of 2013. The value created by these 2 franchise programs is substantial and will continue to grow as rates increase.

We are working closely with our supplier partners to execute all planned rate increases efficiently and effectively. Over the next 3 years, our overall Commercial Airplane output will rise by more than 40%.

In December, we retired significant risk to our production rate ramp-up and growth plans when we reached an early 4-year contract extension with our machinist union in Puget Sound. This landmark agreement secures delivery stability for our customers and contains economics that make us more competitive. Engaging early was the right thing to do, and we were very pleased with the outcome.

Shifting to Defense, Space & Security. Despite a very tough environment, solid operating performance for 2011 generated 9.9% margins as we delivered 115 aircraft, 4 satellites and many other systems and services. Key deliveries for the year included the introduction of the next-generation Apache Block III helicopter, delivery of the first 2 Korean AEW&C aircraft and the final delivery of the Italian tanker.

Equally impressive for Defense, Space & Security in 2011 was a series of strategic wins of new business, starting with the Air Force Tanker Program. This win preserved our 50-year franchise as the provider of aerial refuelers to the United States military, and it opens the door to sizeable international opportunities. The program is progressing to plan with every program milestone met on schedule.

The second big strategic win was the agreement reached between the U.S. government and Saudi Arabia for the purchase of 84 new F-15 aircraft and upgrades to 70 existing aircraft. This purchase will extend the F-15 line into the second half of this decade and position it well for additional international sales.

Other major BDS awards for 2011 include: the Ground-based Midcourse Defense development sustainment contract from the U.S. Missile Defense Agency, a low-rate initial production contract for 13 P-8A Poseidons for the U.S. Navy, a U.K. Ministry of Defense order for 14 new Chinooks, a 5-year C-17 sustainment contract with the U.S. Air Force, and an initial contract for NASA's new Space Launch System.

Looking back at 2011, I think it would be tough to find another year that included such a broad-based set of achievements. We advanced the product and business strategies that are critical to our future, and we are a stronger, more competitive company as a result.

As we begin 2012, I am confident that our strategies and plans are aligned to the changing business environment, and that our focus on disciplined execution of our backlog will result in substantial growth in the years ahead.

At this point, I'd like to take just one more moment to recognize the big fella, James Bell, for his extraordinary service to Boeing. As you are all aware by now, James will retire at the end of the quarter after 40 years with our company. As CFO, he created a world-class finance organization and a culture of continuous improvement. He is an extraordinary leader and business partner, and his contributions over the years will have a lasting impact. We all thank him and wish him the best of luck and continued success in all that he does.

And with that, I want to welcome Greg Smith to his first call as our new CFO. Many of you already know Greg from prior roles, including our Corporate Controller for the last 2 years. He's an extremely capable and seasoned industry leader with a uniquely broad experience set. His insight into how the business works from the ground level up is a tremendous asset to have in a CFO. So Greg, with those kind words, which you may never hear again, over to you.

Greg Smith

Thanks, Jim, and good morning. Let me begin with our 2011 financial results on Slide 4. Revenue for the year was $68.7 billion, up 7% from a year ago due to higher delivery volume and mix. Earnings per share for the year were $5.34, with operating margins at 8.5%, both reflecting strong operating performance across our businesses. Results were also affected by a favorable tax settlement and higher pension expense.

Operating cash for the year was $4 billion. This reflects strong performance from both businesses, offsetting our continued investment in the 787 and 747-8 program.

Let's look at fourth quarter performance on Slide 5. Revenue for the quarter was $19.6 billion, up 18% from the same period last year due to increased commercial aircraft deliveries and mix. Earnings per share for the quarter were $1.84, again reflecting continued strong performance across the businesses and the favorable tax settlement, offset by higher pension expense.

Let's discuss Commercial Airplanes on Slide 6. Boeing Commercial Airplanes fourth quarter revenue was $10.7 billion, with operating margins of 9.2%. This reflects strong core operating performance across the business, lower R&D, partially offset by the dilutive impact of the initial 787 and 747-8 deliveries and higher period costs including 787 fleet support. For the year, Commercial Airplanes reported $36.2 billion of revenue on 477 airplane deliveries with operating margins of 9.7%, again reflecting strong performance across core production programs and our services business.

During the quarter, we extended the accounting quantities on the 737 by 600 units, the 767 by 24 units and the 777 by 50 units. The financial impact of these extensions in the quarter was not significant.

Gross inventory for the company includes $20 billion related to the 787 program, an increase of approximately $6.9 billion during 2011. Gross inventory for the 787 program is expected to increase approximately $4 billion in 2012 as we continue ramping up production rates.

Included in the work-in-process inventory are deferred production costs. The deferred balance for the program was $10.8 billion at the end of the fourth quarter and includes almost 50 airplanes still in process. As we said in the third quarter, the deferred production balance will continue to grow as we increase production rates and introduce the 787-9 derivative. We anticipate the deferred production cost to peak at slightly over $20 billion and then decline after the program achieves the planned production rate of 10 per month and stabilizes at that level.

