Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

We are a global market leader in design, development, manufacturing, sale and support of commercial jetliners, military aircraft, satellites, missile defense, human space flight and launch systems and services. We are one of the two major manufacturers of 100+ seat airplanes for the worldwide commercial airline industry and the United States' second-largest defense contractor. While our principal operations are in the United States, we rely extensively on a network of partners, key suppliers and subcontractors located around the globe.

We operate in six principal segments: Commercial Airplanes; Aircraft and Weapon Systems (A&WS), Network Systems, Support Systems, and Launch and Orbital Systems (L&OS) collectively Integrated Defense Systems (IDS); and Boeing Capital Corporation (BCC). All other activities fall within the Other segment, principally made up of Boeing Technology and Connexion by Boeing℠. Our Commercial Airplanes operations primarily involve development, production and marketing of commercial jet aircraft and providing related support services, mainly to the commercial airline industry worldwide. IDS operations principally involve research, development, production, modification and support of the following products and related systems: military aircraft, helicopters and missiles, space systems, missile defense systems, satellites and satellite launching vehicles, rocket engines, and information and battle management systems. BCC is primarily engaged in supporting our major operating units by facilitating, arranging, structuring and/or providing selective financing solutions to our customers and managing overall portfolio risk exposures. Boeing Technology is an advanced research and development organization focused on innovative technologies, improved processes and the creation of new products. Connexion by Boeing℠ provides two-way broadband data communications service for global travelers. Effective April 1, 2004, Air Traffic Management was absorbed into Phantom Works research division which is included within Boeing Technology. Financing activities other than those carried out by BCC are also included within the Other segment classification.

Our business strategy is centered on running healthy core businesses—Commercial Airplanes and IDS supplemented and supported by BCC. Taken together, these core businesses generate substantial earnings and cash flow to permit us to invest into new products and services and to open new frontiers in aerospace. Our Commercial Airplanes business has been lean and profitable despite severe recent downturn in commercial aviation. We are focused on producing the airplanes the market demands and we price our products to provide a fair return for our shareholders while continuing to find new ways to improve efficiency and quality. IDS is more than a collection of defense programs that acts as a counterweight to the cyclical commercial airplane business. It is a dynamic business with a strategy to establish ourselves as the leading industry partner to governments in developing an effective defense system against conventional and non-conventional threats. BCC delivers value through supporting our business units and reducing our customer financing exposures. Boeing Technology, our advanced research and development unit, provides new systems, technologies and processes to position us for future growth. Connexion by Boeing℠ makes an airplane seem more like the office or home with internet connection at anytime and anywhere.

Risk Factors

We generally make sales under purchase orders that are subject to cancellation, modification or rescheduling without significant penalties to our customers. Changes in the economic environment and the financial condition of the airline industry or continuing availability of the U.S. congressional appropriations could result in customer requests for rescheduling or cancellation of contractual orders.

We depend on a limited number of customers, including the U.S. Government and major commercial airlines. We can make no assurance that any customer will purchase additional products or services from us after our contract with the customer has ended. The loss of a U.S. Government major program or any of the major commercial airlines as customers could significantly reduce our revenues. Several of our commercial airline customers have filed for bankruptcy protection.

We are highly dependent on the availability of essential materials and parts and subassemblies from our suppliers. The most important raw materials required for our aerospace products include aluminum and titanium (sheet, plate, forgings and extrusions). Although alternative sources generally exist for these raw materials, qualification of the sources could take a year or more. Many major components and product equipment items are procured or subcontracted on a sole-source basis with a number of domestic and foreign companies. We are dependent upon the ability of our large number of suppliers and subcontractors to meet performance specifications, quality standards, and delivery schedules at anticipated costs, and their failure to do so could adversely affect production schedules and contract profitability, while jeopardizing our ability to fulfill commitments to our customers. We maintain an extensive qualification and performance surveillance system to control risk associated with such reliance on third parties.

Sales outside the U.S. (principally export sales from domestic operations) by geographic area are included on page 87. Approximately 2% of total sales were derived from non-U.S. operations for each year ended December 31, 2004 and 2003 and 1% for the year ended December 31, 2002. Approximately 47% of our contractual backlog at December 31, 2004, was with non-U.S. customers compared to 41% at December 31, 2003 and 40% at December 31, 2002. Sales outside the United States are influenced by U.S. Government foreign policy, international relationships, and trade policies of governments worldwide. Relative profitability is not significantly different from that experienced in the domestic market.

Consolidated Results of Operations and Financial Condition

Consolidated Results of Operations

The aerospace and defense industry experienced a strong year in 2004. Commercial jetliner deliveries stabilized after two years of steep declines. The U.S. Government continued to increase defense spending and proceeded with the military transformation. On the other hand, we continued to face numerous challenges. Competition from Airbus and regional jet makers intensified as they expand airplane model offerings and competitively price their products. Many airlines, particularly domestic carriers, experienced losses in 2004 negatively impacting new orders for jetliners. Our launch business remained on Air Force suspension and we did not conclude a contract for supplying Tankers to the U.S. Air Force (USAF).

Management responded to the challenges by relentlessly focusing on execution of our business strategy and introducing new products and services. During 2004, we successfully launched the 787 with unprecedented customer interest and the 747 Special Freighter and began offering the 777 Freighter. Commercial Airplanes delivered 285 planes as compared to 281 in 2003 and captured 272 net orders, up 14% from 2003. IDS posted a record year in 2004 by delivering double-digit revenue growth and excellent profitability. BCC more than doubled its pre-tax income while Connexion by Boeing℠ launched its first commercial services in 2004.

The following table summarizes our key indicators of consolidated results of operations for the past three years.

(Dollars in millions)	2004	2003	2002
Revenues	**$ 52,457**	$ 50,256	$ 53,831
Operating Earnings	**$ 2,007**	$ 398	$ 3,426
Operating Margins	**3.8%**	0.8%	6.4%
Net Earnings	**$ 1,872**	$ 718	$ 492
Research and Development	**$ 1,879**	$ 1,651	$ 1,639
Effective Income Tax Rate	**7.1%**	(37.0)%	26.9%
Contractual Backlog	**$109,600**	$104,812	$104,173

Revenues

The increase in 2004 consolidated revenues was driven by strong growth at IDS as its defense and intelligence businesses continued to perform in the healthy markets. IDS revenues grew on increased aircraft deliveries; increased activity in Future Combat Systems (FCS), missile defense, intelligence, airborne command and control programs; and significant increases in supply chain services, life-cycle customer support, and training system and services. Despite increased new aircraft deliveries, Commercial Airplanes revenues declined in 2004. The decline is primarily due to the delivery mix as more single-aisle aircraft and fewer twin-aisle aircraft were delivered in 2004. BCC revenues were down slightly in 2004 due to lower new business volume. (For additional discussion of Commercial Airplanes, IDS and BCC revenues, see pages 35, 43 and 49.)

Lower consolidated revenues in 2003 compared to 2002 were primarily due to reduced deliveries of our commercial airplanes. The reduced deliveries were the result of the airline industry's reduced need for additional new aircraft and increased market share of Airbus. The 2003 overall decrease in Commercial Airplane revenues was partially offset by strong performance by IDS and BCC. IDS posted revenue growth across all segments driven by increased deliveries of Joint Direct Attack Munitions (JDAM); increased volume in homeland security, spares and maintenance, and proprietary programs; and the start up of FCS.

Operating Earnings

Our 2004 operating earnings increased sharply primarily due to the solid performance by IDS. IDS earnings were driven by increased revenue base and improved profitability across all segments. (For detailed discussion of IDS operating earnings please refer to IDS Results of Operation and Financial Condition beginning on page 43.) Commercial Airplanes operating earnings increased slightly as margin improvements and improved period cost performance were partially offset by the negative impact of the change in the model mix and increased research and development costs associated with the 787 program. (See page 36 for additional discussion of Commercial Airplanes operating earnings.) Included in 2004 results is a charge of $555 million related to the USAF 767 tanker program and expenses incurred to end production of the 717 aircraft. $475 million of the charge was recorded by our Commercial Airplanes segment, while $80 million was recorded by IDS (see pages 36, 37 and 41 for additional discussion of the charge). Other significant factors contributing to the 2004 operating earnings compared to 2003 include higher share-based plans expenses, increase in BCC operating earnings, and higher pension expense. The increase in the share-based plans expense in 2004 was attributable to vested and undistributed performance shares. (See Note 17.) For information on BCC operating earnings please refer to page 49. Pension expense is discussed on page 27.

Lower operating earnings in 2003 compared to 2002 reflect lower planned commercial airplane deliveries, charges related to the decision to end production of the 757 program, goodwill impairment charges, charges related to the satellite and launch businesses, lower pension income, and an increase in other expenses, as described below. We delivered 100 fewer commercial airplanes in 2003 compared to 2002, and recognized a $184 million charge associated with the decision to end production of the 757 program. We also recognized $913 million in goodwill charges as a result of a goodwill impairment analysis triggered by the reorganization of our Military Aircraft and Missile Systems and Space and Communications segments into IDS; $572 million recorded at IDS and $341 million recorded at the Commercial Airplanes segment. 2003 operating earnings were negatively impacted by a $1,030 million charge related to the satellite and launch businesses (see page 46 for details of the charge). We experienced lower pension income due to declining interest rates and negative pension asset returns in 2001 and 2002, the impact of which is amortized into earnings in future periods. We also incurred higher estimated environmental cleanup costs, increased workers' compensation claims, and increased legal expense. These factors were partially offset by continued growth and strong operating performance in our

portfolio of defense businesses and by continued improvements in operating efficiencies at Commercial Airplanes.

We incurred net periodic pension benefit cost of $451 million in 2004 compared to net periodic pension benefit income of $67 million in 2003, and $404 million in 2002. Not all net periodic pension benefit income or cost is recognized in net earnings in the year incurred because it is allocated to production as product costs, and a portion remains in inventory at the end of a reporting period. Accordingly, the operating earnings for 2004 included $335 million of pension expense while operating earnings for 2003 and 2002 included $147 million and $526 million of pension income, respectively.

The increase in the pension expense was primarily due to higher amortizations of actuarial losses experienced in the last few years. The actuarial losses were created by a combination of decreasing discount rates, which increased the projected benefit obligation, and negative investment earnings in 2001 and 2002, which reduced the market related value of assets. Our pension plan investment returns of 13 percent for the plan year ended September 30, 2004, and 17 percent for the plan year ended September 30, 2003, reflected strong market and plan asset performance. However, over the past five years, the plan returns were lower than expected. Because we expect low interest rates to persist, we anticipate our pension investment returns over the long term to decrease, as reflected in reduction of the expected long-term asset return rate from 9.00 percent in 2003 to 8.75 percent in 2004 and to 8.50 percent in 2005. We also lowered the discount rate from 6.00 percent to 5.75 percent as of September 30, 2004.

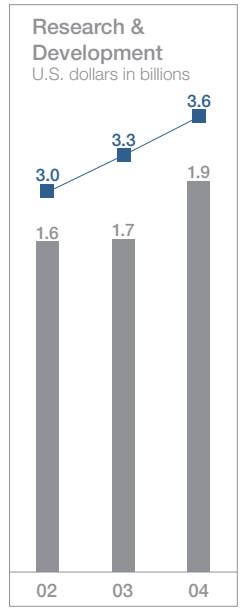
Net Earnings

Our net earnings increased in 2004 due to higher operating earnings partially offset by lower other income and higher income taxes. Additionally, included in 2004 earnings is a $42 million net gain on BCC's disposal of a substantial portion of its Commercial Financial Services business. The increase in 2003 net earnings over 2002 reflects the federal tax settlement mentioned below, partially offset by lower operating earnings.

Other income primarily consists of interest income. Other income in 2004 includes $219 million; of this amount $154 million related to interest income associated with a settlement of federal income tax audits relating to tax years 1983 through 1987 and $65 million related to interest associated with a subsequent settlement for the 1986 through 1997 years. Other income in 2003 increased over 2002 mainly due to the receipt of $397 million of interest income associated with a $1.1 billion partial settlement of federal income tax audits relating to tax years 1992 through 1997. There was no similar interest income in 2002. Also, contributing to lower income in 2002 was $46 million of losses on long-term equity investments.

Research and Development

Research and development expenditures involve experimentation, design, development and related test activities for defense systems, new and derivative commercial jet aircraft, advance space and other company-sponsored product development.



These expenditures are either charged directly against earnings or are included in amounts allocable as reimbursable overhead costs on U.S. Government contracts. In addition, Boeing Technology, our advanced research and development organization, focuses on improving our competitive position by investing in certain technologies and processes that apply to multiple business units. Technology investments currently being pursued within Boeing Technology include network-centric operations, affordable structures and manufacturing technology, lean and efficient design processes and tools, lean support and service initiatives, advanced platform systems and safe and clean products.

Research and development expenses were up in 2004 due to increased spending on the 787 program. The expenses are presented net of payments in accordance with sharing arrangements with some suppliers as described on page 38. Research and development expense increased in 2003, principally reflecting IDS's continued focus on the 767 Global Tanker Transport Aircraft (GTTA) program development as well as the development of communication system architectures in order to support various business opportunities including Future Combat Systems (FCS), Joint Tactical Radio System, FAB-T and Global Missile. In 2003, research and development expenses decreased at Commercial Airplanes due to reduced spending on the development of the 747-400ER. Research and development highlights for each of the major business segments are discussed in more detail in Segment Results of Operations and Financial Condition on pages 38 and 44–46.

Income Taxes

The 2004 effective income tax rate of 7.1% differed from the federal statutory tax rate of 35%, due to Foreign Sales Corporation (FSC) and Extraterritorial Income (ETI) exclusion tax benefits, tax credits, state income taxes, tax benefits from a settlement with the Internal Revenue Service (IRS) of the years 1986-1997, tax benefits associated with state tax audit settlements, and other provision adjustments.

The effective income tax rates of (37.0)% for 2003 and 26.9% for 2002 also vary from the federal statutory tax rate due to FSC and ETI benefits, tax credits, state income taxes, and in 2003, favorable resolution of IRS audit issues and the nondeductibility for tax purposes of certain portions of goodwill impairment charges.

IRS Audit Overview IRS examinations have been completed through 1997 and income taxes have been settled with the IRS for all years through 1996 and for McDonnell Douglas Corporation

for all years through 1992. We have filed appeals with the IRS for 1993 through 1997 for McDonnell Douglas Corporation.

During 2004 we received $896 million relating to federal income tax refunds for which estimated accruals had primarily been recorded in prior periods. Of this amount, $681 million related to the 2003 federal tax return. $104 million related to a settlement of the 1996 tax year and the 1997 partial tax year for McDonnell Douglas Corporation, $69 million related to a settlement of the 1983 through 1987 tax years, and $1 million related to the 1985 tax year. The balance of $41 million relates to a partial settlement of the 1986 through 1997 Boeing Company audit and was recorded in the year ended December 31, 2004. In addition, $217 million of interest income associated with the tax refunds was received and recorded in the Consolidated Statements of Operation. Of the $217 million of interest income received, $40 million was recorded in 2003 and the balance was recorded during 2004. In addition to the cash received above, we are awaiting the receipt of an additional $124 million of federal net income tax refund and $42 million of interest for the settlement of the years 1986 through 1997 which have already been accrued during the year ended December 31, 2004.

Legislative Update On October 22, 2004, the President signed the American Jobs Creation Act of 2004 (the Act). The Act provides a deduction for income from qualified domestic production activities, which will be phased in from 2005 through 2010. In return, the Act also provides for a two-year phase-out (except for certain pre-existing binding contracts) of the existing ETI exclusion tax benefit for foreign sales which the World Trade Organization (WTO) ruled was an illegal export subsidy. The European Union (EU) believes that the Act fails to adequately repeal the illegal export subsidies because of the transitional provisions and has asked the WTO to review whether these provisions are in compliance with their prior ruling. It is not possible to predict what impact this issue will have on future earnings pending the final resolution of this matter. Additionally, the Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividend received deduction for certain dividends from controlled foreign corporations.

On December 21, 2004, the Financial Accounting Standards Board Staff Position (FSP) No. FAS 109-1, *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*, was issued. FSP No. FAS 109-1 clarifies that this tax deduction should be accounted for as a special deduction in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*. As such, the special deduction has no effect on deferred tax assets and liabilities existing at the date of enactment. Rather, the impact of this deduction will be reported in the period in which the deduction is claimed on our tax return beginning in 2005. As regulations are still pending, we have been unable to quantify this impact.

On December 21, 2004, FSP No. FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004*, was issued. FSP No. FAS 109-2 provides companies additional time, beyond the financial reporting period during which the Act took effect, to evaluate the Act's impact on a company's plan for reinvestment or repatriation of certain foreign earnings for purposes of applying SFAS No. 109. FSP No. FAS 109-2 was effective upon issuance. As of December 31, 2004, we have not decided on whether and to what extent we might repatriate foreign earnings under the Act, and accordingly, the financial statements do not reflect any provisions for taxes on unremitted foreign earnings. Based on our analysis of the Act, although not yet finalized, it is possible that under the repatriation provision of the Act we may repatriate some amount of earnings between $0 to $350 million with the respective tax liability ranging from $0 to $26 million. We expect to be in a position to finalize our assessment by June 30, 2005.

Backlog

Contractual backlog of unfilled orders excludes purchase options, announced orders for which definitive contracts have not been executed, and unobligated U.S. and foreign government contract funding. The increase in contractual backlog from 2003 to 2004 primarily relates to new orders for the 787. The increase was partially offset by sales on multi-year contracts that were awarded in prior periods, particulary the C-17 and F/A-18 programs in A&WS, and strong sales on the Ground-Based Midcourse Defense (GMD) program and proprietary programs in Network Systems.

The increase in contractual backlog from 2002 to 2003 related to increases in contractual backlog for A&WS and Network Systems, offset by decreases for Commercial Airplanes. A&WS obtained orders for the Apache helicopters from Greece and Kuwait, the F/A-18 E/F Multi Year II contract and the initial funding for the EA-18G from the U.S. Navy while Network Systems obtained orders for the GMD program and Turkey 737 Airborne Early Warning and Control (AEW&C) programs coupled with the initial funding of the FCS program. Commercial Airplanes' decrease in contractual backlog reflects the impact that the economic downturn has had on the airline industry.

