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Boeing Co. Q3 2007 Earnings Call Transcript

Question-and-Answer Session

Operator

[Operator Instructions]. Our first question... one moment. Our first question comes from Cai von Rumohr of Cowen & Co.

Cai von Rumohr - Cowen & Co.

Yes. If you would give us a little more detail the unit cost margin, looks like was kind of even worse relative to program than it's been in prior quarters. I think you mentioned weak pricing in prior years and that this will continue in the fourth quarter. Was there anything else in that number and when do you expect this to reverse?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Cai, this is James. No, other than the new introduction, new customer introduction cost it is the weak pricing where the pricing was aggressive two or three years ago and now you are seeing those deliveries come through and we do expect that to start correcting itself going forward, but it will be a moderate correction going forward.

Cai von Rumohr - Cowen & Co.

Thank you.

Operator

A next question comes from Heidi Wood of Morgan Stanley.

Heidi Wood - Morgan Stanley

Good morning. Little bit of a demographical question for you. You have a pretty rigorous information system process for aircraft development. It was designed to call out problems really early in the process, and many of us had confidence in it, given the vigor of the detail. But should we believe now that it doesn't work, I mean you've highlighted the personnel changes and going deeper, it is the supply chain but I guess I'd like you to address in more detail how you are going to better drive intellectual objectivity to identify problems earlier because otherwise the new schedules also is susceptible to slipping?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Fair question. Heidi, this is Jim. Listen I think the... as we look back on it, the real time visibility we had with common designed tools on the engineering and development side of this program, were in fact as robust as we thought they were and signaled during the development phase of this issues early that we are able to address and quite frankly, that's why the technology development has gone well here. I think on the supply chain side, we had less visibility on a real time basis than we needed to have as we look back on it and that has been corrected going forward in terms of basically we have six supply chains that need to coordinate better with each other in terms of data exchange and real time visibility and that's we've been focused on the last couple of months. We are close to achieving that and that's what we need to get as an underpinning for getting the supply chain back on schedule and I think so that's where the focus of our effort has been and I think we made real progress there.

Heidi Wood - Morgan Stanley

Great, thanks very much.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Okay Heidi.

Operator

Our next question is from Steven Binder of Bear Stearns.

Steven Binder - Bear Stearns

Hey Jim. I know this has been asked before but I am sure given the schedule changes on the 787, you got a number of suppliers that have come back to BCA looking for equitable relief because of all scope changes both in terms of non-recurring and recurring cost. I am just wondering where do you think we are currently in that phase of discussion with the suppliers, are we in the early stages and do you feel so you have adequately factored into your estimates for R&D in '08 number one, into your cost pull for the 787, any type of equitable relief that you're going to have to provide to the supplier base?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

I'll try to take your three parts of the one question here. In terms of the scope changes, assertions along the way, those discussions are at a fairly mature stage and so I would characterize that as the normal discussions that go on between teammates as they are able to complete other design and production of the earlier airplanes. So we're at a matured stage there. Now, in terms of the impact of the schedule change on them, I think James would say that we have factored in some margin in our cash projections to make sure that the extent to which there is some equitable cash relief required that we're within those projections. And furthermore, any cost that we would incur as we achieve settlements with customers as we move deliveries around on this new schedule, that's also anticipated in our cost... in our program costs going forward. James, you have anything to add there?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Yes. We might go just a step forward and as we're looking up developing the cost base for the 87, we have taken in consideration I think we're been reasonably conservative as to the outcome of that because, although we are in, as Jim said down on the road and maturing those discussions, obviously we want the supply chain focused on helping us get these first airplanes through and built and so we're not pressing as hard as we might otherwise be at the different stage in the program. So we are conservative in our estimates and those outcomes.

Steven Binder - Bear Stearns

Can I just ask a follow up?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Sure.

Steven Binder - Bear Stearns

Just revenues in '08 in your projection, you're starting point at \$33 billion in '07 rough order of magnitude and the incremental deliveries in '08 are presumably just pretty much 73s and a handful of 78s. I am just wondering what you are assumptions, if you provide a little bit of color because I would think that use of mid point of your estimate in '08 most of the increases, some think its volumes and it does sound like there is a whole lot of pricing factored in number one, and two, because there is a much growth assumed in commercial aviation services and third, used aircraft sales... are, is there a decline expecting in used aircraft sales I am just wondering, seems like a fairly conservative forecast in '08?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

The '08 shows the slide out of the 87's which are pretty good revenue producing aircraft and then we have the mix obviously, there's still a lot of things allows but there is growth also assumed forecast. What we think where we are today with the units, we are going to deliver with the pricing that we know for those units that will be delivered in those years, we think it's the pretty accurate forecast Steve.

