



THE BOEING COMPANY

BA | \$156.77

Hold | Target Price: \$188

Robert Spingarn

212-503-6213

robert.spingarn@meliusresearch.com

Scott Mikus

212-503-6208

scott.mikus@meliusresearch.com

The Strike is a Symptom of a Bigger Problem

To be honest, this strike shouldn't have been a surprise. The 25% general wage increase over four years in the tentative agreement was significantly below the union's ask of a 40%+ pay increase. And the elimination of the annual (AMP) bonus made the deal a hard sell for union members despite the union's leadership recommending the agreement. As CFO Brian West stated there was a clear disconnect between the rank-and-file members and the union leadership. But that shouldn't have surprised Boeing. Based on the tentative agreement, we thought the terms were very favorable to Boeing. Touch labor is only about 3% - 5% of the total cost of a commercial aircraft program. So, the notion that a 25% wage increase over four years is Boeing's best offer is a bluff that the rank-and-file IAM members have called. We also note, last summer, Spirit AeroSystems' IAM-represented employees overwhelmingly rejected a labor agreement that was unanimously supported by its union leadership. After a brief strike, Spirit's machinists won additional concessions. While we don't know how long it will take, we think the IAM's strike will yield additional concessions from Boeing.

In the grand scheme of things, the IAM's strike is a microcosm of Boeing's adversarial relationships with its employees, suppliers, regulators, and other stakeholders. To us, nothing sums up Boeing's past contempt for its own workforce like former CEO Jim McNerney's comments on Boeing's 2Q14 earnings call when he stated that he would remain CEO past age 65 and that "the employees will still be cowering." Under his and Dennis Muilenburg's reign, instead of creating and delivering world-class products, Boeing embarked on a strategy of attacking - and arguably bullying - stakeholders that are crucial to Boeing's own success. In the mid-2000s, Boeing sold Spirit AeroSystems for \$900M of cash and saddled it with onerous contracts. Also, under Jim McNerney, Boeing successfully got the IAM to give up its pension by threatening to move work out of the Puget Sound region. Through its Partnering for Success program, Boeing demanded steep price concessions from suppliers and stretched out payment terms, making it harder for small suppliers to finance their own working capital needs.

Those tactics helped drive Boeing's FCF/share and stock price to all-time highs in the 2010s, but they also created an off-balance sheet liability that has come due. When we [downgraded](#) Boeing earlier this year, we stated that investors should not expect Boeing to return to the 2010's FCF margins because it was overearning during that period by underinvesting in its product offerings and squeezing its suppliers and employees. Today, Boeing is paying the price for McNerney's and Muilenburg's decisions. Although it's not included in Boeing's \$45B of net debt, there are very real economic consequences for Boeing's actions in the 2010s.

The rank-and-file IAM members want recompense. We don't know what the ultimate cost of the strike will be, but it will be expensive. For context, the IAM's 58-day strike in 2008 cost Boeing \$6.4B of sales and \$2.5B of cash flow. On average strikes by the IAM at Boeing's Seattle and Wichita locations have lasted 58 days. *Continued...*



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Over the past 20 years, Boeing’s machinists in Seattle have been through a lot. The machinists lost their pensions in a 51/49 vote in 2014. 747 production has ended, and 787 production has been consolidated in South Carolina. They have had to deal with furloughs and layoffs due to the 737 MAX grounding and the impact of Covid. Furthermore, aircraft production volumes in Seattle are 50% below their 2018 peak. Understandably, the rank-and-file IAM members are unhappy and want to win this round of negotiations.

Meanwhile, Boeing’s new CEO, Kelly Ortberg, is left cleaning up another mess that he didn’t create. Kelly took the helm at Boeing last month, so it is hard to blame him for the strike. Overall, we think Kelly is a great hire and that he wants to reset the relationship with the IAM. But the challenges he faces at Boeing are enormous. The strike is his first test, and Boeing isn’t just a financial turnaround. It’s a financial, operational, cultural, public relations, you name it turnaround story. Boeing merged with McDonnell Douglas 27 years ago, and it will take years for Boeing to get back on solid footing. And once it does, it will need to invest in a new clean-sheet aircraft program to replace the 737.

