

Boeing agrees to USD 244m penalty for 737 MAX flaws

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New York: More than two years after the first fatal Boeing 737 MAX crash, the US aerospace giant is still reckoning with the fallout of its faulty design process.

The latest blow fell on January 7, when Boeing and the US [Department of Justice](#) (DOJ) announced a USD 2.5 billion settlement and deferred prosecution agreement that will allow the company to avoid a disastrous criminal conviction. Considering the seriousness of Boeing's offense, it is getting off with little more than a slap on the wrist. That said, even a slap on the wrist will be painful for the company in its weakened state.

Under the deferred prosecution agreement announced that week, Boeing officially accepted responsibility for certain employees who misled Federal Aviation Administration (FAA) officials about the nature of the software system that played a key role in both [fatal 737 MAX](#) crashes.

The agreement calls for the DOJ to charge Boeing with conspiracy to defraud the United States. However, it will not take further action to prosecute Boeing. If the latter complies with the settlement, the charges will be dismissed in about three years.

The DOJ would have faced a high burden of proof to get a criminal conviction. Boeing could not afford to roll the dice, though. A criminal conviction could have potentially crippled Boeing's defense and space business by barring it from future government contracts.

Under the agreement, Boeing will pay just over USD 2.5 billion. However, this includes USD 1.77 billion of customer compensation that Boeing was going to pay anyway. In fact, Boeing expects to spend over USD 7 billion on such customer concessions. The incremental costs are quite a bit lower, consisting of a USD 243.6 million criminal penalty and USD 500 million in additional compensation to the families of 737 MAX crash victims.

Considering the number of lives lost and the economic damage of the grounding, Boeing is getting off rather easily. The criminal penalty is at the low end of the sentencing guidelines range of USD 243.6 million to USD 487.2 million. Moreover, it pales in comparison to the USD 3.9 billion of penalties Airbus agreed to pay a year ago to resolve bribery charges -- a figure that included over USD 500 million of criminal penalties in the US alone.

The deferred prosecution agreement notes that Boeing has implemented executive changes, given its engineers more autonomy, set up new safety committees, and taken other steps to prevent another tragedy. These factors contributed to the relatively light penalty. Still, it also seems plausible that DOJ officials took Boeing's weakened financial state into account when deciding what penalty to pursue.

As of last September, Boeing had USD 61 billion of debt and over USD 15 billion of pension obligations, offset by USD 27.1 billion of cash and investments. Moreover, the company is still burning cash rapidly. A sharp slowdown in 787 Dreamliner deliveries due to plunging demand and manufacturing quality issues will weigh particularly heavily on fourth-quarter cash flow.

The resumption of 737 MAX deliveries late last year will help -- eventually. But in the near term, airlines are applying customer concession balances rather than forking over cash for 737 MAX deliveries. Boeing ended the third quarter with USD 6 billion of outstanding liabilities for customer concessions, so it will take a while to work through that headwind. That is a big reason why Boeing doesn't expect to get back to positive cash flow until 2022.

In short, Boeing's already-subpar balance sheet is poised to weaken further this year. The additional USD 743.6 million of payments to the US government and crash victims' families will add to the pressure on Boeing's finances. While it's a relatively small amount for a company that burned over USD 15 billion in the first nine months of 2020, it deepens the hole Boeing will eventually need to dig itself out of.

With the bursting of the airline industry bubble and market share losses significantly reducing Boeing's long-term cash flow prospects, every extra dollar of debt matters. Until Boeing makes meaningful progress toward cleaning up its balance sheet and getting order flow and deliveries back to normal levels, investors should steer clear of the stock.

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