Unobligated backlog includes U.S. and foreign government definitive contracts for which funding has not been appropriated. The decrease in unobligated backlog in 2004 is mainly due to strong sales throughout the IDS segments but was partially offset by contract awards for the Multi-Mission Maritime Aircraft (MMA) and FCS program extension and an order from DIRECTV for 3 satellites.

For segment reporting purposes, we report Commercial Airplanes contractual backlog for airplanes built and sold to other segments. Commercial Airplanes relieves contractual backlog upon the sale of these airplanes to other segments.

IDS contractual backlog includes the modification performed on intracompany airplane purchases from Commercial Airplanes. IDS relieves contractual backlog for the modification performed on airplanes received from Commercial Airplanes upon delivery to the customer or at the attainment of performance milestones.

Liquidity and Capital Resources

Primary sources of our liquidity and capital resources include cash flow from operations and substantial borrowing capacity through commercial paper programs and long-term capital markets, as well as unused borrowing on revolving credit line agreements. The primary factors that affect our investment requirements and liquidity position, other than operating results associated with current sales activity, include the following: timing of new and derivative programs requiring both high developmental expenditures and initial inventory buildup; growth and contractions in business cycles, including growth and expansion requirements and requirements associated with reducing sales levels; customer financing assistance; the timing of federal income tax payments/refunds as well as interest and dividend payments; our stock repurchase plan; internal investments; and potential acquisitions and divestitures.

Cash Flow Summary

(Dollars in millions) Year ended December 31,	2004	2003	2002
Net earnings	**$ 1,872**	$ 718	$ 492
Non-cash items	**3,070**	3,137	4,357
Changes in working capital	**(1,484)**	(1,146)	(2,513)
Net cash provided by operating activities	**3,458**	2,709	2,336
Net cash provided (used) by investing activities	**(1,369)**	112	(1,382)
Net cash provided (used) by financing activities	**(3,518)**	(521)	746
Net increase (decrease) in cash and cash equivalents	**(1,429)**	2,300	1,700
Cash and cash equivalents at beginning of year	**4,633**	2,333	633
Cash and cash equivalents at end of year	**$ 3,204**	$ 4,633	$ 2,333

Non-cash items Non-cash items in earnings primarily include depreciation, amortization, share-based plans expense, impairments, valuation provisions, and pension expense/income. Non-cash items and corresponding amounts are listed in our Consolidated Statements of Cash Flows.

Working capital During 2004, our investment in working capital increased. This increase is primarily due to $4.4 billion of discretionary and non-discretionary pension contributions made in 2004 (see discussion following on pensions). Other items primarily contributing to the net increase in investment in working capital include:

- an increase in accounts payable, due to normal business operating cycle, principally in our Other operating segment,
- a change in income taxes payable related to the tax refunds recorded and tax expense related to current earnings,
- cash used by customer financing additions of $1,380 million, offset by customer financing collections of $959 million due to normal customer financing activities,
- an increase in advances in excess of related costs due to the recovery of the commercial airplane market,
- an increase in cash received from inventories due to lean initiatives.

During the third quarter of 2004, we received a federal income tax refund of $681 million cash which resulted from net operating and capital loss carry-backs related to large pension contributions in 2003 and first quarter of 2004.

Working capital includes customer financing transactions primarily in the form of notes receivable, sales-type/financing leases and operating leases. These transactions occur as the result of customer related financing activities associated with items recorded in inventory. The origination and subsequent principal collections for these transactions were previously presented as investing activites in our Consolidated Statements of Cash Flows, consistent with the presentation by BCC in their stand alone financial statements. We changed the classification of the cash flow effects of customer financing transactions based on concerns raised by the SEC staff. The amounts for prior periods have been reclassified to be consistent with current year presentation. (See Note 26). For the years ended December 31, 2004, 2003, and 2002, the net impact on operating cash flow was ($421) million, ($1.3) billion, and ($2.0) billion, respectively, for customer financing transactions.

Pensions 2004 operating cash flow included $4.4 billion of cash funding to the pension plans. Almost all of the contributions were voluntary to improve the funded status of our plans. On February 4, 2005, we contributed $450 million to the pension plans. Required pension contributions under Employee Retirement Income Security Act (ERISA) regulations are not expected to be material in 2005. However, we are evaluating discretionary contributions of approximately $550 million (pretax) later in the year. We expect to contribute approximately $17 million to our other postretirement benefit plans in 2005.

We measure our pension plans using a September 30 year-end for financial accounting purposes. Although in 2004 and 2003, actual investment returns were well in excess of the expected rates of 8.75% and 9.0%, respectively, we reduced our expected long-term rate of return on plan assets by 25 basis points to 8.5% beginning in 2005 because of general market conditions and changes in the pension plan investment portfolio allocation. The expected long-term rate of return on plan assets is based on long-term target asset allocations of 50% equity, 31% fixed income, 6% real estate, and 13% other. Current allocations are within 1 to 10% of each of the long-term targets. Historically low interest rates (a key factor when estimating plan liabilities) which have persisted in 2003 and 2004, caused us to recognize an additional non-cash charge to equity in the fourth quarter of 2003. This charge, which resulted in a $358 million increase to the accrued pension plan liability and a $226 million after-tax decrease to the accumulated other comprehensive income account within shareholders' equity, was reversed in the fourth quarter of 2004. The reversal, which was due in large part to $4.4 billion in pension contributions made during 2004, resulted in a $3.5 billion decrease to the accrued pension liability and a $2.2 billion after-tax increase to the accumulated other comprehensive income account within shareholders' equity. The charges in 2003 and reversal in 2004, did not impact earnings or cash

flow, and will change in future periods as interest rates, market performance, and plan returns vary from expected assumptions. We use a discount rate that is based on a point-in-time estimate as of each annual September 30 measurement date. Although future changes to the discount rate are unknown, had the discount rate increased or decreased by 25 basis points, pension liabilities in total would have decreased $1.3 billion or increased $1.5 billion, respectively

Investing activities In 2004, the amount of cash used for investing activities was approximately $1.5 billion greater than in 2003. A portion of our cash used by investing activities in 2004 was offset by cash of $2 billion generated by the sale of a substantial portion of BCC's Commercial Financial Services business. Also, additions to Property, Plant, and Equipment in 2004 were approximately $250 million more than 2003 to support the growth of the 787 program and growth of IDS.

During 2004, we invested $3.0 billion of cash in an externally managed portfolio of investment grade fixed income instruments. The portfolio is diversified and highly liquid and primarily consists of U.S. dollar debt obligations of the United States Treasury, other government agencies, corporations, mortgage-backed and asset-backed securities. The portfolio has an average duration of 1.5 years. Short-term investments are debt securities with maturities less than one year and the remaining securities are long term investments (except cash equivalents with maturities less than 90 days). As of December 31, 2004, amounts invested with a fair value of $2.7 billion were classified as available-for-sale Investments on the Consolidated Statements of Financial Position. We do not intend to hold these investments to maturity, nor do we intend to actively and frequently buy and sell these securities with the objective of generating profits on short-term differences in price. In addition, amounts totaling $108 million were classified as Cash and cash equivalents and $173 million were classified as available-for-sale and recorded in Short-term investments. During 2004, realized gains and losses on these investments were not material.

The majority of BCC's customer financing is funded by debt and cash flow from its own operation. As of December 31, 2004, we had outstanding irrevocable commitments of approximately $6.7 billion to arrange or provide financing related to aircraft on order or under option for deliveries scheduled through the year 2007. Not all of these commitments are likely to be used; however, a significant portion of these commitments are with parties with relatively low credit ratings. (See Notes 15 and 20.)

Financing activities There were no debt issuances during 2004. In 2003, we received proceeds of $1 billion related to our September 13, 2002 shelf registration.

Debt maturities, which include BCC amounts, were $1.1 billion in 2004, $1.8 billion in 2003, and $1.3 billion in 2002. Additionally, BCC issued debt in the amount of $1.0 billion in 2003 and $2.8 billion in 2002. In 2003 and 2002, BCC's debt issuances were generally used for growth in the customer financing portfolio.

On July 26, 2004, BCC redeemed $1 billion face value of its outstanding senior notes, which had a carrying value of $999 million. This redemption included the entire principal amount, equal to $500 million face value, of its 7.10% senior debt securities due 2005 at a redemption price equal to 105.30% of the principal amount of the notes together with interest accrued to the redemption date. BCC redeemed $500 million face value of its 5.65% senior debt securities due 2006 at a redemption price equal to 104.81% of the principal amount of the notes together with interest accrued to the redemption date. BCC recognized a net loss of $42 million related to this early debt redemption. (See Note 15.)

There were 14,708,856 shares repurchased at a price of $752 million in our open market share repurchase program, and 50,657 shares repurchased in a stock swap in 2004 and no shares were repurchased in 2003 or 2002.

Credit Ratings

Our credit ratings are summarized below:

	Fitch	Moody's	Standard & Poor's
Long-term:			
Boeing/BCC	A+	A3	A
Short-term:			
Boeing/BCC	F-1	P-2	A-1

Capital Resources

We and BCC each have a commercial paper program that continues to serve as a significant potential source of short-term liquidity. As of December 31, 2004, neither we nor BCC had any outstanding commercial paper issuances.

We have substantial borrowing capacity. Currently, $3.4 billion remains available to BCC from shelf registrations filed with the SEC and $3.5 billion ($2.0 billion exclusively available for BCC) of unused borrowing on revolving credit line agreements with a group of major banks remains available. (See Note 15). We believe our internally generated liquidity, together with access to external capital resources, will be sufficient to satisfy existing commitments and plans, and also to provide adequate financial flexibility to take advantage of potential strategic business opportunities should they arise within the next year.

On March 23, 2004, we filed a shelf registration with the SEC for $1 billion for the issuance of debt securities and underlying common stock.

In November 2004, we rolled over the 364-day revolving credit facility, reducing it from $2.5 billion to $2.0 billion. Prior to November we had $1.25 billion assigned to BCC and $1.25 billion assigned to us. Currently, there is $1.25 billion assigned to BCC with only $750 million assigned to us. There was no change to the 5-year credit facility of $1.5 billion, of which $750 million remains assigned to BCC, we established in November 2003.

As of December 31, 2004, we are in compliance with the covenants for the 364-day and the 5-year revolving credit facilities.

Disclosures about Contractual Obligations and Commitments

The following table summarizes our known obligations to make future payments pursuant to certain contracts as of December 31, 2004, as well as an estimate of the timing in which these obligations are expected to be satisfied.

Contractual obligations

(Dollars in millions)	Total	Less than 1 year	1–3 years	3–5 years	After 5 years
Long-term debt	**$11,884**	$ 1,250	$ 3,181	$ 514	$6,939
Capital lease obligations	**316**	71	152	32	61
Operating lease obligations	**2,284**	390	665	364	865
Purchase obligations:					
Not recorded on statement of financial position					
Production related	**44,676**	20,981	16,192	6,381	1,122
Pension and other post retirement cash requirements	**2,985**	537	1,174	1,274	
Recorded on statement of financial position	**6,953**	5,718	319	328	588
Total contractual obligations	**$69,098**	$28,947	$21,683	$8,893	$9,575

Purchase obligations Purchase obligations represent contractual agreements to purchase goods or services that are legally binding; specify a fixed, minimum or range of quantities; specify a fixed, minimum, variable, or indexed price provision; and approximate timing of the transaction. In addition, the agreements are not cancelable without a substantial penalty. Long-term debt, capital leases, and operating leases are shown in the above table regardless of whether they meet the characteristics of purchase obligations. Purchase obligations include both amounts that are and are not recorded on the statements of financial position. Approximately 23% of the purchase obligation amounts disclosed above are reimbursable to us pursuant to cost-type government contracts.

Purchase obligations – not recorded on the statement of financial position

Pension and other postretirement benefits Pension funding is an estimate of our minimum funding requirements through 2006 to provide pension benefits for employees based on service provided through 2004 pursuant to the ERISA regulations, although we may make additional discretionary contributions. Obligations relating to other postretirement benefits are based on both our estimated future benefit payments, since the majority of our other postretirement benefits are not funded through a trust, and the estimated contribution to the one plan that is funded through a trust through 2009. Our estimate may change significantly depending on the actual rate of return on plan assets, discount rates, discretionary pension contributions, regulatory rules, and medical trends.

Production related Production related purchase obligations include agreements for production goods, tooling costs, electricity and natural gas contracts, property, plant and equipment, and other miscellaneous production related obligations. The most significant obligation relates to inventory procurement contracts. We have entered into certain significant inventory procurement contracts that specify determinable prices and quantities, and long-term delivery timeframes. These agreements require suppliers and vendors to be prepared to build and deliver items in sufficient time to meet our production schedules. The need for such arrangements with suppliers and vendors arises due to the extended production planning horizon for many of our products, including commercial aircraft, military aircraft and other products where delivery to the customer occurs over an extended period of time. A significant portion of these inventory commitments are either supported by firm contracts from customers, or have historically resulted in settlement through either termination payments or contract adjustments should the customer base not materialize to support delivery from the supplier. Some inventory procurement contracts may include escalation adjustments. In these limited cases, we have included our best estimate of the effect of the escalation adjustment in the amounts disclosed in the table above.

Industrial participation agreements We have entered into various industrial participation agreements with certain customers in foreign countries to effect economic flow back and/or technology transfer to their businesses or government agencies, as the result of their procurement of goods and/or services from us. These commitments may be satisfied by our placement of direct work, placement of vendor orders for supplies, opportunities to bid on supply contracts, transfer of technology, or other forms of assistance to the foreign country. However, in certain cases, our commitments may be satisfied through other parties (such as our vendors) who purchase supplies from our foreign customers. We do not commit to industrial participation agreements unless a contract for sale of our products or services is signed. In certain cases, penalties could be imposed if we do not meet our industrial participation commitments. During 2004, we incurred no such penalties. As of December 31, 2004, we have outstanding industrial participation agreements totaling $7.4 billion that extend through 2015. In cases where we satisfy our commitments through the purchase of supplies and the criteria described in "purchase obligations" is met, amounts are included in the table above. To be eligible for such a purchase order commitment from us, the foreign country or customer must have sufficient capability and capacity and must be competitive in cost, quality and schedule.

Purchase obligations recorded on the statement of financial position

Purchase obligations recorded on the statement of financial position primarily include accounts payable and certain other liabilities including accrued compensation and dividends payable.

Off-Balance Sheet Arrangements

We are a party to certain off-balance sheet arrangements including certain guarantees and variable interests in unconsolidated entities.

Guarantees The following tables provide quantitative data regarding our third-party guarantees. The maximum potential payment amounts represent "worst-case scenarios" and do not necessarily reflect our expected results. Estimated proceeds from collateral and recourse represent the anticipated values of assets we could liquidate or receive from other parties to offset our payments under guarantees. The carrying amount of liabilities recorded on the balance sheet reflects our best estimate of future payments we may incur as part of fulfilling our guarantee obligations.

As of December 31, 2004	Maximum Potential Payments	Estimated Proceeds from Collateral/ Recourse	Carrying Amount of Liabilities*
Contingent repurchase commitments	$3,751	$3,743	
Trade-in commitments	972	947	$ 25
Asset-related guarantees	408	296	12
Credit guarantees related to the Sea Launch venture	510	306	204
Other credit guarantees	60	19	10
Equipment trust certificates	28		
Performance guarantees	64	21	1

As of December 31, 2003	Maximum Potential Payments	Estimated Proceeds from Collateral/ Recourse	Carrying Amount of Liabilities*
Contingent repurchase commitments	$5,712	$5,712	
Trade-in commitments	1,279	1,214	$65
Asset-related guarantees	468	364	5
Credit guarantees related to the Sea Launch venture	519	311	208
Other credit guarantees	106	50	5
Equipment trust certificates	28		
Performance guarantees	56	18	

*Amounts included in accounts payable and other liabilities

In conjunction with signing a definitive agreement for the sale of new aircraft (Sale Aircraft), we have entered into specified-price trade-in commitments with certain customers that give them the right to trade in used aircraft for the purchase of Sale Aircraft. Additionally, we have entered into contingent repurchase commitments with certain customers wherein we agree to repurchase the Sale Aircraft at a specified price at a future point in time, generally ten years after delivery of the Sale Aircraft. Our repurchase of the Sale Aircraft is contingent upon a future, mutually acceptable agreement for the sale of additional new aircraft. If, in the future, we execute an agreement for the sale of additional new aircraft, and if the customer exercises its right to sell the Sale Aircraft to us, a contingent repurchase commitment would become a trade-in commitment. Contingent repurchase commitments and trade-in commitments are now included in our guarantees discussion based on our current analysis of the underlying transactions. Based on our historical experience, we believe that very few, if any, of our outstanding contingent repurchase commitments will ultimately become trade-in commitments. During 2004, we recorded no expense and made no net cash payments related to our contingent repurchase commitments.

Exposure related to the trade-in of used aircraft resulting from trade-in commitments may take the form of: (1) adjustments to revenue related to the sale of new aircraft determined at the signing of a definitive agreement, and/or (2) charges to cost of products and services related to adverse changes in the fair value of trade-in aircraft that occur subsequent to signing of a definitive agreement for new aircraft but prior to the purchase of the used trade-in aircraft. The trade-in aircraft exposure included in accounts payable and other liabilities in the tables above is related to item (2) above.

There is a high degree of uncertainty inherent in the assessment of the likelihood of trade-in commitments. The probability that trade-in commitments will be exercised is determined by using both quantitative information from valuation sources and qualitative information from other sources and is continually assessed by management. As disclosed in the above table, the maximum amounts payable under trade-in commitments were $972 million and $1.3 billion as of December 31, 2004 and 2003. Based on the best market information available at the time, it was probable that we would be obligated to perform on trade-in commitments with gross amounts payable to customers totaling $116 million and $582 million as of December 31, 2004 and 2003. The estimated fair value of trade-in aircraft related to probable contractual trade-in commitments was $91 million and $517 million as of December 31, 2004 and 2003. Accounts payable and other liabilities included $25 million and $65 million as of December 31, 2004 and 2003, which represents the exposure related to these trade-in commitments.

