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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Spirit AeroSystems Holdings Incorporated Fourth Quarter and Full-Year 2017 Earnings Conference Call. My name is Gary, and I'll be your coordinator today. All participants will be in listen-only mode. [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. Kailash Krishnaswamy, Vice President of Investor Relations, M&A and Strategy. Please proceed.

Kailash Krishnaswamy

Head of IR, M&A and Strategy, Spirit AeroSystems Holdings, Inc.

Thank you, Gary, and good morning, everyone. Welcome to Spirit's fourth quarter and full-year 2017 earnings call. I'm Kailash Krishnaswamy 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.

In order to allow everyone to participate in the question-and-answer segment, we ask that you limit yourselves to one question, please.

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 statement 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 & Director, Spirit AeroSystems Holdings, Inc.

Thank you, Kailash, and good morning, everyone. Welcome to Spirit's 2017 fourth quarter and full year earnings call. I'd like to start by highlighting the strong 2017 performance, during which we were able to meet our commitments to our major customers and achieve a number of significant accomplishments that will drive long term benefits.

Let's start with a quick look at our 2017 financial results. From an operational production standpoint, we executed rate increases on our largest programs and delivered a record 1,651 shipsets compared to 1,583 shipsets in the prior year. The number includes 532 737s, 136 787s, 70 777s, 98 350s and 600 A320s.

We once again delivered solid results. Reported revenue of $7 billion, was slightly higher than our guidance, reported earnings per share were $3.01 or $5.35 adjusted to exclude one-time items and that also exceeded our guidance. Operating cash flow was $574 million and free cash flow was $301 million or $537 million, when adjusted to exclude cash repaid under the 787 interim pricing agreement as part of our final Boeing agreement.

Cash flow was at the high end of our 2017 guidance. We returned $549 million to shareholders in 2017, with $502 million in share repurchases and $47 million in dividends. For each of the last two years, we have returned more than 100% of adjusted free cash flow to shareholders. Going forward, our board has authorized an increase in our share repurchase program of approximately $500 million, resulting in a total program authorization of up to $1 billion.

Our backlog at the end of the year increased to $47 billion, which includes work on all commercial platforms in the Boeing and Airbus backlogs. We're fortunate at Spirit to be on the best programs, many of which have planned production increases in the near future. While production rate increases are a great opportunity, they also bring operational challenges. We had a good year, but we also absorbed a lot of cost, especially during the fourth quarter of 2017, as we managed through the rate increases in the mix shift on the 737, which is our largest program.

Going into this year, we're making a concerted effort to get ahead of the rate increases early, so we can achieve them more efficiently. Our actions include hiring and training new employees earlier, improving supplier, delivering quality and ensuring appropriate inventory levels.

Now let's review our 2017 accomplishments. In 2017, we finalized comprehensive agreements with Boeing, which established pricing through 2022, removed the uncertainty, reset the relationship with our largest customer, enabled more collaboration on new technologies and created opportunities to bid on additional work packages.

Separately, Spirit stoop up a full-time program office to develop technologies for next generation aircraft and we will be working aggressively to win work packages on new programs with all our customers. We also laid the groundwork for future growth by announcing expansion plans for fabrication and defense anticipating growing each to $1 billion annually.

For our fabrication business, we are expanding our capabilities. In Wichita, we developed a center of excellence for five-axis machining and chemical processing. In McAlester, Oklahoma, we developed a center of excellence for three- and four-axis machining and we expanded our Malaysia's site for complex assemblies.

For our defense business, we are building up a strong foundation of current programs, including the P-8, the KC-46 the CH-53K, the V-280 and the B21 as well as identifying additional opportunities for growth in this sector. Spirit is a strong value proposition for our military customers, including competitive cost manufacturing, application of commercial best practices and design-build capabilities. We also made excellent progress on reducing our supply chain costs. We had a very rigorous and structured program driving improvements in our supply chain which begins with a process that we call clean sheets which is a view of what the cost of every part should be. During the course of the year, we reset contracts on over 20,000 parts at globally competitive prices.

We'll realize those benefits over the course of the next 10 years and they will help offset some of the headwinds we face in our industries such as escalation in material and labor as well as customer price step-downs. Our intensely competitive global industry also requires that we stay at the forefront of technology innovation in products and manufacturing processes.

We announced a major win with Airbus this year to supply the spoiler for the A320 program. The new spoiler leverages our state-of-the-art capability in Resin Transfer Molding technology, a cutting edge approach to composite fabrication without the expensive use of autoclaves. We also accepted an invitation to join NASA's Advanced Composite Consortium as a Tier 1 member. This consortium is a public-private partnership focused on progressing knowledge of composite materials and improving performance of future aircraft. This membership gives us an exciting opportunity to contribute and collaborate with other industry leaders and ideas that will benefit our customers in the aerospace industry as a whole.