Steven Binder - Bear Stearns

Okay. Thank you.

Operator

Our next questions from Troy Lahr of Stifel Nicolaus.

Troy Lahr - Stifel Nicolaus

Thanks. Question for James, really in the past one analyst have really pushed back on the 2008 BCA margins, you often stated that booking margins would be lower on the 787 or really dilutive to segment margins. I was kind of thinking may be 150 basis points. Now that you aren't booking that lower margin revenue on the 787 in 2008, what is the likely impact to BCA margins? I would think you would see a little bit of a favorable impact, I don't know that's been offset by overhead absorption and may be a little bit of the higher R&D. Can you just kind of help us to understand that?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

You just answered your own question. Clearly, we will get some lift in terms of the margin with the number of 787 slipping out because they are dilutive but that is going to be absorbed with the increased R&D cost.

Troy Lahr - Stifel Nicolaus

The increased R&D cost is only like maybe 60 basis points right, but I mean does that fully offset it or you have the overhead absorption also?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

That's a pretty, in fact we have to do some productivity to offset still some of the R&D effort.

Troy Lahr - Stifel Nicolaus

Okay thanks guys.

Operator

Our next question is from Robert Spingarn of Credit Suisse.

Robert Spingarn - Credit Suisse

Good morning, James could you go back and review the cash flow, perhaps the operating cash flow components, I think we all expected a reduction in '08 cash flow based on the delay and if that would flow as a positive it will be offset in '09. But this materialization of \$3 billion in '07 is a large number, you've attributed it to several components; working capital moving around, advances etcetera. Could you give us some more clarity on the '07 up tick and the '08 down tick in terms of how much is 787, how much is working capital moving around elsewhere?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

I'll do that the...in '07 we're seeing about \$1 billion of that be in acceleration of what we thought we would guide in '08 as we've experienced much better quarter traffic in a lot of higher orders, so that's part of it. A part of it is the fact that our tax payments have been deferred, we got better tax this year, we would... they would be higher because of the higher earnings as we would also payments in this year and that's not happening, that will happen in '03. But it's principally that... and excuse me, in '08 and it's principally that and the working capital management that will continue to focus on and to experience pretty good success within the increase in '07.

Now in '08 the decrease is probably about \$2.5 billion associated with the slide of the 787s and the loss of that revenue and the \$1 billion I had already mentioned to you is an acceleration into '07 as

we've experienced a better order traffic this year and some of our customers have accelerated their advance payments. And then finally, we have a little there to protect against any increases in costs in the supply chain as we go forward and deal with the disruption associated with the slide.

Robert Spingarn - Credit Suisse

I see, thank you.

Operator

Our next question comes from Joe Campbell of Lehman Brothers.

Joseph F. Campbell Jr. - Lehman Brothers

Hi, good morning. I wanted to ask about the 787 production schedule rather than the delivery schedule and as explained in the first two years, there is only a couple of plans that are slipping, so it appears though that we are relatively late on the first, I don't know, it's hard to tell, because you haven't made it clear, but presumably by April or so you had planned to make six flight test airplanes and another 15 or 20 airplanes that doesn't now look likely. So what is happening so that the downturn that we or the shortfall in delivery and production rather than deliveries is going to be made up later and presumably you'll have to go to a higher rate that you didn't anticipate going to sometime later in '09 in order to make up for the shortfall in the front and turn out about even in the end and I'm sort of looking through what Jim said he's done and I don't see in there the kinds of things that would allow you to go even faster than you had previously thought you could go in '09 to make up for the shortfall that you're going to have in '08.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Joe this is Jim. Let's go back and review the bidding. I mean, I think the driving reason for the schedule push out was the completion of the first airplane. The... and we are getting our arms around that as we speak, but we never turned off the supply chain for the completion of all the work they needed to do on the balance of the airplanes.

Joseph F. Campbell Jr. - Lehman Brothers

But I would have thought you needed to have say six airplanes by December FY07 in order to get your flight test going, now looks like I you're going to have two planes by March '08, so it seems like there is a quite a few missing in the front and if that's not right, then of course you don't have to fix things back.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

There is no question Joe that the final assembly of those airplanes will occur later than in the original plan. However, the formation of all the components in the sub assemblies and the major structures of the airplane which takes the most time and which requires the most effort and the most investment that is ongoing as we move forward. So the assembly of the airplanes is in the schedule is compressed as you pointed out, but the majority of the supply chain work will continue on the old schedule so it's a --

Joseph F. Campbell Jr. - Lehman Brothers

But if I go to Spirit or Alenia or whatever, I can't find 14 feet barrels, I mean in the other words I, it looks like the suppliers because, the FAB final assembly was all clogged up. You move two planes around these test units, but that doesn't seem like enough to keep these guys and get them to the rate that they were going to be on?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

I don't think Spirit's supply chain; plan has changed dramatically as a result of this push out and we would be glad to sit down and talk to you about it, but it's a... I think their plans in terms of the components they are building that is not changed and now we are obviously going through the detailed plan to make sure that the detail support where we have all committed we can get to, but its

something that is ongoing right now. And if you need some more visibility Joe, we will be glad to sit down with you.