We have issued various asset-related guarantees, principally to facilitate the sale of certain commercial aircraft. Under these arrangements, we are obligated to make payments to a guaranteed party in the event the related aircraft fair values fall below a specified amount at a future point in time. No aircraft have been delivered with these types of guarantees in several years. During 2004, we recorded no expense and made no net cash payments related to our asset-related guarantees.

We have previously issued credit guarantees to creditors of the Sea Launch venture, of which we are a 40% partner, to assist the venture in obtaining financing. In the event we are required to perform on these guarantees, we have the right to recover a portion of the loss from other venture partners and have collateral rights to certain assets of the venture.

In addition, we have issued other credit guarantees to facilitate the sale of certain commercial aircraft. Under these arrangements, we are obligated to make payments to a guaranteed party in the event that lease or loan payments are not made by the original debtor or lessee. Our commercial aircraft credit-related guarantees are collateralized by the underlying commercial aircraft. A substantial portion of these guarantees have been extended on behalf of original debtors or lessees with less than investment-grade credit. Recent financial weakness in

certain airlines further exposes us to loss under our credit guarantees. During 2004, we recorded expense of $1 million and made no net cash payments related to our credit guarantees.

We had certain obligations to investors in the trusts as a liquidity provider for Equipment Trust Certificates (ETC) pass-through arrangements, which required funding to the trust to cover interest due to such investors in the event of default by United Airlines, Inc. (United). In the event of funding, we are entitled to receive a first priority position in the ETC collateral in the amount of the funding. On February 7, 2003, we advanced $101 million to the trust perfecting our collateral position and terminating our liquidity obligation. On August 9, 2004, The Bank of New York, acting as the collateral agent, reimbursed us for this advance with a total payment of $107 million. The payment included the original advanced amount, as well as interest income related to the advance.

Also relating to an ETC investment, we have potential obligations relating to shortfall interest payments in the event that the interest rates in the underlying agreements are reset below a certain level. These obligations would cease if United were to default on our interest payments to the trust. There were no significant payments made by us during 2004.

We have outstanding performance guarantees issued in conjunction with joint venture investments. Pursuant to these guarantees, we would be required to make payments in the event a third-party fails to perform specified services. We have made no significant payments in relation to these performance guarantees.

Material variable interests in unconsolidated entities Our investments in ETCs, Enhanced Equipment Trust Certificates (EETCs) and Special Purpose Entities (SPEs) are included in the scope of Revised Interpretation No. 46 (FIN 46 (R)), *Consolidation of Variable Interest Entities*. All entities that were required to be consolidated under FIN 46(R) had been previously consolidated, and therefore, the adoption of FIN 46(R) had no impact on our consolidated financial statements.

From 1999 through 2004, we invested in ETCs and EETCs, which are trusts that passively hold debt investments for a large number of aircraft to enhance liquidity for investors, who in turn pass this liquidity benefit directly to airlines in the form of lower coupon and/or greater debt capacity. ETCs and EETCs provide investors with tranched rights to cash flows from a financial instrument, as well as a collateral position in the related asset. Our investment in ETCs and EETCs do not require consolidation under FIN 46 (R). We believe that our maximum exposure to economic loss from ETCs and EETCs is $349 million, comprised of our $321 million investment balance and a maximum potential exposure of $28 million relating to potential shortfall interest payments. Accounting losses, if any, from period to period could differ. As of December 31, 2004, the ETC and EETC transactions we participated in had total assets of $3.9 billion and total debt (which is non-recourse to us) of $3.6 billion. During the year ended December 31, 2004, we recorded revenues of $28 million and cash flows of $70 million.

From 1998 through 2004, we provided subordinated loans to certain SPEs that are utilized by the airlines, lenders and loan guarantors, including, for example, the Export-Import Bank of the United States. All of these SPEs are included in the scope of FIN 46(R); however, only certain SPEs require consolidation. SPE arrangements are utilized to isolate individual transactions for legal liability or tax purposes, or to perfect security interests from our perspective, as well as, in some cases, that of a third-party lender in certain leveraged lease transactions. We believe that our maximum exposure to economic loss from non-consolidated SPE arrangements that are Variable Interest Entities (VIE) is $43 million, which represents our investment balance. Accounting losses, if any, from period to period could differ. As of December 31, 2004, these SPE arrangements had total assets of $451 million and total debt (which is non-recourse to us) of $408 million. During the year ended December 31, 2004, we recorded revenues of $3 million and cash flows of $28 million.

Commercial commitments The following tables summarize our commercial commitments outstanding as of December 31, 2004, as well as an estimate of the timing in which these commitments are expected to expire.

(Dollars in millions)	Total Amounts Committed/Maximum Amount of Loss	Less than 1 year	1-3 years	4-5 years	After 5 years
Standby letters of credit and surety bonds	$3,183	$2,866	$ 152	$ 34	$131
Other commercial commitments	6,661	495	3,755	2,321	90
Total commercial commitments	$9,844	$3,361	$3,907	$2,355	$221

Related to the issuance of certain standby letters of credit and surety bonds included in the above table, we received advance payments of $1.8 billion and $1.0 billion as of December 31, 2004 and 2003, respectively.

Other commercial commitments include irrevocable financing commitments related to aircraft on order and commercial equipment financing. (See Note 20.)

Industrial Revenue Bonds We utilize Industrial Revenue Bonds (IRB) issued by the City of Wichita to finance the purchase and/or construction of real and personal property at our Wichita site. Tax benefits associated with IRBs include a provision for a ten-year property tax abatement and a sales tax exemption from the Kansas Department of Revenue. We record the property on our Consolidated Statements of Financial Position, along with capital lease obligation to repay the proceeds of the IRB. We have also purchased the IRBs and therefore we are the Bondholder as well as the Borrower/Lessee of the property purchased with the IRB proceeds.

We also have a similar arrangement in place with the Development Authority of Fulton County, Georgia where we are both borrower and bondholder. Tax benefits associated with these IRBs are the provision of a ten-year partial property tax abatement.

The capital lease obligation and IRB asset are recorded net in the Consolidated Statements of Financial Position pursuant to FIN 39, *Offsetting of Amounts Related to Certain Contracts*. As of December 31, 2004 and 2003, the assets and liabilities associated with the City of Wichita IRBs were $2.9 billion, and the amounts associated with the Fulton County IRBs were $19 million.

Segment Results of Operations and Financial Condition

Commercial Airplanes

Business Environment and Trends

Airline Industry Environment World-wide air travel experienced a strong rebound in 2004. This rebound is notable in that it represents a recovery from the levels of 2003 which were depressed by the Severe Acute Respiratory Syndrome (SARS) outbreak in Asia, and represents a traffic level that exceeds the previous record which was set in 2000. It has taken the industry four years to exceed that level, indicating the difficulties faced by the world's airlines as they have dealt with the effects of recession, terrorism, and disease. This traffic volume has been driven by strong world-wide economic growth which stimulates demand, and declining real airline yields which makes air travel more affordable to more people.

This increase in demand has produced high load factors, but not industry-wide profitability due to a significant increase in the price of jet fuel. The world's airlines have made great strides in cost efficiency, only to see those improvements be more than offset by price increases of jet fuel. The world-wide increases in the price of crude oil that began in mid 2003 and peaked in late 2004 have contributed to world airline losses that are estimated to be about $5 billion dollars in 2004 and represent the fourth consecutive year of losses for the world's airlines.

This large industry loss does not mean that all airlines are losing money in the current environment. We are seeing divergence in the profitability of different types of airlines as their different business models are proving to be vulnerable or robust to these environmental changes. The hardest-hit have been the large U.S. network carriers. These airlines were the most damaged by the results of the 2001 terrorist attacks on the United States and have been the most vulnerable to increasing competition and technology changes that are changing the air travel business. The large network airlines outside the United States have been more successful in dealing with the challenges of 2004, most are profitable despite current fuel prices, and they continue to order new airplanes. The airlines that have fared best are the low-cost, low-fare airlines. They have been consistently profitable throughout the current challenges and their continued growth represents a real change in the air travel market. These airlines also continue to order and to take delivery of new airplanes.

Further recovery in profitability for the world's airlines is highly dependent on the future movement in oil and fuel prices; as these prices fall the prospects of the world's airlines will improve. As profitability improves and air travel demand continues to increase with increasing economic activity, we see an improvement in the prospects for future airplane orders and deliveries.

Our 20-year forecast of the average long-term growth rate of passenger traffic is 5.2% per annum, and 6.2% per annum for cargo traffic based on projected average annual worldwide real economic growth of 3.0%. Based on global economic growth projections over the long term, and taking into consideration an increasingly competitive environment, increasing utilization levels of the worldwide airplane fleet and requirements to replace older airplanes, we project a $2.0 trillion market for 25,000 new airplanes over the next 20 years. This is a long-term forecast; historically, while factors such as the Gulf War and increased ticket charges for security have had significant impact over the span of several years, they have not dramatically affected the longer-term trends in the world economy, and therefore, our market outlook.

Inherent Business Risks Commercial jet aircraft are normally sold on a firm fixed-price basis with an indexed price escalation clause. Our ability to deliver jet aircraft on schedule is dependent upon a variety of factors, including execution of internal performance plans, availability of raw materials, performance of suppliers and subcontractors, and regulatory certification. The introduction of new commercial aircraft programs and major derivatives involves increased risks associated with meeting development, production and certification schedules.

The worldwide market for commercial jet aircraft is predominately driven by long-term trends in airline passenger traffic. The principal factors underlying long-term traffic growth are sustained economic growth, both in developed and emerging countries and political stability. Demand for our commercial aircraft is further influenced by airline industry profitability, world trade policies, government-to-government relations, environmental constraints imposed upon aircraft operations, technological changes, and price and other competitive factors.

Industry Competitiveness The commercial jet aircraft market and the airline industry remain extremely competitive. We expect the existing long-term downward trend in passenger revenue yields worldwide (measured in real terms) to continue into the foreseeable future. Market liberalization in Europe and Asia has continued to enable low-cost airlines to gain market share. These airlines have increased the downward pressure on airfares. This results in continued cost pressures for all airlines and price pressure on our products. Major productivity gains are essential to ensure a favorable market position at acceptable profit margins.

Continued access to global markets remains vital to our ability to fully realize our sales potential and long-term investment returns. Approximately 2/3 of Commercial Airplanes' third-party sales and contractual backlog are from customers based outside the United States.

We face aggressive international competitors that are intent on increasing their market share. They offer competitive products and have access to most of the same customers and suppliers. Airbus has historically invested heavily to create a family of products to compete with ours. Regional jet makers Embraer and Bombardier, coming from the less than 100-seat commercial jet market, continue to develop larger and more capable airplanes. This market environment has resulted in intense pressures on pricing and other competitive factors.

Worldwide, airplane sales are generally conducted in U.S. dollars. Fluctuating exchange rates affect the profit potential of our major competitors, all of whom have significant costs in other currencies. The recent decline of the U.S. dollar relative to their local currencies is putting unusual pressure on their future revenues and profits. While this may seem like an advantage to us, it contains a potential threat in that competitors may react by aggressively reducing costs, potentially improving their longer-term competitive posture. Airbus has indicated that they are adopting this approach, and plan more than 10% reduction in costs by 2006. If the dollar strengthens by then, Airbus could use the extra efficiency to gain market share and develop new products.

We are focused on improving our processes and continuing cost-reduction efforts. We continue to leverage our extensive customer support services network for airlines throughout the world to provide a higher level of customer satisfaction and productivity. These efforts enhance our ability to pursue pricing strategies that enable us to price competitively and maintain satisfactory margins. While we are focused on improving our processes and continuing cost reduction activities, events may occur that will prevent us from achieving planned results.

We continue to explore strategic options related to our operations at various sites to focus on large-scale systems integration, which is where we are most competitive and can add the most value to our airplanes and services. These sites include but are not limited to Wichita, Tulsa and McAlester. (See Note 27.)

Summary Air travel continues to be the safest, most cost-effective form of travel ever invented. Modern air travel is essential to world-wide economic development, contributing to, and benefiting from increasing global trade. Recent signs of recovery and the continued expectation for long-term growth in air travel are encouraging. The airline industry continues to evolve in a challenging environment. Successful airlines with robust business models are continuing to grow and will need new airplanes to accommodate that growth as well as to maintain modern, cost-effective fleets. We will continue to evolve as well, providing airplanes and services that are recognized as providing the most capable and productive solutions to the airlines' business requirements.

Operating Results

(Dollars in millions)	2004	2003	2002
Revenues	**$21,037**	$22,408	$28,387
% of Total Company Revenues	**40%**	44%	53%
Operating Earnings	**$ 753**	$ 707	$ 2,017
Operating Margins	**3.6%**	3.2%	7.1%
Research and Development	**$ 941**	$ 676	$ 768
Contractual Backlog	**$70,449**	$63,929	$68,159

Revenues

Commercial Airplanes revenue is derived primarily from commercial jet aircraft deliveries. New commercial jet aircraft deliveries were higher in 2004 compared to 2003, but the delivery mix included more single-aisle aircraft and fewer twin-aisle aircraft. The decline in revenue of $1.4 billion in 2004 from 2003 was primarily attributable to new airplane model mix of $1.2 billion and net reduction of $132 million in other products.

The decline in revenue in 2003 compared to 2002 was primarily due to the decline in the commercial aviation market which resulted in fewer commercial jet aircraft deliveries.

Commercial jet aircraft deliveries as of December 31, including deliveries under operating lease, which are identified by parentheses, were as follows:

Model	2004	2003	2002
717	**12(6)**	12(11)	20
737 Next-Generation*	**202**	173	223(2)
747	**15**	19(1)	27(1)
757	**11**	14	29
767	**9(1)**	24(5)	35(1)
777	**36**	39	47
Total	**285**	281	381

*Deliveries in 2004 included intracompany deliveries of three 737 Next-Generation aircraft (two USNR C40A aircraft and one Project Wedgetail AEW&C System aircraft). Deliveries in 2003 included intracompany deliveries of three 737 Next-Generation aircraft (two C-40 aircraft and one AEW&C System aircraft). Deliveries in 2002 included intracompany deliveries of four 737 Next-Generation aircraft (three C-40 aircraft and one AEW&C System aircraft).

The cumulative number of commercial jet aircraft deliveries as of December 31 were as follows:

Model	2004	2003	2002
717	**137**	125	113
737 Next-Generation	**1,622**	1,420	1,247
747	**1,353**	1,338	1,319
757	**1,047**	1,036	1,022
767	**925**	916	892
777	**499**	463	424

The undelivered units under firm order* as of December 31 were as follows:

Model	2004	2003	2002
717	**18**	22	26
737 Next-Generation	**771**	800	765
747	**27**	32	52
757	**2**	13	28
767	**25**	25	39
777	**167**	159	173
787	**52**		

*Firm orders represent new aircraft purchase agreements where the customers' rights to cancel without penalty have expired. Typical customer rights to cancel without penalty include the customer receiving approval from its Board of Directors, shareholders, government and completing financing arrangements. All such cancellation rights must be satisfied or expired even if satisfying such conditions are highly certain. Firm orders exclude option aircraft and aircraft subject to reconfirmation.

Operating earnings The increase of $46 million in operating earnings in 2004 from 2003 was primarily attributable to $466 million from improved program margins due to cost reduction initiatives and decreased period costs offset by lower earnings from the change in model mix of $205 million, 717 program termination charge of $280 million, 767 USAF Tanker program charge of $195 million and increased research and development expense of $265 million. Additionally, in 2003 we had a goodwill impairment charge of $341 million and a charge of $184 million resulting from the decision to end production of the 757 program.

The decline in operating earnings in 2003 compared to 2002 was primarily due to the reduction in revenue as a result of lower delivery volume, a goodwill impairment charge of $341 million, a $184 million charge resulting from the decision to end production of the 757 program, and increased pension expense, all of which was partially offset by improved operating efficiency and reduced research and development expense.

Backlog Contractual backlog of unfilled orders excludes purchase options, announced orders for which definitive contracts have not been executed, and unobligated U.S. and foreign government contract funding. The increase in backlog in 2004 compared to 2003 primarily relates to new orders for the 777 and 787. The decline in backlog in 2003 compared to 2002 represents higher delivery volume on all airplane programs relative to new orders.

Unobligated backlog increased by approximately $0.6 billion for the twelve months ended December 31, 2004. This increase is attributed to the MMA program contract award. There was no unobligated backlog as of December 31, 2003. For each airplane program, we estimate the quantity of airplanes that will be produced for delivery under existing and anticipated contracts. We refer to this estimate as the "accounting quantity." The accounting quantity for each program is a key determinant of gross margins we recognize on sales of individual airplanes throughout the life of a program. See "Application of Critical Accounting Policies-Program accounting." Estimation of the accounting quantity for each program takes into account several factors that are indicative of the demand for the particular program, such as firm orders, letters of intent from prospective customers, and market studies. We review and reassess our program accounting quantities on a quarterly basis in compliance with relevant program accounting guidance.

Commercial aircraft production costs include a significant amount of infrastructure costs, a portion of which do not vary with production rates. As the amount of time needed to produce the accounting quantity increases, the average cost of the accounting quantity also increases as these infrastructure costs are included in the total cost estimates, thus reducing the gross margin and related earnings provided other factors do not change.

The estimate of total program accounting quantities and changes, if any, as of December 31 were:

	717	737 Next-Generation	747	757	767	777
2004	**156**	**2,400**	**1,400**	**1,050**	**959**	**700**
Additions/(deletions)	**8**	**200**	**12**		**(16)**	**50**
2003	148	2,200	1,388	1,050	975	650
Additions/(deletions)	8	200	(13)	(50)	(25)	50
2002	140	2,000	1,401	1,100	1,000	600

717 Program The accounting quantity for the 717 program has been based on firm orders since the fourth quarter of 2001. The 717 program accounting quantity was increased during 2004 due to the program obtaining additional firm orders. As of December 31, 2004, of the 18 remaining undelivered units, 8 units will be delivered to a single customer with uncertain financial condition. As a result, on a consolidated basis, these aircraft are accounted for as long-term operating leases as they are delivered. The value of the inventory for the undelivered aircraft as of December 31, 2004, remained realizable.