The 787 program continues to record a low single-digit gross margin, and we're proactively working opportunities to offset risk and increase profitability. Some of those areas we're addressing include leveraging our buying power by combining purchases on common commodities such as raw material and fasteners, reducing cost for us and our suppliers. Through lean and other initiatives, we continue to look for opportunities to refine our assembly and fabrication methods and designs, focusing on cost and flow time reductions, again in our factories and within our supply chain.

We're also looking at our production rates. Once we've demonstrated our ability to successfully execute the planned rate increases, we will consider rates above 10 per month. All of these and other opportunities are being actively addressed, as improving our profitability on the 787 program continues to be a top priority for us.

Boeing Commercial Airplanes won 391 gross orders during the quarter, including 241 737s and 75 777s, while 11 orders were canceled. The commercial backlog remains very strong at over 3,700 airplanes valued at a record $296 billion.

Moving now to Slide 7 and our Defense, Space & Security business. BDS reported $32 billion of revenue in 2011, with operating margins of 9.9% for the year, reflecting strong core operating performance across the businesses. For the fourth quarter, BDS generated $8.5 billion of revenue with operating margins of 10.2%, again reflecting continued strong performance.

Boeing Military Aircraft quarterly revenues increased 9% to $3.9 billion, driven by improved mix and higher deliveries. Operating margins increased to 9.5%, driven by strong execution across various programs.

Network & Space Systems revenue of $2 billion decreased on lower volume associated with the Brigade Combat Team Modernization termination.

Operating margins decreased to 8.6% due to increased research and development expense as we continue to invest in our future.

Global Services & Support revenue increased 21% to $2.6 billion for the quarter, primarily driven by higher revenue on integrated logistics support. Operating margins were strong at 12.6%. BDS backlog remains strong at $60 billion.

Now turning to Slide 8 and our Other businesses. Boeing Capital reported pretax loss of $8 million in the quarter and a pretax income of $125 million for the year, driven by smaller portfolio and higher asset impairments. The portfolio balance at the end of the year was $4.6 billion, unchanged from the beginning of the quarter and down from $4.7 billion at the beginning of the year.

During the quarter, Other segment earnings of $43 million in the fourth quarter of 2011 were driven by credit rate upgrade on certain financing receivables. In addition, the loss in the unallocated eliminations increased due to higher pension and deferred compensation expense, which was partially offset by the charitable trust contribution that impacted fourth quarter 2010.

During the fourth quarter, we recorded a non-cash income tax benefit of $397 million or $0.52 per share, resulting from a settlement with the IRS for tax years 2004 through 2006. During 2011, pension expense for the company increased $547 million to $1.6 billion, and we contributed $531 million to our pension plans. Our pension asset returns for the year were 8.4%, driven by strong performance in nearly all asset classes.

Our expected return assumptions going forward remain at 7.75%. The discount rates used to calculate pension liability decreased from 5.3% in 2010 to 4.4% at the end of 2011. The company's pension plans are now 75% funded on a financial accounting basis and 99% funded on an ERISA basis.

Let's turn now to Slide 9 to discus cash flow. We generated $4 billion of operating cash in 2011, driven by strong performance across the businesses, greater Commercial Airplane deliveries and advanced payments. Capital expenditures of approximately $1.7 billion were as expected.

Turning to cash and debt balances on Slide 10. We ended the year with $11.6 billion of cash and marketable securities. Debt levels remained flat during the quarter. Our cash position provides strong liquidity and positions us well to continue to focus on our cash deployment strategies and invest for continued growth.

Turning now to Slide 11 to discuss our outlook for 2012. Guidance for 2012 reflects solid core operating performance in our businesses, higher volumes in Commercial Airplanes, partially offset by higher pension expense and the impact of the current DoD environment.

Revenues for 2012 are forecasted to increase by approximately 16% to be between $78 billion and $80 billion, driven by increased deliveries at Commercial Airplanes. EPS guidance is set at $4.05 to $4.25% per share. This includes a $2.21 per share impact for pension expense, an $0.83 per share increase from 2011.

We expect first quarter EPS and cash flow to be the lowest during the year, based on timing of deliveries and phasing of expenditures. First quarter EPS is estimated to be approximately 20% of our full year earnings.

The 2012 commercial delivery forecast is between 585 and 600 airplanes and is sold out. This includes a combined 70 to 85 787s and 747-8 deliveries split roughly equally between the 2 programs. The majority of the 787s being delivered during 2012 will be airplanes that require change incorporation.

We're seeing continued improvements in quality and the condition of assembly of the units coming out of the 787 final assembly line, resulting in reduced change incorporation requirements on each airplane. We have a clear understanding of the scope of work that needs to be completed on each airplane, as well as dedicated resources and the facilities to complete the effort. In addition, we continue to actively engage with our overall supply chain and vigorously monitor predictive metrics that span the entire production system, allowing us to mitigate issues and potential risks.

Airplanes coming off the 787 final assembly line during the first half of 2012 will require substantially less change incorporation work than the earlier planes and by mid-year, we expect airplanes coming off the line will flow more directly into customer deliveries.

Moving to cash flow. We expect 2012 operating cash to be greater than $5 billion. This includes $1.5 billion of discretionary pension funding. We expect minimal required pension contributions through 2013, though we plan to make discretionary contributions above required levels.