Joseph F. Campbell Jr. - Lehman Brothers

Okay, terrific, thank you.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Okay thanks you.

Operator

Our next question is from Robert Stallard of Banc of America.

Robert Stallard - Banc of America

Good morning.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Good morning.

Robert Stallard - Banc of America

Jim, I would like to ask you about the demand environments of BCA, you mentioned that some of the orders have moved forward into '07 from '08, does that imply that we should expect the BCA orders to be down fairly significantly next year and what do you think to be a book-to-bill ratio is going to turn out to be?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Well I think we have been, I should say pleasantly surprised by the strength of the commercial airplane market in the last couple of years. We always anticipated that we would exceed book-to-bill and but we didn't quite frankly think it would be as by as much as we have. I think it's largely driven by wide body demand that came in stronger, particularly the 787. Now in '09, in '08 and '09 we are not in a position to provide guidance right now, but we are seeing strong momentum as we sit here today. And it would not be inconceivable that we ended up with the year, that's not too different than last year, before it's all over.

Robert Stallard - Banc of America

So you're saying that '08 orders could be as big as '07?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

No, no, I didn't say that, I said I am not in a position to tell you, but what I am in a position to tell you is that '07 continues strong as we sit here and we are late into '07, it would not be inconceivable that we would finish strongly and now the momentum as it carries into '08, we are not in a position to opine on that right now, but we will soon.

Robert Stallard - Banc of America

Okay. Thank you.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

You're welcome.

Operator

Your next question comes from Ron Epstein of Bank of America, excuse of Merrill Lynch.

Ronald Epstein - Merrill Lynch

Yes. Good morning.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Good morning Ron.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Good morning

Ronald Epstein - Merrill Lynch

Just to follow up on Joe's line of questions, when you have the suppliers sort of continued to build the plane and you conceivably have this inventory of planes and you deliver. What makes you so confident that there's not going to be some sort of material physical change that you're going to have to make that inventory plan that could come up during flight test that conceivably could be an unbounded viability may give you a really big number depending on what would have to change? I mean what makes you feel comfortable that that risk, it's probably that happening is so small.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

There is some risk of that. As we look back over other programs we've had, we've had substantial builds during flight test and as a matter of fact we build into the flight test, time for rework if there are any issues that pop up during flight test than we have that, we have that planned in our schedule this time. So, look, to say that it's completely risk free is wrong, because something could happen, that's out of balance of the kinds of things we've experienced before. But as we... as the program has been pushed out, quite frankly, we have a little more confidence in these systems and in the structures as we have more time to test them than we do going into a lot of flight test programs. So, not risk free, but we build back the normal margin we have for re-work. The amount of planes we're building is not dramatically different than planes we've build before in other flight test programs

Ronald Epstein - Merrill Lynch

Can I ask one follow on?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Sure.

Ronald Epstein - Merrill Lynch

How many airplanes do you expect to have floating around before you start delivering?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

We can get back to you with a better number, but its somewhere in the 55 to 65 range.

Ronald Epstein - Merrill Lynch

Okay, thank you.

Operator

Our next question is from Howard Rubel of Jefferies.

Howard A. Rubel - Jefferies & Co

Thank you. I want to follow up on the research and development a little bit, I mean there is two parts to it. One is it looks if you add back the supplier payments in this quarter, your R&D has peaked and then as we look into next year with the... I'll call it the accounting change, does that mean that your SG&A will be lower? And then related to that, you've changed your program manager on the 747, so why don't we see that all of these disruptions, the additions to the R&D not in fact have caused some other knock on effects elsewhere in the company?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Howard let me take a shot at that. I will get back to the first part of your question. Clearly, the R&D spend is peaking this year, we do plan to have R&D come down in '08 just not as much as we had originally planned for it to happen. The accounting change was on U.S government contracts where you have the ability on follow-up work to chart the proposal efforts to contracts, we had discussions with our customers this year, decided that it would be better and more appropriate to have that run through the normal B&C and R&D expense. So, it's going from contract to R&D not going back in the G&A, although R&D is part of G&A, but it's separate out. So, there is... that's what's happening on that side and we have looked at the disruption caused by all that's going on in our overall R&D effort, both at BCA and IDS and the guidance we have today and what we are increasing it to, we think accommodates all of that.