We also became a member of the A*STAR aviation technology consortium in Singapore and expanded our R&D initiatives in Scotland in collaboration with Scottish Enterprise.

In addition we entered into a partnership with Norsk Titanium to produce 3D printed titanium components for commercial aerospace. Norsk's rapid plasma deposition technology will be used to build parts at a near-net shape, reducing waste, using less energy and reducing product cost for up to 30%. These are just a few examples of how we are collaborating with industry and technical partners to develop innovative solutions that benefit our customers and help position Spirit as an indispensable partner in future programs.

2017 also marked the celebration of many milestones with our customers including the first flight for the 737 MAX 9, the 787-10, KC46 tanker and V-280. All programs and with Spirit has significant work packages.

Turning to guidance now for 2018. For 2018 our guidance on revenue is between $7.1 billion and $7.2 billion. And guidance on earnings per share is between $6.25 and $6.50 a year-over-year improvement of 22%, which includes the impact of the ASC 606 revenue recognition changes as well as the lower effective tax rate.

We expect free cash flow for 2018 to be between $550 million and $600 million. We intend to reinvest substantially all that savings from tax reform in high-return capital expenditures and R&D to support our growth initiatives. In addition, we are also increasing investment in workforce development and accelerating productivity initiatives. All of these investments will deliver high rates of return.

Let's turn our focus now to 2018 strategic objectives. Commercial aerospace benefits from a number of strong fundamentals, most importantly traffic growth, which was exceptionally strong and robust growing at over 8% in 2017.

We continue to have a lot of confidence in our business and our ability to operate in a strong global market with high demand. Our strategic objectives are aligned to capitalize on the opportunities provided by this industry strength. The first is operational execution. First and foremost, we will continue to execute the multiple production rate increases in 2018 meeting our targets and safety quality, delivery and cost. In 2018 production rate for 737 will increase to 52 aircraft from us.

For reference, we were producing at 21 aircraft per month in 2005, when we split from Boeing. The A350 will increase to 10 aircraft per month in 2018 and we'll work on increasing the 787 to 14 aircraft per month. We are on track to raise the A320s to 60 aircraft per month in 2019. All of these rate increases will create significant operational challenges, but we will maintain our emphasis on flawless execution as we build trust with our various stakeholders.

Our second strategic objective is growth. Our revenue guidance for 2018 will deliver approximately 3% organic growth in line with our targets. Meeting our operational commitments to our customers will position Spirit to win profitable new business whether it be a clean sheet design or just a statement of work on an existing or new platform. We're also investing some of the savings from tax reform in advanced technology and manufacturing techniques on next generation aircraft as differentiators for future growth.

I've already discussed two of our major growth initiatives in terms of expanding fabrication in defense. We have previously said that we intend to target each to $1 billion. During 2018, we expect fabrication to achieve $650 million in value and for defense to generate about $500 million in revenue both double digit percent increases over 2017.

In addition, we continue to explore inorganic growth targeting opportunities that will give us more Airbus content, more military content in an expanded low-cost country footprint. As I've mentioned in the past any potential M&A activity must meet their strategic objectives, as well as our internal return thresholds.

Our third objective is culture. Last year, we rolled out a new set of values at Spirit emphasizing transparency, collaboration and inspiration. These values reinforced the core elements of our DNA including safety, quality, delivery and customer focus. While any culture change is a lengthy journey, employees will begin adapting and incorporating these values into their everyday activities, our goal is to create a culture to attract, retain and develop our world-class teams.

Our fourth objective is meeting commitments and margins in productivity. For long-term success in our industry, Spirit must continue to have a competitive cost structure. In 2018, we are targeting further supply chain productivity that utilizes our clean sheet process as well as an increased focus on improving internal productivity through increased automation and further digitization.

Fifth and finally, our goal is to be a trusted partner. Spirit's brand is to be a trusted partner to all of our stakeholders, which include customers, employees, suppliers, shareholders and in the communities in which we operate. This focus will be the foundation for our continued success for many years to come. So after a strong performance in 2017, Spirit is well-positioned heading into 2018. We will continue to improve our operational execution as we meet the rate increases of our customers and accelerate our growth initiatives.

With that, I'll ask Sanjay to lead you through the detailed financial results. Sanjay?

Sanjay Kapoor

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

Thank you, Tom, and a very good morning, everybody. Let me take you through the details of our 2017 financials as well as our outlook for 2018. So let's start on slide 4. Revenue for the year was $7 billion, up from the previous year driven by higher production deliveries in the 737, the A350 and the Airbus A320 programs, as well as increased defense-related revenue, partially offset by lower production deliveries on the 777 program and decreased aftermarket revenue.

For the year, we delivered a record 1,651 shipsets, including 532 737s, 136 787s, 70 777s as well as 608, A320s and 90 Airbus A350 shipsets. Backlog grew to $47 billion which provides top line stability and growth in the future.