In the near-term, an equity issuance is probably needed if Boeing wants to maintain its investment grade credit rating or even think about launching a new development program to replace the 737. Right now, consensus is looking for \$5B of FCF in 2025 compared to our most recent estimate of \$1.9B. With another \$1B of charges at Boeing Defense expected in 3Q, higher labor costs, and a slower commercial aircraft delivery ramp, a credible argument could be made that Boeing won’t even be FCF positive in 2025. Point being, investors shouldn’t expect a quick fix. Boeing will have to spend money to attract and retain the right people, support its suppliers, and to refresh its stale narrowbody product line up.

Figure 1: Kelly Ortberg faces numerous challenges at Boeing. Turning around the company won’t be easy, but if Kelly is successful, he will be viewed as a hero in the aerospace industry.

Short (12 - 18 months)	Medium (2-4 years)	Long (5+ years)
Changing the culture	Changing the culture	Changing the culture
Labor negotiations with IAM	Developing a roadmap for 737 replacement	Rebuilding trust with stakeholders (regulators, customers, employees, etc.)
Certifying 737 MAX 7, MAX 10, and 777X	Labor negotiations with SPEEA (engineers)	Refresh Boeing Commercial Airplanes product line
Integrating Spirit AeroSystems	Stemming losses at Boeing Defense	Rethink Boeing's role in the defense market
Bring in high quality talent	Ramp delivery and production rates	
Fix quality control issues		
Repair balance sheet		

Source: Melius Research

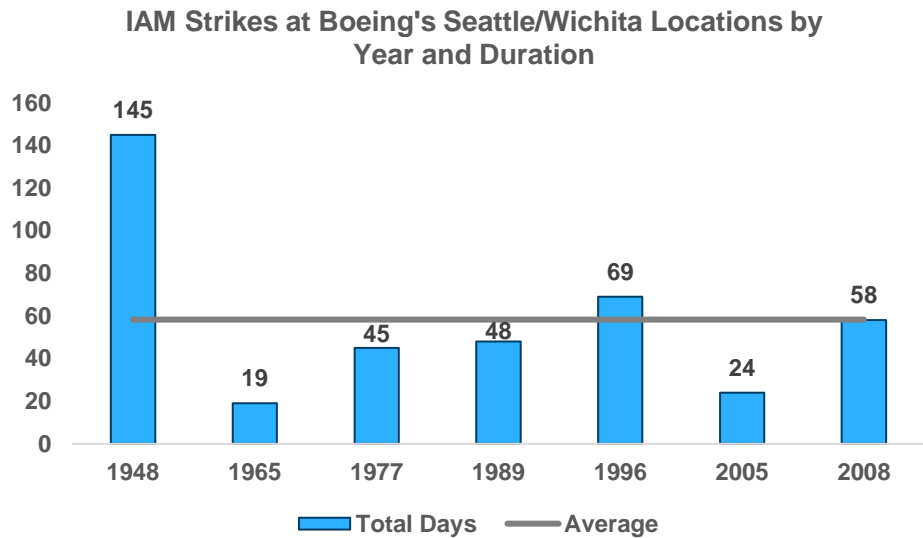


Figure 2: Prior to the 737 MAX grounding, Boeing was producing 66 aircraft per month in Seattle. With 747 production over and 787 production fully consolidated in South Carolina, Boeing only produces ~30 aircraft per month in Seattle. This is why the IAM wants a guarantee that Boeing’s next commercial aircraft will be manufactured in Seattle.

Monthly Boeing Aircraft Production in Seattle		
Aircraft Family	2018 Peak Rate	Current Rate
737	52	~25
747	0.5	0
767	2.5	~3
777	5	~2
787	6	0
Total	66	~30

Source: Company Data and Melius Research

Figure 3: On average, strikes by IAM-represented employees at Boeing’s Seattle and Wichita locations have lasted 58 days.