Program continuity at the end of the third quarter of 2004 was dependent on the outcome of current sales campaigns. During the nine months ended September 30, 2004 firm orders for six additional units had been received and during November 2004, firm orders for two additional units had been received.

On January 12, 2005, we decided to conclude production of the 717 commercial airplane in 2006 due to the lack of overall market demand for the airplane. The decision is expected to result in total pre-tax charges of approximately $385 million, of which $280 million is incorporated in the 2004 fourth quarter and year end results.

Of the $280 million charge that was incorporated in the 2004 fourth quarter and year end results, supplier termination charges are estimated to be $171 million; production disruption and related charges are estimated to be $36 million; pension/post-retirement curtailment charges are estimated to be $43 million; and severance charges are estimated to be $30 million. Of the $105 million charge that is expected to be recorded in periods subsequent to 2004, pension settlement charges are estimated to be $60 million and plant shutdown charges are estimated to be $45 million. The termination of the 717 line will result in $385 million of cash expenditures that are expected to occur during 2005 through 2007. This charge is determined based on current facts and information and we will revise our estimates accordingly as new facts and information become available.

737 Next-Generation and 777 Program The accounting quantity for the 737 Next-Generation and 777 programs were increased during 2004 as a result of the programs' normal progression of obtaining additional orders and delivering aircraft.

747 Program The 747 program accounting quantity was increased during 2004 as a result of additional orders received since 2003. We are continuing to monitor the commercial market for the 747 and potential new derivatives. The future of the program largely depends on market acceptance of these new derivatives. Due to the uncertainty of the market acceptance, completion of production is reasonably possible. A forward loss is not expected as a result of a decision to complete production but program margins would be modestly impacted. Additionally, completion of production may create excess spares inventory, resulting in a charge that is not expected to be material. A decision to proceed with a new derivative or complete production is likely to be made mid-year 2005.

757 Program Due to lack of demand for the 757 program, a decision was made in the third quarter of 2003 to end production of the program. Production of the 757 program ended in October 2004. There are two remaining aircraft that will be delivered in the first half of 2005.

In 2003, the 757 program charge of $184 million included $15 million of spares inventory writedown and $169 million forward loss. The forward loss was comprised of $111 million in vendor termination charges and $58 million due to the requirement to allocate incurred inventory costs over a reduced quantity of 757 airplane deliveries. Other than an estimated $17 million of tooling disposition and plant clean-up costs, which will be expensed as incurred, no future charges related to the 757 airplane program are expected. However, we will continue to monitor the total estimated cost of sales and total estimated revenues for the remaining program, and will revise our estimates accordingly as new facts and information become available.

767 Program Based on the regular quarter and year-end reviews, our updated assessment of securing the specific USAF 767 Tanker contract resulted in the decision that the precontract costs should no longer be deferred, given the continued delay and now likely recompetition of the contract. Commercial Airplanes' portion of the charge was $195 million consisting of $125 million of incurred development and tooling costs, $54 million of spending, net of scrap value, for production of a partially complete USAF Tanker, and $16 million of supplier termination liability.

The decrease in the 767 program accounting quantity during 2004 was due to the removal of anticipated future 767 Tanker deliveries to the USAF. The long term viability of the 767 program is dependent on receiving a timely USAF Tanker contract. We will be closely monitoring the future market for the 767. Due to the uncertainty, production completion is reasonably possible. A forward loss is not expected as a result of this decision but program margins would be significantly impacted. Additionally, completion of production may create excess spares inventory, resulting in a charge that is not expected to be material. A decision to complete production is likely to be made mid-year 2005. We continue to actively market the 767 program to commercial customers and position the program to support a USAF 767 Tanker contract and other military applications. (See IDS 767 Tanker Program on page 41 for further discussion.)

The accounting quantity for each program may include units that have been delivered, undelivered units under contract, and units anticipated to be under contract in the future (anticipated orders). In developing total program estimates all of these items within the accounting quantity must be addressed. The percentage of anticipated orders included in the program accounting estimates as compared to the number of cumulative firm orders* as of December 31 were as follows:

	717	737 Next-Generation	747	757	767	777
2004						
Cumulative firm orders (CFO)	**155**	**2,393**	**1,380**	**1,049**	**950**	**666**
Anticipated orders	**N/A**	**5**	**19**	**N/A**	**6**	**34**
Anticipated orders as a % of CFO	**N/A**	**0%**	**1%**	**N/A**	**1%**	**5%**
2003						
Cumulative firm orders	147	2,220	1,370	1,049	941	622
Anticipated orders	N/A	N/A	17	N/A	32	28
Anticipated orders as a % of CFO	N/A	N/A	1%	N/A	3%	5%
2002						
Cumulative firm orders	139	2,012	1,371	1,050	931	597
Anticipated orders	0	N/A	29	49	67	3
Anticipated orders as a % of CFO	0%	N/A	2%	5%	7%	1%

*Cumulative firm orders represent the cumulative number of commercial jet aircraft deliveries (see table in Commercial Airplanes Revenues discussion) plus undelivered units under firm order (see table in Commercial Airplanes Revenues discussion). Cumulative firm orders include orders that fall within the current accounting quantities as well as orders that extend beyond the current accounting quantities. Cumulative firm orders exclude program test aircraft that will not be refurbished for sale.

Deferred production costs Commercial aircraft inventory production costs incurred on in-process and delivered units in excess of the estimated average cost of such units, determined as described in Note 1 represent deferred production costs. As of December 31, 2004 and 2003, there were no significant excess deferred production costs or unamortized tooling costs not recoverable from existing firm orders for the 777 program.

The deferred production costs and unamortized tooling included in the 777 program's inventory at December 31 are summarized in the following table:

(Dollars in millions)	2004	2003
Deferred production costs	$703	$794
Unamortized tooling	485	582

As of December 31, 2004 and 2003, the balance of deferred production costs and unamortized tooling related to all other commercial aircraft programs was insignificant relative to the programs' balance-to-go cost estimates.

Fleet support We provide the operators of all our commercial airplane models assistance and services to facilitate efficient and safe aircraft operation. Collectively known as fleet support services, these activities and services include flight and maintenance training, field service support costs, engineering services and technical data and documents. Fleet support activity begins prior to aircraft delivery as the customer receives training, manuals and technical consulting support, and continues throughout the operational life of the aircraft. Services provided after delivery include field service support, consulting on maintenance, repair, and operational issues brought forth by the customer or regulators, updating manuals and engineering data, and the issuance of service bulletins that impact the entire model's fleet. Field service support involves our personnel located at customer facilities providing and coordinating fleet support activities and requests. The costs for fleet support are expensed as incurred and have been historically less than 1.5% of total consolidated costs of products and services. This level of expenditures is anticipated to continue in the upcoming years. These costs do not vary significantly with current production rates.

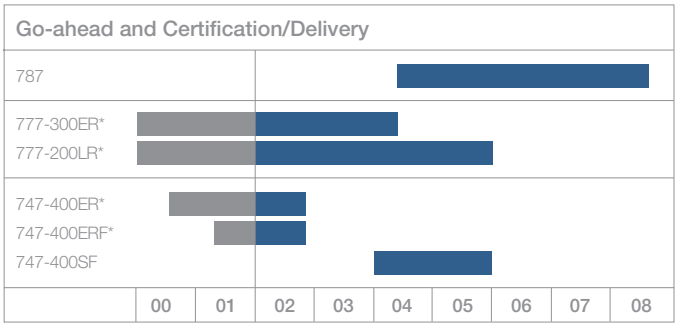
Research and development We continually evaluate opportunities to improve current aircraft models, and assess the marketplace to ensure that our family of commercial jet aircraft is well positioned to meet future requirements of the airline industry. The fundamental strategy is to maintain a broad product line that is responsive to changing market conditions by maximizing commonality among our family of commercial aircraft. Additionally, we are determined to continue to lead the industry in customer satisfaction by offering products with the highest standards of quality, safety, technical excellence, economic performance and in-service support.

The increase in 2004 research and development compared to 2003 was primarily due to increased spending on the 787. The decrease in 2003 research and development compared to 2002 was primarily due to reduced spending on the development of the 747-400ER. The initial delivery of the 747-400ER and the rollout of the first 777-300ER occurred in the fourth quarter of 2002. The initial delivery of the 777-300ER occurred during the first half of 2004.

We are currently focusing our new airplane product development efforts on the 787 program, which with the three planned versions will seat 223 to 296 passengers in multiple class configurations. In early 2004, we received the initial launch order for the 787 and Board of Directors (BoD) approval to proceed with full development and production. Entry into service is targeted for 2008. We project a continued increase in our research and development spending in 2005, primarily driven by spending on the 787 while we also continue to develop derivatives and features for our other programs primarily the 737, 747-400 Special Freighter modification and 777 programs. Commercial Airplanes' development work to support the MMA contract with the U.S. Navy is being deferred as part of the contract costs and is not reflected as research and development.

During 2004, we established cost sharing arrangements with some suppliers for the 787 that will enhance our internal development capabilities and offset a substantial portion of the financial risk of developing the 787 product. Amounts received from these suppliers will reduce our research and development expense related to the 787, since we will have no obligation to refund any amounts earned per the arrangements regardless of the outcome of the development efforts. Our cost sharing arrangements explicitly state that the supplier contributions are for reimbursements of costs we incur for experimentation, basic design and testing activities during the development of the 787. In each arrangement, we will retain the same rights that have been available under traditional supplier arrangements on past airplane programs. For 2004, 787 supplier development cost sharing payments earned were $205 million.

The following chart summarizes the time horizon between go-ahead and certification/initial delivery for major Commercial Airplanes derivatives and programs.



*Go-ahead prior to 2002.

Integrated Defense Systems

Business Environment and Trends

IDS is comprised of four reportable segments, which include A&WS, Network Systems, Support Systems and L&OS. The IDS business environment extends over multiple markets, including defense (A&WS, Network Systems and Support Systems segments), homeland security (Network Systems), civil

space transportation and exploration (L&OS), and launch and satellites (L&OS). IDS derives over 85% of its revenue from sales to the U.S. Government and we are forecasting this business mix will remain at this level into the foreseeable future. Specifically, the primary customers of IDS are the DoD for our products in the defense market, the U.S. Department of Homeland Security for the homeland security market, NASA for the civil space transportation and exploration market, and the U.S. Government and commercial satellite service providers for the launch and satellite market. Since the trends associated with these markets impact IDS opportunities and risks in unique ways, the various environmental factors for each are discussed individually below.

Defense environment overview The U.S. DoD represents nearly 50% of the world's defense budget. The current defense environment is characterized by transformation and change in the face of shrinking force structure, aging platforms, and levels of operations and engagements worldwide that are expected to remain high for the foreseeable future. The current environment is also heavily influenced by the continuing war on terrorism and the need to bring new technologies to assist the war fighter. The United States' leadership in the global war on terrorism demonstrates the value of networked intelligence, surveillance and communications, interoperability across platforms, services and forces, and the leveraging effects of precise, persistent, and selective engagement. The significance and advantage of unmanned systems to perform many of these tasks is growing. These experiences are driving the DoD, along with militaries worldwide, to transform their forces and the way they operate. Network-centric operations are at the heart of this transformation. There will continue to be pressure between this transformation goal and the support required for the existing forces.

The 2005 DoD authorization was approved in the fourth quarter of 2004 at a total level of $402 billion, including supplementals. Supplementals are the additional funds that are requested by the DoD to cover extraordinary events that were not planned for in the usual budget cycle. Although under pressure, the DoD budget remains strong and focused on transformation. This will provide opportunities for IDS products in the future. However, with a struggling global economy and anticipated federal budget deficits, allocations to DoD procurement decreased between fiscal year 2004 and 2005, and will remain under pressure in the near future. This suggests that the DoD will continue to focus on affordability strategies emphasizing network-centric operations, joint interoperability, long-range strike, unmanned air combat and reconnaissance vehicles, precision guided weapons and continued privatization of logistics and support activities as a means to improve overall effectiveness while maintaining control over costs. Along with this, we are already seeing the need for the military to make difficult choices between programs in an effort to support their highest priority. Programs will be continually evaluated with program performance and relevancy to the overall DoD vision as the measures for continuation or cancellation.

Military transformation The defense transformation is evidenced by a trend toward smaller, more capable, interoperable, and technologically advanced forces. To achieve these capabilities, a transformation in acquisition is underway with an increasing trend toward early deployment of initial program capabilities followed by subsequent incremental improvements (referred to as spiral development), cooperative international development programs and a demonstrated willingness to explore new forms of development, acquisition and support. Along with these trends, new system procurements are being evaluated for the degree to which they support the concept of jointness and interoperability among the services.

Institutions and events continue to shape the defense industrial environment. The DoD's implementation of a new Joint Capabilities Integration and Development Systems organization and process, along with revisions to the Defense Acquisition System, Program Planning Budgeting and Execution processes and the establishment of the Office of Force Transformation, has created a durable institutional foundation for continued transformation. Operations in the continuing global war on terrorism reaffirm the need for the rapid projection of decisive combat power around the world and emphasize the need for new capabilities and solutions for the war fighter. They also highlight the need for improved logistics and stability operation capabilities at completion of hostilities. Toward that end, the DoD is fully committed to a transformation that will achieve and maintain advantages through changes in operational concepts, organizational structure and technologies that significantly improve war fighting capabilities.

Missile Defense Funding for the missile defense market is primarily driven by the U.S. Government Missile Defense Agency (MDA) budget. The primary thrusts in this market are the continued development and deployment of theater missile defense systems and the Ground-based Midcourse Defense (GMD) program. The overall MDA missile defense budget for 2004 was approximately $9 billion and appropriations for 2005 are about $10 billion. With the Administration trying to curb the rise in defense spending it appears the MDA's budget will begin to come under pressure. That said we feel the GMD program has continued to make great progress over the past year in meeting President Bush's call to deploy a capability by the end of 2004. We believe this program, which is the cornerstone of our Missile Defense business, will be supported. Through our leadership position on the Missile Defense National Team and our prime contractor role on the GMD segment program and on the Airborne Laser program, IDS is positioned to maintain its role as the MDA's number one contractor.

Defense Competitive Environment The global competitive environment continues to intensify, with increased focus on the U.S. defense market, the world's largest and most attractive. IDS faces strong competition in all market segments, primarily from Lockheed Martin, Northrop Grumman, and Raytheon. Foreign companies such as BAE Systems and EADS continue to build a strategic presence in the U.S. market by strengthening their North American operations and partnering with U.S. defense companies.

We expect industry consolidation, partnering, and market concentration to continue. Prime contractors will continue to partner or serve as major suppliers to each other on various

programs and will perform targeted acquisitions to fill technology or customer gaps. At the lower tiers, consolidation persists and select companies have been positioning for larger roles, especially in the aerospace support market.

Homeland Security Environment The Department of Homeland Security became official in 2003, a year characterized by significant U.S. Government transformational and organizational challenges. Organizational alignment is ongoing and procurement practices are evolving. It is important to realize that this department has been formed from existing agencies and their budgets, and therefore a large portion of the near-term budget is committed to heritage programs and staffing. Until some of these existing commitments are complete, funding for new opportunities will represent a small share of the overall Department of Homeland Security budget. We expect Homeland Security to be a stable market with minimal growth and emphasis being placed on Information Analysis and Infrastructure Protection.

Congress and the Administration appropriated $33 billion to The Department of Homeland Security in fiscal year 2005. This amount is a slight decrease compared to the fiscal year 2004 appropriations of $29 billion, but still exhibits a continued commitment to homeland security. Only 50% of the federal spending on homeland security is within the newly formed Department of Homeland Security. Other federal agencies such as the DoD still have homeland security and homeland defense funding under their direction. We will continue to leverage our experience as the systems integrator on the Explosive Detection Systems program, our aviation heritage and our Integrated Battlespace and network-centric operations expertise and capabilities into the homeland security marketplace.

Civil Space Transportation and Exploration Environment Congress approved very close to full funding of NASA's fiscal year 2005 budget request, including needed funds for Space Shuttle Return to Flight, International Space Station, and new initiatives associated with the Vision for Space Exploration. NASA fiscal year 2005 appropriations of approximately $16 billion is a slight increase over the fiscal year 2004 funding level.

The Administration recently released a new Space Transportation Policy. This document recognizes the critical need for Space Shuttle Return to Flight, reinforces the nation's commitment to the Vision for Space Exploration—including the development of a Crew Exploration Vehicle (CEV)—provides for the evaluation of Shuttle-derived systems, and supports a viable space transportation industrial and technology base. We believe NASA will remain focused on supporting this new policy even as they transition to a new Administrator, who has yet to be named. The New Vision for Space Exploration and the priorities laid out in the new Space Transportation Policy will provide great opportunities for industry to develop new technologies and operational concepts to take human beings beyond low earth orbit. IDS, with our strong heritage in the development of space systems and our expertise in the area of human space flight, including the Space Shuttle and the International Space Station, is well positioned to work with and support our customer in accomplishing their goals. IDS will continue its work on the Space Shuttle and International Space Station programs along with development of critical technologies such as rocket propulsion and life support systems to prepare to meet the challenge of returning to the Moon and exploring the Solar System.

Launch and Satellite Environment The commercial space market has softened significantly since the late 1990s in conjunction with the downturn in the telecommunications industry. This market is now characterized by overcapacity, aggressive pricing and limited near-term opportunities. Recent projections indicate these market conditions will persist until the end of this decade. We believe there will be lower commercial satellite orders through this decade, along with lower demand for commercial launch services as compared to the high points of the early to mid-1990s. However, the replacement market for satellites will drive some recovery in the second half of this decade. In this extremely limited market, we see a growing amount of overcapacity, which in turn is driving the continued deterioration of pricing conditions. We will continue to pursue profitable commercial satellite opportunities, where the customer values our technical expertise and unique solutions, like the recently awarded order by DIRECTV. However, we will not pursue commercial satellite orders or launch contracts at a loss, and given the current pricing environment, we have decided, for the near-term, to focus on our Delta IV program on the government launch market, which we believe is a more stable market.

