02-Aug-2017

Spirit AeroSystems Holdings, Inc. (SPR)

Q2 2017 Earnings Call

CORPORATE PARTICIPANTS

Ghassan Awwad
Executive Director of Investor Relations and Corporate Strategy, Spirit AeroSystems Holdings, Inc.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

OTHER PARTICIPANTS

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Myles Alexander Walton
Analyst, Deutsche Bank Securities, Inc.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Jason Gursky
Analyst, Citigroup Global Markets, Inc.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Howard Alan Rubel
Analyst, Jefferies LLC

David E. Strauss
Analyst, UBS Securities LLC

George D. Shapiro
Analyst, Shapiro Research LLC

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Cai von Rumohr
Analyst, Cowen & Company, LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Spirit AeroSystems Holdings Incorporated Second Quarter 2017 Earnings Conference Call. My name is Phil, and I'll be your coordinator today. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the presentation over to Mr. Ghassan Awwad, Director of Investor Relations. Please, proceed.

Ghassan Awwad

Executive Director of Investor Relations and Corporate Strategy, Spirit AeroSystems Holdings, Inc.

Thank you and good morning, everyone. Welcome to Spirit's second quarter 2017 earnings call. I'm Ghassan Awwad and with me today are Spirit's President and Chief Executive Officer, Tom Gentile; and Spirit's Executive Vice President and Chief Financial Officer, Sanjay Kapoor.

After opening comments by Tom and Sanjay regarding our performance and outlook, we will take your questions.

Before we begin, I need to remind you that any projections or goals we may include in our discussion today are likely to involve risks, which are detailed in our earnings release, in our SEC filings and in the forward-looking statements at the end of this web presentation. In addition, we refer you to our earnings release and presentation for disclosures and reconciliation of non-GAAP measures we use when discussing our results. And as a reminder, you can follow today's broadcast and slide presentation on our website at investor.spiritaero.com.

With that, I would like to turn the call over to our Chief Executive Officer, Tom Gentile.

Thomas C. Gentile III

President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

Thank you, Ghassan, and good morning, everyone. Welcome to Spirit's 2017 second quarter earnings call. Executing on our commitments to our customers and to our shareholders resulted in excellent operating performance in the second quarter. But before we get to an overview of that outstanding performance, I want to take a minute to describe in more detail the exciting news that we have reached an agreement with our largest customer, Boeing, into 2022 on open commercial issues related to a range of programs, including the 737 MAX and the 787.

We have signed an MOU reflecting our agreement and will now be working on formal amendments to the program agreements. As described in the earnings release this morning, the MOU requires that the parties negotiate and execute definitive documentation in the third quarter of 2017, and both parties are motivated to do so.

Overall, by addressing a range of programs and not just the 787 pricing, the MOU reduces much uncertainty that has long existed in the relationship with our largest customer and preserves our ability to meet our long-term cash flow goals.

One of the biggest challenges in our discussions with Boeing has been 787 pricing. As part of this new MOU with Boeing, we are extending the block from 1003 units to 1300 units and establishing a planning block through line unit 1405. Although the 787 contract had agreed price step-downs for the 787-8, we had never agreed with Boeing on pricing for the 787-9 and 787-10. We have now agreed on modified step-down pricing for the 787-9 and 787-10 through line unit 1405.

As a result of the MOU, we have recognized a reach-forward loss of $353 million on the 787 program. This loss amount is based on a number of assumptions, including our estimates of the future cost of the program. To that end, the agreement also includes a commitment from both organizations to work together on joint cost reduction efforts with financial incentives for both parties.

There are several other important elements to the MOU. First, we have agreed with Boeing that we will jointly study advanced aerostructures and manufacturing processes. And as part of our commitment to Partnering for Success, we agreed to productivity discounts tied to volume commitments from Boeing on the 737. We have also agreed with Boeing to pricing on the MAX. Boeing and Spirit have an agreement on investments for rate increases on both the 737 and 787.

In addition, as we expected, once definitive documentation is in place, we will return the $235 million received under the 787 interim pricing agreement. As we have discussed in the past, our understanding has always been that we will return the interim payment once we reached agreement. And as a reminder, we have never recognized this as revenue or reported cash flow.

Finally, as part of the agreement, Spirit will move to industry standard payment terms. We will leverage a vendor financing program, so that this should not impact cash flow. Sanjay will provide more details on the financial aspects of this agreement shortly.

I would like to turn now to the strong operating highlights from the quarter. Excluding the impact of the MOU, our earnings per share were $1.57. In the second quarter, we delivered a record 424 shipsets compared to 408 shipsets in the same period last year, primarily driven by the ramp-up in production rates in the 737, the A320 and the A350 programs.

Our supply chain cost reduction initiatives are gaining traction and we are finally fully recovered in Kinston and back to our normal mode of sea transportation, following Hurricane Matthew last October. As we mentioned in our last quarter's earnings call, we have filed appropriate claims with our insurers and anticipate having a resolution before year-end.

With regard to capital deployment, in the second quarter, we repurchased 2.2 million shares for $126 million. Year-to-date, we have deployed a total of $208 million and repurchased 3.6 million shares under the existing authorization of up to $600 million. Separately, we met with our board and conducted a strategic review of the market. Presently, we do not see any large acquisitions that would meet our strategic and return thresholds.

The board has, therefore, authorized an increase of our share repurchase program by $400 million, resulting in a total program authorization of $1 billion. Since we have already deployed $208 million, we have approximately $800 million remaining. In addition, after paying our third quarterly dividend of $12 million in July, our board of directors declared another quarterly cash dividend of $0.10 per share to be paid in October.

Turning to some key milestones in the second quarter. Early in the quarter, we celebrated with Boeing the first delivery of the 737 MAX to Malindo Air. Spirit proudly produced 70% of the aerostructures and every derivative of the 737 plane.

The main highlight of the second quarter was the Paris Air Show. As the aviation world converged on Paris in June, our Spirit team took full advantage of the opportunity and conducted hundreds of meetings with customers, suppliers, investors, and government officials. We also made several key announcements through multiple press releases regarding business growth opportunities and strategic technology collaboration with one of our suppliers.

One of the most exciting announcements came from our largest customer, Boeing, on day one of the air show when they announced the launch of the 737 MAX 10. On the day of the announcement, the MAX 10 received more than 240 orders and commitments, and by the end of June, that number had increased to an impressive 361 orders and commitments.

The key design change for the MAX 10 is the fuselage stretch of 66 inches compared to the MAX 9. Spirit builds 100% of the fuselage structures of all current and future 737 derivatives right here in Wichita, and we are extremely proud to be a key enabler and a trusted partner in the successful launch of the MAX 10.