Howard A. Rubel - Jefferies & Co

Thank you.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

You are welcome.

Operator

Our next question is from Joe Nodal of J.P. Morgan.

Joseph Nadol - J.P. Morgan

Thanks, good morning.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Good morning Joe.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Good morning Joe.

Joseph Nadol - J.P. Morgan

Jim, my question is back in the 787 and it's on Pat Shanahan. Is any change to the plan you announced, I guess it was last week or two weeks ago, is there any change to that schedule on the table or is that now what we shouldn't expect any change certainly the rest of the year and obviously and see how things go next year? And did Pat have any input into that plan?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Pat had no direct input into the plan. Pat is going through a slow down of the plant right now with the team. However, all the people that supported the new plan and all the functions that supports the new plan as well as our suppliers did support the new plan. Now, and as I said before I thought as Scott and I thought that Pat was the best guy to implement this phase of the program, which is much more of a supply chain operating focus day-to-day program management task. So that's... and he has embraced that, he knows the people, he knows the functions, he's been in BCA and there has been nothing that's popped out of the last week that suggest that this plan is not the right plan.

Joseph Nadol - J.P. Morgan

So is there a time in the next few weeks where we can assume basically that he's fully vetted to plan, vetted... gone through all the nooks and crannies of the program imbibed into it or is it still subject to change if he comes back to and says, 'look I didn't know about this, this and this?'

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

There is a remote possibility that that could happen but I doubt it. I mean he is... he has been into this plan and over the next couple of weeks, I think the details will be flushed out of the operating plan at a very detailed level of the first and second tier supplier level that will support it. As I said before, our supplier partners already supported it. So, I think the likelihood of the surprise is not high.

Joseph Nadol - J.P. Morgan

Okay, thanks.

Operator

Our next question comes from George Shapiro of Citigroup.

George D. Shapiro - Citigroup

Yes, good morning.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Good morning George.

George D. Shapiro - Citigroup

There is a slight reduction in deliveries that you're projecting through this year down to low end of your guidance of 440, which is you alluded to it in the second quarter. But my question is, with demand seemingly as strong as it is, I haven't seen any deferrals throughout the rest of this year,

so do I conclude properly or improperly that there maybe some supplier issues that have prevented you from getting to kind of the higher end of the 445 and if so, what's the risk for reaching the higher deliveries next year?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

No, they are not supply chain issues, George. They are just... its just timing issues with our customers in when they want to take the airplane and so that's where we are, but what we think it will be 440.

George D. Shapiro - Citigroup

But given the strong demand out there James, you would have thought that you would have demand for the higher end of what you were projecting?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

But it's the customer decides when they want to take delivery and they've told us that this is about the... what we are telling you the guidance is going to be for the next quarter and for the total year that's where they are and it won't impact '08 though.

George D. Shapiro - Citigroup

Okay, can I get one follow up too.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Why should you be different?

George D. Shapiro - Citigroup

Yes thanks Jim. The margin ex-R&D this quarter was dropped down to 19.21 from 19.29 in the second quarter. Now is that just reflecting some mix difference out there or is there anything else involved?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

No, I just think it's some period expense and the timing of it. I don't think... there is nothing major that's causing that phenomenon.

George D. Shapiro - Citigroup

Okay, thanks very much.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Sure George.

Operator

Our next question comes from Doug Harned of Stanford Bernstein.

Douglas Harned - Stanford Bernstein

Good morning.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Good morning

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Good morning.

Douglas Harned - Stanford Bernstein

On defense James, you commented that you are looking at a lower margin guidance in 2008 and that's to protect against program risk. I know as also you had lower revenue guidance in IDS for 2007. Could you talk a little bit about what's driving this, and are there specific risks that you are concerned about next year?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

The revenue guidance in 2007 is higher.

Douglas Harned - Stanford Bernstein

Is it?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Yes. I said that we are going up to \$66 billion driven by IDS and it's better volume principally in Network Systems.

Douglas Harned - Stanford Bernstein

But then in '08, can you talk about the lower margin guidance in any program risk you might have?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Yes. It gets down to we are at the front end of a lot of multi-year contracts. The mix that we will see next year and you know obviously, it is a constrained funding year and then when you put the R&D increase that we have associated with IDS it just as we ought to temper the margins to deal with that. Now we are going to still be challenging them to do better but obviously with what we see today that's about where we think it will be.

Douglas Harned - Stanford Bernstein

Okay good. Thank you.

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

Good.

Operator

Our next question is from David Strauss of UBS.