Inherent business risks Our businesses are heavily regulated in most of our markets. We deal with numerous U.S. Government agencies and entities, including all of the branches of the U.S. military, NASA, and the Department of Homeland Security. Similar government authorities exist in our international markets.

The U.S. Government, and other governments, may terminate any of our government contracts at their convenience as well as for default based on our failure to meet specified performance measurements. If any of our government contracts were to be terminated for convenience (TFC), we generally would be entitled to receive payment for work completed and allowable termination or cancellation costs. If any of our government contracts were to be terminated for default (TFD), generally the U.S. Government would pay only for the work that has been accepted and can require us to pay the difference between the original contract price and the cost to re-procure the contract items, net of the work accepted from the original contract. The U.S. Government can also hold us liable for damages resulting from the default.

On February 23, 2004, the U.S. Government announced plans to terminate for convenience, the RAH-66 Comanche EMD contract. The joint venture of Boeing and Sikorsky Aircraft (a division of United Technologies Corporation) had a 50/50 share in program work share and earnings. On March 19, 2004, the U.S. Government issued a partial TFC notification. By March 19, 2005, a termination proposal will be submitted and negotiations will commence with the U.S. Government shortly thereafter. The program represents less than 1% of our projected revenues for 2005 and less than 1% of our revenues for 2004.

U.S. Government contracts also are conditioned upon the continuing availability of Congressional appropriations. Long-term government contracts and related orders are subject to cancellation if appropriations for subsequent performance periods become unavailable. On research and development contracts, Congress usually appropriates funds on a government fiscal year basis (September 30 year-end), even though contract performance may extend over several years.

Many of our contracts are fixed-price contracts (just over 50% of IDS revenues are generated from fixed-price type contracts). Of the fixed-price contracts, 40% are fixed-price delivery contracts and 10% are fixed-price milestone. While firm, fixed-price contracts allow us to benefit from cost savings, they also expose us to the risk of cost overruns. If the initial estimates we use to calculate the contract price prove to be incorrect, we can incur losses on those contracts. In addition, some of our contracts have specific provisions relating to cost controls, schedule, and product performance. If we fail to meet the terms specified in those contracts, then we may not realize their full benefits. Our ability to manage costs on these contracts may affect our financial condition. Cost overruns may result in lower earnings, which would have an adverse effect on our financial results.

Just under 50% of IDS revenues are generated from cost type contracts. Revenues related to cost type contracts are recorded as costs are incurred plus an agreed upon profit in relation to the costs incurred. Cost type contracts are normally used for development and study type programs. Cost overruns on these contracts usually result in a lower profit to cost ratio. Sufficient notification must be given to the customer for any anticipated cost growth and customer authorization received to proceed in order to be reimbursed for said costs.

Sales of our products and services internationally are subject not only to local government regulations and procurement policies and practices but also to the policies and approval of the U.S. Department of State and DoD. The policies of some international customers require "industrial participation" agreements, which are discussed more fully in the "Disclosures about contractual obligations and commitments" section on page 31.

We are subject to business and cost classification regulations associated with our U.S. Government defense and space contracts. Violations can result in civil, criminal or administrative proceedings involving fines, compensatory and treble damages, restitution, forfeitures, and suspension or debarment from U.S. Government contracts. We are continuing discussions towards resolution with the U.S. Government regarding the allocation methodology of pension costs and have assessed the impact of potential outcomes. Based on our assessment, the most probable outcome of this matter is expected to be immaterial to our business, financial condition, results of operations, and liquidity. However, it is not possible at this time to predict when resolution will be reached nor the final outcome.

767 Tanker Program Prior to the fourth quarter of 2004 we incurred pre-contract costs related to development costs and one in-production aircraft. These costs were being deferred based on our assessment that it was probable that we would recover these costs from the USAF 767 Tanker contract. The pre-contract costs were being deferred and recorded in inventory based on AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, which states that costs may be deferred if the costs can be associated with a specific anticipated contract and if their recoverability from that contract is probable. Our assessment of probability was based on the following:

> The Department of Defense Appropriations Act for fiscal year 2005 provides $100 million funding for tanker replacement. The National Defense Authorization Act for fiscal year 2005 provides authorization for the procurement of 100 tanker aircraft and associated support contracts. We believed, based on our understanding of the requirements, that our 767 aircraft was the most cost effective solution that meets those requirements and it is therefore probable we would be awarded the USAF 767 Tanker contract. Based on prior DoD contracting practices we believed it was probable that we would also be awarded the initial support contracts.

On January 14, 2005 we announced our plan to recognize pre-tax charges totaling $275 million related to the USAF 767 Tanker program. The charge is related to the initial production of the aerial refueling tankers for the USAF and includes expected supplier obligations. The Commercial Airplanes segment share of the charge is $195 million and the IDS segment share is $80 million. Within IDS, the A&WS and Support Systems segments were impacted by the charge. We used our own money and received no government funding in development of the USAF 767 Tanker.

The charge, which is a result of our regular quarter and year-end reviews, reflects our updated assessment of securing the specific USAF 767 Tanker contract that was being negotiated, given the continued delay and now likely recompetition of the contract. This charge covers both incurred cost and anticipated liabilities associated with the USAF 767 Tanker program.

We remain firmly committed to the USAF 767 Tanker program and are ready to support our customer in whatever decision is made regarding the recapitalization of the nation's current aerial refueling fleet.

Sea Launch The Sea Launch venture, in which we are a 40% partner, provides ocean-based launch services to commercial satellite customers and is reported in the L&OS segment. For the year ended December 31, 2004, the venture conducted two successful launches and a third launch where the satellite reached an orbit that will meet or exceed its expected life with the aid of its propulsion system.

We have issued credit guarantees to creditors of the Sea Launch venture to assist the venture in obtaining financing. In the event we are required to perform on these guarantees, we have the right to recover a portion of the loss from other venture partners. We believe our total net maximum exposure to loss from Sea Launch at December 31, 2004 totals $212 million. The components of this exposure are as follows:

	Maximum Exposure	Estimated Reserves	Established from Proceeds Recourse	Net Exposure
Credit Guarantees	$ 510	$204	$306	
Partner Loans (Principal and Interest)	401	241	160	
Advances to Provide for Future Launches	209		35	$174
Trade Receivable from Sea Launch	202	202		
Performance Guarantees	35	1	21	13
Subcontract Termination	25			25
Other Receivables from Sea Launch	35	35		
	$1,417	$683	$522	$212

We made no additional capital contributions to the Sea Launch venture during the year ended December 31, 2004. (See Notes 12 and 20.)

Delta IV In 1999, two employees were found to have in their possession certain information pertaining to a competitor, Lockheed Martin Corporation, under the Evolved Expendable Launch Vehicle (EELV) Program. The employees, one of whom was a former employee of Lockheed Martin, were terminated and a third employee was disciplined and resigned. In March 2003, the USAF notified us that it was reviewing our present responsibility as a government contractor in connection with the incident. In June 2003, Lockheed Martin filed a lawsuit against us and the three individual former employees arising from the same facts. It is not possible at this time to predict the outcome of these matters or whether an adverse outcome would or could have a material adverse effect on our financial position. In addition, on July 24, 2003, the USAF suspended certain organizations in our space launch services business and the three former employees from receiving government contracts for an indefinite period as a direct result of alleged wrongdoing relating to possession of the Lockheed Martin information during the EELV source selection in 1998. The USAF also terminated 7 out of 21 of our EELV launches previously awarded through a mutual contract modification and disqualified the launch services business from competing for three additional launches under a follow-on procurement. The same incident is under investigation by the U.S. Attorney General in Los Angeles, who indicted two of the former employees in July 2003.

The cost estimates for the Delta II and Delta IV programs are based, in part, upon estimated quantities and timing of launch missions for existing and anticipated contracts (the Mission Manifest) to determine the allocation of fixed costs for individual launches. Revenue estimates include probable price adjustments due to contractual statement of work changes where we have established contractual entitlement. The Mission Manifest represents management's best estimate of the launch services market, taking into account all known information. Due to the volatility of the government launch market, and the current suspension, as described in Note 23, it is possible that changes in quantity and timing of launches could occur that would change the Mission Manifest and therefore the financial performance of the Delta programs. The Delta II and IV programs are reported in the L&OS segment.

Satellites As is the standard for the commercial satellite industry contracts are fixed price in nature. Many of the existing satellite programs have very complex designs including unique phased array antenna designs. As technical or quality issues arise, we have continued to experience schedule delays and cost impacts. If the issues continue they could result in a material charge. These programs are on-going, and while we believe the cost estimates reflected in the December 31, 2004 financial statements are adequate and appropriate, the technical complexity of the satellites create financial risk, as additional completion costs may become necessary, or scheduled delivery dates could be missed, which could trigger TFD provisions or other financially significant exposure. In 2004, two satellites were delivered retiring the TFD risk on those satellites. At the end of 2004, we had one commercial satellite contract (NSS-8) that could have exposed us to the risk of contract TFD notification. In January 2005, we entered into an amended agreement with New Skies Satellites B.V. which revised the satellite's contractual delivery schedule, payments and other terms. As a result of this agreement, management no longer believes that we have a material risk of contract TFD notification. The agreement increases the financial exposure to the performance of the satellite over its contracted on-orbit life. The estimated earnings impact of this agreement has been recognized in 2004. Our satellite programs are reported in either the Network Systems or L&OS segments.

On August 16, 2004, in response to a draft demand for arbitration from ICO Global Communications (Operations), Ltd. (ICO) seeking return of monies paid by ICO to Boeing Satellite Systems International, Inc. (BSSI) under contracts for manufacture and launch of communications satellites, BSSI filed a complaint for declaratory relief against ICO in Los Angeles County Superior Court. BSSI's suit seeks declaratory judgment that ICO's prior termination of the contracts for convenience extinguished all claims between the parties. ICO filed a cross complaint with the court on September 16, 2004, alleging breach of contract, other claims, and seeking recovery of all amounts it invested in the contracts, approximately $2 billion. We believe that ICO's claims lack merit and intend to aggressively pursue our suit against ICO for declaratory relief and to vigorously defend against ICO's cross-complaint.

On September 10, 2004, a group of insurance underwriters for Thuraya Satellite Telecommunications (Thuraya) requested arbitration before the International Chamber of Commerce (ICC), against BSSI. The Request for Arbitration alleges that BSSI breached its contract with Thuraya for sale of a 702 Satellite which experienced anomalies with its concentrator solar arrays. The claimants seek approximately $238 million consisting of insurance payments either already made to Thuraya or currently in dispute between Thuraya and its insurers, as well as reserving their right to increase the amount claimed to $365 million (plus claims of interest, costs, and fees) comprising the

total loss allegedly incurred by Thuraya. We believe that these claims lack merit and intend to vigorously defend against them. BSSI filed its answer to the arbitration on December 2, 2004 with the ICC.

In certain launch and satellite sales contracts, we include provisions for replacement launch services or hardware if we do not meet specified performance criteria. We have historically purchased insurance to cover these exposures when allowed under the terms of the contract. The current insurance market reflects unusually high premium rates and also suffers from a lack of capacity to handle all insurance requirements. We make decisions on the procurement of third-party insurance based on our analysis of risk. There is one contractual launch scheduled in early 2005 for which full insurance coverage may not be available, or if available, could be prohibitively expensive. We will continue to review this risk. We estimate that the potential uninsured amount for this launch could range between $65 million to $315 million depending on the nature of the uninsured event.

Integrated Defense Systems

(Dollars in millions)	2004	2003	2002
Revenues	**$30,465**	$27,361	$24,957
% of Total Company Revenues	**58%**	54%	46%
Operating Earnings	**$ 2,925**	$ 766	$ 2,009
Operating Margins	**9.6%**	2.8%	8.0%
Research and Development	**$ 834**	$ 846	$ 742
Contractual Backlog	**$39,151**	$40,883	$36,014

Revenues Increased revenues from 2003 to 2004 were driven by three segments. A&WS revenues increased in total by $628 million. This increase was due to additional production aircraft deliveries, remanufactured rotorcraft deliveries and amounts recognized on development programs such as the EA-18G Growler, partially offset by decreased F-15 and JDAM volume. Network Systems revenues grew by over $2 billion from increased volume in the Missile Defense and Integrated Battlespace markets including such programs as GMD, FCS, Intelligence, Airborne Command and Control programs and the ramp up of the MMA of $2.3 billion. This growth was partially offset by reduced Homeland Security & Services revenue volume. Increased volume in spares, Training Systems & Services, Life Cycle Customer Support (LCCS) and Modernization & Upgrades of $560 million was partially offset by decreased Contractor Logistical Support & Services (CLSS) in the Support Systems segment. L&OS revenues remained constant with increased Return to Flight activity in the NASA businesses and a satellite TFC settlement of $240 million, offset by decreased satellite and Delta launch deliveries and satellite milestone slips.

Increased revenues from 2002 to 2003 were primarily driven by additional production aircraft and JDAM deliveries and F/A-22 Raptor volume in A&WS; increased volume in Homeland Security & Services, Intelligence programs and the start up of FCS in Network Systems; increased volume in spares, maintenance and LCCS in Support Systems; and increased Delta launch deliveries in L&OS.

Operating Earnings The increase in operating earnings from 2003 to 2004 reflects strong performance from the A&WS, Network Systems and Support Systems segments partially offset by losses recorded in the L&OS segment. Operating earnings were also negatively impacted by $80 million of charges taken in the fourth quarter of 2004 related to the USAF 767 Tanker program.

In 2004, A&WS earnings were driven by an increased revenue base contributing $82 million from the segment's major production programs as a result of efficiencies achieved through lean initiatives to reduce costs by $210 million, partially offset by the USAF 767 Tanker charge of $62 million taken in the fourth quarter of 2004 and increased research and development investment on the 767 GTTA program. Network Systems segment earnings improved from 2003 primarily due to increased revenues generating additional earnings of $200 million and improved performance from the Homeland Security & Services, Military Satellite Communications and Intelligence programs of $147 million, partially offset by cost growth in the Missile Defense market. 2003 Network Systems earnings were also impacted by a $55 million charge related to our investment in a joint venture that lost an imagery contract award. Support Systems had another outstanding year driven by an increase in revenue that generated additional earnings of $45 million along with improved performance of $139 million throughout the segment's businesses. The Support segment was also impacted by the USAF 767 Tanker charge taken in the fourth quarter of 2004 by $18 million. L&OS operating earnings improved from 2003 to 2004 driven by the 2003 charges described in the L&OS discussion. Excluding the 2003 charges, 2004 operating earnings were lower due to cost growth from technical and quality issues on satellites currently in the factory and write-offs of slow moving satellite inventory coupled with decreased Delta IV deliveries in 2004, partially offset by increased USA Venture earnings and increased NASA Systems Shuttle Return to Flight volume.

The decreased operating earnings from 2002 to 2003 reflects increased operating losses recorded for the L&OS segment, partially offset by strong performance from the A&WS, Network Systems and Support Systems segments.

In 2003, A&WS earnings were driven by strong performance from the segments major production programs and an increased revenue base. Network Systems segment earnings improved from 2002 primarily due to increased revenues in Homeland Security & Services, FCS and proprietary programs, partially offset by cost growth on military satellite programs and a charge related to our investment in a joint venture. Support Systems had another outstanding year driven by an increased revenue base along with improved performance in many of the segment's businesses. The L&OS segment was impacted by charges throughout the year described in detail in the L&OS segment discussion.

Backlog The decrease in contractual backlog from 2003 to 2004 is attributed to sales on multi-year contracts that were awarded in prior periods, particularly the C-17 and F/A-18 programs in A&WS and strong sales on the GMD program and proprietary programs in Network Systems. The decrease was partially offset by orders in L&OS, satellites and Shuttle Return to Flight and Shuttle contract extensions, as well as orders in the Support Systems segment. IDS total backlog decreased by 5% from 2003 to 2004 primarily from sales on multi-year contracts that were awarded in prior periods, partially offset by contract awards for the MMA, FCS program extension and an order from DIRECTV for 3 satellites.

Aircraft & Weapon Systems

(Dollars in millions)	2004	2003	2002
Revenues	**$11,394**	$10,766	$10,569
% of Total Company Revenues	**22%**	21%	20%
Operating Earnings	**$ 1,636**	$ 1,422	$ 1,269
Operating Margins	**14.4%**	13.2%	12.0%
Research and Development	**$ 382**	$ 360	$ 304
Contractual Backlog	**$18,256**	$19,352	$15,862

Revenues A&WS increased revenues from 2003 to 2004 were driven by additional deliveries on F/A-18E/F Super Hornet, and AH-64 Apache programs, increased remanufactured deliveries on rotorcraft programs, and additional hardware deliveries on the F/A-22 Raptor program. 2004 A&WS revenues also grew with increased development volume on programs such as EA-18G Growler.

A&WS increased revenues between 2002 to 2003 were primarily driven by additional deliveries on JDAM, F/A-18E/F Super Hornet, F-15E Eagle and F/A-22 Raptor volume, partially offset by lower rotorcraft deliveries.

Deliveries of units for principal production programs were as follows:

	2004	2003	2002
C-17 Globemaster	**16**	16	16
F/A-18E/F Super Hornet	**48**	44	40
T-45TS Goshawk	**7**	12	14
F-15E Eagle	**3**	4	3
CH-47 Chinook*	**–**	–	7
737 C-40A Clipper	**3**	1	3
AH-64 Apache*	**3**	–	15

*New Builds Only

Operating Earnings A&WS 2004 operating earnings growth reflects increased revenues, strong performance on our major production programs resulting from manufacturing cost of sales efficiencies achieved through lean initiatives, risk mitigation efforts, and reductions in period expenses associated with the expanding business base. A&WS 2004 results were adversely impacted by a pre-tax charge of $62 million that was taken in the fourth quarter of 2004 related to the USAF 767 Tanker program.