Source: Company Data and Melius Research



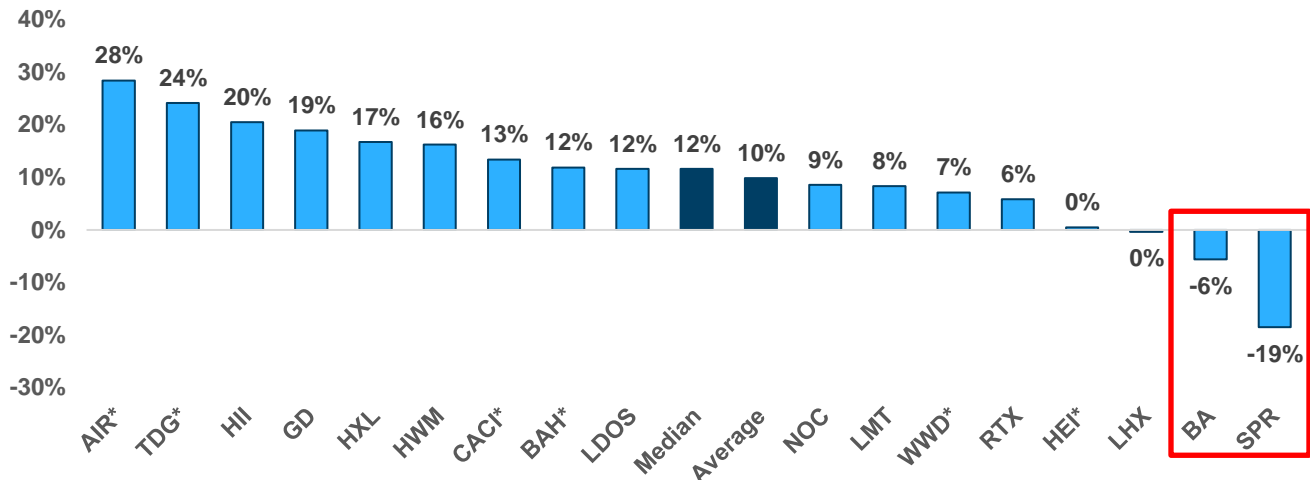
Figure 4: Full list of IAM strikes at Boeing’s facilities.

Year	Union	Location	Total Days
1941	IAM 837	St. Louis, MO	2
1948	IAM 751 & 70	Seattle/Wichita	145
1965	IAM 751 & 70	Seattle/Wichita	19
1965	IAM 837	St. Louis, MO	12
1967	IAM 837	St. Louis, MO	16
1969	IAM 837	St. Louis, MO	33
1974	IAM 725	Torrance, CA	112
1975	IAM 837	St. Louis, MO	90
1977	IAM 751 & 70	Seattle/Wichita	45
1989	IAM 751 & 70	Seattle/Wichita	48
1996	IAM 751 & 70	Seattle/Wichita	69
1996	IAM 837	St. Louis, MO	100
2005	IAM 44	Decatur, AL	98
2005	IAM 725	Torrance, CA	98
2005	IAM 725	Huntington Beach, CA	98
2005	IAM 751 & 70	Seattle/Wichita	24
2005	IAM 2766	Huntsville, AL	98
2006	IAM 2709	Oakridge, TN	79
2008	IAM 751 & 70	Seattle/Wichita	58
2012	IAM 110	Seymour Johnson Air Force Base	71
2012	IAM 2296	Seymour Johnson Air Force Base	71
Total Strikes			21
Average Length			66
Median Length			71

Source: Company Data and Melius Research

Figure 5: From 2018 to 2023, the median employee compensation within our coverage list grew 12%. In contrast, the total compensation for Boeing’s median employee declined by 6% over that period.

Cumulative Change in Median Employee Compensation (2018 - 2023)