Spirit recently made several announcements regarding the growth of our global fabrication business. We announced the creation of a new 5-axis fabrication center of excellence and the expansion of our chemical processing capabilities on our Wichita, Kansas, campus.

In addition, we announced the creation of a new three- and four-axis fabrication center of excellence in McAlester, Oklahoma, and the expansion of our manufacturing facilities in Malaysia. All of these initiatives solidify Spirit as a world leader in the fabrication of detailed parts for the commercial and military aerospace industry.

Another announcement Spirit made in Paris was a technology collaboration with Norsk Titanium. The agreement focuses on 3D printing of titanium parts using Norsk Titanium's proprietary Rapid Plasma Deposition technology to reduce our material cost substantially.

In addition, we have captured next-generation spoiler work on the A320 platform through application of our R&D technology strategy as part of our cost reduction partnership with Airbus. We are very pleased with the range of technical interactions we are now having with Airbus, and this win positions us better in the future to win even more Airbus work.

Now, let's take a look at second quarter results. For the quarter, we reported revenue of $1.8 billion, about flat with last year. Operating income was a loss of $83 million and net income was a loss of $57 million, taking into account the Boeing MOU. Reported earnings per share were negative $0.48. Adjusting for the impact of the MOU with Boeing, EPS was $1.57.

Operating cash flow was $222 million and free cash flow was $175 million. Our backlog at the end of the second quarter remained steady at $46 billion with work packages on all the commercial platforms in the Boeing and Airbus backlog. Sanjay will provide you with more specifics about the second quarter financials in a moment.

Now, turning to 2017 guidance. Given the strong performance in the first half of 2017, we are raising our full year adjusted earnings per share guidance by $0.40 to a new range of $5 to $5.25 per share from the previous range of $4.60 to $4.85. Additionally, we are raising our free cash flow guidance to a new range of $500 million to $550 million from the previous range of $450 million to $500 million. We continue to support the guidance we gave you last quarter for revenue to be between $6.8 billion and $6.9 billion.

With that, I'll turn it over to Sanjay to provide you with more specifics about the second quarter financials. Sanjay?

Sanjay Kapoor

Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

Thank you, Tom, and a very good morning, everybody. Obviously a lot to talk about today. I'm also reading that Dow is [indiscernible] (10:21) about 22,000, so we certainly picked a good day to have our earnings call. Well, first and foremost, we've had a terrific second quarter from an execution perspective and I want to thank the entire Spirit team for once again executing and demonstrating consistent and strong results. And we will talk in detail about those results in a moment.

But before we jump into the quarter and given the importance of the MOU with Boeing, let me provide a bit more color on the components of the deal. The MOU strengthens our relationship with our biggest customer and further aligns the parties for future success. It also enables us to spend additional time focusing on our operations and future growth opportunities.

While we are never happy about taking forward losses on any program, the 787 settlement coupled with other aspects of our agreement is an acceptable outcome for us and allows us to generate consistent and increasing cash flow going forward.

So, on the 787 program, some additional color. First, we are extending our block to 1300 units. This is consistent with Boeing, and also establishing a planning block till the line unit 1405, which is consistent with our pricing agreement. And this reach-forward loss covers both of these blocks.

So now we are making estimates on our cost all the way into line unit 1405. And while, as required, we are making prudent assumptions on supply chain and learning costs over this extended period, I must stress that we have internal plans to do better on those cost goals. Since delivery of these units is likely to stretch into 2022, we have some time to affect real change to convert our opportunities and eliminate our risks.

Second, if there should be a rate increase from 12 aircraft per month to 14 aircraft per month, as Boeing has talked about, there could be a modest benefit from that fixed cost absorption that should help with this effort to reduce cost further than assumed. Third, both companies have agreed on mechanisms backed by shared financial incentives to help each other in bringing this cost further down.

Fourth, most of this reach-forward loss relates to units beyond our current block. And so there is time to get some of our ideas in play, but also, as you know, after line unit 1120, we should finally be done paying off the advance payments of $700,000 per shipset and neutralize some of the cash flow headwind for the company on this program after that timeframe.

Last and definitely not the least, we have a fantastic team on the 787 program, one of the best. And as many of you know, they've demonstrated a steadfast performance relative to coming down from aggressive curves established during the execution of our first block, and in fact at the end, performed slightly better than the original cost challenges we laid out for them in 2013. So we have renewed confidence in their ability to once again perform.

Tom also talked about our agreements on the other programs that are part of our master agreement. While we cannot discuss program-by-program details, nor can we get too specific, I can repeat a few facts. First, it locks in pricing into 2022. Second, it has productivity discounts which are cleanly tied to volume changes. Third, we have agreed on investments to achieving these rate changes. Fourth, it sets the price for the 737 MAX. Fifth, it allows us to return the $235 million of interim cash, net of some payments owed to us in 2017 that was part of our current year guidance. Lastly, we are transitioning to industry standard payment terms which will take effect upon us working through supply financing arrangements.

So, finally, what does this mean in terms of our long-term outlook on our ability to generate cash? Over the last few years, we have made tremendous progress on focusing the company on generating cash flow. Since 2013, we have steadily improved our performance, reduced our risks, balanced our investments, and consistently delivered increasing cash flow. And all Spirit employees have this in our performance metrics. We have also communicated on numerous occasions to you our goal to generate 6% to 8% free cash flow to revenue, which we believe is a good metric to measure our performance. Our guidance for this year also is in that range.

Subject to concluding this arrangement with Boeing, we would like to increase our goal to a new range of 7% to 9% of revenue. Let me repeat, while we are not giving guidance beyond this year, we are changing our goal from 6% to 8% to 7% to 9% going forward. Also, this agreement will allow us to ensure that our cash flow will continue to improve each year, including next year as we approach the higher end of that range.

In a nutshell, that summarizes our economic outlook. We believe the agreement with Boeing is fair and allows the company to preserve the ability to generate meaningful cash flow consistently going forward. This will also allow us to fuel the growth strategies that Tom has talked about in fabrication and defense.

So with that, let's now transition into the solid Q2 results and full year guidance. Starting on slide 4, revenue for the quarter was $1.8 billion, consistent with the same period of 2016, driven by higher production deliveries on the 737 and the Airbus A350 programs, and offset by lower production deliveries on the 777 program and decreased aftermarket activity.

For the quarter, we delivered a record 424 shipsets, including 136 737s, 19 777s, 36 787s and 150 A320s and 23 A350 shipsets. Our backlog at the end of the second quarter remained stable at $46 billion.

