Update Note

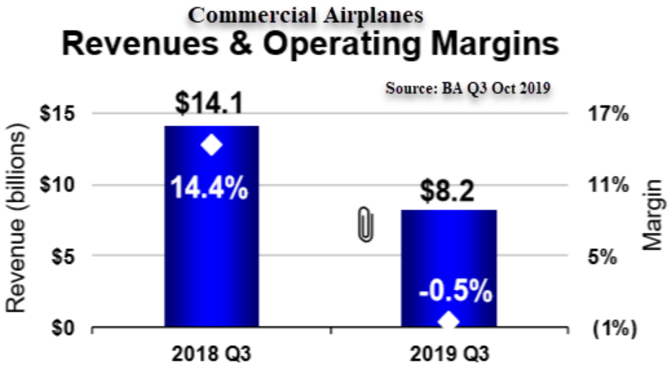
Boeing Company (BA)

January 3, 2020

Rev/Employee: $568.56 k	**Number of Employees: 153,000**	**Avg ROIC: 68.49%**	**Industrials**

BA: The Board Loses Confidence

The firing of CEO Dennis Muilenburg (55) and appointment of his successor, current Chairman Dave Calhoun (62) as the firm's new President & CEO effective January 13th is a reactive but needed step in restoring confidence in Boeing. The action came barely a month after the Board separated the Chairman and CEO roles and appointed Calhoun (then lead Director) as the firm's Chairman. BA's CFO Greg Smith (53) is serving as the interim CEO for the next 2 weeks and Director Lawrence Kellner (60) will become the Board's new Chairman on the 13th. In October, Boeing also replaced Commercial president Kevin McAllister with Stan Deal and the firm's General Counsel, Mike Luttig (65) announced he will retire this month after 12 years with the firm.



Management Team Update: Incoming CEO Calhoun is confronting a major cash flow crunch as well as the many regulatory issues surrounding the 737 MAX fiasco. Job 1 for the new CEO will be to stem the huge cash burn being caused by the 737 MAX production issue as group revenues have declined 20% Y/Y. Commercial Air revenue is dropping even more precipitously as the BA chart at right demonstrates, threatening the divisions substantial order backlog. Former CEO Muilenburg's steady but unrealistic optimism and pronouncements on quick fixes that never came has undermined both the Board's and the Company's credibility during the 10 month grounding of the MAX. Management has said that the MAX regulatory issues will be an "iterative process" across multiple country jurisdictions and we worry the firm's damaged reputation may start to cause quality assurance delays in other divisions as well. CEO-elect Calhoun has a wide range of leadership experience but none of it is directly operating an aerospace firm and he is facing a mammoth triage process. The new CEO has a blunt but candid operating style that is well suited to challenges this year (see a good interview here). This year, the Board created an Airplane Policies and Process Committee that made safety recommendations and the Chief Engineer reports directly to the CEO. We think his prior experience as the Chairman of Caterpillar during its tax evasion scandal with the IRS may prove his most valuable prior experience this year in dealing with regulatory officials. He is a former managing director at Blackstone where he ran operations and he was previously Nielson Holdings' CEO for nearly 4 years under private equity ownership (2010 to early 2014) during which time the firm did serial acquisitions, initiated a dividend and delivered moderately positive operating results. His most relevant industrial experience, is working at GE for over 26 years in the Transportation, Aircraft Engines and Reinsurance businesses. Calhoun has a BSc from Virginia Tech University New Commercial Airplanes president Stan Deal will be focused on a rapprochement with the FAA while avoiding a bigger Congressional investigation in the Company. Deal was President and CEO of Boeing Global Services.

Pay & Incentive Alignment: CEO-elect Calhoun's new pay plan has not yet been released and his vested share stake prior to his appointment was only 25k shares. His predecessor was paid an annual salary of $1.7 million and received total pay worth $23.4 million in 2018 that included a $13.1 million cash bonus that may now be subject to claw-back provisions in our view. Former CEO Muilenberg's vested shares and options in BA were about 218k shares at the end of December and he had not sold any of his holdings during the first 11 months of this year. CFO Smith's $8.7 million total pay in 2018 was also cash heavy and included only $2.6 million in LTIP equity. The CFO is paid a $1 million salary and last year received a large $4.6 million cash bonus. CFO Smith's vested BA shares and options total about 185k shares. We note, unfavorably, that the CFO sold material amounts of his personal share stake in late 2018 and early 2019. CFO Smith's net proceeds from stock sales for the 15 months prior to March 2019 totaled about $25 million. Executive's cash bonus targets range from 75% to 175% (CEO Muilenburg's). We