Moving to slide 5. We reported adjusted earnings per share of $5.35 compared to $4.56 in 2016 and this represents a robust 17% increase year-over-year. 2017 adjusted earnings per share excludes the impact of the MOU with Boeing that was formalized in Q3 2017 and also the impact of the tax reform legislation that was signed in December last year.

The earnings per share improvement year-over-year was driven by both our overall execution as we met all our delivery commitments and customer requirements in quite a challenging environment and a lower share count as we aggressively executed our share repurchase program. As many of you know we are experiencing unprecedented levels of rate and mix changes across our core programs. And this is truly hard work.

So while 2017 was a good year and the team did a great job meeting these challenges, we did absorb additional costs ramping to these new rates and mix changes particularly on our core 737 program due to higher levels of hiring and overtime, training costs, some disruptions due to tight supply chain deliveries as well as new initiatives to drive higher levels of quality in our factory, which would all pay good dividend in the future but do cost more in the near-term.

Turning to free cash flow on slide 6. Adjusted free cash flow for the year was $537 million compared to $420 million in the same period last year, reflecting a 28% increase year-over-year. Compared to 2016, adjusted free cash flow growth was driven by several items both positive and negative. Positive changes were driven by operational performance, a focus on working capital, and benefits in cash taxes and offset by negative impacts due to the increased advance repayments as well as higher capital expenditures.

Capital expenditures for the year was $273 million compared to $254 million in the same period last year. As we continue to increase the investment in ourselves both for rate increases as well as in areas where we believe we can improve productivity and make ourselves more competitive for the future. Our focus on generating strong free cash flow remains as we continue to demonstrate year-over-year improvement in a tough environment.

Turning next to capital deployment on slide 7. In 2017, we repurchased 7.5 million shares for $502 million or 6% of our outstanding shares and also paid $47 million to shareholders through dividends. For the second year in a row, we returned over 100% of our free cash flow to shareholders. Our board of directors has now authorized an increase to our share repurchase program for a total authorization of up to $1 billion.

As always, our first priority is to invest in ourselves as often these investments bear the best returns, but we also continue to look at acquisition options that match our stated objectives of enhancing our diversification as well as making us more competitive. In the absence of other uses of cash that meet our internal return thresholds, we expect to continue to return our free cash flow to shareholders through repurchases and dividends in 2018.

Now, let's look at our segment performance. And for the Fuselage segment results, let's turn to slide 8. Fuselage segment revenue in 2017 was $3.7 billion, up 7% from $3.5 billion in 2016, primarily due to higher production deliveries on the 737 and the Airbus A350 programs, increased nonrecurring and defense activity, partially offset by lower production deliveries on the 777 program and lower aftermarket activity.

Operating margin for the year was 9.3% as compared to 13.4% last year, primarily driven by the forward loss charge recognized on the 787 program. On a normalized basis after reversing change in estimate impact as well as the impact of the Q2 MOU with Boeing Fuselage segment margin was 15.6%. On the A350 program, we delivered 25 shipsets in the fourth quarter or 90 shipsets for the full year compared to 69 shipsets in 2016.

The Airbus A350 team also reached the 200 delivery milestone in the fourth quarter of 2017. Deferred production balance on the A350 increased by approximately $100,000 per shipset in the fourth quarter, but this was primarily driven by onetime claims, excluding these onetime costs, our core performance in the quarter was an improvement of approximately $700,000 were shipset. And as Tom mentioned 2018 will be a critical year as the Fuselage teams prepare to execute multiple production rate increases.

Now, turning to slide 9 for our Propulsion segment results. Propulsion segment revenue in 2017 was $1.7 billion, down from $1.8 billion in 2016, primarily driven by lower production deliveries on the 777 program, decreased aftermarket sales, partially offset by higher production deliveries on the 737 program.

Operating margin for the year was 16.5% compared to 18.3% in 2016, primarily driven by the forward loss charge on the 787 program. On a normalized basis, after reversing change in estimate impact, as well as the impact of the Q2 MOU with Boeing, Propulsion segment margin was 18.8%.

For our Wing segment results, let's turn to slide 10. Wing segment revenue in 2017 was $1.6 billion, up from $1.5 billion in 2016, primarily due to higher production deliveries on the 787, A350 and A320 programs partially offset by lower production deliveries in the 777 program. Operating margin for 2017 was 13.5% compared to 14.8% in 2016, primarily driven by the forward loss charge on the 787 program and offset by higher production deliveries on the A320 program. On a normalized basis after reversing change in estimate impact as well as the impact of Q2 MOU with Boeing, Wing segment margin was 14.5%.

Turning to the next slide, I wanted to touch on a couple of accounting changes that and the impact on revenue, earnings and segment margins you will see in our 2018 reporting. This is due to the adoption of ASC 606 and ASC 715 related to pension. We have provided detailed disclosures on these topics in our filings. But wanted to highlight the ASC 606 impacts, which will primarily be on deferring revenue on the 787 program and recognizing earnings on the A350 program.