In 2012, we expect Other segment expense to be about $200 million and unallocated expense to be about $1.6 billion. 2012 pension expense is expected to be $2.6 billion, an increase of $1 billion from last year. This increase is primarily driven by the low interest rate environment. R&D expense for 2012 is forecast to be between $3.3 billion and $3.5 billion as we continue to invest for future growth.

We are forecasting capital expenditures to be about $2 billion in 2012. This represents continued investment and ramp-up of commercial production rates, as well as investments in support of long-term growth and productivity.

Let me turn now to Slide 12 to discuss how we bridge our 2011 performance to our 2012 guidance. Our overall performance across the business continues to be strong in '12, with core operating engine producing 7% growth in adjusted EPS. Commercial Airplane core performance as well as increased 737 and 777 deliveries will provide positive impact to earnings in 2012.

Margins at BCA will be largely impacted by the lower R&D, offset by the 787 and 747-8 margin dilution, continued ramp-up of 787 fleet support and continued investment to support ongoing business growth. Earnings and margins remain strong in the Defense business, but are expected to decrease in 2012. This decrease is driven by both volume and mix as we continue to realize the impact of the evolving DoD environment.

As I mentioned earlier, pension expense will be a headwind for us in 2012 when the expected EPS impact an additional $0.83. We expect that tax rate for 2012 to increase to approximately 35% due to reduced R&D spending and the resulting lower R&D tax credit.

Again, 2011 was a strong year driven by solid core performance across our businesses. We expect that performance to continue into 2012 as we remain focused on production program profitability, rate ramp-up and productivity improvements.

Now I'll turn it back to Jim for some final thoughts. Jim?

W. James McNerney

Thank you, Greg. In 2011, Boeing improved on every major financial metric: revenue, earnings and operating cash and all by pretty wide margins. And we generated tremendous momentum for the future with exciting new programs like the 737 MAX and the Air Force tanker.

As we enter 2012, our ongoing focus and priorities are: production ramp-up and profitability across all our Commercial Airplane programs; successful execution of ongoing development efforts on the 787-9, 737 MAX and Air Force tanker; and to continue repositioning our Defense business while extending our core programs and expanding internationally.

On the strength of our product and services strategies and our team's commitment to innovation and continuous productivity improvements, we have positioned Boeing for a period of strong and sustained growth in the years ahead. This is the moment we have been waiting for, and we look forward to delivering on the promise.

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

Question-and-Answer Session

Operator

[Operator Instructions] And our first question is from Ron Epstein with Bank of America Merrill Lynch.

Ronald J. Epstein - BofA Merrill Lynch, Research Division

So I've got a question that's kind of a commercial question. So if I look at what you're saying about your delivery guidance for 2012, it looks like the company's planning on delivering somewhere between 35 and 45 787s. Only 3 were delivered last year. You went through the targets where you want to get to in terms of break points of production rates. So the question really is how did that get there? And how did that dovetail with the operating margin projection for 2012, which is 8.5% to 9%, which seems kind of disappointing given where production rates are going?

W. James McNerney

Well, is there a particular part of that question you'd like me to focus on there, Ron? I mean, is it the...

Ronald J. Epstein - BofA Merrill Lynch, Research Division

They're both kind of tied together, so you pick.

W. James McNerney

Okay, yes. All right. I'll just start. Look, we're confident in the amount of 87s and 47s we have projected to deliver. Recalling that a little more than half of the 87s are going to come out of change incorporation, I mean, they're being worked on today and many of them are largely finished and the balance will come out of production, come off the end of the line as an increasing number as the mix changes from changing core planes to straight off-the-line planes, we'll get through a lot of that mountain this year. So there's a little more than half 87s in work now, a high degree of confidence in being able to predict when they'll be done. On the 47-8, I mean we're -- the production ramp-up is going well. I think if you extrapolate what we've delivered in the last part of 2011 into 2012, that all hangs together very nicely. And the margins, I think we've been very open with you on the margins on the 87, and we've got a big program that Greg outlined to improve them. But the margin -- if your question ultimately gets to why isn't there more operating margin?

Ronald J. Epstein - BofA Merrill Lynch, Research Division

Yes, where's the leverage?

W. James McNerney

It's in 2012. Look, I think as Greg said, the guidance for BCA is prudent. I mean, it hangs together. We're in an industry where experience has shown to be prudent at the front end and unfold as you go along is the way to live life. And this all hangs together in terms of increased lead support that we've got to do with the new airplanes and some sort of one-time things that are associated with 2 simultaneous introductions, those are headwinds, and the pension that we talked about. I think it's -- there's an opportunity to do better. But it's -- often times, it's prudent to plan for some things that have happened historically.

Operator

And next we'll go to Rob Spingarn with Credit Suisse.

Robert Spingarn - Crédit Suisse AG, Research Division

Perhaps, Greg, you could talk a little bit more about the operating cash flow and the components within for '12; some of the moving pieces. You talked about deferred production, which rises throughout the year, because of course the peak sounds like it's a few years away. But maybe you can also talk about physical inventory and other components. For example, maybe the difference between production and delivery and how that works out on 787? It sounds like they're roughly similar. And then maybe finish up with your priorities on cash deployment.