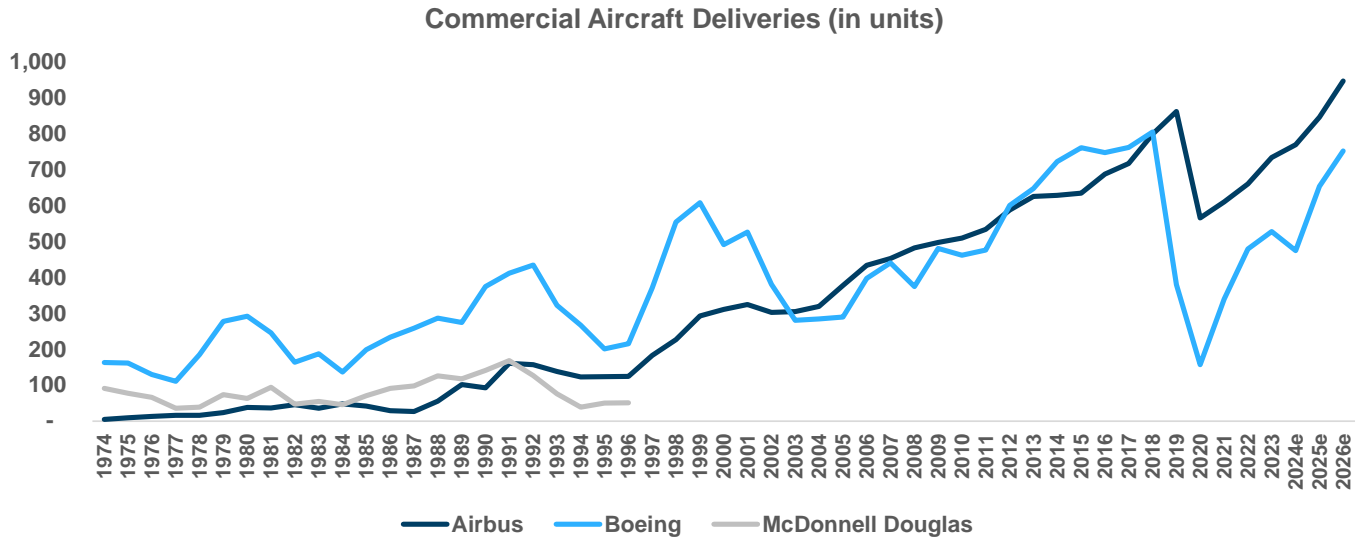


Source: Annual Proxy Statements and Melius Research

*Non-calendar fiscal-year

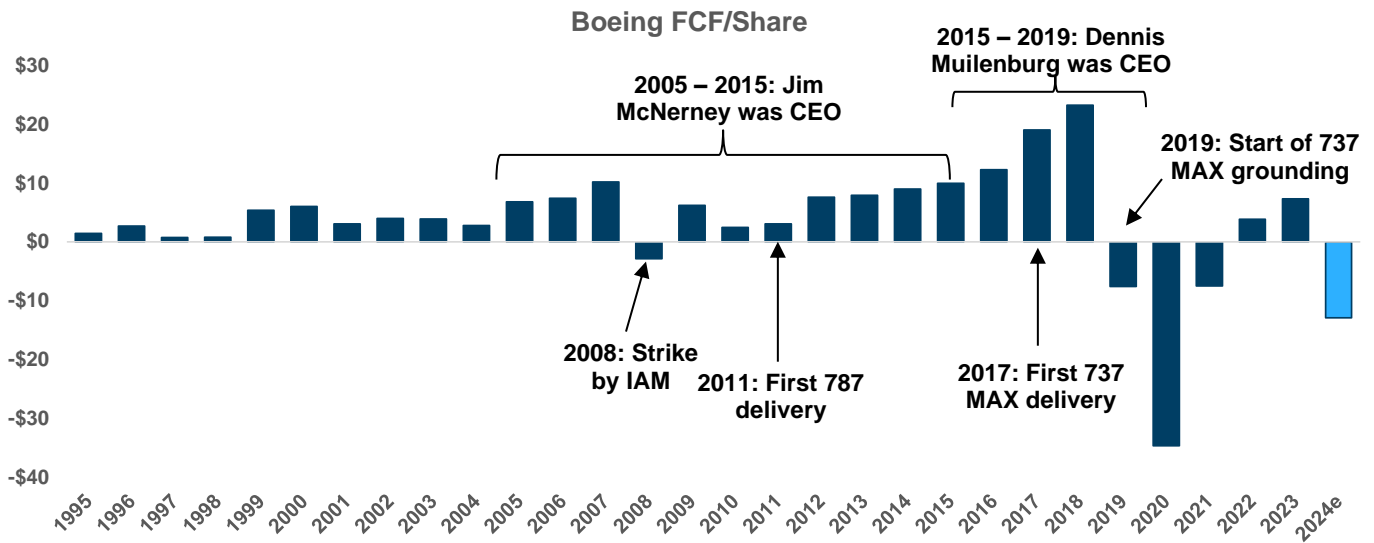


Figure 6: By the early 1990s, Airbus had gained more market share than McDonnell Douglas. In 2003, Airbus delivered more commercial aircraft than Boeing for the first time. With Airbus now holding 60% of the large commercial aircraft backlog, Boeing is unlikely to catch up to Airbus this decade. If Boeing doesn't launch a clean-sheet aircraft, it may not catch up to Airbus in the 2030s either.