David E. Strauss - UBS Securities

Good morning, thanks. Could you just address profitability on an initial batch of 787, I think in the past you talked about from a program accounting standpoint you expected it to be possible. I think from a unit accounting standpoint you also said it would be profitable. With the delay obviously we are seeing the schedule with some of the penalty payments and I am not sure if you are capitalizing any other cost, could you just address what you are looking as far or thinking about in terms of profitability on the initial batch?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

We still think the initial units will be profitable. We haven't gone through and completed our analysis yet on what the accounting quantity side will be and are they still working all the cost estimates and then obviously we have a pretty good feel on pricing because we have sold so many of the airplanes but we haven't concluded those... that analysis yet we are working through our auditors and we will meet quite frankly, but we do know and still feel that those initial units will be profitable, but they will be diluted from a margin standpoint to our marked mature material programs.

David E. Strauss - UBS Securities

Okay and as a follow up, I recall two weeks ago when you announced the delay on the 787 that you said that R&D was not going to increase in 2008, its now --

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

No, I never say that.

David E. Strauss - UBS Securities

Okay.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

I had said that... I said in '07 we would hold it. In '08 we always had high risk on the R&D number, but what we've said is if in fact it has to go up, we would still be able to hold the current guidance on earnings per share and we are holding earnings per share guidance.

David E. Strauss - UBS Securities

Okay fair enough, thanks.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Okay, you're welcome.

Operator

Our next question comes from Myles Walton of CIBC World Markets.

Myles Walton - CIBC World Markets

Thanks good morning.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Good morning.

Myles Walton - CIBC World Markets

Jim, I know it's a bit away, but given you have your machine of contract ups in September of '08, is there anything you can do in advance to perhaps pull forward negotiations to mitigate that work stoppage at such a critical time in this delivery schedule for yourselves?

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

Well, I mean we are working with our employees, our represented employees all the time and I think the... I think there is a low probability that we would change the timing of that discussion and the in-contracts offer a variety of reasons, but I think there is a little probability of doing that and I think we are in a rhythm of working together with the union to come up with the successful negotiation and that's what I anticipate quite frankly.

Myles Walton - CIBC World Markets

And can you remind us if there were work stoppage, are customer penalties excluded from you paying those if it's due to work stoppage or is air customer penalties still on the table?

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

I am not aware of any of that would where there were stoppage, it would be included in the penalty set, but I don't want to answer that categorically, by and large we have some and so many words, indemnification from that.

Myles Walton - CIBC World Markets

So in fact could give you a little flack?

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

Pardon me.

Myles Walton - CIBC World Markets

Work stoppage could in fact give you a little flack, if that were to occur?

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

No, we do not want work stoppages, okay. I understand why you make that comment, but the disruption for our customers and the pain we would cause them would be far worse than any slight sorting out of a supply chain issue. We do not want that.

Myles Walton - CIBC World Markets

Fair enough, thank you.

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

Yes.

Operator

Our next question is from Ben Fidler of Deutsche Bank.

Benjamin Fidler - Deutsche Bank

Yes morning. Question if I could, just to clarify a bit more on the 787. Just in terms of how far through the supply renegotiations and the discussions with your airline customers you now are on the 787 and when you expect to fully complete those?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

When you said did you say customer or the supply chain?

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

I think he said both.

Benjamin Fidler - Deutsche Bank

Both actually yes, both.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Well obviously we're on the supply chain as Jim mentioned, the discussions around any changes associated with the slide, any changes in statement of work associated with the development program are pretty mature and we believe we have the... what the ultimate settlement position on that already taking care of both in our R&D guidance, where would be the R&D related and then our assumptions for booking rate on the program of accounting the assumptions. So that when we start to delivering in the next year, that is already included.

On the customer side, we have obviously talked all of them. And they are not pleased but, and we are obviously disappointed that we are calling them not to be pleased but, on the other hand they are very, very supportive of the products and we really don't at this point, given what our... the current plan is believe we are going to have a fatal issue with the customer.

Benjamin Fidler - Deutsche Bank

Okay, thank you. And maybe just one follow on clarification as Jim what you've mentioned earlier, which is when you expect Pat will complete his own sort of review of 787? Did you put a time on that?

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

Well I characterize the flushing out of the detailed plan against the new schedule as occurring over the next two or three weeks.

Benjamin Fidler - Deutsche Bank

Okay. That's great. Thank you very much.

Operator

Our next question comes from Gary Liebowitz of Wachovia.

Gary Liebowitz - Wachovia

Good morning.

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

Good morning.

Gary Liebowitz - Wachovia

The 787 is not the only new commercial aircraft you plan to introduce next year. How should we think of the risks of the extra engineering and flight testing resources that have to be dedicated to 787, affecting the other programs?