Moving to slide 5, second quarter reported EPS was negative $0.48 compared to $0.35 in the second quarter of 2016. As we have disclosed, both periods included significant onetime events. For comparison, adjusted EPS in the second quarter was $1.57 compared to $1.21 in the second quarter of 2016, reflecting a 30% year-over-year improvement.

2Q 2017 EPS was adjusted by $2.05 per share to account for the impact of the MOU with Boeing compared to $0.86 in 2Q 2016 for the Airbus settlements and other onetime charges. This improvement in adjusted EPS was driven by three equal factors; first, a lower share count; second, some benefits associated with lower tax rates; and most importantly, better operational performance.

Turning to free cash flow on slide 6. Free cash flow for the quarter was $175 million compared to $161 million of free cash flow in the same period last year, a 9% year-over-year increase. Capital expenditures for the quarter were $47 million compared to $54 million in the same period last year. This is only a timing issue. We still expect CapEx for the full year to remain steady in the range of $250 million to $300 million.

Turning next to capital deployment on slide 7. In the second quarter, we repurchased 2.2 million shares for $126 million. Year-to-date, we have purchased 3.6 million shares for $208 million. Built on the foundation of a long-term agreement with our largest customer, our conservative balance sheet and our new goal of 7% to 9% free cash flow conversion, our board of directors has authorized an increase of $400 million to our existing share repurchase program, resulting in a total authorization of up to $1 billion, of which $792 million is now available to deploy. In addition, our board of directors declared another quarterly cash dividend of $0.10 per share to be paid in October. As we mentioned previously, our fundamental focus remains on generating strong free cash flow and then deploying it to our shareholders.

Now, let's look at our segment performance. For our Fuselage segment results, let's turn to slide 7 (sic) [8] (20:11). Fuselage segment revenue in the quarter was $939 million (sic) [$938 million] (20:15), up 2% from $924 million in the same period last year primarily due to higher production deliveries on the 737 program, increased defense-related activity, partially offset by lower production deliveries on the 777 program and lower aftermarket activity.

Operating margin for the quarter was negative 8.5% as compared to 2.3% in the same period last year primarily due to the impact from the Boeing MOU. On a normalized basis, after reversing the impact of the MOU and other changes in estimate charges recognized during 2Q 2017, Fuselage segment margin was 17.6%.

In the quarter, we delivered the 600th 787 shipset to Boeing, and we are now operating at a steady drumbeat of 12 shipsets per month. On the A350 program, we delivered 23 shipsets in the quarter compared to 20 shipsets in 2Q 2016. Deferred production balance decreased by $7.7 million in the second quarter despite an unfavorable foreign exchange impact.

We are now fully recovered in Kinston from the aftermath of Hurricane Matthew and, in the quarter, recognized a final residual charge of $9.1 million, which brings the total cost of this weather-related event to $32 million, for which we have filed appropriate claims with our insurers. And we have made an appropriate assumption for recovery on these claims in 2017. Consistent with what we have said before, future Fuselage margins are forecasted to be in the 16% to 17% range.

Now turning to slide 9 for our Propulsion segment results. Propulsion segment revenue in the quarter was $437 million, down from $482 million in the same period last year, primarily driven by lower production deliveries on the 777 program, lower revenue on the 787 program and decreased aftermarket activity, partially offset by higher production deliveries on the 737 program.

Operating margin for the quarter was 9.4% compared to 15.4% during the same period of 2016, primarily driven by the impact from the MOU with Boeing. On a normalized basis, after reversing the impact of the MOU and other changes in estimate charges recognized during 2Q 2017, Propulsion segment margin was 19.6%. Future Propulsion margins, again, forecasted to be in the 17% to 18% range.

For our Wing segment results, let's turn to slide 9 (sic) [10] (23:12). Wing segment revenue in the quarter was $451 million, up 6% from $424 million in the same period last year, in part due to higher production deliveries on the A350 and A320 programs, as well as higher revenue recognized on the Boeing 787, partially offset by the absence of onetime claim settlements with customers that took place in the second quarter of 2016.

Operating margin for the quarter decreased to 6.8% compared to 15.3% during the same period last year. On a normalized basis, after reversing the impact of the MOU and other changes in estimate charges recognized during 2Q 2017, Wing segment margin was 14.1%. Future Wing margins are forecasted to be in the 13% to 14% range.

Turning now to 2017 guidance on slide 10 (sic) [11] (24:14). We are increasing our full year adjusted EPS guidance by $0.40 to a new range of $5 to $5.25. We are also increasing our free cash flow guidance for 2017 by $50 million to a new range of $500 million to $550 million. And we are reaffirming our revenue guidance for 2017 to be between $6.8 billion and $6.9 billion. Our guidance is based on an effective tax rate of approximately 29% which is reflective of the Q2 charge.

Lastly, I want to reiterate that we are increasing our goal for free cash flow conversion to be between 7% to 9%, instead of 6% to 8%.

Now, let me hand it back over to Tom for some closing comments.

Thomas C. Gentile III

President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

Thanks, Sanjay. As you can see, we had a strong operating quarter and exceeded our target objectives. Execution on our important long-term initiatives is proceeding on plan. Most importantly, we are executing on our quality, delivery and rate commitments for our customers, including Boeing and Airbus. In addition, our supply chain initiatives are delivering and we are expanding our third-party fabrication capabilities, and we are making headway in our growing defense business.

But the big news in this quarter, of course, is the MOU with Boeing and settling longstanding commercial issues on a range of programs, including the 737 MAX and the 787. This agreement will help reduce the uncertainty surrounding the commercial terms with our largest customer and position us to be an even stronger partner with them going forward. The MOU preserves our ability to deliver on our long-term cash flow objectives. Overall, we are pleased to achieve this important milestone with Boeing, and it makes us even more optimistic about the future than ever.

With that, we'll be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Doug Harned with Bernstein. Please go ahead.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Thank you. Good morning.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Good morning.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Good morning, Doug.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

So it wasn't very long ago when you were talking about the big gap between you and Boeing, and Boeing said the same thing. Could you give us an idea of what happened here? This seemed to come together pretty quickly. And once this agreement is finalized, how do you see it changing the way you work with Boeing from an operating standpoint, because this has been kind of a painful overhang for quite some time.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Right. Well, Doug, as we mentioned in the last call, there was a significant gap. Following that call, though, we continued discussions with Boeing at very senior levels and they ebbed and flowed. But really in the last few weeks, they started to coalesce and we started – we had a framework, and we started to reach some agreements on some key aspects of the agreement.