As I mentioned last quarter, the 787 forward loss relates to costs greater than revenue in front of us and thus the program will continue to reflect zero margin performance. In addition, given price step-downs that are contractually negotiated on the 787 program in the future, we will defer some revenue to later years to match our performance obligations on those deliveries.

In contrast, the forward loss on A350 relates to activity that is behind us and thus will adjust through retail earnings in the transition adjustment to ASC 606. The A350 will no longer be booked at zero margin going forward and earnings will result directly from revenue less cost on a unit by unit basis. This will therefore be accretive to earnings per share.

The change on the A350 along with shortened accounting contracts on some of our other programs will likely lead to variability in quarterly earnings per share going forward. For example, we expect first quarter EPS to be lower compared to other quarters, due not only to higher production rates later in the year, but also due to shortened accounting contracts which are absorbing a higher percentage of the near-term cost increases to support these rate. In addition, the A350 program will have higher contributions from margins and earnings per share as it continues down the learning curve in the second half of 2018.

Another impact on earnings and segment margin in 2018 is related to the changes in pension accounting. On our overfunded frozen pension plans, we generate pension income that was previously recorded inside our segment reporting and now under ASC 715 will be reflected in other income. This change will thus be dilutive to segment margins.

Uniquely on the 787 program which is in a forward loss position. We will record the entire value of the pension change, up to line unit 1,405 in Q1 of 2018, but only record corresponding offsets in other income on an annual basis. This forward loss is in the range of $15 million to $20 million and will be taken in the first quarter of 2018 as we adopt ASC 715. This impact has been fully assumed in our 2018 earnings per share guidance. Over the long-term, this change in pension accounting will have no effect on overall income. And finally and more importantly, these accounting changes do not impact free cash flow which remains a core measure for us.

Turning now to slide 12. We are guiding revenue to be between $7.1 billion and $7.2 billion, earnings per share to be between $6.25 to $6.50 and free cash flow to be between $550 million to $600 million. And our guidance is based on an effective tax rate of 21% to 22%.

One important note on our cash flow guide which obviously incorporates the Tax Cuts and Jobs Act that was legislated recently by Congress. We believe that the best way to utilize and amplify the benefits of this tax change is to reinvest in our company and as a result, we have decided to significantly elevate our capital expenditure and R&D in 2018 as compared to previous years.

In total, these higher investments should be in the range of $75 million and will focus on improving productivity in our factory but also fund technology development that should make us more competitive and stronger as we bid on future platforms for commercial and military programs that are now emerging. All these investments will make us a stronger and more diversified company in the future and will contribute to our long-term success.

So with that let me hand it back over to Tom for some closing comments.

Thomas C. Gentile III

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

Thanks, Sanjay. 2017 was a strong year for Spirit as highlighted by strong deliveries, the completion of the Boeing agreement, the launch of our growth initiatives in fabrication and defense and the continued emphasis on total capital return for our shareholders.

During 2017, we grew earnings per share 17% and grew adjusted free cash flow 28% while delivering more than 100% of our free cash flow to shareholders through share repurchases and dividends for the second year in a row.

In 2018, our focus will be on operational execution of planned rate increases, achieving our growth initiatives and meeting our commitments on margin and productivity. Our guidance for 2018 anticipates continued revenue growth, an increase in EPS of 19% to a range of $6.25 to $6.50 and an increase in free cash flow to a range of $550 million to $600 million, which is within our long term target of 7% to 9%. We will continue to evaluate this long term target in light of the positive impact of tax reform.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Finbar Sheehy with Bernstein Research. Please go ahead.

Finbar Thomas Sheehy, CFA
Analyst, Sanford C. Bernstein & Co. LLC

Q

Good morning.

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

A

Good morning.

Finbar Thomas Sheehy, CFA
Analyst, Sanford C. Bernstein & Co. LLC

Q

You've mentioned just there that you are planning to invest an additional $75 million, I guess, in CapEx and R&D in light of the lower tax rates. Last quarter you said that you were already making or planning to make all the investments that you need and that you need to be careful with CapEx in order to achieve fixed cost absorption for the productivity agreements or to match the productivity agreements you have with Boeing. Can you expand on how the tax rate change changes that calculus and tell us what is it that you're planning to invest in, are you accelerating things or you're doing additional things you wouldn't have done otherwise?

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

A

Well, what the tax reform gave us was an opportunity to take a look more broadly at opportunities, which before weren't necessarily in focus. And so what we did as we said now that we have these additional funds in 2018, how can we accelerate some of the initiatives that we had been planning, but hadn't been able to execute in the past. Let me give you some examples of that. So for example in the capital area as Sanjay was saying and I was highlighting, the rate increases are – are a significant operational challenge. And so, we've been looking for ways to make that more efficient.