Source: Aviation Week Fleet Discovery, Company Data, FactSet, and Melius Research

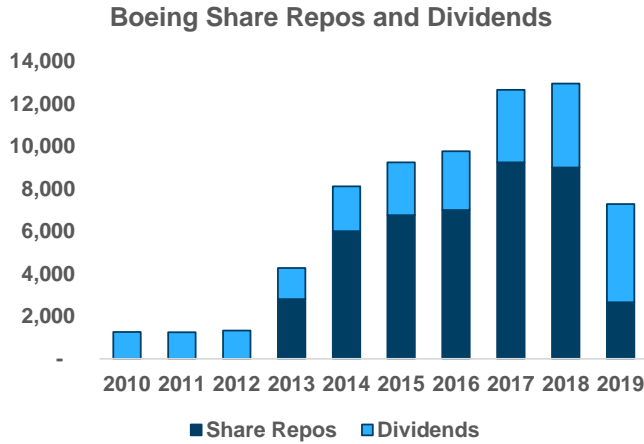
Figure 7: Although the merger with McDonnell Douglas marked the start of a cultural shift within Boeing, under Jim McNerney and Dennis Muilenburg, Boeing became too focused on FCF/share growth.



Source: Company Data, FactSet, and Melius Research

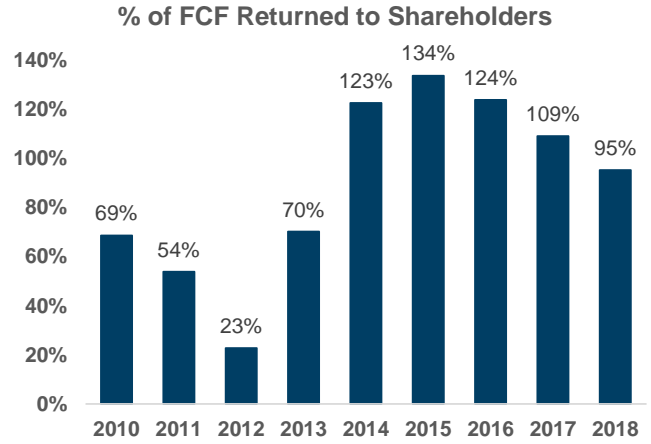


Figure 8: From 2010 – 2019, Boeing returned over \$68B of capital to shareholders through share repos and dividends. That amount of capital could have funded the investment required for two clean-sheet aircraft programs.



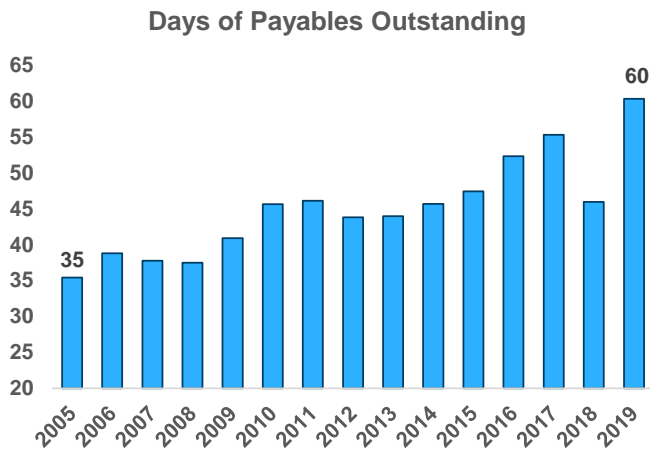
Source: Company Data and Melius Research

Figure 9: From 2010 – 2019, Boeing returned more than 100% of its FCF to shareholders. In 2019, Boeing returned \$7.3B of capital to shareholders despite reporting a \$4.3B FCF burn that year.



