



# Recommendation

We recommend longing Boeing Co. an aerospace company at its current price \$391.472 due to multiple catalysts and potential future growth within the stock. Target Price is \$416.28.



# Company Background:

- Boeing is composed of three main parts: Commercial Airplanes; Defense, Space and Security; and Global Services.
- The company's Commercial Airplanes segment develops, produces and markets jetliners for passenger and cargo flights.
- Boeing Defense, Space and Security segment researches and manufactures manned and unmanned military aircraft and weapons technology, including missile, surveillance and reconnaissance systems.
- Boeing's market cap is 218.7B with a geographic focus in the United States.
- Boeing employs more than 140,000 people across the United States and in more than 65 countries.



# Investment Thesis

- Currently, market views Boeing as the standard for commercial aviation and military aircraft.
- As a result, the company has been awarded new contracts to manufacture airplanes, defense, space and security. This has led to Boeing trading at new highs.
- Stock price is considered above average compared to other peers within the industry.



# Investment Thesis

Within the past year:

- Boeing's operating margins have increased 4.8 Pts.
- The company's operating cash flow has increased 27%.
- Boeing's net earnings increased 67%.

## **Commercial Airplane:**

Revenue decreased by 2% from previous year.

Boeing's commercial airplane deliveries increased by 2% from previous year.

Operating margin in 4th quarter of 2017 increased 11.5%.

## **Defense, Space and Security:**

Revenue decreased by 7% from the previous year.

Operating margins increased by 1.9 Pts from the previous year.

Revenue in the 4th quarter of 2017 increased \$5.5 billion and operating margins increased by 10 points in the 4th quarter as well.

## **Global Services:**

Revenue increased by 5% from the previous year

Operating margins decreased 0.2 Pts.



# Investment Thesis

- The **Commercial Airplane** sector of Boeing made up 60% of the total revenue of Boeing.
  - ❖ There are 72,465 employees who work in **Commercial Airplanes** sector.
- The **Defense, Space and Security** sector of Boeing made up 22% of the total revenue of Boeing.
  - ❖ There are 50,699 employees who work in the **Defense, Space and Security** sector.
- The **Global Services** sector of Boeing made up 9% of total revenue of Boeing.
  - ❖ There are 20,000 employees who work in **Global Services**.
- Boeing's **Single Aisle airplane** deliveries made up 73% of all airplane delivers. **WideBody** accounted for 19%, **Freighters** 2% and **Regional Jet** 5%
  - ❖ **Single Aisle** airplanes have a 3,480B market value. **WideBody** 2,480B, **Freighters** 280B, **Regional Jet** 110B.
- Analysts who closely follow the aerospace company predict earnings growth for the company to grow 17.07% by December 2020.



# Catalysts

- Blue Origins LLC, a space transportation run by Jeff Bezos won a contract to provide their E-4 engines for Boeing and Lockheed Martin Corp joint rocket venture called United Launch Alliance. These engines will be placed on their Vulcan Rocket and according to WSJ United Launch Alliance stated “Our new rocket will be superior in reliability, cost and capability.”
- Boeing secured contracts from the Pentagon which was worth \$9.2 billion to build new trainer jets for the Air Force. The contract to build these jets and supply training services is one of the largest Defense Department programs awarded in recent years.
  - This contract will increase sales in defense arm for the first time in four years
- Boeing won a \$2.4 billion contract to replace Air Forces helicopters that were aging. These helicopters were tasked with security missions as well as protecting America’s nuclear missile arsenal.
- The UK government is currently talking to Boeing about a multi billion dollar contract to replace its fleet of aging surveillance aircraft for the Royal Air Force.



# Catalysts

- Boeing is in the early stages of developing a passenger plane which could travel from New York to London in roughly 2-hours the aircraft is part of a plan that involves both commercial and military applications.

- A 10 percent aluminum tariff would increase the cost of a plane by about 1.2 percent.

- 25 percent tariff on steel would cost aerospace companies less than \$100 million.

- Aluminum tariff would increase Boeing's 787 plane cost about 0.09 percent.

## How would Trump's tariff affect the cost of Boeing's 737?

Aluminum makes up 80 percent of the weight of the plane, but the impact of a 10 percent aluminum tariff on Boeing's production costs would be less than 1 percent.

$$\begin{array}{ccccccccc} \mathbf{35\ percent} & \times & \mathbf{33\ percent} & \times & \mathbf{25\ percent} & \times & \mathbf{10\ percent} & = & \mathbf{0.3\ percent} \\ \hline \text{Cost of aluminum} & & \text{Cost of aluminum} & & \text{Percentage of} & & \text{Tariff proposed by} & & \text{Increase in} \\ \text{parts as a} & & \text{(raw material) as a} & & \text{aluminum (raw} & & \text{the Trump} & & \text{overall} \\ \text{percentage of} & & \text{total cost of} & & \text{material) that is} & & \text{administration on} & & \text{production cost} \\ \text{the plane's total} & & \text{aluminum parts} & & \text{imported} & & \text{imported} & & \text{due to tariff} \\ \text{factory cost} & & & & & & \text{aluminum} & & \end{array}$$

Source: AlixPartners

C. Chan 06/03/2018

REUTERS





# Valuation

- Our **Target Price** of \$416.28 was calculated by taking current share Price x trailing PE/ forward PE.
- Current P/E Ratio is 21.96 compared to the average 45.24 within the AeroSpace Industry.
  - This indicates that Boeing's future earnings are substantially less than the industries average, showing neither volatility or much growth.
- Current P/B Ratio is 7.8 compared to the average 6.43 within the AeroSpace Industry.
  - Boeing's ratio is slightly overvalued stating that it can be earning high returns on it's assets.
- Current Price/Sales Ratio is 1.93 compared to the average 1.83 within the AeroSpace Industry.
  - The higher price/sales ratio indicates that Boeing has a higher value placed on each dollar of the company's sales or revenues compared to the average industry.



# Investment Risks

- Demand for Boeing's product is highly cyclical. The company is geographically diversified with low margins and high debt. Boeing relies on the long term stability of the commercial airplane market which makes the company less flexible when/if the market is disrupted.

## **Cyclical, Low Production Volume and Customer Concentration**

- Demand for commercial airplanes are cyclical and this market produces 66% of Boeing's revenue (As of 2014).
- Bust periods of an economic cycle would impact revenue, profit, and cash flow of Boeing. This bust would lead to inventory management problems which would negatively affect cash flow.
- In 2014 Boeing delivered 723 commercial airplanes which was a higher delivery volume compared to the past 2 years. If there is a delay or cancellation in orders this will have an impact on inventory and cash flow.



# Investment Risks

## Mature Industry

- Mature industries have average growth rates with small margins. Both of these apply to Boeing.
- Boeing's revenue has grown about 5.6% over the past 10 years. If you compare this to Airbus (a competitor) they posted a 7% growth rate over the past 10 years. Both companies are held back by competition within the market so investors don't expect rapid growth.
- Boeing posted a 15.1% gross margin in June 2015 which was better than Lockheed Martin (a competitor) who posted a 11.7% gross margin. Even though they had the advantage in gross margin, Boeing's operating margin was 450 basis points below Lockheed's Martin and 840 basis points under United Technology Corporation. These margins reduce the company's ability to invest in product development or pursue an aggressive pricing strategy.

