



## The Boeing Company

**Rating: T2-**

**Status: Downgrade**

**Outlook: Negative**

*Based on the materials reviewed, a company with a rating of "T2-" provides limited transparency, consistency, and straight-forwardness. There are considerable indications of concern within the presentation, description of the financials, and other corporate activity.*

The above rating was completed on August 30, 2009, and it primarily covers the quarter-ended June 30, 2009. The below analysis is based on the following inputs:

- Q2, 2009, 10-Q
- Q1, 2009, 10-Q
- 10-K, 2008
- Q2, 2009 earnings call transcript ("earnings call"), dated July 22, 2009
- Form 8-K, dated August 27, 2009
- Q2, 2009 financial press release, dated July 22, 2009
- Q2, 2009 financial presentation

<u>Category</u>	<b>Q2, 2009</b>	<b>Q2, 2008</b>	<b>Variance</b>	<b>Growth (%)</b>	<b>% of Rev</b>	
					<b>Q2, 2009</b>	<b>Q2, 2008</b>
Revenue	17,154,000,000	16,962,000,000	192,000,000	1.1%		
Gross margin	3,390,000,000	3,077,000,000	313,000,000	10.2%	19.8%	18.1%
Net income (loss)	998,000,000	852,000,000	146,000,000	17.1%	5.8%	5.0%
Cash flow from Operations	1,001,000,000	(251,000,000)	1,252,000,000	n/a	5.8%	-1.5%
Cash balance	3,268,000,000	7,042,000,000	(3,774,000,000)	-53.6%		

## **I. Synopsis**

The Boeing Company engages in the design, development, manufacture, sale, and support of commercial jetliners, military aircraft, satellites, missile defense, human space flight, and launch systems and services worldwide. It operates in five segments: Boeing Capital Corporation, Boeing Military Aircraft, Commercial Airplanes, Global Services and Support, and Network and Space Systems. The company was founded in 1916. Its headquarters are in Chicago, Illinois.

Boeing's (NYSE: BA) rating was downgraded from T2 to T2-, due to the low quality of management's communications regarding the problems on the 787 project. The outlook for the company is negative, as additional problems are expected within the 787 project.

## **II. Introduction**

Companies that convey minimal financial transparency and poor managerial candor generate a greater information disparity between management and the investment community. Assessing financial transparency and candor of management provide significant insight into the underlying issues within a given company. Identifying weak transparency or questionable management statements or actions will enable an investor to make more informed investment decisions, thus lowering risk.

Companies that exhibit strong financial transparency and trust-worthy attributes should sell at a premium to companies who demonstrate less financial transparency and low trust-worthiness, all other things being equal.

## **III. Financial Transparency**

Income statement: Boeing provided adequate information and explanation with regard to both revenue and net income changes and composition. However, the company did not adequately address changes that affected gross margin. The company has chosen to focus on operating margin at the business segment level.

Cash flow statement: The company provided a sufficient level of transparency into the statement of cash flows.

Balance sheet: The company provided limited to no information on a majority of the assets and liabilities on its balance sheet.

Off-balance sheet: The company has approximately \$4.0 billion of “contingent repurchase arrangements” and other off-balance sheet items. The company adequately addressed its current off-balance sheet items.

Operational and strategic: Boeing’s current operations were clearly explained and straightforward in nature. The company’s overall strategy is clear; however, there is ambiguity surrounding its strategy for addressing the 787 problems. Based on management’s statements, it is not clear, whether a solution been identified, or if management is still evaluating its options. If management does have a plan for fixing the problem then why does the management team have to wait to determine the impact on the schedule and costs?

Legal: The company provided an adequate level of information on its current legal proceedings. However, there are numerous outstanding legal proceedings with considerable potential adverse impact. The most significant outstanding legal concern pertains to the A-12 case that came to Boeing through the acquisition of McDonnell Douglas. The case has an associated potential loss of almost \$1.7 billion. On June 2, 2009, the Court of Appeals upheld its judgment against Boeing. Additionally, there are several lawsuits against the company for employee-related issues, which could indicate improper treatment of its employees. The company also identified several government investigations outstanding, but it did not provide specific details.

Mergers, acquisitions, & divestitures (“M&A”): The company adequately presented the information surrounding recent M&A activity.

Active measures or events that distort or cloud financials: There was minimal indication of any potential earnings management or smoothing within the current financials. Between Q2, 2008 and Q2, 2009, cash flow from operations increased by a significantly higher percentage than earnings. However, earnings increased while cash decreased for the same period. Cash flow has been positive for two of the last three years, and it was positive for the six months of 2009. The only reference to non-GAAP figures was “free cash flow,” which is a common non-GAAP figure. Net accruals were an insignificant percentage of total assets within the last reporting period.