A&WS 2003 operating earnings growth reflected increased revenues, strong performance on our major production programs and a favorable adjustment of $45 million associated with the F-15 Eagle program pre-tax charges of $270 million initially taken in 1999. The adjustment amount was based on negotiated termination liability with suppliers and aircraft deliveries that incorporated inventory associated with the original 1999 charge.

Research and Development A&WS segment continues to focus its research and development where it can use its customer knowledge, technical strength and large-scale integration capabilities to provide transformational solutions for the war fighter's needs. Research and development activities leverage our capabilities in architectures, system-of-systems integration and weapon systems technologies across a broad spectrum of capabilities designed to enhance situational awareness and survivability; increase mission effectiveness and interoperability and improve affordability, reliability and economic ownership. Continued research and development investments in unmanned systems have enabled the demonstration of multi-vehicle coordinated flight and distributed control of high performance unmanned combat air vehicles. Research and development in advanced weapons technologies emphasizes, among other things, precision guidance and multi-mode targeting as evidenced by our successful Small Diameter Bomb (SDB) offering. Research and development investments in the GTTA program represents a significant opportunity to provide state of the art refueling capabilities to domestic and international customers, demonstrating the synergistic value of our diversified company-wide portfolio. Other research and development efforts include upgrade and technology insertions to network-enable and enhance the capability and competitiveness of current product lines such as the F/A-18E/F Hornet, F-15E Eagle, AH-64 Apache, CH-47 Chinook and C-17 Globemaster III.

Backlog A&WS contractual backlog decreased from 2003 to 2004 primarily due to sales on multi-year contracts that were awarded in prior periods. This was partially offset by orders on Chinook, T-45, V-22 and the Joint Helmet-Mounted Cueing system programs.

A&WS increased contractual backlog from 2002 to 2003 is primarily attributed to the capture of several key awards including the F/A-18 E/F Multi Year II contract, Apache helicopter new builds, and the initial funding for the EA-18G. Backlog also increased due to rate increase on the F/A-22 low rate initial production and weapon orders for SDB, Harpoon, and SLAM-ER.

Network Systems

(Dollars in millions)	2004	2003	2002
Revenues	**$11,432**	$ 9,384	$8,113
% of Total Company Revenues	**22%**	19%	15%
Operating Earnings	**$ 993**	$ 626	$ 546
Operating Margins	**8.7%**	6.7%	6.7%
Research and Development	**$ 234**	$ 195	$ 132
Contractual Backlog	**$10,190**	$11,715	$6,700

Revenues Increased revenues for the Network Systems segment in 2004 were primarily driven by increased volume from the Missile Defense and Integrated Battlespace markets including programs such as GMD, FCS, Intelligence, Airborne Command and Control programs and the ramp up of the MMA, partially offset by reduced activities in Homeland Security & Services.

Network Systems increased revenues from 2002 to 2003 were primarily driven by the ramp up of the FCS program, increased activity in Intelligence and Homeland Security & Services programs, and the successful launch of a Naval satellite (UHF F11).

Operating Earnings Network Systems 2004 earnings results were primarily driven by increased revenue stated above, in addition to improved performance on Airborne Command and Control, Military Satellite Communication, Intelligence programs and capture of award fee earnings on cost type contracts. 2003 results were adversely impacted by a $55 million pre-tax non-cash charge taken on Resource 21 (a joint venture we had entered into) as a result of a decision by NASA to not award an imagery contract to Resource 21.

Network Systems increased earnings from 2002 to 2003 were primarily driven by the increased revenue while partially offset by the military satellite cost growth and the Resource 21 write-off mentioned earlier.

Research and Development The Network Systems research and development funding remains focused on the development of Communications and Command & Control capabilities that support a network-centric architecture approach for our various government customers. We are investing in the communications market to enable connectivity between existing air/ground platforms, increase communications availability and bandwidth through more robust space systems, and leverage innovative communications concepts. Key programs in this area include Joint Tactical Radio System, Global Positioning System, and Transformational Communications System. Investments were also made to support various Intelligence, Surveillance, and Reconnaissance business opportunities including MMA, AEW&C aircraft, and concepts that will lead to the development of next-generation space intelligence systems. A major contributor to our support of these DoD transformation programs is the investment in the Boeing Integration Center (BIC) and extended network of modeling, simulation and analysis capabilities where our Network-Centric Operations concepts are developed in partnership with our customers. Along with increased funding to support these areas of architecture and network-centric capabilities development, we also maintained our investment levels in Global Missile Defense and advanced missile defense concepts and technologies. In 2004 we continued investment to pursue the Homeland Security & Services market, with emphasis on funding to develop and tailor the network-centric capabilities already being applied to many DoD opportunities in this emerging market.

Backlog Network Systems contractual backlog decreased from 2003 to 2004 primarily due to the strong sales on GMD and IDS Proprietary programs from orders received in 2003. This was partially offset by orders on the FCS program and the capture of the MMA program that contributed to IDS total backlog in 2004.

The 75% increase in contractual backlog from 2002 to 2003 is mainly attributed to the initial funding of the FCS program and orders for the GMD and Turkey 737 AEW&C programs.

Support Systems

(Dollars in millions)	2004	2003	2002
Revenues	**$4,670**	$4,219	$3,484
% of Total Company Revenues	**9%**	8%	6%
Operating Earnings	**$ 638**	$ 472	$ 376
Operating Margins	**13.7%**	11.2%	10.8%
Research and Development	**$ 57**	$ 59	$ 43
Contractual Backlog	**$6,505**	$5,882	$5,286

Revenues Support Systems increased revenues from 2003 to 2004 were driven by increased volume in Training Systems & Services, Spares for tactical aircraft, LCCS, and Modernization & Upgrades, partially offset by decreased CLSS activity.

Support Systems increased revenues from 2002 to 2003 were driven by increased volume in spares for tactical aircraft, LCCS, Maintenance & Modification, and CLSS.

Operating Earnings Support Systems increased operating earnings from 2003 to 2004 were driven by the revenue volume stated above, favorable contract closeout activity and cost reductions through improved efficiencies generating strong performance throughout the businesses. Support Systems 2004 results were adversely impacted by a pre-tax charge of $18 million that was taken in the fourth quarter of 2004 related to the USAF 767 Tanker program.

Support Systems increased operating earnings from 2002 and 2003 were due to a higher revenue base and performance improvement in the Supply Chain Services and Modification & Upgrades businesses.

Research and Development Support Systems continues to focus investment strategies on its core businesses including Engineering and Logistic Services, Maintenance, Modifications & Upgrades, Supply Chain Services, Training and Support Systems and Advanced Logistics Services. Investments have been made to continue the development and implementation of innovative, disciplined tools, processes and systems as market discriminators in the delivery of integrated customer solutions. Examples of successful programs stemming from these investment strategies include the C-17 Globemaster Sustainment Partnership, C-130U Gunship 4 Buy and C-130 Avionics Modernization Program.

Backlog Support Systems increased contractual backlog from 2003 to 2004 primarily due to orders on LCCS programs. Also contributing to the increase were Modernization & Upgrade programs, partially offset by strong sales on Supply Chain Services programs.

The increase in contractual backlog from 2002 to 2003 is attributed to orders for C-17 sustainment and KC-10 support as well as orders in the CLSS business.

Launch & Orbital Systems

(Dollars in millions)	2004	2003	2002
Revenues	$2,969	$ 2,992	$2,791
% of Total Company Revenues	5%	6%	5%
Operating Losses	$ (342)	$(1,754)	$ (182)
Operating Margins	(11.5)%	(58.6)%	(6.5)%
Research and Development	$ 161	$ 232	$ 263
Contractual Backlog	$4,200	$ 3,934	$8,166

Revenues L&OS revenues remained constant from 2003 to 2004 primarily due to the increased return to flight activity in the NASA businesses and a satellite TFC settlement offset by lower satellite and Delta launch deliveries and delays in satellite milestone completions.

L&OS revenues increased from 2002 to 2003 primarily due to increased Delta launch deliveries.

Deliveries of production units were as follows:

	2004	2003	2002
Delta II	4	4	3
Delta IV	–	2	1
BSS Satellites	2	3	6

Operating Earnings L&OS increased operating earnings from 2003 to 2004 were driven by the 2003 charges described below. Excluding the 2003 charges, 2004 operating earnings were lower due to cost growth from technical and quality issues on satellites currently in the factory and write-offs of slow moving satellite inventory coupled with no Delta IV deliveries in 2004, partially offset by increased USA joint venture earnings and NASA Systems Shuttle Return to Flight volume.

L&OS 2003 operating earnings were negatively impacted by a first quarter goodwill impairment charge of $572 million. This impairment charge resulted during an internal reorganization, when the SFAS No. 142 reportable segments, operating segments, and reporting unit designations changed, causing significantly different relationships between reporting unit carrying values and fair values. Specifically, the new L&OS reporting unit was created by combining six pre-existing reporting units: Boeing Satellite Systems, Human Space Flight & Exploration, Expendable Launch Systems, United Space Alliance Joint Venture, Rocketdyne Propulsion & Power, and Sea Launch Joint Venture. The carrying value of one of these reporting units, Boeing Satellite Systems, exceeded its fair value resulting in the goodwill balances at this reporting unit being fully impaired during calendar year 2002. However, the carrying values of the other five reporting units were less than their fair values, so the goodwill balances at these reporting units were not impaired during calendar year 2002. In addition, the BoD approved in early 2003 our long range business plan which included downward revisions to cash flow projections for the L&OS reporting unit. The combination of these factors resulted in the newly created L&OS reporting unit having a carrying value that exceeded its fair value, prompting recognition of the goodwill impairment charge.

L&OS 2003 operating earnings were further impacted by a second quarter charge of $1,030 million of which $835 million was attributable to the Delta IV program, caused by a combination of factors. The most significant of these factors was the requirement to spread fixed costs of the Delta IV program to an overall reduced number of anticipated launches as a result of continued weakness in the commercial space launch market, accounting for $412 million of the charge. The Delta IV program experienced cost growth of $360 million, primarily related to payload integration and launch support costs. In each of these cases, the additional costs were not billable under the respective contracts. In addition, the remaining $63 million of the charge resulted from determining it was no longer probable that our U.S. Government customer would agree to price increases for change orders in connection with existing contracted and awarded Delta IV launches as a result of the EELV procurement integrity issue. The remaining $195 million of the second quarter charge relates to Boeing Satellite Systems incurring additional costs as a result of satellite program complexities. These complexities caused technical and quality issues resulting in schedule delays, cost impacts, and late delivery penalties, which were not billable under the respective contract. The 2003 results also include the adjustments made to equity investments in Ellipso, SkyBridge and Teledesic resulting in a net write-down of $27 million. The 2002 results include a $100 million pre-tax charge to write-down an equity investment in Teledesic, LLC. Also contributing to the 2002 decreased operating earnings was cost growth on commercial satellite programs and the continued downturn in the launch and commercial satellite market.

We are a 50/50 partner with Lockheed Martin in a joint venture called United Space Alliance, which is responsible for all ground processing of the Space Shuttle fleet and for space-related operations with the USAF. United Space Alliance also performs modifications, testing and checkout operations that are required to ready the Space Shuttle for launch. United Space Alliance operations are performed under cost-plus-type contracts. Our 50% share of joint venture earnings is recognized as income. The segment's operating earnings include earnings of $70 million, $52 million, and $68 million, for 2004, 2003 and 2002, respectively, attributable to United Space Alliance. These results include all known or expected impacts related to the Space Shuttle program based on the findings from the Columbia Accident Investigation Board (CAIB) investigation.

Research and Development Our research and development investment in L&OS declined as most versions of the Delta IV expendable launch vehicle reached operational status. Continued investment was made in the Delta IV Heavy program to support the successful demonstration launch in December 2004. We also continue to make investments in this segment to develop key technologies and systems solutions to support our NASA customer in the development of new space exploration systems. Prudent investment of research and development resources was made in the satellite manufacturing business to enhance existing designs to meet evolving customer requirements.

Backlog L&OS contractual backlog increased from 2003 to 2004 primarily due to orders in our Commercial Satellite (DIRECTV order for 3 satellites) and NASA businesses. This increase was partially offset by solid sales from our NASA business unit.

The contractual backlog decrease from 2002 to 2003 was due to the adjustment in the Delta IV Launch manifest. The adjustment was a result of missions lost on the EELV (see "EELV Suspension" in Risk Factors section) contract and a continued weakness in the commercial space market and sales on the existing orders.

Boeing Capital Corporation

Business Environment and Trends

At December 31, 2004, BCC's portfolio consisted of financing leases, notes and other receivables, equipment under operating leases, investments and assets held for sale or re-lease.

BCC's strategic direction has shifted from a focus on growing the portfolio to a focus on supporting our major operating units and managing overall portfolio risk exposures. For the commercial aircraft market, BCC facilitates, arranges, structures and/or provides selective financing solutions to our Commercial Airplanes segment customers. For the defense and space markets, BCC primarily engages in arranging and structuring financing solutions for our IDS segment government customers. In addition, BCC continues to enhance its risk management activities to manage exposures associated with its current portfolio and future business activities.

On May 24, 2004, BCC entered into a purchase and sale agreement with General Electric Capital Corporation (GECC) to sell substantially all of the assets related to its former Commercial Financial Services business, which was primarily engaged in providing lease and loan financing to a broad range of commercial and industrial customers. (See Note 9.) The assets sold to GECC consisted of leases and financing arrangements having a carrying value of $1.9 billion as of May 31, 2004. The purchase agreement, as amended, called for the sale of the assets to take place in a series of closings, commencing on May 31, 2004 and ending no later than December 31, 2004. The final asset sale closed on December 27, 2004. BCC intends to dispose of the remaining assets identified to its Commercial Financial Services business that are not subject to the purchase and sale agreement with GECC by the end of the second quarter of 2005.

Refer to discussion of the airline industry environment in the Commercial Airplanes – Business Environments and Trends.

Aircraft values and lease rates are impacted by the number and type of aircraft that are currently out of service. The number of worldwide parked commercial jet aircraft has declined by approximately 100 aircraft from the number of aircraft parked at December 31, 2003, reaching a new post-September 11, 2001 low in terms of both the number of parked aircraft and the parked percentage of the active fleet. Approximately 1,900 commercial jet aircraft (10.6% of current world fleet) continue to be parked, including both in production and out-of-production aircraft types.

BCC's portfolio at December 31, 2004 totaled $9.7 billion, of which $9.3 billion was related to our products, primarily commercial aircraft. While worldwide traffic levels exceed traffic levels carried by the airlines in 2000, the effects of declining yields and higher fuel prices on the airline industry continue to impact commercial aircraft values. Recently published sources and market transactions indicate that, while lease rates for aircraft are increasing, values for the various aircraft types serving as collateral in BCC's portfolio generally have not increased. Aircraft valuations could decline materially if significant numbers of aircraft, particularly types with relatively few operators, are idled on account of further airline bankruptcies or restructurings. At the same time, the credit ratings of many airlines, particularly in the U.S., have remained at low levels.

On January 12, 2005, Commercial Airplanes decided to conclude production of the 717 program in 2006 due to the lack of overall market demand for the aircraft. While BCC continues to believe in the utility and marketability of the 717 aircraft, BCC is unable to predict whether or how the end of the 717 program, as well as overall market conditions, may impact 717 aircraft values and rental rates. At December 31, 2004, $2.4 billion of BCC's portfolio was collateralized by 717 aircraft. Should the 717 aircraft suffer a significant decline in utility and market acceptance, the aircraft values may decline, which could result in an increase to the allowance for losses on receivables. While BCC is unable to predict the likelihood of these impacts occurring, such impacts could result in a potential material adverse effect on its earnings, cash flows and/or financial position.

In October 2003, Commercial Airplanes announced the decision to end production of the 757 program, and the final aircraft was produced in October 2004. While BCC is unable to determine how much of the 757 used aircraft value decline was attributable to the decision to end production of the 757 program, the impact of any declines in 757 used aircraft values due to this decision had been reflected in reserves, as of December 31, 2004. At December 31, 2004, $1.5 billion of BCC's portfolio was collateralized by 757 aircraft of various vintages and variants. This included $1.2 billion of passenger aircraft (33 aircraft at 12 operators). The remainder of the 757 portfolio consisted of converted freighters on long-term lease.

At December 31, 2004, BCC had $37 million of assets that were held for sale or re-lease, of which $25 million were identified with firm contracts to be placed on lease. Additionally, approximately $409 million of BCC's portfolio currently represents scheduled lease terminations in 2005 for which the related aircraft will be remarketed, of which $109 million were identified with firm contracts in place at December 31, 2004 to be sold or placed on lease. Potential delays in selling or placing these assets on lease at reasonable rates may negatively affect BCC's earnings, cash flows and/or financial position.

Significant Customer Contingencies

A substantial portion of BCC's portfolio is concentrated among commercial airline customers. Certain customers have filed for bankruptcy protection or requested lease or loan restructurings; these negotiations were in various stages as of December 31, 2004. These bankruptcies or restructurings could have a material adverse effect on BCC's earnings, cash flows and/or financial position.

United Airlines, Inc. At December 31, 2004 and 2003, United accounted for $1.1 billion and $1.2 billion (11.7% and 11.5%) of BCC's total portfolio. At December 31, 2004, the United portfolio was secured by security interests in two 767 aircraft and 13 777 aircraft and by an ownership and security interests in five 757 aircraft. At December 31, 2004, United was current on all of its obligations related to these 20 aircraft. At December 31, 2004, United was BCC's second largest customer. United continues to operate under Chapter 11 bankruptcy protection. On June 28, 2004, United's application to obtain federal loan guarantees was denied by the Airline Transportation Stabilization Board, which also withdrew United's eligibility to reapply. On August 20, 2004, United obtained approval from the bankruptcy court to extend its debtor-in-possession financing credit facilities through June 30, 2005 and increase its available funds by $500 million. United is continuing to pursue alternative financing through private investors. During the third quarter of 2003, BCC completed a restructuring of United's aircraft loans and leases. The lease rate for the five 757s on lease to United was negotiated downward. BCC applied guidance in SFAS No. 13, *Accounting for Leases*, and determined that these leases were required to be reclassified from finance leases to operating leases. The loans with United were restructured to defer certain principal payments by extending the maturity of the loans. BCC applied the guidance in SFAS No. 15, *Accounting for Debtors and Creditors for Troubled Debt Restructurings*, and determined that a troubled debt restructuring charge was not required because the effective yield of each loan receivable after the restructuring was equal to or greater than its effective yield prior to the restructuring.