And one of the ways to do that is to drive some more automation to support the rate increases. So, we're investing in new capital that will help improve our drilling and fastening, as we go up in rate. We're also looking, for example, to consolidate a lot of our warehousing, which takes up a lot of space in our campus right now. So, by doing that, we will free up new space across our campus, which will allow for more growth and expanded rate. So, for example, we've talked about growing our fab business. This year, we're going to look at making investments to improve and increase our centers of excellence in areas like material cutting, 3-D printing, as well as new machining capabilities. We're also upgrading the infrastructure on our campuses in areas like Wi-Fi or uninterrupted power supply things that will help drive productivity as we go up in rate. So those are just some of the ways that we're using these funds to be more productive and also to drive growth in the future.

The other area that we've mentioned is research and development. And with the tax increases it really gave us an opportunity to relook at our R&D. As I said in the past, we probably didn't spend enough on R&D and now is really a great time to accelerate those investments. Especially as some of our biggest customers are considering their next generation of aircraft like Boeing with the NMA, and Airbus thinking about their [ph] Wings of the Future or their Fuselages of Future (00:31:12) for the next generation of aircraft. So one of the things that we had done last year stood up an engineering team to look at how we could leverage all of our technologies to capture some more packages on these new programs. And we've actually accelerated that and increased it.

So, we focus on – we call them seven distinctive capabilities in R&D and we've really accelerated our activity in all of these areas to develop new architectures, new types of tooling, material optimization, new structures, and accelerate our learning curves. And all of this it really requires some additional funding in R&D. So we expect we're going to get a lot of return on these investments and with the tax reform it was just the right time to pull the trigger and accelerate these initiatives.

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

Finbar, I hope that answers your question there.

Finbar Thomas Sheehy, CFA
Analyst, Sanford C. Bernstein & Co. LLC
Q

I think it mostly does. Maybe just one quick follow up; are you thinking of this then as more of an acceleration of kind of the same plans into the nearer term or should we think about this as being a higher level of CapEx in R&D will make sense going forward for some period of time now than you would otherwise have had?

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

This is really an acceleration. I mean as you know we always have a whole pipeline of activities and ideas and projects for both productivity and growth. And with the tax reform we just had an opportunity to accelerate those things into 2018. And as I said, we'll take a lot longer term at what the full impact of the tax reform is and make decisions about the future going forward. But this was just an opportunity to accelerate some of these ideas that we already had and start them right now in 2018.

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

Yeah, Finbar, I don't think we are guiding for 2019 or anything like that, but this is 2018, we are accelerating activity and we'll see what we do in 2019 based on projects and available options at that stage.

Finbar Thomas Sheehy, CFA
Analyst, Sanford C. Bernstein & Co. LLC
Q

Okay. Thanks.

Operator: The next question comes from Seth Seifman with JPMorgan. Please go ahead.

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

Good morning, Seth.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Good morning. Thanks very much. I wonder if you could talk about you know the outlook for – in cash from operations. I mean I would think that – just the elimination of the A350 advance payments could get you pretty far into the range from last year to this year. And the business is growing and some of the tax reform investments will happen in CapEx rather than cash from ops. So, I wonder if you can talk about some of the puts and takes in terms of bridging 2017 to 2018?

Sanjay Kapoor

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

A

Sure, sure. Seth, that's a fair question. And let me give you some sort of typical tailwinds and headwinds as to try and compare 2017 to 2018. So you're absolutely right, the A350 both in terms of number of deliveries and as I mentioned in my prepared remarks we're walking down nicely on the curve and decreasing our deferred and generating cash there. But also in the context of we finished finally, thank god, the advance repayments on that program. So that clearly is a tailwind for us into 2018, along with the 737 volume and the MAX activity.

Having said that don't forget the headwinds we have in 2018, [ph] we have all (00:34:31) coming and I have to emphasize that 777 volume is significantly lower in 2018 compared to 2017. We both talked about that as these rate increases are happening we are building more inventory and we're building more inventory for a variety of good reasons to insist on some stability in our factories as well as match what our customers' ramp up needs are. And physical inventory kind of grew in 2017, it's going to grow continuously in 2018 as well.

I will also tell you that like I said in my prepared remarks we do face the headwind of price step-downs on 787, which happened later in the year. And then last but not the least even though the tax rates have come down, our cash taxes 2017 versus 2018 is a headwind for us. And again these are the nuances of cash taxes but in 2017 driven by the forward loss on 787 was actually a benefit. And then there are certain other triggers associated with the 737 MAX that raised our taxes in 2018 compared to 2017. So, overall cash taxes year-over-year are actually a headwind.

So, if you factor in all of that, it's consistent with what we kind of laid out with all of you that we want to focus on cash flow and show year-over-year improvement. The tax benefit so to say we've decided to invest in ourselves. That's how I would answer that question and hope that helps.

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Q

Absolutely. Thanks, Sanjay.