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

Well I think the... there is a 777 Freighter flights are... is also occurring next year. We think both are accomplishable, and that is really the only potential conflict that I see in terms of work... push out work on the 87 having to be dovetailed with other work on new products next year.

Gary Liebowitz - Wachovia

So no impact maybe on 747-8 little further down the line?

W. James Mc Nerney, Jr. - Chairman, President and Chief Executive Officer

We don't see that. I mean there is obviously engineering resources that have shown up late on the -8 program versus an original plan, but we found ways to work around that through accessing engineers through our other parts of the Boeing system and some external resources.

Gary Liebowitz - Wachovia

Thank you.

David Dohnalek - Vice President of Investor Relations

Thank you. Operator we have time for one more question from analyst please.

Operator

Our last question before media questions comes from Peter Arment of AmTech Financial.

Peter Arment - AmTech Financial

Gary just addressed my question. Thank you.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Okay, Peter thank you.

David Dohnalek - Vice President of Investor Relations

Okay operator, we can shift now to the media questions please.

Operator

That completes the analyst question-and-answer session. [Operator Instructions]. I would now return you to the Boeing Company for introductory remarks by Mr. Tom Downey, Senior Vice President and Communications. Mr. Downey Please go ahead.

Thomas J. Downey - Senior Vice President, Communications

Thank you. We'll continue with the questions for Jim and James. If you have questions after the session ends, 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

Thank you. Our first question comes from Lynn Lunsford of Wall Street Journal.

Lynn Lunsford - Wall Street Journal

Good morning.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Good morning, Lynn.

Lynn Lunsford - Wall Street Journal

One of the things that Jim that you've said in the past is that the 787 program has sort of lives and dies by transparency and you said earlier in the conference call that Boeing had some additional people out to the suppliers. One of the key things that it seems like that Boeing has have to get a handle on as it is been able to determine whether your supplies were telling you what you wanted to here versus you what you needed to hear. Are you feeling like you've got a good idea into that or a good window into that particular part of the equation given that you rely on them so much for being able to complete U.S. production?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

I understand your question Lynn. I mean, I think the... we were surprised on the physical reality of some of the things that we received from suppliers versus the documentation we realized, we really needed to work with them to make sure we had better visibility on the build and on the components that were coming into them, which is why we have sent out a number of procurement and manufacturing people as opposed to the engineering types that had been working with them historically on the design. And one of the end products of that work is trying to get real time visibility on the supply chain there as well as here in the United States and I would say those efforts are ongoing, but almost complete and to your point, we need that data transparency across all of the build in order to execute the plan that we've laid out and that's what we are doing.

Lynn Lunsford - Wall Street Journal

One quick follow up and that is I don't know if you've really characterized it, but when you initially said that there was a slight delay to the program, but that you still felt like you could make the initial first slide you qualified it by saying that pretty much everything had to go right.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Yes.

Lynn Lunsford - Wall Street Journal

In this case, are you with saying that you can still deliver approximately the same number of airplanes by the end of '09, is that a conservative or conservative kind of statement or are you again saying that that's if everything goes right?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

I would characterize it as an aggressive plan with normal margins in it.

Lynn Lunsford - Wall Street Journal

Okay thanks.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Okay Lynn.

Operator

Our next question comes from Kevin Done with Financial Times.

Kevin Done - Financial Times

Could you confirm for me please whether you said that 39 deliveries were being moved out of '08 into '09 and that will mean you expect now to deliver how many in '08 and how many in 09 of 787s? And Jim, did I assume correctly that you said you thought of now gross orders for this year 2007 could easily be as strong as 2006? Many thanks.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Yes, I did. Just to answer your last one, first, I believe that with the current momentum we have got, it could happen and I think order of magnitude a good guess would be plus or minus '06, now whether that momentum carries through to '08 I think we've got to think about, before we provide additional guidance. I think the... to your first question, I think we mentioned that 35 plans were moving out from 08 to '09 and a claim [ph] totaled by the end of '09, our current target is 109, versus 112 which was the original schedule so, three being pushed into 10 net impact.

Kevin Done - Financial Times

And to how many would you deliver in '08?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Very few, a handful.

Kevin Done - Financial Times

Can you put a figure on it.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Three or four, something like that.

Kevin Done - Financial Times

Thank you.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

We will double check that number for you.

Kevin Done - Financial Times

Thank you.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Thank you.

Operator

Our next question comes from the Dominic Gates of Seattle Times.

Dominic Gates - The Seattle Times

Hi Good morning.

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Good morning Dominic.

