

Boeing Co. (BA)

Alert: 787 Issues Appear Manageable at This Point

■ Company Update

- **What's New** – Boeing shares are down almost 6% over the past two days (S&P -0.5%) in reaction to two incidents at Boston Logan involving Japan Airlines 787s: yesterday's fire and today's fuel leak. At this point, we still like BA shares and we're buyers on weakness. These incidents - while unfortunately clumped together - do not signal grave issues with the long-term prospects for this aircraft, in our view.
- **Recent issues w/ the 787** – Since initial delivery to ANA over a year ago, the 787 has had a combination of typical teething issues associated w/ new aircraft & manufacturing errors requiring quick fixes. In November 2010, an electronics-related fire aboard a test jet halted the test program for months and was later blamed on debris in the electronic compartment. December 2012 was a tough month: a United 787 generator failure warning forced an emergency landing and the FAA ordered inspections of fuel line connections after ANA and JAL experienced leaks (the airlines quickly fixed these leaks). In our view, these issues have eroded market confidence in the 787 and have generated concerns around customer/consumer aversion to a troubled plane. However, the aircraft continues to fly and customers are still reportedly happy with their performance.
- **Recent developments on Logan fire** – Initial NTSB findings released this afternoon indicate that the auxiliary power unit (APU) battery had severe fire damage. WSJ reports that last night United found some faulty wiring in the APU battery section of one of its 787 after conducting overnight inspections. Meanwhile, Boeing has said that there is no link between the 787 fire and prior electrical issues. Both the NTSB and Boeing continue to investigate.
- **Design vs. manufacturing** – The most important question at this point is whether the fire is a result of a manufacturing **or** a design problem. Boeing, its suppliers, and airline maintenance crews are dealing with these planes for the first time and mistakes are unavoidable, albeit unfortunate. The electronic and fuel issues to-date (outside of the Logan fire as that one is still undetermined) appear to be manufacturing-related. Indeed, we would hope that the rigorous certification process reduces the probability that this is a design-related issue which would require a complex fix potentially involving aircraft grounding and re-certification. However, we're keeping a close eye on further indications from NTSB, Boeing, and customers on whether this is a design or a manufacturing issue. Clearly, a manufacturing issue would be "better" news.

Buy	1
Price (08 Jan 13)	US\$73.71
Target price	US\$84.00
Expected share price return	14.0%
Expected dividend yield	2.7%
Expected total return	16.7%
Market Cap	US\$55,583M

Price Performance (RIC: BA.N, BB: BA US)



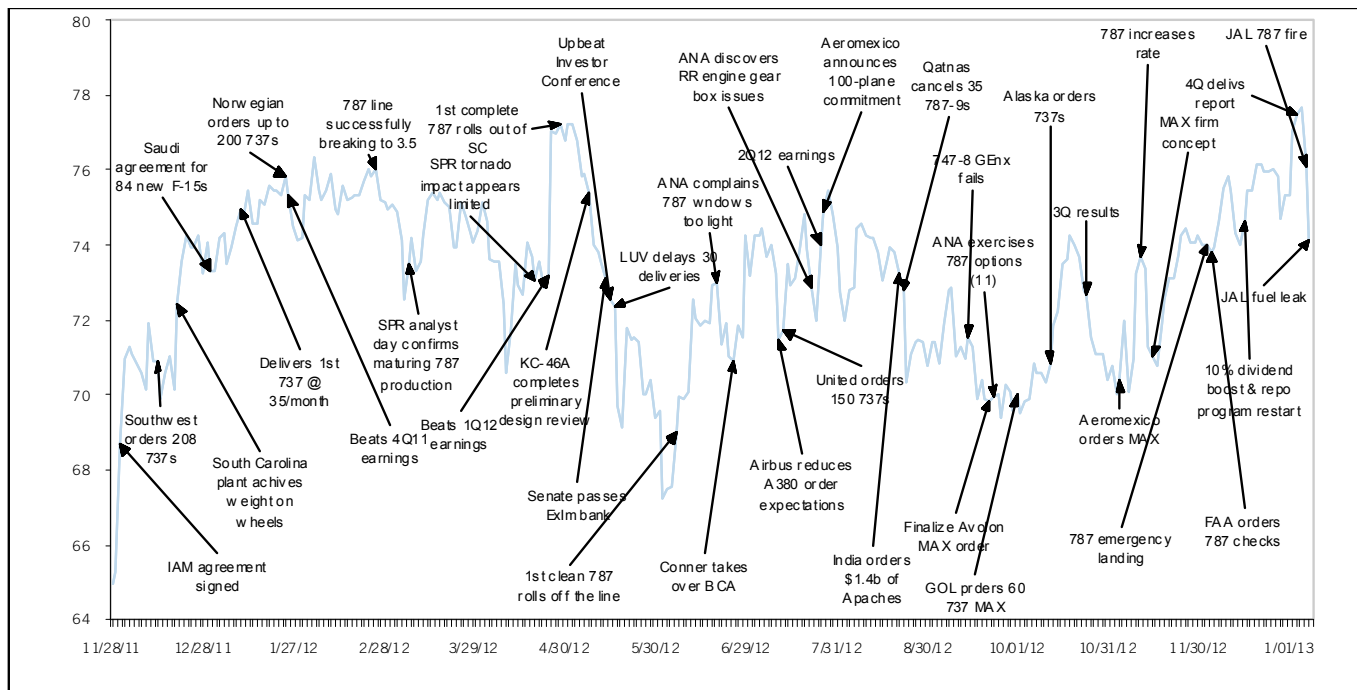
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Figure 1. Annotated BA Price Action