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

Cai von Rumohr

Analyst, Cowen and Company, LLC

Q

Yes, thank you very much. Maybe you could give us some color; you had $32 million of forward loss reversals, $19 million of negative cum catches I assume the negative cum catches were on the (sic) 37 [737] (00:36:24). But where were the forward loss reversals, because on the A350 the new accounting impact presumably won't take place until this quarter?

Sanjay Kapoor

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

A

Thanks, Cai. As always you're keeping us [indiscernible] (00:36:38). So you're right, the negative cum cash unfortunately is on our core 737 programs. And like both Tom and I talked about it we are incurring higher costs as we are managing the rate increases, which are never easy. We always talk about it internally as it's a good problem to have, but it's certainly a challenge.

The forward loss reversal relates to the 787 program, if you recall back earlier last year, we had talked about the fact that if Boeing was to go to higher rates and they did announce in the third quarter to go to 14 aircraft a month, we did our homework and analysis on that. I think at the Investor Day, Tom might have guided you that it's somewhere around $25 million to $30 million reversal. We actually did our math, it's close to $40 million. And that was the forward last reversal in the fourth quarter and it relates to the 787 going to 14 per month.

Cai von Rumohr
Analyst, Cowen and Company, LLC
Q

Thank you very much.

Operator: The next question comes from Carter Copeland with Melius Research. Please go ahead.

Carter Copeland
Analyst, Melius Research LLC
Q

Hey. Good morning, guys.

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

Good morning, Carter.

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

Good morning, Carter.

Carter Copeland
Analyst, Melius Research LLC
Q

Just to clarify because I want to make sure we get this right. And I know you don't want to guide for 2019, but with respect to the CapEx, is it fair to characterize 2018 as something above what you would consider a normal level?

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

Yeah. I think that's a fair characterization. We're sitting here right now at the beginning of the year and we've got some unique opportunities in front of us related to for example, investing in R&D for the NMA and other Airbus programs as well as defense programs, in addition to the fabrication and defense opportunities, so those centers have excellence that I mentioned. So 2018 as we come out of the blocks we have the tax reform benefits and we have these ideas and we thought now is the right time to initiate those.

Carter Copeland
Analyst, Melius Research LLC
Q

I totally get it – just within the context of the percentage of revenue target that you had laid out in the past, this is a one-time-ish sort of opportunity. With respect to what these projects are and thank you for the examples, in terms of you know the IRR hurdles, was there something – is there something unique about these that made it not invest – you didn't invest in them in the past or they're newly identified or any context you can give us around that?

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

A

No. I mean, these are projects that are all well in excess of our return thresholds for new investments. And it's like anything you always have a huge pipeline and you draw a line at a certain point for a whole variety of reasons, and you say I can invest in these not those and with the tax reform benefits, we are able to draw that line a little bit lower and pull some more projects into 2018.

Carter Copeland
Analyst, Melius Research LLC

Q

Okay. Totally fine. And just one last one, Sanjay on the on the unfavorable cums, I mean clearly that that number was bigger than, I think we've seen in several quarters. I know there's a lot of stuff that moves around in that. Is there anything that 737 NG versus 737 MAX related in that that's worth noting or not?

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

A

No, I think that's fair. I mean, both Tom and I have talked about this, I mean, we're handling not just rate increases, but actually it's rate changes, some rates are going up, some rates are sort of staying static and some others going down, actually. But it's also the mix changes, and if [ph] you really (00:40:11) take the number of model mix changes inside the 737 between the MAX and the various models associated with MAX, it does create a certain level of challenge in our factories as we manage this in terms of productivity and supply chain and so on and so forth.

So these higher costs is what manifested itself in the fourth quarter, now like Tom said in his remarks I mean, we've taken – a lot of lessons learned here, we are applying them, we are hiring earlier, we're training better, we are trying to make these changes so that at the end of the day, we will make our deliveries to our customer, that's the most important thing you bring to the table. But we are bearing some additional cost as we are doing that, right.

Carter Copeland
Analyst, Melius Research LLC

Q

Great. Thank you for the color, gentlemen.

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

A

Thanks, Carter.

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

A

Thanks.

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 & Director, Spirit AeroSystems Holdings, Inc.
A

Good morning.

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

Hi, Rajeev.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

First, a quick clarification in terms of some of these headwinds that you're highlighting, is that showing up in these higher CapEx and R&D dollars or the higher CapEx in R&D is really just focused on accelerating investments, that's the first one.

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

Well, as I said the accelerated capital expenditure is really about accelerating those investments in things that we had already identified that are aligned with productivity for rate increases and also growth in areas like fabrication and defense.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

Okay. And then, as it relates to some of the headwinds that you're highlighting on the 737, how is the impacting your guide for 2018 if at all? That's the main one.