And an agreement like this is very complicated. It focuses on 737 and 787, but there's probably 13 or 14 elements to it, and Sanjay described some of those as I did. But over really the last few weeks, everything came together and we finally reached agreement. So that's a big step and we still have some work to do on the detailed documentation in the program agreements, but the good thing is that we pushed ourselves hard in the last few days even to put in place a fairly detailed MOU. And by going through a lot of detail at MOU, we flushed out all the big issues and we know where we are and we documented that in some detail.

So we have that as we go into the detailed documentation and we expect to get that done by the end of the third quarter. Both parties are motivated to do that. So I'm quite confident that it will happen. And so that was definitely worth the effort to do a detailed MOU.

On the operating side of things, this certainly helps. We've always had a good relationship at the program level and between our factories. We have mechanic-to-mechanic communication. We have regular program reviews.

And so that relationship has always been healthy, but there's, in fairness, always been an overhang because of these outstanding commercial issues.

Now that those are resolved, this should result in a better level of overall cooperation. We will rejuvenate those technical cooperation initiatives and I mentioned that we have an agreement to have a study in advanced aerostructures and manufacturing processes. And so I'm confident that by having this agreement now behind us, we can start to have a healthier relationship. Still going to be focused on cost quality and delivery every day. That's what being a partner is all about and we're really focused on the Partnering for Success that Boeing has initiated and making sure we're doing our part and this agreement really preserves that and strengthens the relationship and makes it more likely that we'll work together in the future on different initiatives. So all in all, a good outcome.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

But would it be fair to say that the completion of this takes away what I would say any extra pressure related to Partnering for Success pressure on your margins, that sort of thing? Not that you aren't going to still focus on cost, both of you will, but there's not sort of a next shoe to drop or anything like that with respect to impact on your margins from Boeing?

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Right. We've agreed to what we're going to deliver in terms of all the different programs, and so it creates a level of certainty that didn't exist before. So that's exactly right.

Douglas Stuart Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Great. Thank you.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Thanks, Doug.

Operator: The next question comes from Myles Walton with Deutsche Bank. Please go ahead.

Myles Alexander Walton
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks. Good morning. The comments that you made, Sanjay, around the forward loss and it more tied to the aircraft deliveries inside of the extension of the block. I'm just curious, so if you hadn't had the extension of the block, presumably this charge would have been pretty de minimis, but when you entered the next block, that's when you would have absorbed all of this negativity? Is that the way to think about it?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

I think, Myles, that would be a fair way to think about it. Obviously, like I tried to hint to you, when you extend your block, you have to make cost assumptions that are quite a bit out there. And obviously we have, like Tom talked about, agreed to modify step-down pricing in the context of between now and 1405.

So, yes, and, again, I gave you the best color I could which by telling you that most of this cash flow would be in those out years. And we have some time to go and affect real change and work on our opportunities so that we can bring some of that home and derisk some of the other risks that we have. So that's the way we look at it. Yes.

Myles Alexander Walton
Analyst, Deutsche Bank Securities, Inc.

Q

So just to clarify, so that means in the near-term, nearer-term, 787 kind of cost margins or unit margins would be about breakeven, consistent with what...

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Well, again, I won't get into that specific, Myles, because we've never told you program-by-program. I think what we painted to you always is measure us on free cash flow that all programs generate in totality and collectively. But we have a good plan. I think the way you should look at this, Myles, is we have a good plan now in the 787.

I certainly take a lot of comfort on the fact that the last time we laid out a plan, we slightly beat it. So we have full confidence in the way we've done this, both in terms of our cost in supply chain or our own learning curves, et cetera.

And we have the added benefit that we're going to work, like Tom said, really hard with Boeing together very collaboratively to try and work on supply chain costs that are a big part of any program, even harder, and there are good mechanisms that will facilitate that. So we feel pretty good about the 787 program from here on out.

Myles Alexander Walton
Analyst, Deutsche Bank Securities, Inc.

Q

And just one clarification, the payables, you're probably going from, what, 45 days to 60 days or 75 days?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Well, again, the numbers are commercially confidential. We did accept industry payment terms. And I think the way we view this is when Spirit was formed as a brand-new entity, obviously Boeing gave us some pretty generous terms, and it's been 10 years, as you know.

And today we stand on our own feet, and we can absorb going to what is commercial normal aerospace kind of payment terms, and we're going to establish some financing to facilitate that. So overall, it should not affect our free cash flow.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

One of the ways I look at it is we're kind of growing up and maturing as a company. And as Sanjay said in the early years, Boeing was very generous with payment terms to help get us off the ground. But now, we're more mature, we're generating a lot of free cash flow. And just like the young adult gets the job and moves out of their parent's basement, that's kind of how we look at this. We're ready to stand a little bit more on our own and have industry standard payment terms.

Myles Alexander Walton
Analyst, Deutsche Bank Securities, Inc.

Q

All right. Thanks, guys.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

And the good news is, with Boeing's assistance, we're going to be able to get a vendor financing program using their credit rating, which will help lower the interest rate charges on that. And because it's vendor financing, it won't impact our cash flow.

Myles Alexander Walton
Analyst, Deutsche Bank Securities, Inc.

Q

Okay.

Operator: The next question comes from Rajeev Lalwani with Morgan Stanley. Please go ahead.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Morning, gentlemen.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Good morning.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Good morning, Rajeev.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Tom, Sanjay, [indiscernible] (34:30) you have five, six years of visibility ahead of you, can you talk about how you're thinking about growth in margins, free cash flow? I know, Sanjay, you talked about it a bit earlier, but – and just more on whether or not 2017 is going to be a year for you to [ph] grow also (34:46).

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Well, I mean – let me just take a first cut at that. The MOU with Boeing and then eventually the definitive agreement enables us to stabilize the relationship with our largest customer, and therefore, turn our attention to some of those growth initiatives. And one of the things that we've been talking about is we still have opportunity to grow with Boeing. On the margin, there's lots of ways for us to continue to grow and we'll compete for future generation programs as well with them. So this enables us and it positions us to compete better for future Boeing work. So that's one thing. But the other thing is that we're continuing to look at growth opportunities with Airbus. We've had a lot of technical interchanges with them. I mentioned we won some work on a spoiler, which is a nice piece of work, relatively small, but a good start and it positions us for more in the future.

And then we're also looking at more defense work. I mean today, defense is less than 5% of what we do, but with the work packages that we have on not only the military derivatives of the commercial Boeing aircraft like the 767 Tanker or the P8, which is a 737 derivative, but we're also on the CH-53K heavy-lift helicopter and we're one of seven suppliers named on the B21. So we see defense becoming a much bigger part of our growth initiative as we go forward.

