

The boeing 7e7



Is there anything else the board of directors should consider in assessing the financial appeal of this project? Why might the board vote 'yes' on the 7E7, when the cost of capital estimate is greater than the IRR? Why might the board vote 'no' if the cost of capital is less than the IRR?

What should the board do?

Introduction

Ultimately Boeing needs to determine if the project will be profitable and if it will have positive cash flows in accordance with business requirements. Our analysis shows that the WACC, NPV and IRR are favorable (according to sensitivity analysis) and the project will likely be profitable. Boeing should keep this project as an individual project within the commercial business division. Defense projects and commercial projects both have unique factors that can be handled efficiently through separate divisions with the ability to share research and knowledge between the two divisions. Boeing should pursue the project with disciplined focus on maintaining cost efficiencies.

The analysis identifies both risks and benefits associated with undertaking the 7E7 project. Giving a calculated WAAC of 15.44% for the commercial division of Boeing, the project is feasible and profitable. As you will find, the financial calculations provided in this report show that the project will increase the wealth of the shareholders, also identifying the associated risks and how those could be minimized. Assuming the development costs are correctly estimated and the market response is properly gauged, the reasons to go forward with the project outweigh those against it.

The market competition corroborated with the unfavorable economic conditions prompt a swift and decisive answer from Boeing. The new 7E7 will have lower operating costs due to increased cargo space and increased fuel economy due to new engine design, would also be versatile and suitable for both short and long flight routes. Ensuring the development and manufacturing costs are kept down by employing decades of engineering expertise and already proven technologies and solutions, it is recommended that Boeing undertakes the 7E7 project.

The launch of the 7E7 project

In early 2003, Boeing announced its plans to develop a new airplane (7E7 & 7E7 Stretch) in a market that was facing a tight squeeze on profits. The decline in the airline industry was attributed in large part to the war in Iraq, international terrorism, and fear of spreading SARS. The development of this new aircraft could possibly bring Boeing out of their innovation slump and potentially give them an advantage in the mid-sized aircraft market.

Since 1994, Boeing had not put a new airplane into production and had failed to follow through on two commercial aircraft programs. The company was in desperate need of an aircraft that would set them apart from Airbus, their main competitor and market leader. Boeing's vision for the 7E7 was a cost efficient plane that used less fuel, had cheaper operating costs, and flexibility for short or long haul routes. The new plane would be made with cheaper composite parts which would reduce the production time from 20 days to 3 days.

The new project faced some concerns. The cost efficiency relied on the use of composite materials that had not gained regulators' confidence. Also, Boeing would have to design completely new production methods for this new plane. Unfortunately, Boeing has a track record of problems with their production methods and delivering planes on time.

The board of directors also expected development cost estimates to be substantially reduced prior to approving such a product. The demand in the market was for cheaper and more efficient planes, and that ideology needed to be part of Boeing's development strategy plus this is why Boeing is contemplating the launch of 7E7 project.

Airbus, the market leader, produced planes to serve the short, medium and extended-range routes. Analysts believe that Airbus seemed to be more bullish on the future of the large aircraft market leaving Boeing an opportunity to gain back market share in the mid-size market, assuming that Airbus did not pursue the mid-range segment with a competing product. Boeing had a drop in commercial airplanes delivered from 527 in 2001 to 381 in 2002 and needed this project to keep them in the hunt with Airbus.

The board will also have to consider the decades it may take to recoup the costs of starting this project. Development costs in the airline industry are substantial leading to many years of negative cash flows. The introduction of a new plane is a make-or-break activity for the producers and requires huge financing capabilities. The development costs and per-copy costs were difficult to predict, and Boeing also faced engineering uncertainty with the project. The success of the project depends heavily on Boeing's ability to

keep the production costs low and actually deliver a more efficient aircraft than the competition.

Yes this is the good time for Boeing to launch their new aircraft. At this time, the price of raw materials are very cheap caused by unexpected disasters. Although there's no demand at this moment, but they can still continue making the aircraft. The further information will describe how Boeing can continue making the aircraft.

The value of 7E7 will create

Boeing's vision for the 7E7 was a cost efficient plane that used less fuel, had cheaper operating costs, and flexibility for short or long haul routes. The Boeing company consideration is that the company needs to be evaluated is the set up of the Boeing business. It is set up as two separate businesses- the integrated defense systems business and the commercial business. The defense systems group experienced significant revenue growth due to the war and demand from fear of terrorism. analysis shows that the WACC, NPV and IRR are favorable (according to sensitivity analysis) and the project will likely be profitable.

Boeing should keep this project as an individual project within the commercial business division. Defense projects and commercial projects both have unique factors that can be handled efficiently through separate divisions with the ability to share research and knowledge between the two divisions. Boeing should pursue the project with disciplined focus on maintaining cost efficiencies. To determine whether this project is beneficial

to the company, the rate of return required by shareholders is calculated using weighted average cost of capital (WACC).

Since Boeing 7E7 is a product being developed for the commercial airplane segment of the company, determining WACC for the commercial segment rather than a firm-wide WACC would provide a more accurate depiction of the benefit from this project. We also can see whether 7E7 will create value from company financial statement.

The financial flow of Boeing 7E7 company can be seen from exhibit 1 , 2, 3 . In exhibit 1, it shows the revenues, operating profit and identifiable assets by segment for the Boeing company . It a comparison between 3 years that is from 2000 until 2002. The total of each year , can made the differences to give us idea how many profit each year the company gain. In exhibit 2, it shows the Boeing balance sheets (\$ in million). It between 2001 and 2002 . The total of both total assets and total liabilities must equal and balance to each other. And in 2002 the total is \$ 52, 342. Exhibit 3 shows the Boeing income statement (\$ in millions). And the earning per share gain each year show the company income .