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

Right. Well, as Sanjay said 737 is going up in rate, which is great, but there's a lot of complexity in terms of the model mixes with MAX starting to really ramp-up significantly and NGs is coming down, there's many variations of each of those. And so, as we go through these rate increases, we see some part disruptions. We've got to hire a lot of people. And because of the quantity of people we're hiring, it's difficult to get people with the kind of mechanical experience that we had in the past. And so, there's a little bit more overtime to compensate. Now, everything in terms of these disruptions and challenges is already incorporated into the guidance for 2018.

So, we had some challenges in 2017. We're starting the year recovering from those challenges, but we fully expect to get back into control as we get into that early to mid-part of the year and achieve the rate increases for this year. But, we're doing a lot of things to offset that. So for example with recruiting, one of the things Sanjay mentioned is we're hiring people in earlier. So we've already started hiring for the rate increases in 2018. A lot of people are on board. We're doing more training, we've almost doubled the amount of time we do for orientation training. We've put more first line managers onto the floor. Another thing that we did for example is we're bringing retirees back, some recent retirees who have a lot of experience with our products to service on the job trainers. So, they are actually on the floor next to the new recruits answering questions, helping them through their initial weeks. So that they don't have to disturb the existing workers and we can be more productive overall. So, we're trying to take a lot of these actions to get in front of the rate increases, but we've incorporated all that into our guidance for 2018.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Very helpful. Thank you, Tom.

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

Audrey Preston
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. It's actually Audrey Preston on for Rob Spingarn. So we've been seeing some double-digit aftermarket growth across the industry this quarter and I was just wondering if you could expand on what caused some of your aftermarket revenue to decline? Thank you.

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

A

Sure. So, as you know we're in the structures business and so structures doesn't have a lot of aftermarket normally, I like to always say we build things right the first time, so they don't require aftermarket repairs. But that said, we've gone through a number of changes in terms of our aftermarket. In particular, we changed the nature of the relationship we have with the market, with regard to Boeing. So, in the past we had a part manufacturing authority license, we sold directly to airlines and so some of that was incorporated last year into those aftermarket numbers as well as some changes in our [ph] rotable pools (00:44:46) that we had.

What Boeing wanted to do as they are growing their service businesses, they want to have the interface directly with the customers. So, we no longer sell directly to the customer we sell through Boeing and that did result in some short term reductions in revenue. Aftermarket is never going to be a huge part of our business. We are in the structures segment, but it's a solid part, there's good profitability and we will see reasonable growth, but off of these levels. And there was a little bit of a reset based on the change in the relationship with Boeing from last year to this year.

Audrey Preston
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you.

Operator: The next question comes from Sheila Kahyaoglu with Jefferies. Please go ahead.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Hi, good morning and thanks for taking my question.

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

A

Good morning.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Can you maybe talk about the profitability across the segments over the near and medium term? How do we think about some of the mix matters that you mentioned with the 777 rate declines, the A350 [ph] rev-rep (00:45:41) change and the potential for that platform in terms of profitability? And then on the 737 production rate hike and the mix shifts?

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

A

Right. Let me just provide a high-level comment on that. And I'll let Sanjay, go through some of the details.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Sure.

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

A

But in our industry as we've said in the past you have to run very fast just to stay in the same place. And so we've got a lot of supply chain initiatives. I mentioned that we've reset prices on over 20,000 parts and so we've got a lot of savings baked in over the next 10 years. For the most part those savings offset some of the headwinds that we naturally see across all of our segments. So, escalation in material and labor as well as the customer step-downs on price, for example we've talked about productivity discounts that we agreed with Boeing on 737 as rates go up, and we also talked about price step-downs on the 787 in the out years.

Now, the good news is that the productivity that we're seeing from our supply chain initiatives in particular are offsetting some of those productivity discounts and the price step-downs in 2018 and beyond. So, we're going to – our goal is to try to maintain margins in the face of those headwinds by driving those productivity initiatives particularly in areas like supply chain. So Sanjay, maybe you can just provide a little bit more detail.

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

A

Yeah, Sheila. I think like I said in my prepared remarks and I was trying to give you a little caution that again with the 606 changes there will be some variability every quarter now. Because unlike in the past where you had long blocks and you booked a certain margin over a number of units, now you will see results that reflect performance in much shorter window. So there will be some variability. And in addition, because A350, fundamentally generates margin going forward, you will see the impacts with that on the Fuselage and in the Wing segments.

Having said that, again the A350 is going to go through a learning curve, so that's going to start off slow and end up at higher numbers naturally as you would expect. So, I'm not sitting here and giving you guidance for quarter-by-quarter or for the full year, you'll see the tracking, it's baked into our guidance in the earnings per share numbers that we gave you. We're comfortable with that but just wanted to caution you that you will see a little bit of movement around.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Great. Thank you.

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 & Director, Spirit AeroSystems Holdings, Inc.

A

Good morning, Sam.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

You've talked a lot about the fabrication, defense and Airbus is kind of the opportunity for inorganic growth. Can you just talk about what you're seeing in terms of the M&A pipeline? There's obviously some big suppliers in the public markets that have come up, but just you know what are you seeing and should I presume that if you don't buy anything that we – that all of the cash will go back in terms of buyback this year?