United retains certain rights by operating under Chapter 11 bankruptcy protection, including the right to reject the restructuring terms with its creditors and return aircraft, including BCC's aircraft. The terms of BCC's restructuring with United, which were approved by the federal bankruptcy court, set forth the terms under which all 20 aircraft BCC financed are expected to remain in service upon United's emergence from Chapter 11 protection. If United exercises its right to reject the agreed upon restructuring terms, the terms of all of the leases and loans with United would immediately revert to the original terms, which are generally less favorable to United. United would retain its rights under Chapter 11 to return BCC's aircraft in the event of a reversion to the original lease and loan terms. During the fourth quarter of 2004, United requested that BCC restructure its financing terms as part of their ongoing efforts to emerge from bankruptcy. BCC is currently evaluating the request from United.

ATA Holdings Corp. At December 31, 2004 and 2003, ATA Holdings Corp. (ATA) accounted for $705 million and $743 million (7.3% and 7.3%) of BCC's total portfolio. At December 31, 2004, the ATA portfolio primarily consisted of 12 finance leases for 757 aircraft and an investment in ATA mandatorily redeemable preferred stock with a face value of $50 million, which was written down to zero in 2004.

During the third quarter of 2004, BCC's assessment of ATA's continued financial difficulties led them to conclude that its portfolio of finance leases and note receivable with ATA were specifically impaired. Accordingly, in 2004, BCC increased its allowance for losses on receivables by approximately $49 million (an additional $38 million was recorded by the Other segment) in order to reserve for the amount by which the carrying value of the ATA related assets exceeded the assets' collateral values. Additionally, during the third quarter of 2004, ATA requested that BCC restructure its finance lease terms and provide additional short-term financing support. On October 26, 2004, ATA filed for Chapter 11 bankruptcy protection. As a result, on December 29, 2004, BCC entered into an agreement in principle with ATA whereby ATA agreed to continue to lease the 12 757s under restructured terms and agreed to return eight of the 12 757s during the second half of 2005 and early 2006. The restructured lease terms with ATA, including ATA's agreement to return the eight 757 aircraft starting in July 2005 are subject to approval by the bankruptcy court. ATA is obligated to pay rent on all aircraft until returned.

While BCC believes it has provided for an adequate allowance for losses on receivables on ATA's finance leases and notes receivable, in the event that future negotiations or proceedings result in the return of a substantial number of aircraft, there could be a material adverse effect on our earnings, cash flows and/or financial position, at least until such time as the aircraft are sold or redeployed for adequate consideration.

Hawaiian Airlines, Inc. At December 31, 2004 and 2003, Hawaiian Airlines, Inc. (Hawaiian) accounted for $456 million and $506 million (4.7% and 5.0%) of BCC's total portfolio. At December 31, 2004, the Hawaiian portfolio consisted of 11 717 aircraft and three 767 aircraft. Hawaiian filed for Chapter 11 bankruptcy protection on March 21, 2003. In December 2003 and January 2004, BCC permitted Hawaiian to return two 717 aircraft leased by BCC. These 717 aircraft were leased to a third party in the first quarter of 2004.

In September 2004, BCC reached an agreement with the bankruptcy trustee for the Hawaiian estate relating to the restructuring of all of its leases and on the amount of its unsecured claim resulting from Hawaiian's bankruptcy. The claim amount represented costs and losses incurred by BCC for the period of time prior to the September 2004 settlement and losses that would be incurred by BCC based on the differences between the restructured and the original lease payments. On September 27, 2004, following a request by Hawaiian's trustee, the bankruptcy court approved BCC's unsecured claim against the Hawaiian estate and also approved the new terms of its

restructured leases. In September 2004, BCC sold its unsecured claim to RC Aviation LLC (Ranch). In connection with the approval of its claim by the bankruptcy court, BCC recorded $35 million of income relating to recovered costs and lost revenues prior to the approval of the claim by the bankruptcy court. Additionally, as a result of BCC's approval of claims for lost lease rental revenue, BCC recorded $31 million of unearned income associated with its 767 leases to Hawaiian. BCC recorded a provision for losses of $13 million due to the difference between the approved bankruptcy claim and the amount it received when it sold the claim. Prior to Hawaiian's bankruptcy, BCC accounted for all of its 717 leases and two of its three 767 leases as finance leases. Subsequent to the approval of the restructured lease terms, BCC will continue to account for these leases as finance leases.

Hawaiian retains certain rights by operating under Chapter 11 bankruptcy protection, including the right to reject restructuring terms with its creditors and return aircraft, including BCC's aircraft. The terms of BCC's restructuring with Hawaiian, which were approved by the federal bankruptcy court, set forth the terms under which all 14 aircraft financed by BCC are expected to remain in service upon Hawaiian's emergence from Chapter 11 protection.

Summary Financial Information

(Dollars in millions)	2004	2003	2002
Revenues	**$ 959**	$ 991	$764
% of Total Company Revenues	**2%**	2%	1%
Operating Earnings	**$ 183**	$ 91	$ 35
Operating Margins	**19.1%**	9.2%	4.6%

At December 31,	2004	2003
Portfolio	**$9,680**	$10,118
% of Total Receivables in Valuation Allowance	**4.2%**	5.1%
Debt	**$7,024**	$ 9,177
Debt-to-Equity Ratio	**5.0-to-1**	4.7-to-1

Revenues BCC segment revenues consist principally of interest from financing receivables and notes, lease income from operating lease equipment, investment income, gains on disposals of investments and gains/losses on revaluation of derivatives.

The decrease in revenue in 2004 compared with 2003 was primarily attributable to lower new business volume. The increase in revenue in 2003 compared with 2002 was primarily attributable to growth in the portfolio.

Operating Earnings BCC's operating earnings are presented net of interest expense, provision for losses adjustments, asset impairment expense, depreciation on leased equipment and other operating expenses. The increase in 2004 operating earnings was principally driven by a substantial decrease in the provision for losses from a provision of $151 million in 2003 to a recovery of $38 million in 2004 due to receivable recoveries and asset sales during 2004, lower charges related to receivable restructurings in 2004 compared with 2003, the mitigation of collateral exposure from agreements with certain customers, and refinements in portfolio measurements in 2004 and a decline in BCC's receivables portfolio. The increase in net income was partially offset by a decrease in BCC's total revenue and increases in operating expenses, higher asset impairment expense related primarily to the writedown of two investments and debt redemption costs.

As summarized in the following table, during the year ended December 31, 2004, we recognized pre-tax expenses of $165 million in response to the deterioration in the credit worthiness of BCC's airline customers, airline bankruptcy filings and the continued decline in the commercial aircraft and general equipment asset values, of which $68 million related to BCC. For the same period in 2003, we recognized pre-tax expenses of $338 million, of which $272 million related to BCC.

(Dollars in millions)	BCC Segment	Other Segment	Consolidated
2004			
Provision (recovery) for losses	**$ (38)**	**$82**	**$ 44**
Revaluation of equipment on operating lease or held for sale or re-lease	**27**	**2**	**29**
Other adjustments	**79**	**13**	**92**
	$ 68	**$97**	**$165**
2003			
Provision for losses	$151	$61	$212
Revaluation of equipment on operating lease or held for sale or re-lease	100	5	105
Other adjustments	21		21
	$272	$66	$338

During 2004, BCC's decrease in the provision for losses included a special reduction of $55 million offset by the normal monthly provision of $17 million. The primary factors contributing to this reduction in the provision for losses during the year ended December 31, 2004 were: $53 million of benefit from the mitigation of collateral exposure from agreements with certain customers; $28 million of net benefit due to refinements in the methodology for measuring collateral values; $11 million of net benefit due to the sale of various notes thus decreasing collateral exposure; and a $49 million increase in the requirement in the allowance account resulting from the determination that receivables from ATA were subject to a specific impairment. The Other segment recorded an $82 million charge to earnings during the year ended December 31, 2004, compared to $61 million and $80 million during the same period in 2003 and 2002. The increase in the Other segment's provision for losses during the year ended December 31, 2004 was due to deteriorated airline credit ratings and depressed aircraft values based on our quarterly assessment of the adequacy of customer financing reserves, which was primarily related to the determination that receivables from ATA were subject to a specific impairment.

Additionally, during the year ended December 31, 2004, BCC recorded pre-tax non-cash asset impairment-related charges totaling $106 million. This was comprised of $47 million related to an other-than-temporary impairment of a held-to-maturity investment in ATA maturing in 2015, $32 million related to the impairment of a D tranche EETC which finances aircraft with Delta, $16 million of specific impairment charges related primarily to aircraft trading and $11 million of valuation loss on one Boeing Business Jet reclassified from discontinued operations to continuing operations as a result of our decision to retain the aircraft in our executive fleet. During the same period of 2003, BCC recognized charges of $121 million, of which $21 million was due to the write-off of forward-starting interest rate swaps related to Hawaiian. During the same period of 2002, BCC recognized charges of $93 million. Additionally, the Other segment recognized charges of $15 million, $5 million, and $146 million during the years ended December 31, 2004, 2003 and 2002, respectively. During 2004, the charge consisted of $13 million related to the decline in lease rates on certain aircraft and a charge of $2 million related to aircraft and equipment under operating lease and held for sale or re-lease. BCC carefully monitors the relative value of aircraft equipment since we remain at substantial economic risk to significant decreases in the value of aircraft equipment and their associated lease rates.

Other Segment

Other segment operating losses were $535 million during 2004 as compared to losses of $379 million during 2003. The increase in operating losses reflects increased costs of $36 million at Connexion by Boeing℠ in conjunction with the launch of commercial services which began in May 2004, a $61 million write-off of depreciation related to a demolished building, an $18 million loss related to accounting for various real property transactions and increased employer taxes of $12 million related to our share value trust payout.

As of December 31, 2004, we had investments of approximately $3.4 billion. On an ongoing basis, we perform an impairment test on our investment securities to determine if the fair value decline of a security is other-than-temporary. If the impairment is other-than-temporary, we reset the cost basis for the impaired security and record the charge in the Consolidated Statements of Operations. (See Note 12.)

Research and development activities in the Other segment relates primarily to Connexion by Boeing℠. Research and development activities in the Other segment remained constant in 2004.

Astro Ltd., a wholly owned subsidiary, operates as a captive insurance company. This subsidiary enables certain of our exposures to be insured at the lowest possible cost to us. In addition, it provides flexibility to us in structuring our insurance and risk management programs and provides access to the reinsurance markets. Currently, Astro Ltd. insures a portion of our aviation liability, workers compensation, general liability, property, as well as various smaller risk liability insurances.

Critical Accounting Policies and Standards Issued and Not Yet Implemented

Application of Critical Accounting Policies

Contract Accounting

Contract accounting is used for development and production activities predominately by the A&WS, Network Systems, Support Systems and L&OS segments within IDS. These activities include the following products and systems: military aircraft, helicopters, missiles, space systems, missile defense systems, satellites, rocket engines, and information and battle management systems. The majority of business conducted in these segments is performed under contracts with the U.S. Government and foreign governments that extend over a number of years. Contract accounting involves a judgmental process of estimating the total sales and costs for each contract, which results in the development of estimated cost of sales percentages. For each contract, the amount reported as cost of sales is determined by applying the estimated cost of sales percentage to the amount of revenue recognized.

Total contract sales estimates are based on negotiated contract prices and quantities, modified by our assumptions regarding contract options, change orders, incentive and award provisions associated with technical performance, and price adjustment clauses (such as inflation or index-based clauses). The majority of these contracts are with the U.S. Government. Generally the price is based on estimated cost to produce the product or service plus profit. The Federal Acquisition Regulations provide guidance on the types of cost that will be reimbursed in establishing contract price. Total contract cost estimates are largely based on negotiated or estimated purchase contract terms, historical performance trends, business base and other economic projections. Factors that influence these estimates include inflationary trends, technical and schedule risk, internal and subcontractor performance trends, business volume assumptions, asset utilization, and anticipated labor agreements.

Sales related to contracts with fixed prices are recognized as deliveries are made, except for certain fixed-price contracts that require substantial performance over an extended period before deliveries begin, for which sales are recorded based on the attainment of performance milestones. Sales related to contracts in which we are reimbursed for costs incurred plus an agreed upon profit are recorded as costs are incurred. Contracts may contain provisions to earn incentive and award fees if targets are achieved. Incentive and award fees that can be reasonably estimated are recorded over the performance period of the contract. Incentive and award fees that cannot be reasonably estimated are recorded when awarded.

The development of cost of sales percentages involves procedures and personnel in all areas that provide financial or production information on the status of contracts. Estimates of each significant contract's sales and costs are reviewed and reassessed quarterly. Any changes in these estimates result in

recognition of cumulative adjustments to the contract profit in the period in which changes are made. Due to the size and nature of many of our contracts, the estimation of total sales and costs through completion is complicated and subject to many variables. Assumptions are made regarding the length of time to complete each contract because estimated costs also include expected changes in wages, prices for materials, fixed costs, and other costs.

Due to the significance of judgment in the estimation process described above, it is likely that materially different cost of sales amounts could be recorded if we used different assumptions, or if the underlying circumstances were to change. Changes in underlying assumptions/estimates, supplier performance, or circumstances may adversely or positively affect financial performance in future periods.

During 2004, IDS's gross margin performance fell within the historical range of plus or minus 0.5% change to gross margin. If the combined gross margin for all contracts in IDS for all of 2004 had been estimated to be higher or lower by 0.5%, it would have increased or decreased income for the year by approximately $152 million.

Program Accounting

We use program accounting to account for sales and cost of sales related to all our commercial airplane programs by the Commercial Airplanes segment. Program accounting is a method of accounting applicable to products manufactured for delivery under production-type contracts where profitability is realized over multiple contracts and years. Under program accounting, inventoriable production costs (including overhead), program tooling costs and warranty costs are accumulated and charged as cost of sales by program instead of by individual units or contracts. A program consists of the estimated number of units (accounting quantity) of a product to be produced in a continuing, long-term production effort for delivery under existing and anticipated contracts. To establish the relationship of sales to cost of sales, program accounting requires estimates of (a) the number of units to be produced and sold in a program, (b) the period over which the units can reasonably be expected to be produced, and (c) the units' expected sales prices, production costs, program tooling, and warranty costs for the total program. (See Commercial Airplanes discussion in the Accounting Quantity section.)

The use of estimates in program accounting requires the demonstrated ability to reliably estimate the relationship of sales to costs for the defined program accounting quantity. Factors that must be estimated include sales price, labor and employee benefit costs, material costs, procured parts, major component costs, and overhead costs. To ensure reliability in our estimates, we employ a rigorous estimating process that is reviewed and updated on a quarterly basis. Changes in estimates are recognized on a prospective basis.

Underlying all estimates used for program accounting is the forecasted market and corresponding production rates. Estimation of the accounting quantity for each program takes into account several factors that are indicative of the demand for the particular program, such as firm orders, letters of intent from prospective customers, and market studies. Total estimated program sales are determined by estimating the model mix and sales price for all unsold units within the accounting quantity, added together with the sales for all undelivered units under contract. The sales prices for all undelivered units within the accounting quantity include an escalation adjustment that is based on projected escalation rates, consistent with typical sales contract terms. Cost estimates are based largely on negotiated and anticipated contracts with suppliers, historical performance trends, and business base and other economic projections.

Factors that influence these estimates include production rates, internal and subcontractor performance trends, asset utilization, anticipated labor agreements, and inflationary trends.

We recognize sales for commercial airplane deliveries as each unit is completed and accepted by the customer. The sales recognized represent the price negotiated with the customer, adjusted by an escalation formula. The amount reported as cost of sales is determined by applying the estimated cost of sales percentage for the total remaining program to the amount of sales recognized for airplanes delivered and accepted by the customer during the quarter. Because of the higher unit production costs experienced at the beginning of a new airplane program (known as the "learning curve effect"), the actual costs incurred for production of the early units in the program will exceed the amount reported as cost of sales for those units. The excess or actual costs over the amount reported as cost of sales is presented as "deferred production costs," which are included in inventory along with unamortized tooling costs.

Our experience in the last two years, with all current programs being relatively mature, has been that estimated changes due to model mix, escalation, cost performance, and accounting quantity adjustments have resulted in a net range of plus or minus 1.0% for the combined cost of sales percentages of all commercial airplane programs. If combined cost of sales percentages for all commercial airplane programs for all of 2004 had been estimated to be higher or lower by 1.0%, it would have increased or decreased income for 2004 by approximately $180 million.

Aircraft Valuation

Used aircraft under trade-in commitments and aircraft under repurchase commitments In conjunction with signing a definitive agreement for the sale of new aircraft (Sale Aircraft), we have entered into specified-price trade-in commitments with certain customers that give them the right to trade in used aircraft upon the purchase of Sale Aircraft. Additionally, we have entered into contingent repurchase commitments with certain customers wherein we agree to repurchase the Sale Aircraft at a specified price, generally ten years after delivery of the Sale

Aircraft. Our repurchase of the Sale Aircraft is contingent upon a future, mutually acceptable agreement for the sale of additional new aircraft. If, in the future, we execute an agreement for the sale of additional new aircraft, and if the customer exercises its right to sell the Sale Aircraft to us, a contingent repurchase commitment would become a trade-in commitment. Based on our historical experience, we believe that very few, if any, of our outstanding contingent repurchase commitments will ultimately become trade-in commitments. Exposure related to the trade-in of used aircraft resulting from trade-in commitments may take the form of: (1) adjustments to revenue related to the sale of new aircraft determined at the signing of a definitive agreement, and/or (2) charges to cost of products and services related to adverse changes in the fair value of trade-in aircraft that occur subsequent to signing of a definitive agreement for new aircraft but prior to the purchase of the used trade-in aircraft. The trade-in aircraft exposure related to item (2) above is recorded in 'Accounts payable and other liabilities' on the Consolidated Statements of Financial Position.