Dominic Gates - The Seattle Times

Just a quick question, you talked about sending a lot of people out to the supply chain, could you just and answering Lynn Lunsford, you seem to indicate that there is less engineers and more procurement people. Can you give us any idea how many people Boeing has got placed in this supply chain and maybe just talk a little bit more about the difference in the type of work they are doing compared to earlier. By the way, Jim I think I heard you say that you have... you were basically dealing with six supply chains, what are those?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

We are talking about the big supplier, the suppliers of the sub assemblies the MHIs, KHIs --

Dominic Gates - The Seattle Times

Your software partners?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Yes that's what I meant by that comment.

Dominic Gates - The Seattle Times

Okay.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

The answer in the terms of the number of Boeing folks out at suppliers, it's in the 100s is the way I characterize it. And I would say the mix of the type of people out there used to skew more toward the front of the development effort, which is more engineering and some procurement. Now the mix skews toward actual manufacturing folks and procurement folks. Not that they aren't an engineer or two out there, but it's and I don't the number precisely, but the mix has changed substantially, as the task has come, has become more supply chain oriented and less design oriented.

Dominic Gates - The Seattle Times

Is there are any shortage engineers in Fugitsu [ph] to do things likes this 747-8 program and the other engineering work that needs to be done?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Well, as I mentioned before as some pressure on the engineering population occurred due to the 87 push out, I think we had to tap into other parts of Boeing and that's one of the advantages of our size. Other parts of Boeing to staff some of the -8 work, but we see that peak passing in '08, so there has been some pressure and we've had to scramble a little bit, but I think by and large we've been able to get the work done.

Dominic Gates - The Seattle Times

Thank you.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Thank you.

Operator

Our next question is from Molly McMillan of Wichita Eagle.

Molly McMillan - Wichita Eagle

Hi good morning.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Good morning

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Good morning

Molly McMillan - Wichita Eagle

Hi I wanted to follow-up on Joe Campbell's line of questioning with Spirit and how many barrels do they have in production over there and what is their schedule now? And then two, I know they were

going to get paid until last certification through their contracts, but have you renegotiated that where now payments remain back on the original schedule or whether it be a delay?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

I haven't been to which I thought accounts specifically but the last time I revived it, it was 10 or more barrels but I... we'll get you a specific answer there.

Molly McMillan - Wichita Eagle

Okay.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

And that supports the plan that we are on. What was the part of your questions there?

Molly McMillan - Wichita Eagle

The payments.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Oh the payments, yes, we do have contractual milestones on payments and but the extend to which we cause suppliers undo problems we will have fair discussions with them.

Molly McMillan - Wichita Eagle

Okay have you had any other discussions yet or?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

No, no, not that kind of discussions specifically.

Molly McMillan - Wichita Eagle

Okay and can I ask one clarification. There 10 or more barrels now that's the new plan, what was the old plan?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Well, I think that was my point earlier trying to say to Joe, that the... in terms of the build for Spirit, the two plants are not dramatically different. We are continuing to build the major sub assemblies for the airplane at the same rate; it's the deliveries that will be pushed out.

Molly McMillan - Wichita Eagle

Okay thanks you.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

You're welcome.

Operator

Our next question comes from Stanley Holmes of BusinessWeek.

Stanley Holmes - BusinessWeek

Good morning Jim.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Good morning, Hi Stanley.

Stanley Holmes - BusinessWeek

A couple of quick questions; one is on update regarding the 787 systems. First you mentioned last call that the flight control software was pretty much completed to struggles of the challenges there you had handled, however, there is seen to be quite a bit of struggle and challenge with the actual software systems that Smiths is overseeing and various other contractors that are connecting in with Smiths, what's the status on that?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Well I think that the overview comment would be that the software systems and as you point out Honeywell and Smiths are two major partners there. As we see it now they are not long poles in the tent as we address this new schedule. I think the Honeywell work is maturing nicely, in fact we were hopeful of even getting a later generation of software into the first planes and we are working, we are

seeing if we can do that now. So that's a better new story I would say, is there some risk, yes. But I think we are feeling much better about that.

On the... on some of that and I think you alluded earlier to some of the break control work that Smiths is doing and we had to reschedule that we had accomplished there. We had some struggles, but I think that the joint team is feeling better about the schedule there and it fully supports what we are doing here.

Stanley Holmes - BusinessWeek

All right, so the key it will be the Smiths part of the equation which means not just Smiths, but the other suppliers that are connecting the software with the boxes that Smiths is producing. You feel that that is can now support the new schedule.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Yes we do.