Source: Citi Research, FactSet

Boeing Co.

Valuation

We apply a sum-of-the-parts valuation methodology to Boeing. To the commercial business (68% of 2014 segment income) we apply a 15x FTM P/E multiple, in line with commercial aerospace peers. In our view, a premium multiple is warranted due to the production up-cycle we're embarking upon as well as the relative resiliency of the commercial aerospace market. We apply a 10.6x multiple to the defense business (32% of income), representing a 20% discount to the market. This is a slight premium to our target defense multiple (25% discount) due to BDS' premium backlog visibility and international content. This gives us a blended target multiple of 13.6x, which yields an \$84 target price when applied to our 2014 EPS estimate of \$6.19.

Risks

The commercial aerospace industry is intrinsically risky given its vulnerability to unpredictable shocks that cannot be incorporated into earnings models, such as terrorism, volatile oil prices, and epidemics. Furthermore, the industry is highly correlated to economic growth, and relies on economic expansion for air traffic growth. The company's other exposure is the defense market, which is subject to changes in public opinion, global threats to the U.S. and its allies, the state of the federal budget, and the condition of existing U.S. and allied military equipment.

Boeing's shares may materially underperform our target price should the broader economy slip back into recession, resulting in decreased airline traffic and plane orders. Shares would also underperform to the extent that DoD budgets were severely cut. The company is also subject to intense commercial competition with Airbus, especially in the narrow-body segment, where defending market share could come at the expense of margin. If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

GS Yuasa

(6674.T; ¥335; 2)

Valuation

Our ¥330 target price is derived from our FY3/14 EPS estimate of ¥30 and a target PER of 11x (the current average for the auto parts sector names covered by our auto parts analyst based on his forecasts). Our target price also corresponds to an FY3/12A PBR of 1.2x, and this looks appropriate given RoE (FY3/13E 7%, FY3/14E 10%).

Risks

Risks to our target price include the following: 1) EV demand trends and customer acquisition trends, 2) trends in the auto and industrial equipment markets, and 3) fluctuations in lead prices. As far as (1) is concerned, major customers Honda and Mitsubishi Motors plan to launch PHEVs in 2012. We think PHEVs could spread as a substitute for EVs and will need to monitor launch developments for both firms. All

of these factors could cause the shares to diverge from our target price if the business environment differs from our assumptions.

Appendix A-1

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Boeing Co. (BA)

Ratings and Target Price History

Fundamental Research

Analyst: Jason Gursky

Covered since July 15 2010



	Date	Rating	Target Price	Closing Price
1	31-Jan-10	2H	*59.00	60.60
2	19-Apr-10	2H	*73.00	70.96
3	14-Jul-10	*1H	*80.00	64.75
4	13-Jan-11	1H	*85.00	69.83
5	27-Jan-11	1H	*84.00	70.56
6	27-Apr-11	1H	*90.00	76.12

* Indicates change

	Date	Rating	Target Price	Closing Price
7	27-Jul-11	1H	*85.00	70.63
8	8-Oct-11	Stock rating system changed		
9	8-Oct-11	*1	85.00	61.81
10	18-Oct-11	1	*87.00	63.47
11	26-Oct-11	1	*78.00	66.56
12	17-Nov-11	1	*82.00	66.09