During the earnings call and in the Q2, 2009 financial press release, the company indicated earnings per share (“EPS”) increased by 22%, while the underlying earnings number only increased by 17%. Management did point out this discrepancy, but the presentation of EPS could mislead investors on the earnings growth of the company.

Boeing has actively utilized large mergers and acquisitions as a means to grow the company and move into new arenas. The company adequately addressed the risks of acquiring and integrating target companies into the base organization.

The company is purchasing Vought Aircraft for \$580 million, coupled with releasing Vought Aircraft from having to pay Boeing \$422 million. The total cost of the acquisition is approximately \$1 billion. The acquisition is scheduled to close in the third or fourth quarter of 2009.

The acquisition is within the company's area of operational expertise. Vought Aircraft is currently involved in the building and development of the 787 airplane. Though not specifically stated, Boeing may be acquiring Vought to gain more control over the 787 airplane development.

Overall, the company displayed **adequate financial transparency**. Boeing exceeded the minimum reporting requirements and provided an appropriate level of financial information and analysis to the investment community.

Actions to be taken: No immediate action necessary at this time. Companies that display an adequate level of financial transparency tend to outperform companies with a low level of financial transparency; however, valuation and pricing should be factored into any investment decision.

Timeline: No anticipated significant positive or negative changes to the company, based on the assessment of its financial transparency.

Likely outcomes: Management will continue to present financial information in a clear format.

#### **IV. Behavioral Assessment**

There were many misleading and questionable statements surrounding the delay of the 787 project. During the question and answer portion of the earnings call, Boeing's Chief Executive Officer, Mr. W. James McNerney, Jr., stated that the company had made "solid progress" toward resolving the 787 project issues. However, in the Q2, 2009 10-Q, it stated "...have identified a technical solution from a number of options. We are currently evaluating alternative ways to implement that solution." In connection with the resolution of the 787 issue, Mr. McNerney stated that the company had determined a straight-forward fix, yet at other times he referenced the uncertainty surrounding the implementation of the fix.

There are also significant concerns pertaining to the timing of the release of information (June 23, 2009) surrounding the delay, and the information management possessed prior to that date but failed to provide to its shareholders. The manner in which this problem was addressed and the inconsistencies in the managerial statements could indicate that full-disclosure of this

problem(s) is still forthcoming. The handling of this situation provides *significant* cause for concern around how management is addressing and reporting internal problems to its shareholders!

There was inconsistency around management's presentation of the liquidity and stability of the company. Management indicated that cash flow was strong. Management further stated that cash flow will be even stronger in 2010, yet management indicated that it is likely that the company will have to access the debt markets.

Management teams exhibit indicators of potentially misleading or deliberately confusing behavior for various reasons. Some of the most common reasons why management would fail to provide full and accurate information to the investment community include: promoting the stock or products; managerial self-interest; competitive, legal, and/or regulatory; concealing illegal or unethical behavior; covering up internal incompetence; mitigating concerns over potential future problems; and/or concealing what management perceives as a short-term, fixable problem.

Based on the information reviewed and the analysis conducted, we feel that Boeing is trying to **conceal what management perceives as an existing short-term or fixable problem.**

Actions to be taken: Ensure all investment positions are protected against a significant decline.

Timeline: Imminent – 3-6 months+

Likely outcomes: Significant write-down to earnings “big bath” or potential earnings management.

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## Tiarta Rating System

### Tier I: Lower Risk

T1: A rating of "T1" is the highest rating a company is able to achieve from Tiarta. Based on the materials reviewed, the rated company provides transparent, consistent, and direct information.

T1-: Based on the materials reviewed, a company with a rating of "T1-" provides transparent, consistent, and direct information with minimal indications of concern within the presentation, description of the financials, and other corporate activity.

### Tier II: Medium Risk

T2+: Based on the materials reviewed, a company with a rating of "T2+" provides fairly transparent, consistent, and direct information. The reviewed documents do exhibit some indications of concern within the presentation, description of the financials, and other corporate activity.

T2: Based on the materials reviewed, a company with a rating of "T2" provides fairly transparent, consistent, and direct information. The reviewed documents do exhibit several indications of concern within the presentation, description of the financials, and other corporate activity.

T2-: Based on the materials reviewed, a company with a rating of "T2-" provides limited transparency, consistency, and straight-forwardness. There are considerable indications of concern within the presentation, description of the financials, and other corporate activity.

### Tier III: Higher Risk

T3: Based on the materials reviewed, a rating of "T3" denotes a company that provides significantly limited transparency, consistency, and straight-forwardness. There are significant concerns within the presentation, description of the financials, and other corporate activity.

*Caveats & disclosures: The contents of this report constitute an opinion and not considered facts; therefore, they cannot be accurate (correct) or inaccurate (incorrect). Companies with the same ratings may have similar, but not identical risk profiles. Ratings are not predictive, nor are they an endorsement to buy or sell a given security. Nothing in this report constitutes financial, legal, or tax advice.*

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