Stanley Holmes - BusinessWeek

Okay and then finally, what about on these when the 787 is finally assembled and their production rate in Everett. Do you expect to see our hiring of more mechanics and machinists than you previously had expected in order to catch up and to keep the so many lines humming at a peak?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Yes, I think there will be incrementally more labor required than we had originally scheduled because as you know there is the traveled work on the first couple of planes which obviously generates more labor requirement. And as we go through a transition from doing less and less of that the as the condition of assembly from our suppliers gets closer to the original plan which is a 100%, we are going to need some labor over the next few months to do that traveled work.

Stanley Holmes - BusinessWeek

And just a quick follow up to that, does that mean is there a number, I mean can you give us kind of a just a ballpark figure of what you are anticipating to employ in final assembly versus what likely the new number will be to get you over the hump?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

I can't give you that number Stanley; I think the...it's not a large number.

Stanley Holmes - BusinessWeek

Okay. So alright thanks.

Operator

Your next question is from Laura Mandaro of MarketWatch.

Laura Mandaro - MarketWatch

Yes hi. I was wondering you might have mentioned this, but I want to make sure I understand. Question about customers who were scheduled to deliver the airplane and we are going to see these certified plants pushed off by at least six months. Have you already agreed to compensate some of them and have agreed to compensate some of them and what did you say that cost will show up, is that part of the R&D expense or is it somewhere else?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

We have had discussions with all the impacted customers. There is constructive discussion on both sides and any penalties that are incurred by Boeing would flow in to the program accounting of the total program.

Laura Mandaro - MarketWatch

So that's not part of the --

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Not a direct period expense.

Laura Mandaro - MarketWatch

Okay, okay. And then could you just give a brief description of how your earnings outlook stays the same, while the revenue projection is shaped for '08, I thought I heard you talk about cost I mean where is that coming from? Are you taking people out of other programs?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

No, what we said is the earnings we will be able to hold because we have really robust productivity programs underway and that's going to contribute a portion of the improvement that allows us to absorb the additional costs and then we are also doing things here at corporate office in terms of affecting our compensation costs, affecting our pinching cost and some of the other things that we are responsible here. Between the two of those, they will offset the increased costs we are going to experience by the slide.

Laura Mandaro - MarketWatch

Could you give an example of what the productivity program is like, I know what you're talking about?

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

Like lean for instance where we are leaning out how we manufacture our products by taking out unnecessary steps, improving our cycle time while improving our quality and reducing the costs and the number of hours it takes to produce the products.

Laura Mandaro - MarketWatch

Okay, so on the manufacturing floor. And then if I say, you're trying to restrain compensation or to shape compensation in some way, is that --

James A. Bell - Executive Vice President, Finance and Chief Financial Officer

We changed our compensation plan last year, our long-term compensation, but that still provides a great incentive entitled directly to the performance of our executive, but it is the expense of that program is less than our prior program.

Laura Mandaro - MarketWatch

I see. Okay alright. Thank you.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

You're welcome.

Thomas J. Downey - Senior Vice President, Communications

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

Operator

Thank you. Our final question comes from Mike Meacham of Aviation Week.

Michael Meacham - Aviation Week

Good morning.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Good Morning Mike.

Michael Meacham - Aviation Week

In your early recovery plan, you were going to shave some of the steps in flight test and moving back further end of the program. Now that you're on a new plan, are you going back to an original approach on flight test that is to pull... to push fully through flight test both engines as well as looking at improvements that might be applied in the aircraft later on gross weight and stuff like that is, is it normal part of flight test so that you get some data to be applied to the program further down the lane?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

The way I characterize it Mike is, when we... as part of the reschedule, we put some normal margin back in the flight test program. We had squeezed most of that out as we tried to meet the original

schedule and so I would say we are back to the originally contemplated test that it does include the certification of both engines that does leave room for some rework if some of the test results suggest we should do it. So I would characterize it as sort of the original schedule.

Michael Meacham - Aviation Week

That would mean if... I'm trying to think numbers, it were still more aggressive than what you get on 777?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

Yes, it was more aggressive. I think we... as we pointed out before we had sort of 24x7 we have more commonality in the airplane so less variance the test. We had some work we'd done with the systems pre-flight test that we hadn't before, so we are trying to learn from prior flight test programs to quote lean out the flight test program to begin with and there is no e-tops serve required here either as there was on the triple.

Michael Meacham - Aviation Week

So that's saving you time there. But in the hurried up plan if can I characterize it that way, it was referred to running of flight test as if it were an airline. Are you offset kind of intensity?

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

No, we have kept that kind of intensity but we inserted normal margin for our hiccups.

Michael Meacham - Aviation Week

Okay. Thank you.

W. James McNerney, Jr. - Chairman, President and Chief Executive Officer

You are very welcome.

Thomas J. Downey - Senior Vice President, Communications

That concludes our earnings call. Again for members of the media, if you have further questions please call our media relations team at 312-544-2002. Thank you.

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