	Date	Rating	Target Price	Closing Price
13	6-Jan-12	1	*87.00	73.98
14	16-Apr-12	1	*89.00	72.68
15	17-Jul-12	1	*93.00	73.11
16	25-Jul-12	1	*89.00	74.03
17	25-Oct-12	1	*84.00	71.54

Rating/target price changes above reflect Eastern Standard Time

Boeing Co. (BA)

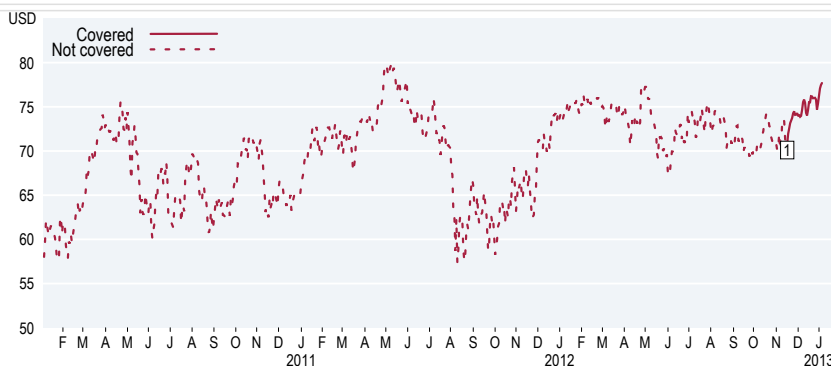
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Jason Gursky

Covered since July 15 2010



	Date	Rating	Target Price	Closing Price
1	16-Nov-12	*ADD MP	-	70.77

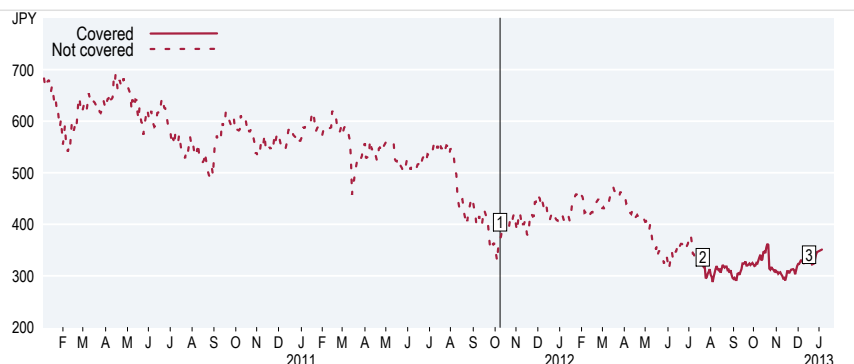
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GS Yuasa (6674)

Ratings and Target Price History Fundamental Research

Analyst: Tsubasa Sasaki
Covered since July 20 2012



	Date	Rating	Target Price	Closing Price
[1]	8-Oct-11	Stock rating system changed		

* Indicates change

	Date	Rating	Target Price	Closing Price
[2]	20-Jul-12	*2	-	320

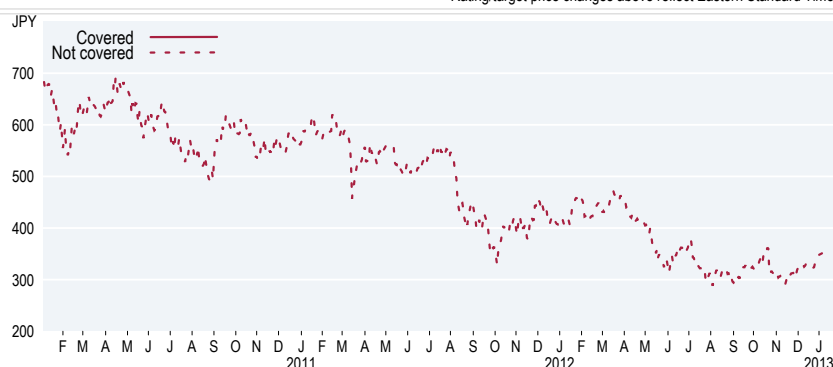
	Date	Rating	Target Price	Closing Price
[3]	18-Dec-12	2	*330	329

Rating/target price changes above reflect Eastern Standard Time

GS Yuasa (6674)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Tsubasa Sasaki
Covered since July 20 2012



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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
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49%	38%	12%	7%	86%	7%
53%	49%	45%	60%	49%	55%

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