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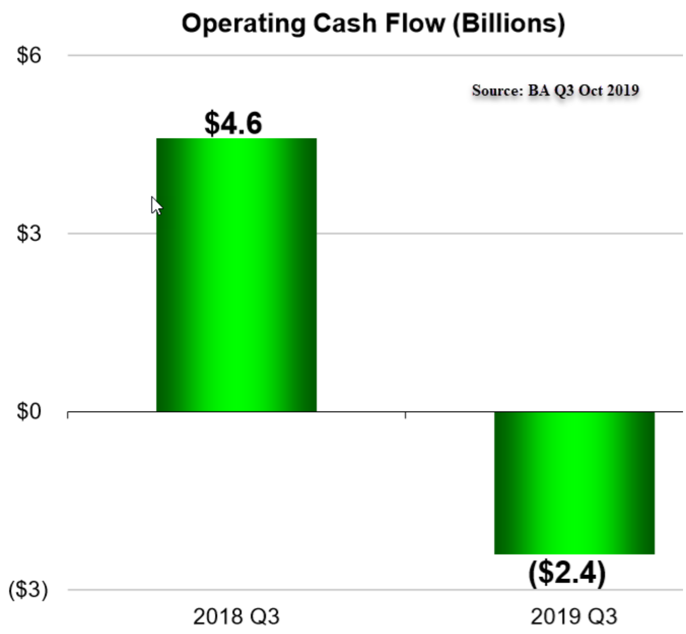
do like the bonus metrics, with 50% based on free cash flow and the balance divided equally between core EPS and revenue. The equity LTIP is split between performance awards, performance-based restricted stock units (PBRSUs), and time vesting RSUs. We don't like the redundant use of the same metrics for the PSUs financial targets as are used for the annual bonuses. The other 50% of the PSUs vest based on 3 year relative total return vs the S&P 500 but we note unfavorably that any performance above the bottom quintile of the index will earn vesting privileges.



Capital Allocation Update: CFO Smith is wrestling with a sudden drop in the firm's operating cash flows causing the firm to take on significantly more leverage and potentially disrupt its relationships with suppliers. YTD, its operating cash flow was -$226 million compared to $12.4 billion in the year-ago period. The firm's woes are impacting its supply chain as suppliers worry about the production hiatus. From 2016-18, BA's OCF grew from $10.5 billion to $15.3 billion. CapEx was $1.7 billion in both 2017 and 2018, and it was about $1.4 billion for the first 9M of '19. CFO Smith has issued $10.5 billion worth of notes this year and we think more is likely. BA's debt was $24.7 billion (including $1.9 billion from Boeing Capital, or BCC) at the end of Q3 '19 compared to $13.8 billion at year end ($2.5 billion associated with BCC). We like that the Board curtailed the share repurchase program earlier this year after spending $2.7 billion YTD. Annual repurchases in 2017 and 2018 were about $9 billion. CFO Smith says he does not anticipate restarting the buyback program until the MAX returns to service and the business is stabilized. While BA has a history of annual dividend increases, the February 2020 payout was kept flat at $2.055/share (2.4%) and we think there is some risk of a dividend cut in 2020 as the new CEO and his Board will seek to rebase the firm's cash expenses.

Fiduciary & Other: The rapid changing of the Chairman at the Board level should reinstill a broader sense of "refreshment" on a 12 person Board that we think is stale and has lots of moderately qualified Directors. A permanent Aerospace Safety Committee was recently established, and, in October retired Admiral John Richardson (59), who served in the U.S. Navy for 37 years, was elected to the Board to join the new committee. CEO Calhoun has indicated he is resigning from his affiliations with Blackstone but we found nothing official yet. In February, former UN Ambassador Nikki Haley (47), was elected to BA's Board. Director Caroline Kennedy (61), is the former U.S. Ambassador to Japan (who sits on the Audit and Finance Committees). We think the Board should replace several Directors this year in the interest of bringing in fresh viewpoints, particularly given the company's issues. Candidates for replacement are Ed Giambastiani's (70, Director since 2009), Seventh Vice Chairman of the U.S. Joint Chiefs of Staff, Arthur Collins (71, Director since 2007), Senior Advisor at Oak Hill Capital Partners and the former Chairman and CEO of Medtronic, Edward Liddy (73, Director since 2010), former Chairman and CEO of Allstate, Director Schwab (Director since 2010), Ronald Williams (69, Director since 2010), former Chairman and CEO of Aetna, and Mike Zafirovski (65, Director since 2004), Executive Advisor Blackstone and former President and CEO, Nortel. In December, Michael Luttig (65), who was Counselor and Senior Advisor to the Board since his May retirement as GC, announced his departure at year end. EVP/Division President Leanne Caret's husband, Steven Carat, has worked at BA since 2004, and was paid $261k in 2018.