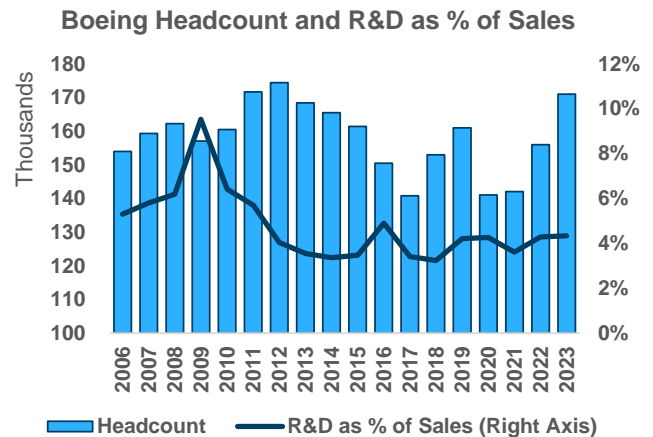
Source: Company Data and Melius Research

Figure 10: Under Jim McNerney and Dennis Muilenburg, Boeing boosted its FCF by stretching out payment terms to its commercial suppliers.



Source: FactSet and Melius Research

Figure 11: After the 787 entered service in 2011, Boeing reduced headcount and R&D spend as a % of sales to increase its cash flow.



Source: Company Data and Melius Research

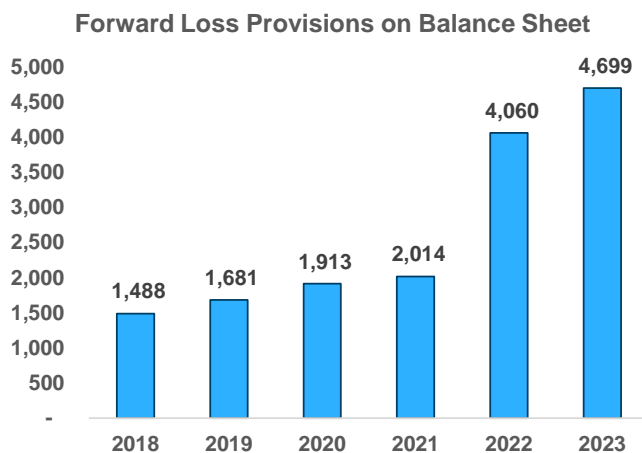


Figure 12: Stemming the losses at Boeing’s defense segment is another challenge that Kelly Ortberg will have to face. Since 2018, Boeing has booked nearly \$12B of charges on the below fixed-price development programs.

Boeing Defense Charges on Fixed-Priced Programs (USD, billions)								
Description	Program Name	2018	2019	2020	2021	2022	2023	1H24
Air Force One	VC-25B			168	318	1,452	482	250
Starliner	Commercial Crew	57	489		185	288	288	125
Trainer Aircraft Development	T-7A EMD					203		
Trainer Aircraft Production	T-7A Production Options	400				552	275	372
Aerial Refueling Tanker	KC-46A	736	148	1,320	402	1,374	309	519
Unmanned Aircraft	MQ-25	291				579	231	
Total		1,484	637	1,488	905	4,448	1,585	1,266

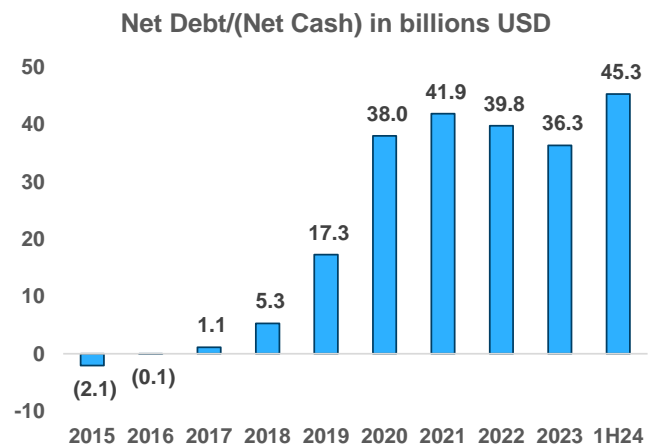
Source: Company Data and Melius Research

Figure 13: Although it isn’t counted in the net debt figure, Boeing ended 2023 with \$4.7B of forward loss provisions on its balance sheet, which will weigh on cash flow in future years.