Greg Smith

Sure. I mean, Rob, obviously a lot of the cash that's being generated in 2012 is directly linked to our delivery profile coming out of BCA. So the 787s and the 747s Jim just talked about, as well as the increased production on the 37 and obviously on the 777 deliveries, that is the key driver to our increased cash flow and it will be going forward. With regards to inventory, as I talked about, the inventory is going to continue to grow here, and that'll really start to taper off once we hit peak production on the 87 and start to stabilize at that rate, that's when you'll start to see that turn. And I think we've got solid plans in place to make that happen. What was your follow-on there?

Robert Spingarn - Crédit Suisse AG, Research Division

The last -- yes, how do you think about deployment? Yes.

Greg Smith

Cash deployment. Yes. I mean, certainly as we look at our plan and we look at our improved operating cash going forward, it's a priority for us. We continuously look at it. You saw we increased the dividend in the first quarter. But we'll take a balanced approach like we have in the past. We'll look at share repurchase. We'll look at our pension plans. We'll look at investing in our future and balance that out. But it's certainly at the forefront of our mind as we continue to deliver strong cash flow.

Robert Spingarn - Crédit Suisse AG, Research Division

Greg, do you see different types of cash return solutions at different times like '12 versus '13 and '14?

Greg Smith

Well as I said, I think as we execute '12, we'll be looking a lot harder and ramping up our deployment strategies '13 and beyond.

Operator

And we'll go to Doug Harned with Sanford Bernstein.

Douglas S. Harned - Sanford C. Bernstein & Co., LLC., Research Division

I want to go back on the 787. And the rate has continued to slide. And I'm trying to understand 2 things. One is first, you've held fast to the 10 per month at the end of 2013, even as the rate has pushed to the right a little bit over the last year. And then also, when we look at the rate coming down, I'm trying to understand where the risk is on margin. And by that, I mean there's the margin on the 787 program itself, but if you see delays, that results in customer compensation, it results in issues around overhead absorption on other programs. So where should we look -- if we see more delays, where should we look for the margin issue? So really, those 2 things. How to keep the rate at this level, and where we should see the margin impact?

Greg Smith

Well, yes. There's no question, Doug. That would all put pressure on the margin if everything moved to the right. But as I mentioned, we are working other initiatives and opportunities to try to offset that risk. But when you look at kind of near-term, as Jim talked about, a lot of the airplanes that are -- or at least the majority that are going to get delivered next year on the 87 are in mod center. They're in the changing corp area. So when you separate that from rate ramp and then you look at the balance coming out of rate ramp, as you know, we've executed the last rate ramp and we're about to execute the next one. And then we'll execute another one by the end of the year. So we're on a steady pace. Charleston, you know the progress that we've made there, and we'll expect a delivery out of there in the second half as well. So we're balancing all of that. There's certainly -- again, there's no question that if you have delays, its going to put pressure on margins, but I think we're actively working opportunities, and we're trying obviously not have any schedule slips and execute to the plans we got in place between the change center and final delivery out of Charleston and out of Everett.

Douglas S. Harned - Sanford C. Bernstein & Co., LLC., Research Division

But the rate ramp, if we go back a year ago, you had the same target at the end of 2013. I'm trying to understand, the shape of that rate ramp looks somewhat different today. What's happened? What has that meant for performance in getting this ramp that obviously has to accelerate more in the back end?

W. James McNerney

I think, Doug, over -- I'd have to look at it to be sure, and the guys can clean this up if I'm a little bit wrong. I don't think the rate ramp has changed much over the last year, 1.5 years. I think what's happened, as events came out of flight test, as we went through flight test, a lot of engineering change went back into planes we'd already built. And that's been our challenge, is the planes that are in change incorp now are the ones that have been pushed out. That flow of change has stopped now. So there is much more clarity on what has to be done in the change incorporation. The rate ramp has stayed. That has been our plan for the last year, 1.5 years. And so we're -- and that's not the issue. The issue is engineering change, which has now largely stopped, back into the early produced airplanes based on flight test discoveries. That's done now. I think that math -- maybe you could sit down with me, Doug. If that makes any sense to you, Doug.

Douglas S. Harned - Sanford C. Bernstein & Co., LLC., Research Division

So your concern right now is more on getting deliveries out, which includes a lot of change incorporation more than it is getting your production rate up. Is that fair?

W. James McNerney

Yes. I mean that's forcing me into a big statement, because we're worried about both, okay? Those are both execution things that we've got to monitor very closely and work very hard on. But as I said before, more than half of the planned 87 deliveries this year are coming out of change incorp and then the ramping up after that. And there'll be some off the end of the line, but the ramping up after that will be as we move from 2.5, which we've already done, to 3.5 in the second quarter, to 5 by the end of the year. And that looks manageable as we sit here today.

Operator

Our next question is from Howard Rubel with Jefferies.

Howard A. Rubel - Jefferies & Company, Inc., Research Division

I thought I would change things for a moment and talk about freighters, Jim. There's a number of things that you've accomplished, and you've still got some things still to do. Could you sort of address some of the open items still related with the 78 -- excuse me, the 74-8, and what are you -- how you're going to place those Atlas airplanes, for example? And then related to the FedEx order, you talked about incremental opportunities. Could you also talk and address sort of how this dovetails with what you're doing on the tanker?