Obligations related to probable trade-in commitments are measured as the difference between gross amounts payable to customers and the estimated fair value of the collateral. The fair value of collateral is determined using aircraft specific data such as, model, age and condition, market conditions for specific aircraft and similar models, and multiple valuation sources. This process uses our assessment of the market for each trade-in aircraft, which in most instances begins years before the return of the aircraft. There are several possible markets to which we continually pursue opportunities to place used aircraft. These markets include, but are not limited to, (1) the resale market, which could potentially include the cost of long-term storage, (2) the leasing market, with the potential for refurbishment costs to meet the leasing customer's requirements, or (3) the scrap market. Collateral valuation varies significantly depending on which market we determine is most likely for each aircraft. On a quarterly basis, we update our valuation analysis based on the actual activities associated with placing each aircraft into a market. This quarterly collateral valuation process yields results that are typically lower than residual value estimates by independent sources and tends to more accurately reflect results upon the actual placement of the aircraft.

Based on the best market information available at the time, it is probable that we would be obligated to perform on trade-in commitments with gross amounts payable to customers totaling $116 million and $582 million at December 31, 2004 and 2003, respectively. Accounts payable and other liabilities included $25 million and $65 million at December 31, 2004 and 2003, respectively, which represents the exposure related to these trade-in commitments.

Using a measurement date of December 31, 2004, had the estimate of collateral value used to calculate our obligation related to trade-in commitments been 10% higher or lower than our actual assessment, accounts payable and other liabilities would have decreased or increased by approximately $9 million. We continually update our assessment of the likelihood of our trade-in aircraft purchase commitments and continue to monitor all these commitments for adverse developments.

Used aircraft acquired by the Commercial Airplanes segment are included in 'Inventories' at the lower of cost or market as it is our intent to sell these assets. To mitigate costs and enhance marketability, aircraft may be placed on operating lease. While on operating lease, the assets are included in 'Customer financing', however, the valuation continues to be based on the lower of cost or market. The lower of cost or market assessment is performed quarterly using the process described above.

Asset valuation for equipment under operating lease, assets held for sale or re-lease, and collateral underlying receivables Included in 'Customer financing' assets are operating lease equipment, notes receivables and sales-type/financing leases. Sales-type/financing leases are treated as receivables and allowances are established in accordance with SFAS No. 13, Accounting for Leases and SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended.

We periodically assess the fair value of assets we own, including equipment under operating leases, assets held for sale or re-lease, and collateral underlying receivables to determine if their fair values are less than the related assets' carrying values. Differences between carrying values and fair values of finance leases and notes and other receivables, as determined by collateral values, are considered in determining the allowance for losses on receivables.

We use a median calculated from published collateral values from multiple external equipment appraisers based on the type and age of the aircraft to determine the fair value of aircraft. Under certain circumstances, we apply judgment based on the attributes of the specific aircraft or equipment, usually when the features or use of the aircraft vary significantly from the more generic aircraft attributes covered by outside publications.

Impairment review for equipment under operating leases and held for sale or re-lease When events or circumstances indicate (and no less than annually), we review the carrying value of all aircraft and equipment under operating lease and held for sale or re-lease for potential impairment. In 2004, we reviewed all aircraft and equipment under operating lease and held for sale or re-lease. We evaluate assets under operating lease or held for re-lease for impairment when the expected undiscounted cash flow over the remaining useful life is less than the carrying value. We use various assumptions when determining the expected undiscounted cash flow. These assumptions include expected future lease rates, lease terms, end of economic life value of the aircraft or equipment, periods in which the asset may be held in preparation for a follow-on lease, maintenance costs, remarketing costs and the remaining economic life of the asset. We state assets held for sale at the lower of carrying value or fair value less costs to sell.

When we determine that impairment is indicated for an asset, the amount of asset impairment expense recorded is the excess of the carrying value less asset value guarantees, if

applicable, over the fair value of the asset. For aircraft assets, we use a median calculated from the published fair values from multiple external equipment appraisers based on the type and age of the asset to determine the fair value. However, if the features or use of the aircraft varies significantly from the generic aircraft attributes covered by outside publications, we apply judgment based on the attributes of the specific aircraft to determine fair value. Had the fair values of these assets deemed impaired during 2004 been 10% lower at the time each specific impairment had been taken, we estimate that the assets impairment expense would have increased by approximately $9 million. We are unable to predict the magnitude or likelihood of any future impairments.

Allowance for losses on receivables The allowance for losses on receivables (valuation allowance) is used to provide for potential impairment of receivables on the Consolidated Statements of Financial Position. The balance represents an estimate of probable but unconfirmed losses in the receivables portfolio. We estimate our allowance for losses on receivables on the basis of two components of receivables: (a) specifically identified receivables that are evaluated individually for impairment, and (b) pools of receivables that are evaluated for impairment.

We determine a receivable is impaired when, based on current information and events, it is probable that we will be unable to collect amounts due according to the original contractual terms of the receivable agreement, without regard to any subsequent restructurings. Factors considered in assessing collectibility include, but are not limited to, a customer's extended delinquency, requests for restructuring and filings for bankruptcy. We determine a specific impairment allowance based on the difference between the carrying value of the receivable and the estimated fair value of the related collateral. Each quarter, we review customer credit ratings, published historical credit default rates for different rating categories, third-party guarantees (if applicable) and third-party aircraft valuations as a basis to validate the reasonableness of the allowance for losses on receivables. There can be no assurance that actual results will not differ from estimates and values or that the consideration of these factors in the future will not result in an increase/decrease to the allowance for losses on receivables.

The allocation for general purposes represents our best estimate of losses existing in the remaining receivables considering delinquencies, loss experience, collateral values, guarantees, risk of individual customer credits, published historical default rates for different rating categories, results of periodic credit reviews and the general state of the economy and airline industry.

We review the adequacy of the general allowance attributable to the remaining pool of receivables (after excluding the receivables subject to a specific allowance) by assessing both the collateral exposure and the applicable cumulative default rate. Collateral exposure for a particular receivable is the excess of the carrying value of the receivable over the fair value of the related collateral. A receivable with an estimated fair value in excess of the carrying value is considered to have no collateral exposure.

Prior to the third quarter of 2004, the collateral value was determined by averaging collateral values obtained from third-party equipment appraisers' industry data. In the third quarter of 2004, we began determining the collateral value by calculating the median of those appraised values. The median value method provides a better weighted measure of aircraft collateral values. The applicable cumulative default rate is determined using two components: customer credit ratings and weighted-average remaining contract term. Internal credit ratings are identified for each customer in the portfolio. Those ratings are updated based on public information and information obtained directly from our customers. Prior to the third quarter of 2004, we based the cumulative default rate on the weighted-average remaining life of the entire portfolio. In the third quarter of 2004, we began determining the cumulative default rate for each receivable based on its weighted-average remaining life. By measuring each receivable's weighted-average remaining life as opposed to using a portfolio average, we have increased the overall accuracy of this measurement.

We have entered into agreements with certain customers that would entitle us to look beyond the specific collateral underlying the receivable for purposes of determining the collateral exposure as described above. Should the proceeds from the sale of the underlying collateral asset resulting from a default condition be insufficient to cover the carrying value of our receivable (creating a shortfall condition), these agreements, would, for example, permit us to take the actions necessary to sell or retain certain other assets in which the customer has an equity interest and use the proceeds to cover the shortfall.

In recognition of the uncertainty of the ultimate loss experience and relatively long duration of the portfolio, a range of reasonably possible outcomes of the portfolio's credit-adjusted collateral exposure is calculated by varying the applicable default rate by approximately plus and minus 15%. The resulting range of the credit-adjusted collateral exposure as of December 31, 2004, was approximately $382 million to $413 million. We adjusted the valuation allowance to $403 million at December 31, 2004.

Goodwill impairment

Because our composition has changed significantly due to various acquisitions, goodwill has historically constituted a significant portion of our long-term assets. We account for our goodwill under SFAS No. 142, *Goodwill and Other Intangible Assets*. This statement requires an impairment only approach to accounting for goodwill.

The SFAS No. 142 goodwill impairment model is a two-step process. First, it requires a comparison of the book value of net assets to the fair value of the related operations that have goodwill assigned to them. If the fair value is determined to be less than book value, a second step is performed to compute the amount of the impairment. In this process, a fair value for

goodwill is estimated, based in part on the fair value of the operations used in the first step, and is compared to its carrying value. The shortfall of the fair value below carrying value represents the amount of goodwill impairment. SFAS No. 142 requires goodwill to be tested for impairment annually at the same date every year, and when an event occurs or circumstances change such that it is reasonably possible that an impairment may exist. We selected April 1 as our annual testing date.

We estimate the fair values of the related operations using discounted cash flows. Forecasts of future cash flows are based on our best estimate of future sales and operating costs, based primarily on existing firm orders, expected future orders, contracts with suppliers, labor agreements, and general market conditions, and are subject to review and approval by our senior management and BoD. Changes in these forecasts could cause a particular operating group to either pass or fail the first step in the SFAS No. 142 goodwill impairment model, which could significantly change the amount of impairment recorded, if any.

The cash flow forecasts are adjusted by an appropriate discount rate derived from our market capitalization plus a suitable control premium at the date of evaluation. Therefore, changes in the stock price may also affect the amount of impairment recorded. At the date of our previous impairment test, a 10% increase or decrease in the value of our common stock would have had no impact on the financial statements.

Postretirement plans

We sponsor various pension plans covering substantially all employees. We also provide postretirement benefit plans other than pensions, consisting principally of health care coverage, to eligible retirees and qualifying dependents. The liabilities and net periodic cost of our pension and other postretirement plans are determined using methodologies that involve several actuarial assumptions, the most significant of which are the discount rate, the long-term rate of asset return, and medical trend (rate of growth for medical costs). Not all net periodic pension income or expense is recognized in net earnings in the year incurred because it is allocated to production as product costs, and a portion remains in inventory at the end of a reporting period.

We use a discount rate that is based on a point-in-time estimate as of our September 30 annual measurement date. This rate is determined based on a review of long-term, high quality corporate bonds as of the measurement date and use of models that match projected benefit payments of our major U.S. pension and other postretirement plans to coupons and maturities from high quality bonds. A 25 basis point increase in the discount rate would decrease the 2004 pension and other postretirement liabilities by approximately $1.3 billion (3%) and $193 million (2%), respectively, and decrease the 2004 net periodic pension expense by approximately $21 million and increase other postretirement expense $4 million, respectively. A 25 basis point decrease in the discount rate would increase the 2004 pension and other postretirement liabilities by approximately $1.5 billion (4%) and $213 million (3%), respectively, and increase the 2004 net periodic pension and other postretirement expense by approximately $14 million and $1 million, respectively.

Net periodic pension costs include an underlying expected long-term rate of asset return. In developing this assumption, we look at a number of factors, including asset class return by several of our trust fund investment advisors, long-term inflation assumptions, and long-term historical returns for our plans. The expected long-term rate of asset return is based on a diversified portfolio including domestic and international equities, fixed income, real estate, private equities and uncorrelated assets. Pension income or expense is especially sensitive to changes in the long-term rate of asset return. An increase or decrease of 25 basis points in the expected long-term rate of asset return would have increased or decreased 2004 pension income by approximately $85 million.

Net periodic costs for other postretirement plans include an assumption of the medical cost trend. To determine the medical trend we look at a combination of information including our future expected medical costs, recent medical costs over the past five years, and general expectations in the industry. The 2004 postretirement benefit obligation for non-pension plans reflects a small decrease in medical trend compared to the expected 2004 medical trend used in the 2003 measurement. Recent gains due to lower-than-expected increases in medical claims costs have created an unrecognized gain in 2004. The assumed medical cost trend rates have a significant effect on the amounts reported for the health care plans. A 100 basis point increase in assumed medical cost trend rates would increase the 2004 other postretirement liabilities by approximately $727 million. A 100 basis point decrease in assumed medical cost trend rates would decrease the 2004 other postretirement liabilities by approximately $628 million. A 100 basis point increase in assumed medical cost trend rates would increase the 2004 other postretirement costs by approximately $71 million. A 100 basis point decrease in assumed health care cost trend rates would decrease the 2004 other postretirement costs by approximately $61 million.

Standards Issued and Not Yet Implemented

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs – an amendment of ARB No. 43*. This Standard requires abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) to be recognized as current period charges. Additionally, it requires that allocation of fixed production overhead costs be allocated to inventory based on the normal capacity of the production facility. The provisions of this Standard apply prospectively and are effective for us for inventory costs incurred after January 1, 2006. While we believe this Standard will not have a material effect on our financial statements, the impact of adopting these new rules is dependent on events that could occur in future periods, and as such, an estimate of the impact cannot be determined until the event occurs in future periods.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS No. 123R), *Shared-Based Payment*. This Standard requires companies to measure share-based payments at grant-date fair value and recognize the compensation expense in their financial statements. While we previously adopted the fair value based method of accounting pursuant to SFAS No. 123, *Accounting for Stock Based Compensation*, SFAS No. 123R changes our method of measuring compensation expense for our Performance Shares from market price to fair value at grant date and requires a forfeiture assumption for our unvested awards. Additionally, SFAS No. 123R amends the presentation of the statement of cash flows and requires additional annual disclosures. We will early adopt the provisions of SFAS No. 123R as of January 1, 2005 using the modified prospective method. We believe the impact of applying an estimated forfeiture assumption to our unvested awards will not have a material effect on our financial statements.

Contingent Items

Various legal proceedings, claims and investigations related to products, contracts and other matters are pending against us. Most significant legal proceedings are related to matters covered by our insurance. Major contingencies are discussed below.

Government investigations

We are subject to various U.S. Government investigations, including those related to procurement activities and the alleged possession and misuse of third-party proprietary data, from which civil, criminal or administrative proceedings could result or have resulted. Such proceedings involve, or could involve claims by the Government for fines, penalties, compensatory and treble damages, restitution and/or forfeitures. Under government regulations, a company, or one or more of its operating divisions or subdivisions, can also be suspended or debarred from government contracts, or lose its export privileges, based on the results of investigations. We are also a defendant in suits filed by Lockheed Martin Corporation, ICO Global Communications, Ltd. and several of our employees. We believe, based upon current information, that the outcome of these disputes and investigations will not have a material adverse effect on our financial position, except as set forth in Note 23 to our Consolidated Financial Statements.

Other contingencies

We are subject to federal and state requirements for protection of the environment, including those for discharge of hazardous materials and remediation of contaminated sites discussed. Such requirements have resulted in our being involved in legal proceedings, claims and remediation obligations since the 1980s.

We routinely assess, based on in-depth studies, expert analyses and legal reviews, our contingencies, obligations and commitments for remediation of contaminated sites, including assessments of ranges and probabilities of recoveries from other responsible parties who have and have not agreed to a settlement and of recoveries from insurance carriers. Our policy is to immediately accrue and charge to current expense identified exposures related to environmental remediation sites based on our best estimate within a range of potential exposure for investigation, cleanup and monitoring costs to be incurred.

The costs incurred and expected to be incurred in connection with such activities have not had, and are not expected to have, a material adverse effect on us. With respect to results of operations, related charges have averaged less than 1% of historical annual revenues. Although not considered likely, should we be required to incur remediation charges at the high level of the range of potential exposure, the additional charges would be less than 3% of historical annual revenues.

Because of the regulatory complexities and risk of unidentified contaminated sites and circumstances, the potential exists for environmental remediation costs to be materially different from the estimated costs accrued for identified contaminated sites. However, based on all known facts and expert analyses, we believe it is not reasonably likely that identified environmental contingencies will result in additional costs that would have a material adverse impact on our financial position or to our operating results and cash flow trends.

We have entered into standby letters of credit agreements and surety bonds with financial institutions primarily relating to the guarantee of future performance on certain contracts. Contingent liabilities on outstanding letters of credit agreements and surety bonds aggregated approximately $3.2 billion as of December 31, 2004 and approximately $2.4 billion at December 31, 2003.

Forward-Looking Information is Subject to Risk and Uncertainty

Certain statements in this report may constitute "forward-looking" statements within the meaning of the Private Litigation Reform Act of 1995. Words such as "expects," "intends," "plans," "projects," "believes," "estimates," and similar expressions are used to identify these forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Forward-looking statements are based upon assumptions as to future events that may not prove to be accurate. Actual outcomes and results may differ materially from what is expressed or forecasted in these forward-looking statements. As a result, these statements speak only as of the date they were made and we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Our actual results and future trends may differ materially depending on a variety of factors, including the continued operation, viability and growth of major airline customers and non-airline

customers (such as the U.S. Government); adverse developments in the value of collateral securing customer and other financings; the occurrence of any significant collective bargaining labor dispute; our successful execution of internal performance plans, production rate increases and decreases (including any reduction in or termination of an aircraft product), acquisition and divestiture plans, and other cost-reduction and productivity efforts; charges from any future SFAS No. 142 review; an adverse development in rating agency credit ratings or assessments; the actual outcomes of certain pending sales campaigns and the launch of the 787 program and U.S. and foreign government procurement activities, including the uncertainty associated with the procurement of tankers by the U.S. DoD; the cyclical nature of some of our businesses; unanticipated financial market changes which may impact pension plan assumptions; domestic and international competition in the defense, space and commercial areas; continued integration of acquired businesses; performance issues with key suppliers, subcontractors and customers; significant disruption to air travel worldwide (including future terrorist attacks); global trade policies; worldwide political stability; domestic and international economic conditions; price escalation; the outcome of political and legal processes, changing priorities or reductions in the U.S. Government or foreign government defense and space budgets; termination of government or commercial contracts due to unilateral government or customer action or failure to perform; legal, financial and governmental risks related to international transactions; legal and investigatory proceedings; tax settlements with the IRS and various states; USAF review of previously awarded contracts; and other economic, political and technological risks and uncertainties. Additional information regarding these factors is contained in our SEC filings, including, without limitation, our Quarterly Reports on Form 10-Q for the period ending March 31, 2004, June 30, 2004 and September 30, 2004.