And then finally, fabrication. We're already one of the biggest third-party fab companies in the world, but we consume everything internally. And so what we're going to look to do now is to sell more of our detailed parts, machining, sheet metal, composite fabrication assembly to third parties, including Boeing and Airbus, but also defense companies and potentially other Tier 1s.

So we see a number of growth initiatives that we can really pursue now with a little bit more focus that we are close to finalizing the agreement with Boeing. And that will enable us to drive the top line and as we've talked about a lot, the supply chain initiatives that we have are enabling us to drive productivity which will help us offset some of the pressures in terms of escalation and customer price downs on margin and continue to deliver a healthy free cash flows. And as Sanjay said, we are absolutely committed to our long-term goals that we have stated in the past and we're going to even look to improve on those.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

That's helpful. So, Tom, [indiscernible] (37:18) you're saying that it's not off the table for you to maybe grow not just revenues and free cash flow from here but maybe margins as well.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Well, that's always going to be the goal. But I would say that this is a tough industry in the sense that there's escalation on material, there's escalation on labor, customers are always looking for productivity, and we're committed to delivering that. So all the initiatives that we're doing, first, we'll offset those pressures and then we'll be looking at increasing margins as well.

But we've got a very healthy pipeline of initiatives across our cost base material, supply chain, core operations. We're digitizing our factories. So we've got a healthy pipeline and we're very confident we can offset the pressures and even improve on those for our long-term margin improvement.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

And, Sanjay, just a quick direct one for you. Can you just bridge the old and new earnings and free cash flow guidance, just what some of the big drivers were?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

The $50 million [ph] of the sale (38:18)? Well, some of that…

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Right.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

...you saw the operational improvement. That clearly is a big driver. The second, obviously, we are benefiting from a lower tax rate. So there will be some improvement because of that. But it's fundamentally the operations. Rajeev, we've done this thing now for the last three or four years. We've sort of set ourselves some internal aggressive plans. Our teams are very focused on that.

I think I may even have mentioned this in the last quarter. We get into sometime in the second quarter timeframe. In August, we have a good perspective on how well we are doing and how well we intend to do in the future. And this is around the time that we feel confident that we can generate the cash flows that we have now guided to. So it is operational improvement. There are a couple of other small things like the taxes, et cetera. But we're continuously focused on getting to that 7% to 9% now.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

Very helpful. Thank you and congrats on growing up.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.
A

Thank you.

Operator: The next question comes from Jason Gursky with Citigroup. Please go ahead.

Jason Gursky
Analyst, Citigroup Global Markets, Inc.
Q

Yes. Good morning, everyone. Sanjay, just a quick – yes, a quick clarification for you. The 7% to 9% free cash flow target, would there be upward bias on that range of 7% to 9% should you find some of those savings that you'll end up sharing with Boeing over time?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Jason, Tom and I were joking about this. We were always at 6% to 8%, and people would push us towards the higher end. I think I had mentioned to you we're going to be now at 7% to 9%, and I know you would like to push us to the – our goal is to stay in that range and be consistent inside that range. And, yes, do we have aspirations to go to the higher end and eventually even higher than that? Of course we do.

But our methodology in our company has always been to give you guidance and ranges and goals that we feel comfortable achieving. Now, this is an industry that's [ph] fraught (40:25) with all kinds of challenges. Even [ph] just take rates (40:27) in the last year can go up and down. We've got some massive supply chain initiatives that you guys are very familiar with.

We're now in the execution phase of that program. If we execute it well, there's lots of upside. And, yes, do we have internal plans to get to the higher end of those ranges? Of course, we do. But we feel comfortable telling you that we think we can set a goal on – inside 7% to 9%.

Jason Gursky
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Good enough. And then I was intrigued by the comments that were made during the prepared remarks around some of the new initiatives that you're engaged with on Boeing around aerostructures. Can you talk a little bit more about what's going on there and whether that sets you up to participate in the middle of the market aircraft if that aircraft ends up getting launched? Thanks.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Right. Well, first of all, there's no agreement to be on the middle of the market. That's going to be in the future we will compete. I think what this agreement does is that it enables us to compete and have an opportunity to win. But it doesn't include anything on that. What we've agreed is that we'll work together with technological exchanges on advanced aerostructure concepts and also manufacturing processes.

And let me just give you a couple of examples. For example, I mentioned that we had signed an agreement with Norsk Titanium to use their 3D printing technology called Rapid Plasma Deposition to create near-net shapes of titanium, which we then machine to create parts. And what that does is it enables you to reduce the material cost substantially because right now, when you do machining and you're reducing metal, we might take off 80% or 90% of a block of titanium which is all waste. By creating a near-net shape using Rapid Plasma Deposition, we can reduce the waste by 70% or 75%.

Now, we've got some parts that are getting close to production, but so does Boeing with the same technology. So there is an opportunity for us to collaborate more on a very exciting technology for the future. The other thing is we've talked about technical exchanges in terms of production systems. Boeing has made huge amount of progress by adapting the Toyota Production System into a Boeing Production System to reduce flow days and achieve what they call champion times. And this is a very high impact. They're getting great results and as part of this agreement, we've talked about how they can share some more of that technology and we can get involved and apply that to different programs including the 787 program. So those things will help us achieve some of these targets that we've set for ourselves.

And then we've talked about – in the past, we've had a lot of technology exchanges in areas like Propulsion and those have waned recently, but this gives us an opportunity to rejuvenate those efforts. And so those are the kinds of things that this entails. And we're very excited about those. There's a lot that we can learn from Boeing and if we can apply it in the appropriate way to our programs, there's quite a bit of savings that we can achieve. So that's a very exciting aspect of this whole agreement that we have reached with Boeing.

Jason Gursky
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thanks, guys.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Thanks, Jason.

Operator: The next question comes from Ron Epstein with Bank of America. Please go ahead.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch Q

Yes. Hey. Thanks. Good morning, guys.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc. A

Good morning, Ron.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch Q

Sanjay, if you could talk about, in the cash flow from operations, quarter-to-quarter, there was about $190 million of other, what was that?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc. A

Cash flow from operations of $190 million of other?

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch Q

[indiscernible] (44:11). You got $190 million of cash [ph] in your CFO (44:15).

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc. A

The only thing that could have happened here is we re-classed our $235 million that we said we were going to pay back. I'm just going through – let's keep going to the next question. I'll come back [indiscernible] (44:38).