W. James McNerney

Sure. Let me address the 47-8. The production is going well, and we have a pretty decent pipeline, Howard, of planes that we're working right now, most of which are decisionable in 2012. So we're cautiously optimistic about good order news this year. Now as you know, Howard, you've been around this industry a long time, I mean, this has been, for the ultra-big airplanes going through this economic cycle, has not been a big -- huge airplane's friend. But having said that, the freighters are very productive machines for these guys. The amount of money an operator makes versus what he's been making is tremendous incentive. But it's not only freighters. We have a decent international -- intercontinental pipeline, and there's some VIP airplanes that we're talking to people about. So a pretty decent pipeline. On the 67, we have -- the FedEx order was important for a very important customer, provides a nice bridge to the tanker production. We have a couple of other customers who are continuing to operate the 67 and with whom we are discussing. And a couple of them stand a good chance to come home. I think the -- but the linchpin was the FedEx order. And some of the others, we would have to sort of work in around FedEx and tanker production. We can do it, and we are actively trying to do it. But the big downside has been avoided, okay, is the way to think about that.

Howard A. Rubel - Jefferies & Company, Inc., Research Division

All right. But still you have -- just to push back for a second, you still have a couple of open-risk items on the 78. You've got that flutter issue -- excuse me, 74-8, excuse me, the flutter issue on the tail. And then also, as I said, how do you encourage someone to take the rejected Atlas airplanes?

W. James McNerney

Well, we're in active discussions on the Atlas airplanes. And the flutter issue -- look, any issue that we have to address is an important issue. I would not characterize that as out of bounds in terms of normal issues we deal with, with new introductions. And we have a good degree of confidence we'll be able to work through that issue, as do we on placing the Atlas airplanes and on executing a pipeline beyond the orders we have right now.

Operator

And next we go to Carter Copeland with Barclays Capital.

Carter Copeland - Barclays Capital, Research Division

Jim, please extend our congrats to James on an amazing career.

W. James McNerney

We'll do. We'll do.

Carter Copeland - Barclays Capital, Research Division

All right. Greg, I wondered if we could dive into some details with 2 quick accounting clarifications. First, you said the block extensions had no material impact on the quarter, but I would assume that those 600 737s should be higher average margin, unless you're leaving some room for a downturn in the kind of mid-decade. So if you could clarify there, it would be helpful. And then sticking with the accounting, it looks like the universe's program differences in Q4 were a little under $1 billion on a net basis. But I presume on a gross basis the 87 and 47 were a bit higher, with some offset from the mature programs. So if you could give us some color on how those numbers looked on a gross rather than a net basis, since you guys didn't provide a 47 deferred production disclosure, that would be helpful.

Greg Smith

Yes. So on that point, on the 87, I'd tell you on a unit basis, it's improved as we'd expect. So as we're coming down the learning curve, we'll have improved unit margins. I'd also mention that that's not -- don't expect that to be linear going forward because of the way we're delivering airplanes and some are coming out of change incorp, some of them are coming out of Everett final assembly, you're going to see a little bit of bouncing around on a unit basis. But certainly for this quarter, the biggest impact was the 9 747s. And that's really the big driver in there from when you at the difference over Q3 to Q4. But again, 87 on a unit did improve.

Carter Copeland - Barclays Capital, Research Division

And was there a material -- on a gross basis, was there a material offset from the 37s and 777s in the quarter that gets you back down to $1 billion?

Greg Smith

Yes. It was a small offset there, Carter.

Carter Copeland - Barclays Capital, Research Division

Okay. And on the block extension, on the 600 73s?

Greg Smith

Yes. So obviously, some of -- it's a competitive environment we're dealing with on the 737, but we're facing into that. We're looking at obviously cost reductions going forward. And when you look at the maturity of that program and how far out this is in the time frame, it doesn't have a significant impact on the overall block. And obviously, it's something we continue to focus on and look at, but nothing significant within this quarter.

Carter Copeland - Barclays Capital, Research Division

But presumably, those airplanes are priced already, right? I mean, the backlog's so deep, you would know the prices on those planes. So I would think the only uncertainty would be the volume of when you're producing those 600 airplanes, which is kind of in the middle of the decade. So if I were to compare the production rates in the middle of the decade rather to where they are now, unless there's some sort of material negative to the pricing or unless you've got room there for reductions in volume, just for prudence, then I would assume that it'd be something. But apparently, there's nothing.

Greg Smith

Not material.

Operator

Our next question is from Joe Nadol with JPMorgan.

Joseph Nadol - JP Morgan Chase & Co, Research Division

I have -- I'm going to cheat a little bit. I have a clarification request and then a question. They're both pretty simple. On the clarification, Greg, the R&D -- I'm looking at Slide 12 in your margin reconciliation for Commercial, and R&D is 100 bip pickup. When I do the math, given your revenue guidance, that implies the R&D is going to be up $400 million in Commercial.

Greg Smith

I don't know -- I haven't done the math to that degree, but it's going to be lower by $500 million. And that should obviously give us a positive impact on the margin.

Joseph Nadol - JP Morgan Chase & Co, Research Division

Yes. I mean R&D was 7.5% of sales in 2011, and you're saying it's going to be 6.5%. But 6.5 times $48.5 billion of revenue is...

