BOEING 777 AN ELEPHANT IN THE ROOM, SAYS RBC

News / Manufacturer

RBC cuts price target on Boeing driven by concern over 777 demand and production.

In a research note published on February 10, RBC reiterated its Sector Perform rating on Boeing Co.but cut its price target from $143 to $135, driven by low earnings per share margins. RBC sees many fundamental issues that could impact the aircraft maker's revenue and profit.

The research firm sees the 777 as the elephant in the room. Boeing has already projected weak demand for the jet airliner, and decreased its production to seven per month, from an earlier 10 per month. However, RBC believes that the rate of production would decline even further to six per month in 2018, and then five per month in 2019.

Currently, there is a backlog of 218 planes for the 777-300 airliner, but at the present rate Boeing

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requires another 140 plane orders to fill in the empty slots. If the company is unable to fill in the demand gap, it may see a $5 billion loss during 2018-2020. RBC expects a cash drag from the production of the 777-300, which may have a downward effect on profit as well.

Although the corporation has enough backlog to secure revenues for a decade, most of the backlog is from developing economies. These markets face threat of declining economic growth and currency devaluation against the US dollar.

Investors have shown concern over the potential of airline carriers from the emerging economies to secure deliveries of new aircraft as scheduled, as the strong US dollar prevails and oil prices decline. Shareholders are particularly concerned about Middle Eastern and Chinese carriers, which make up 16% of the total backlog for Boeing.

If the Chinese slowdown and commodity price slump continues, Boeing is likely to witness a slowdown in aircraft orders from these two markets. “Perhaps the biggest bombshell in Boeing's 4Q15 results was the unexpected dip in 737 deliveries this year,” RBC wrote in the report.

The research house also notes that Boeing is into its seventh straight year of an up-cycle, and its history shows that the company has a cyclical tradition. RBC sees Boeing’s expansion plans as being too optimistic, as the aircraft maker has long lead times in its backlog orders and no new significant aircraft model has been launched.

If demand for air travel decreases, the aerospace giant might face significant cancelations, leading to further profit contraction. Analysts are closely watching the Zika virus threat, which has affected more than 30 countries across Latin America and could adversely affect air travel in the region.

Both investors and RBC are concerned about the current status of 737 NG. “There is now more focus on whether all of the NG slots have been sold, what sort of profit/cash hit is expected from transition, and whether the risk on the MAX is really as low as has been generally assumed,” the firm wrote.

Even though the defense sector brings majority of the revenue for Boeing, its commercial segment hasn’t been doing too well compared to its archrival Airbus. Boeing has also announced job cuts in its commercial airline sector in a bid to reduce its operational costs. The job cuts will affect executive as well as managerial positions.

It will be interesting to see how Boeing fares in the low crude environment. Investors are advised to keep a close watch on the company, as it is due for some major announcements this year.

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