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch Q

Yes. Sure. Yes, no problem. Then maybe, Tom, there's a big, big picture question for you, right? When we look at 787, kind of the history there and it's kind of – this program has been – Spirit made great technical strides and all that, but financially, it's been a [ph] throwing in that side (44:56) of the company for a long time. A350 isn't hugely profitable either. How should we think about that next airplane you guys do, right? Like, how come we feel comfortable that if you get on the middle of the market airplane, or whatever airplane it is, right, just use that as an example, that the profitability there will be any better than what it's been on the last two.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc. A

Right.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch Q

And then the second part of this is shouldn't that [indiscernible] (45:21) maybe you guys should spend less on share buybacks and a little more on just investment for the future?

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Right. Well what I would say on 787 and A350 is those programs go back all the way to the point where Spirit split off from Boeing, fairly new. And many [indiscernible] (45:41) the 787 program were kind of already taking shape. The A350 is work that we bid on subsequently. And the company at that time was less experienced in terms of bidding on and winning work on new programs and setting them up and managing not only the execution of the development, but then also into the recurring stage where we're focusing on getting down the learning curve.

We have learned a lot of lessons, not only in terms of how to bid on work, how to execute development programs and how to work through the initial stages of manufacturing to get down on the learning curve. And those are lessons that we would apply to any future program in terms of how we would bid it and execute on it.

So we've learned a lot and I expect that we would be better as we bid on new generation of programs to put in place economics that are achievable and are acceptable over the long-term. So no doubt about it, we struggled on these two programs, but we now have a path forward that we feel is stable and consistent. We know what the specific targets are. We have the experience to execute and we're confident that we're going to deliver as we have laid out for both the A350 program and the 787 program.

In terms of capital deployment, [indiscernible] (46:58) we'll be spending more on investing for the future, we try to be balanced. As we look at our cash flow, we apply a certain amount of it toward buybacks and dividends, and we think that's appropriate because our shares historically have been undervalued and our stock in investing in our company in that way has always proved to be a good investment with good returns. But it doesn't mean that we're not investing for the future. Each year, our capital expenditures have been in the $250 million to $300 million range. A lot of that is about investing in growing rates on the best programs in the industry, the 737, the A320, the A350, the 787. And so those are great investments and we'll continue to make those.

We're also investing some money in R&D and that's going to increase. We just had our strategy review session with our board, and we're going to triple our investment in R&D over the next few years. Not necessarily all in our own nickel, but in terms of using other people's money, in terms of contract research and development, as well as leveraging third-party institutions to get leverage on the investments that we make. But by increasing substantially our R&D, we're going to look to generate ideas on the next-generation aerostructures, which will position us as an indispensible partner for our customers in the future.

So we are doing buybacks today, but it doesn't mean we aren't investing in the future as well to make ourselves a better company and to advance our technology. We think that's critical to remaining a trusted partner and winning work on future generation programs.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Yes. And, Ron, just to – that is the $235 million. I'm looking at the same cash flow sheet as you're looking at in our press release. And if you look at the deferred revenue and our deferred credits, that's a negative impact and you see the other as a positive impact. That's just a re-class of the $235 million that we talked about, that was interim, that we are returning to Boeing.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Okay.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

So net-net, it doesn't have any impact on our cash flow.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Okay. All right. Thank you.

Operator: The next question comes from Howard Rubel with Jefferies. Please go ahead.

Howard Alan Rubel
Analyst, Jefferies LLC

Q

Thank you very much. Just a couple. First, Sanjay, you talked about the insurance recovery. Did you factor that into 2017 numbers? Wanted to...

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Yes, I did, Howard. We made a prudent assumption, and it's certainly inside the bounds of our guide. And again, we are progressing well. It's been a year almost. There's a lot of data and facts and figures that we've exchanged. So we made a prudent assumption in terms of the recovery there.

Howard Alan Rubel
Analyst, Jefferies LLC

Q

Okay. Airbus has had challenges with a couple of its suppliers, and they've been not shy about talking about it. Have you had further conversations with them with regard to aerostructure opportunities other than just this modest spoiler?

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Yes, we've been in discussions with them about some of the initiatives they have around dual sourcing, some rather large packages. And we've bid on some of those in the past, and we're continuing to bid on those. And as they decide to do that in the future, we'll be open to it. One of our stated objectives is to grow Airbus content.

And so if they are looking to dual source some of their aerostructures work, we're absolutely going to be trying to bid on it. And we're bidding on some programs now. So they'll make their decisions in due time, but it's something that we're interested in doing, and we are actively engaged with them on that.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Howard, and if I can just add in here...

Howard Alan Rubel
Analyst, Jefferies LLC

Q

Sure, sure.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

I just want to throw a little [ph] kudo (50:39) out to – I mean, often in these calls, at least today, we're not talking too much about our Airbus activity. And whether it be in Kinston where we've really done some good performance to get back on so-called the boat shipments, or in Prestwick where the team's worked really, really hard on the A320 rates that are also going up and some good [indiscernible] (51:00) catches out of – you just saw in our Wing margins as well.

And what I wanted to tie back here was, at the end of the day, whether it be with Boeing or with Airbus, everybody wants good cost and good performance whether it be a new bid or an existing program. And I think we have demonstrated that repeatedly in the last few years, and we continue to make progress there. So, at some stage, we hope to get some traction on that with Airbus as well.

Howard Alan Rubel
Analyst, Jefferies LLC

Q

And maybe, Sanjay, that sort of brings me to the last question. There's two parts to it. One is the agreement sort of indicates that globally you're low cost and reasonably good quality because if you hadn't reached an agreement and Boeing decided to move the work, you would've – they're obviously looking for best value. So, maybe you could talk about that.

But also just with regard to Airbus, you did allude or you were very specific and said you dug a little bit into the deferred cost on the A350. And with all of these things that you've learned of late of how to produce large structures, is that sort of also giving you some confidence that maybe the bogie you set for the A350 has some room for you to perform better?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

So, probably let me start at 30,000 feet and I'm sure Tom will jump in on this because – you know, one of the benefits that we've had in the last two or three years is we took a very determined and maybe a longer route into figuring out what a should cost when we started off in our clean sheet processes, particularly for our suppliers. But as part of that process, we also try to benchmark ourselves and try and see how we are performing compared to what a should cost should be.

And so, our internal targets are all focused on that. And as we get closer and closer to those utopian goals, but clearly good goals, and everybody has a different way of looking at it. You can look at it in terms of champion times or ultra champion times or you can look at it in terms of should cost. We think we made good progress.

Now a big component of this in any aerostructure company is material, because we like every other company buy 2/3 of our stuff of that size on the outside. So we have done a lot of homework and a lot of very determined, slow, methodical implementation of how we go and source and what we buy and what we make and what we buy where. And that is now in the execution phase. So as we get closer and closer to implementing that, I think we'll become a really good aerostructures company that has good quality, not just acceptable quality, but good quality and the right cost structure.