Greg Smith

You know what we'll do, Joe? I'll have Scott call you right after and make sure we clear it up.

Joseph Nadol - JP Morgan Chase & Co, Research Division

Okay. I mean, it just seems like an $800 million gorilla kind of hiding the numbers. But...

Greg Smith

Okay. It is coming down, and we'll get a margin increase for that. But he'll get together with you and sort it out.

Joseph Nadol - JP Morgan Chase & Co, Research Division

Sure enough. Okay. And then in the fourth quarter, your margin looked like it did tick down a little bit in your core programs, if I kind of back out a reasonable revenue number for the 47s and the 87s. Was there a pickup in fleet support? Or is there something else going on there? Did gross margins change on the 37 and 777 I guess is the question?

Greg Smith

Yes, there was a little bit of pickup on fleet support. And then we had some higher escalation as well that was incorporated into the booking rates. So that was essentially it.

Joseph Nadol - JP Morgan Chase & Co, Research Division

So gross margins were, on the 2 core programs there, were intact sequentially?

Greg Smith

One was up slightly, and one was down slightly.

Operator

And we'll go to Sam Pearlstein with Wells Fargo Securities.

Samuel J. Pearlstein - Wells Fargo Securities, LLC, Research Division

Can you talk a little bit about, I guess, the order outlook as you look into 2012? I'm trying to think about BCA and really with the 737 MAX, those indications turning into firm orders, and excluding that as well? And then if you can give us some indication on the defense side, I don't know if all of those orders, the Saudi, the GMD, I don't know exactly if everything is in backlog yet or if we should still see some pickup on that order activity as well? And then, I guess related to that is what that means on the advances line when we look at the cash flow?

W. James McNerney

I'll answer the market-oriented question while Greg is thinking about advances. With my tongue in my cheek a little, we will have more orders than production next year. But we -- and that's our official guidance. But we should have a pretty good orders year next year. As you pointed out, the conversion of the MAX commitments into orders, that's I think largely visible to you as you track this. But we also see robust order activity in our other product lines. And so we see, by historical comparisons, a pretty robust order situation of BCA. And Greg, you correct me if I'm wrong here. I think the Saudi deal, the finalization of that is not in backlog as we sit here right now. There's some final details being worked through between the governments before we can properly book it. But the arrangements are -- the key elements of the arrangements are done. So that is a pickup you will see. And on GMB -- is that in backlog? Yes, that'll be over the next couple of months as well.

Samuel J. Pearlstein - Wells Fargo Securities, LLC, Research Division

And on the advances, is that something...

W. James McNerney

Greg? Go ahead, Greg.

Greg Smith

Are you talking on the Commercial?

W. James McNerney

I think he's talking Commercial. Right?

Samuel J. Pearlstein - Wells Fargo Securities, LLC, Research Division

Specifically, it's mostly commercial because unless it's -- I'm not sure if that's a direct order or not, the Saudi, but just in terms of just on the cash flow line, that advances line, how much of a net source will that be over the course of the year?

Greg Smith

I mean, it'll definitely be up, the Saudi being a big driver of that. And then the strong commercial orders that we're foreseeing will certainly help that in 2012.

Operator

And next we'll go to Heidi Wood with Morgan Stanley.

Heidi R. Wood - Morgan Stanley, Research Division

I wanted to put a little finer point on the orders in 2012. And also, actually, Jim, see if you can touch on financing and pricing a little bit for us. So you said it should be pretty good but obviously, when we look at the 737 MAX commitments, does it look like you could get north of 1,000 orders this year versus what you did last year?

W. James McNerney

Well again, I don't want to put an exact number down because as you know, it can move around. But I will say that the vast majority of the commitments that we got last year, in all likelihood will be booked this year, okay? And as you know, we exited the year with close to 1,000 orders and commitments, most of those were commitments. So there's a good slug there. And we have a pretty robust pipeline on our other models. So I don't want to exactly compare year-over-year, but it's -- versus historical kinds of years, it should be another pretty robust year. And that's included in our cash guidance.

Heidi R. Wood - Morgan Stanley, Research Division

And then with respect of financing, Jim, because obviously there's concern about the European banks, is all of financing substantially in place for the 2012 planes? And maybe turn to comments on pricing, are you getting price appreciation on the 777 now the A340 is officially dead? And talk about 737 MAX pricing.

W. James McNerney

Yes. I think the -- I'll just take them in reverse order. The 737 pricing is about what we'd projected. I mean, there are not huge impact swings versus our plan. And as you know it's a competitive marketplace, but it is not dramatically different. And the dynamics there are to continue to sell out the NG up to and including the blend in of the MAX. And that's going well. As you've noticed, with -- i think virtually every commitment we've gotten on MAX's, we've also gotten commitments on NGs, which in some cases puts a little pressure on pricing, but more than offset by the economies of ensuring a smooth dovetail and smooth production. And so that all works out economically on a margin basis. And on the 777 -- listen, the 777 is in a very strong market position right now. And the value we're getting for that airplane is all different kinds of value, of which prices one element remains very strong. And then the financing situation you were asking about, Heidi, we do not see an issue with getting our backlog financed this year. I mean, there are some finance sources moving around, some people with less appetite, more with others who have more appetite. But I think when our BCC people and our treasury folks take a very cold-eyed hard look at it, and I know XM's being debated in Congress and we anticipate resolution there, I think we feel comfortable with getting the backlog financed.