Source: Company Data and Melius Research

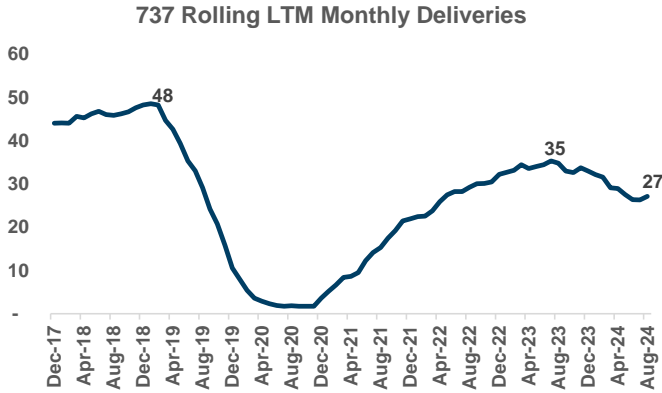
Figure 14: With \$45.3B of net debt on its balance sheet, Boeing may need to issue equity to maintain its investment grade credit rating.



Source: Company Data and Melius Research

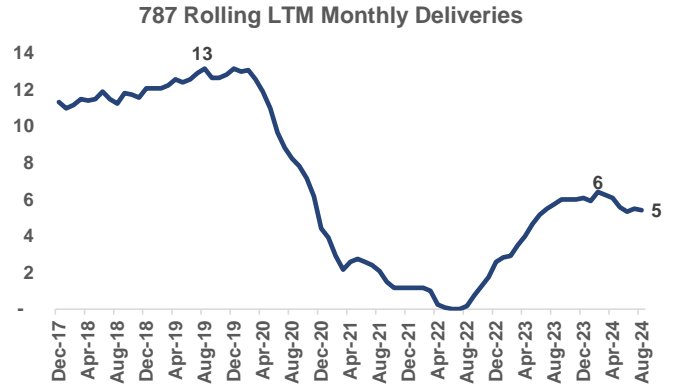


Figure 15: Ramping 737 production and delivery rates is crucial to Boeing's FCF recovery. That ramp won't be possible without the IAM's cooperation.



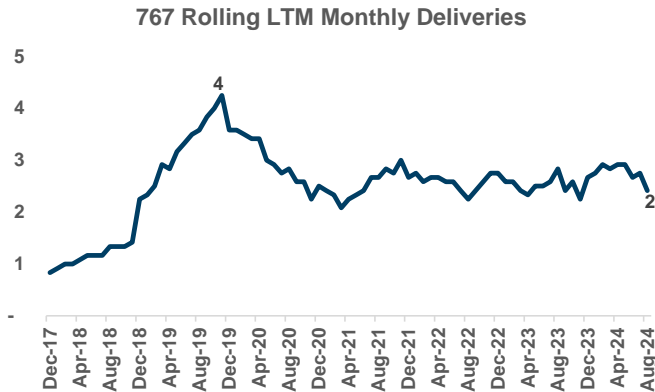
Source: Company Data and Melius Research

Figure 16: Although the 787 is no longer manufactured in Seattle, Boeing's machinists in Seattle are doing rework on already built 787s. The strike will impact Boeing's ability to deliver those already built 787s sitting in Seattle.



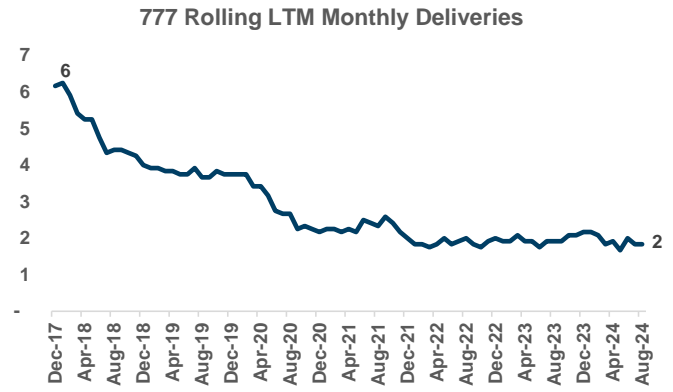
Source: Company Data and Melius Research

Figure 17: The IAM's strike will negatively impact Boeing's ability to delivery 767 freighters and KC-46 tankers.



Source: Company Data and Melius Research

Figure 18: Likewise, 777 production and deliveries will also be impacted by the strike.



Source: Company Data and Melius Research



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