And if we do that, then yes, I think we will earn the right to be on multiple platforms, either new ones or existing ones. And I'll just add, and then I'll turn it over to Tom. Tom, do you want to add something to that?

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.
A

Well, there's no doubt, Boeing is looking – as Airbus. This is a competitive industry. They're always looking for productivity. And they push themselves hard and they push all their suppliers hard. So in the case of Boeing with this MOU, they were rightfully looking for us to be a good partner as part of the Partnering for Success program and deliver productivity on an ongoing basis. And so we're confident that we have met those expectations and I think the fact that they are willing to enter into this agreement with us would support that.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Howard, just one last thing since you asked specifically on the A350. We are making good progress on the A350. We are confident about the plan we've set. Having said that, one of the things that's obviously key is rates. And we are absolutely on track now and like I said, we are back on the boat and we are – it's hard to go up in rate and take your cost down, but we are there now. But rates are going to be important going in the future as well.

Howard Alan Rubel
Analyst, Jefferies LLC
Q

Thank you, gentlemen, very much.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.
A

Thanks, Howard.

Operator: The next question comes from David Strauss with UBS. Please go ahead.

David E. Strauss
Analyst, UBS Securities LLC
Q

Thanks and congratulations.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Thank you, David.

David E. Strauss
Analyst, UBS Securities LLC
Q

Sanjay, just wanted to – thanks – wanted to go back, I think, with Myles' question on the timing on the forward loss on 787. So as I understand, it seems what [indiscernible] (55:28) is the step downs are fairly modest out to the end of this block. Around that time, your advances will – your advanced payback will end, and that's where you see more aggressive step-down. So, kind of, it levels out the cash hit.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Well, I was trying to give you both sides. I mean obviously the 787 step-downs are what we've agreed to, and I was just trying to remind everybody that, yes, in the future, after line unit 1120, we've certainly, from a cash flow perspective, have finished paying off the advances, so there will be a sort of $700,000 a shipset less impact in those years. So, yes, that's what I was hinting at.

David E. Strauss
Analyst, UBS Securities LLC

Q

Okay. And then wanted to follow up on the A350 deferred, you comment the progress there, the progress has slowed the last couple of quarters. I know with the hurricane impact – is that mainly what we're seeing in the numbers or it's step-down pricing that's hit you the last two quarters and should – with the hurricane impact behind you, should we see an acceleration in the deferred progress here over the near-term?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Well, the hurricane was captured outside that program. But, David, as we've talked about in the past, deferred per shipset is a good measure, but are not completely accurate measure on performance, because unfortunately on a program, even today, even though we're shipping out 23 units per quarter, FX can make a difference. There are sometimes settlements on a supply or other issues that we incur in terms of costs. That can make a difference.

But are we on plan on that project? Absolutely. We are tracking to that plan. A big part of going down that plan is to achieve the supply chain savings that we had articulated and laid out for ourselves. And we feel we are absolutely on track on that.

So as long as we make the rates and we are certainly making them, and we expect to make them in all of that, I think we'll continue to see that burn down commitment to – remember, when we set that forward loss, we said we will recover about $450 million over the next – till line unit 800. And, yes, we are on track for that.

David E. Strauss
Analyst, UBS Securities LLC

Q

Okay. Thanks for the color.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Thank you.

Operator: The next question comes from George Shapiro with Shapiro Research. Please go ahead.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Hi, George.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Hi. How are you? Couple of questions. I assume the 737 wasn't changed much in the agreement because otherwise you would have spelled something out about it. I mean...

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Well, we...

George D. Shapiro
Analyst, Shapiro Research LLC

Q

[indiscernible] (58:20) your expectation?

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Right. We indicated on the 737, A, we agreed on the price for the MAX, which for us is an important milestone. And, B, we agreed to some productivity achievements and discounts linked to the volume requirements.

So, as volume goes up, I mean, volume is going up on the 737 from 42 to 47, then to 52, then to 57. And so there's a lot of fixed cost absorption. And so Boeing would rightfully expect to see some of that reflected in discounts. And then plus just ongoing productivity improvements, and we're getting much better at driving those.

And so we've got to – just like Boeing is expecting it from themselves and expecting it from their other suppliers as part of Partnering for Success, we've committed to deliver those. And so our supply chain initiatives and all the other cost out initiatives that we have will help us offset those commitments and continue to contribute to the rest of our business. But we did make some exemptions in terms of productivity discounts on the 737 as part of the overall agreement.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Okay. And just the 7% to 9% free cash flow yield, I assume you're expecting the revenues to grow some next year?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

George, we are on the right programs. We've always said to you we want to grow this company. Tom's articulated areas of growth outside of our current portfolio, including in growing Airbus, growing Boeing, growing defense, growing fabrication. So yes, we expect top line growth as well, yes.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

And then the last one, Sanjay, if you could just reconcile like particularly in Wing and your normalized margin is $50.4 million MOU impact, but on the front page, you say there's something like $70 million, [ph] I forget (60:09) the precise number, $70 million of net loss in Wing. So what's the reconciliation there? And in the other sectors, it's a little different, but not a lot, but this one is pretty significant.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Yes. Well, you're right. There is some [indiscernible] (60:25) in the Wing segment. Some of it has to relate – we can't get into the specifics, George, but some of it has to relate to some of the settlements we've done as part of this MOU. There were certain recoveries that we had. That's why when I give you segment information, I try and take all the clutter out and then I also try and give you information on where margins are likely to be on a more normalized basis going forward as well.

So, yes, there was some recovery of some shipments that we had made and it was part of the settlement. And like Tom said, this MOU is terrific, because not only that it set the stage for between now and the next five, six years, but it also cleaned up several other things that were historic and small things that inside our businesses needed to get cleaned up. So a little bit of it is just onetime thing.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

And then actually, let me get one last one. The litigation reserve reversal, I assume pertains to the settlement by the – or the agreement by the Delaware Court that's ruled in your favor. Where is that spread in the income statement?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

So that's spread across in each one of the segments. And, yes, that was something that we – was obviously a benefit to us in the quarter likewise. And I know we didn't get too much time this quarter. It was a fantastic result, I think, in the second quarter. We didn't get time. There were some offsetting charges as well. So that's when I was in my prepared remarks talking about the EPS improvement year-over-year, there are lots of pluses and minuses like the one you just mentioned. There were a couple of other minuses as well. We had some inventory issues, some obsolete stuff, et cetera. That all neutralized itself and that's why when I gave you the color in terms of EPS improvements year-over-year, I broke it down fundamentally into those three categories of share count, taxes and operational benefits, and they were about in equal measure.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Okay. Thanks very much. Very good numbers.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Thank you.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Thank you. Thank you.