Heidi R. Wood - Morgan Stanley, Research Division

Great. And quickly, Greg, can you talk to us about the timing of cash flow over the course of the year? Is it lumpy? Or how should we think about that over the next coming quarters?

Greg Smith

Yes, it's lumpy but back-loaded as we would typically see in our profile.

Scott Fitterer

Operator, we have time for one more analyst question.

Operator

And that will come from Cai Von Rumohr from Cowen and Company.

Cai Von Rumohr - Cowen and Company, LLC, Research Division

So it looks like you missed your 787 delivery for the year and your forecast for this year assumes that you exit the year, it looks like, at approximately the same number of planes in inventory. So it appears as if completions are more difficult. Could you help us understand why? And secondly, it seems like maybe your ability to ramp the rate is in line with expectations or maybe improving. So maybe give us some color on those 2 issues if you could?

W. James McNerney

Well, you're right. A couple of planes slid out of '11 into '12 coming out of change incorporation, but they've already been delivered. This was not a major slide indicating a different view of our production capability. And as I said before, Cai, the majority of the planes we will deliver this year will come out of change incorp, slightly more than half. But we will exit the year with a pretty good production flow going. But there still will be some change incorp planes that are yet to be delivered. And so the lines -- you're right, change incorp down; production up; inventory same beginning of year, end of year. But then that will begin to change over time as the change incorp planes get flushed out of the system pretty soon thereafter.

Cai Von Rumohr - Cowen and Company, LLC, Research Division

So do you feel -- I mean, it sounds like the completions are a little more difficult, but do you feel equally or maybe more confident about your ability to kind of reach your increase in final assembly rates without having to incur an additional pause?

W. James McNerney

I think the way I'd say it is that the engineering change flow has slowed down to a trickle. Pretty much done. And as every day passes and we get closer to the goal and we pass other milestones yes, my confidence does increase because we are executing to plan. And the statement of work is better known without all the change flowing in. And so I think as each week passes, each month passes, my confidence does grow. It's something, though, that is -- these ramp-ups are always difficult and it has our attention.

Operator

And 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 of Corporate Communications. Mr. Downey, please go ahead.

Tom Downey

Thank you. We will continue now with the time remaining to take a couple of 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're ready for the first question. And in the interest of the limited time we have, we ask that you limit everyone to just one question, please.

Operator

And we'll go to Brendan Kearney with Post and Courier.

Brendan Kearney

Jim, in November, Jim Albaugh said he was very pleased with how the North Charleston operation was coming along, saying that some of the units had already demonstrated they could produce at a rate of 10 a month. I subsequently learned that he was talking more about the machines than the human element here. And then also between now and then, the NLRB cloud has cleared. And so with those things in mind, how do you feel about each of the 3 major units in North Charleston, aft midbody and final assembly and how they're doing now?

W. James McNerney

Yes, I feel good about them. They're all on plan or, in some cases, slightly ahead of plan. I think Jim -- I didn't read Jim's quote, but he may have been referring to the aft and midbody, which go to both Charleston final and Everett final and that ramp is on schedule. Final assembly. Actually, we're slightly ahead of our plan in final assembly, so I feel good about the execution I'm seeing down there.

Brendan Kearney

Okay. And you said -- I've heard second quarter here for the first delivery, but I heard midyear and second half during this call. Is it...

W. James McNerney

Yes, second quarter. Yes. I think one of us misspoke a little. Second quarter.

Operator

Our next question is from Susanna Ray with Bloomberg News.

Susanna Ray

I am wondering, with this huge production increase, is this in the works and planned? I'm wondering about your employment forecast, both for this year and for the next 2 years, I guess, through the 2014 guidance?

W. James McNerney

Well, a lot of the employment ramp happened in 2011. Our company added 11,000 employees, high-tech jobs in the United States, which are the bedrock of our company and very fashionable these days. But those employees were added both for the 787, 747-8 ramp in anticipation of the ramp of some of our other programs. And we're going to be adding some more, somewhat offset by some reductions in BDS. The defense side is tough right now, as you know. And I think all defense players, including that part of our company which is Defense, are tightening employment. So that will net out to a slight add this year. But most of the adds were last year.

Susanna Ray

Okay. Do you have any forecast then as far as how many more you might, like, total, including the BDS reduction you might add?

W. James McNerney

Yes. I think it's not going to be a big -- we'll get back to you. I don't have that specific number in front of me, Susanna. Tom will get back to you.

Susanna Ray

And the 11,000, that was global, right? Not just the U.S.?

W. James McNerney

Well, that was -- 99% of that's U.S.

Operator

Our next question is from Joshua Freed with Associated Press.

Joshua Freed

The status of the American Airline's MAX order, you talked about conversions earlier. When do you think that one might convert? And does it seem likely at this point that, that would happen post-Chapter 11 for them?

W. James McNerney

Just an overall comment would be -- I mean, Chapter 11 probably strengthens the likelihood of that getting booked, quite frankly, as the company goes through. And I think it's hard to predict because they're just at the beginning of the process. Whether that would be finalized, in bankruptcy or just after, it's hard to -- all I know is that American will emerge from that process more able to execute those orders than they would have had they not gone through it.

Joshua Freed

Okay. But I mean are you making your plans in one direction or the other in terms of the timing of that?

W. James McNerney

Well, our plan is to deliver them when we committed to deliver them which is, I believe, starting in '17. And so our anticipation is that their financing will all be sorted out well before that.

Operator

Our next question is from Dominic Gates with the Seattle Times.

Dominic Gates

I'm just going to ask for a little clarification on the 787 delivery rate this year. So you're guiding for 35 to 42 787s approximately in the year, and you said in the call that about half of those will be change incorp planes. And it's not quite computing for me because you're at 2.5 a month now flowing out of the factory...

W. James McNerney

No, you are right, Dominic. You're right. You're right. We said more than half. It's a lot more than half, okay? Greg, do you...

Dominic Gates

A lot more than half are change incorp?

Greg Smith

Yes. More like 2/3 of them are coming out of change incorp.

Dominic Gates

I'm still not quite understanding because if you're 2.5 now flowing out of the factory, 2.5 a month, you're moving to 3.5 next quarter I think you said? And to 5 -- I think you said 5 a month before year end? So let's say you're averaging 3 a month at the low-end, that will be 36 planes flowing out of the factory with, you're saying, not too much work to be done on them. So shouldn't you have more of those planes rather than more of the change incorp planes?

Greg Smith

Well, some of those -- as I talked about, some of those will still require change incorp, just not as much. So as they're coming out of the factory, some of those will get -- go into change incorp and then get delivered through 2012. They just don't require as much as they do on those earlier units that we're referring to.

Dominic Gates

Right. So they might still require months of work actually?

Greg Smith

I'm sorry?

Dominic Gates

They might still require some months of change incorp work [indiscernible] coming out?

Greg Smith

Yes, yes. Some level of change, right.

Operator

And we'll go to Molly McMillin with the Wichita Eagle.

Molly McMillin

My question is I know when the announcement was made that the Wichita plant is closing that the folks are saying that an official study started last summer. But I'm wondering, when did you all start kicking around the idea of closing the plant and wanting to pursue that line of information?

W. James McNerney

Well, I think the -- it was that timing when it began to fall under serious considerations. I mean, we are always reviewing our plans, but I would say it really didn't crystallize. And of course the reason it did, I think the planning started to accelerate then, is a very difficult defense market, which it became clear middle of last year that there was going to be serious surgery done on defense programs, and we had to take an aggressive inventory of our sites and figure out where the most efficient places to produce our wares and our services in a dramatically constrained environment that we saw coming. And that's what really precipitated the second half of the year study in Kansas.

Molly McMillin

Okay. And then on the Air Force side, was it written in the contract for the tanker that Wichita would be doing the finishing work? Or was it more of a contingency plan in there? Or do you know...

W. James McNerney

No, I don't think it was written in the contract. We can tell you exactly what was written in the contract, but I'm pretty confident there was nothing like that in the contract.

Molly McMillin

Okay. So when you talk to the Air Force, they're fine with the change? Or how are they accepting it I guess?

W. James McNerney

Well, the Air Force has pressed us for a very good deal, and they're leaving it to us to make the decision on where and how to produce it. That's the nature of this particular contract.

Tom Downey

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

Operator

And that will be from Mike Mecham from Aviation Week.

Michael Mecham

Can you talk a little bit about where you stand on your plans for MAX production? Your labor deal puts it in Renton for sure. So where's the planning stand on all of that?

W. James McNerney

Where's the what? The planning?

Michael Mecham

The planning for how you'll phase-in doing both aircraft and the production elements.

W. James McNerney

Yes. I think there's 2 elements to the answer. One is we're on track with the development plan that we're working on now. And as you know, there's minor modifications needed to the overall airplane. The engine is the big story, and that's going well. The other element is to sustain productions of NGs up until the point we start blending in the MAXs in the first part of 2017 and I think when we start delivering them and as I mentioned earlier, we're making good progress on accomplishing that objective. Virtually every MAX order we're getting now or every MAX commitment has associated with it a NG order or commitment which will help bridge us right to the point of the MAXs, and that is also very important. So I think the planning is going well on a development side and on a production side, and I feel good about it.

Michael Mecham

Will the plant require a lot of tooling requirements or modifications actually to the factory itself?

W. James McNerney

I think the -- most of the work that'll be required there will relate to the increased volumes that we've got that will hit that plant a couple of years before the MAX. But there will be some modification required for the MAX, but it'll be done within the footprint that's established for the 42 a month that we've -- that we will be into 2014, 2015.

Michael Mecham

So it's ordering more of what you've got kind of a situation as far as tooling, because the aircraft is essentially the same...

W. James McNerney

The aircraft, yes. I mean -- but there will be some differences. I mean, the engine, the engine buildup and the cell and that part of it. There's a modification to a few things. But we can largely leverage the current footprint we've got, both in terms of tooling and in terms of facilities after we get up to the 42 a month in 2014.