Operator: The next question comes from Rob Spingarn from Credit Suisse. Please go ahead.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Good morning.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Good morning, Rob.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC
Q

Going back to something that George just asked on the 737. As you get these rate increases of about, let's call it, 10% per annum for the next few years, as the rate rises, would you say that under the new assumptions that your EBIT growth in 737 will track that increase, or will it exceed or be below? So that's my first question.

The second question, Sanjay, could you quantify maybe a little bit more specifically what percentage of the 787 provision is backward-looking? In other words, is repricing of aircraft already shipped, and therefore I would imagine non-cash? In other words, what's the forward cash shortfall relative to the charge? Thanks.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Yes. Let me take the second question first, and then, Tom, maybe if you want to talk about 737. No. None of this is backward-looking, or if it is, it's very small, like I said, some cleanup activity that happened.

But most of this is forward-looking, and it's between now and line unit 1405. So this is not sort of cash behind us. It's sort of in front of us. But it's accounted for in the new sort of goal we've established for ourselves in terms of 7% to 9%, as is whatever...

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. So, it's [indiscernible] (64:06) cash.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Yes.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.
A

Okay. And just to respond to your 737 question, obviously with rates going up so high, the revenue on 737 will go up. We've committed to productivity savings for Boeing, and our goal would be to drive our own internal initiatives to offset those to keep EBIT basically constant.

So that's the – the EBIT percent, obviously. So that's what the goal is, and we have a lot of work to do that on internal execution, but we're quite confident we can do that given what we have already achieved with our supply chain initiatives.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. And then just a further – thank you, Tom, [indiscernible] (64:47), Sanjay. Beyond the block...

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Yes.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC
Q

...how do you think about the cash profitability of the program once we get into either a new extension or a clean block once we're done with this? Are you cash flow positive?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Well, if you're talking about questions associated with what happens on line unit 1406, no. Again, there is no pricing agreement that we've talked about today associated with beyond line unit 1405. And so like any, that's something that will have to get negotiated at that stage based on where the costs are, where the market is and what the contract is and so on and so forth.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.
A

But the good news is that 1405 won't occur anytime before 2022. So we have a little bit of time.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Yes.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. Thank you.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Yes.

Operator: The next question comes from Sam Pearlstein with Wells Fargo. Please go ahead.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC
Q

Good morning.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Good morning, Sam.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.
A

Good morning, Sam.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

Can I follow up on the 737 and the productivity discounts tying to volume? Just trying – since there isn't a deferred balance to our forward loss to look at, how do we tell what that pricing, how it compares to what your planning was? And I assume it does affect some of the revenues for the units that you've already booked to date.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

It's more of a go-forward...

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

Okay.

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

...situation.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Sam, it's not anything booked today. This is a – this is a – again, I have to remind everybody just cautiously if we've got an MOU in place, we are working to get the definitive agreement in place as well, which we are confident we'll get done, but it has to get done. Having said that, this is a going-forward deal. And I know you're concentrating now on the 737 like we have been on the 787. That's one of the reasons why we feel it's a fair deal and we feel that with this deal, we are now able to generate 7% to 9%. So inside that is productivity discounts offset by our own cost reductions which we have internal goals to always do better. Inside that is whatever the assumptions are on the 787 and so on.

So I know it's a macro view from the outside but there are five or six components of the deal that we discussed. We agreed on a variety of things, 787, 737 MAX pricing, the rate increases, investments required, productivity initiatives, shared initiatives on cost reductions, et cetera, et cetera, because we believe it's a fair deal and it's something that allows us now to focus on our future and deliver higher cash flow returns.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

Can I just follow up just in terms of just some of the more macro pieces of it is who is spending the money in terms of the capital investments? Could you talk about an agreement? Is it you or are you getting help for some of the capital investment? And I guess related, is the volume discounts of the master agreement originally tied all of the Boeing programs ex the 787 in terms of the volume? Does this start to separate them into the volume of individual programs?

Thomas C. Gentile III
President, Chief Executive Officer, Spirit AeroSystems Holdings, Inc.

A

Right. So, first on capital, what we've agreed is that the capital that needs to be spent for these programs and the rate increases, that who pays for what is not something that we really have focused on publicly. So I'd rather not get into that. But what we have agreed is what the capital investments need to be for those rate increases.

In terms of the volume discounts, the agreement really blocked things into kind of twin aisle programs, legacy twin aisle programs, 737 and then 787. And so there were very specific focus areas for each of those, and I think we've highlighted those. The twin aisle programs were not a major part of this agreement. The majority of the focus was on the 737 and the 787.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Ghassan, I think we are...

Ghassan Awwad
Executive Director of Investor Relations and Corporate Strategy, Spirit AeroSystems Holdings, Inc.

A

Yes. Operator, we'll take one more question, please.

Operator: Okay. Thank you. The next question comes from Cai von Rumohr with Cowen and Company. Please go ahead.

Cai von Rumohr
Analyst, Cowen & Company, LLC

Q

Yes. So, just on the cash flow, does the $500 million to $550 million, is that after paying the $235 million? So that's really $700 million-plus?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

No. No, Cai. The $235 million was never included in our cash flow numbers in prior years when we got it.

Cai von Rumohr
Analyst, Cowen & Company, LLC

Q

Got it. Okay.

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

So, that's just sitting on our balance sheet. Free cash flow, as we generate free cash flow this year, that's $500 million to $550 million.

Cai von Rumohr
Analyst, Cowen & Company, LLC

Q

Okay. And then looking forward, I think you said, Sanjay, you expected cash flow to continue to increase over the next couple of years. How far are we looking out to 2022 or 2020 or give us some color on that?

Sanjay Kapoor
Executive Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.

A

Okay. Well, I think I publicly said in my prepared remarks, including next year, and we are not giving guidance for next year. But I did try to tell you that this is a major outcome and I was trying to give you some color at least beyond this year. So, we are not giving you guidance for 2018 today. We'll do that sometime in January. But I did tell you that our journey has been, our goal has changed. It's no longer 6% to 8%. It's now 7% to 9%. And I had also said, this agreement allows us to increase our cash flow year-over-year, including next year. And that's how I'd leave it.

Cai von Rumohr
Analyst, Cowen & Company, LLC

Q

Thank you very much.

Ghassan Awwad
Executive Director of Investor Relations and Corporate Strategy, Spirit AeroSystems Holdings, Inc.

Okay. This concludes our earnings call for today. Thank you for your participation.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.