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

A

Right.

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

A

Well, it's – there's a lot of activity out there right now, Sam. And as we said we're keeping our focus very narrow. We view ourselves as the structures business, first and foremost. And so, what we're looking for is Airbus content, military content low-cost country footprint. And working with a lot of people on Wall Street, we've really done a very thorough review on everything that's out there and continue to look to see what would be a good fit that not only meets the strategic objectives, but also our return thresholds.

Now, that said, valuations if you look at any of the statistics are at really multi-year highs right now. And so, we want to grow inorganically, but we don't want to do it in a way that is going to be at returns that aren't meeting our threshold. So we're going to be very judicious and make sure it meets not only our strategic objectives but also our return thresholds.

And you're right, if we don't see a significant acquisition opportunity, we will continue to use our free cash flow for share repurchase and dividends like we have in the past. And we're proud about the fact that for last two years, we basically returned more than 100% of our adjusted free cash flow to shareholders in the form of the share repurchases and the dividends.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC
Q

Thanks. And Sanjay, if I can just follow-up on the 606, you talked about the 787 and revenues getting pushed out later in time. How does this ultimately affect your free cash flow as a percentage of revenues, if it shifts the revenues a little bit you've talked about the 7% and 9%, does that change at all now with the ASC 606 accounting?

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

Yeah. Well. Clearly, the top line does reduce, Sam, but it's very small, I mean, it will depend on the number of deliveries we make on the 787 primarily and it's in – probably in the range of $30-ish million a quarter, so it's a very small change to the top line. The ranges that we've guided you for our free cash flow as a percentage of sale is still intact.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC
Q

Thank you.

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

George D. Shapiro
Analyst, Shapiro Research LLC
Q

Yeah, good morning.

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

Good morning.

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

Good morning, George.

George D. Shapiro
Analyst, Shapiro Research LLC
Q

Sanjay, if you look at the balance sheet at the end of Q3, you had like $98 million of legacy credit there which I would have thought is somewhat of a hedge against the problems that you're seeing in the ramp up on the 737 MAX. So if you could just explain why that credit wasn't reduced or maybe it was reduced?

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

Yeah.

George D. Shapiro
Analyst, Shapiro Research LLC
Q

And then the second one for Tom, is given the problem that you had in the ramp up with – to the MAX, you mentioned how you're seeing ramp-ups in many other programs in 2018. What's the confidence that you have that we don't see further problems on those programs? Thanks.

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

A

Sure. George, the quick answer, and I'll let Tom answer the next one, but the quick answer on the credit, it's really related to 787 only, it's not the 737 like it used to be in the past. It's the 787 program. And I'm sure our IR team can take us through the details of that if you have further questions on this. But Tom, you might want to answer the -

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

A

Yeah. So, the ramp up to the MAX as I said did create some challenges that we're working through. And it's not just because of the rate increases because of all of the mix changes at the same time. That said, I would say we are very confident that we are going to work through these and be in a controlled situation very early in 2018. I mean we have a strong operating team on the factory floor and we're augmenting that in a number of ways like I mentioned. We learned a lot over the last couple of years as we've gone up on these rate increases for the first time in a while.

So, we've increased the number of frontline managers that we have. We're doubling our training programs. We're putting rapid response teams on the floor. We're digitizing and automating much more. So we feel very confident that we're going to manage through these situations and meet the rate requirements. I mean the one good thing about last year, as we met all the delivery requirements of our customers. And so, we've talked about being a trusted partner. That means that we sometimes have to go to extraordinary means to ensure that we keep those deliveries going at the right levels of quality while maintaining a safe work environment. So, I'd say that level of confidence is very high.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Okay. Thank you.

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

A

Thanks, George.

Operator: The next question comes from Jon Raviv with Citi. Please go ahead.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

Hey good morning, thanks for taking the question.

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

A

Good morning.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

On the – just to draw on those pressures, around those – on those issues with the production ramp, that's something that you guys have pretty good visibility on, Boeing and Airbus give you pretty good heads up in terms of when things are going up. So, how would you characterize some of the issues you encountered? Sounds like there was [ph] no fee internal (00:53:45), was there any external issues that still have to be rectified there?

And then also given all that growth ahead and those challenges you're experiencing there, why would you want to go and take on something significant on an inorganic side if you have some of these organic growth levers to – to, I guess work on?

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

A

Right. Well, let me answer the first part. First in terms of the pressures, internally as I mentioned the hiring has been a challenge as to get the number of people to meet these rate requirements. Just requires a little bit more training and we have to start earlier. So that was really the internal pressures.

Externally, we deal with a very complex supply chain and we depend on our partners, the suppliers to meet these increased rates as well. And so they had some challenges and that resulted in some part disruptions, which we have to then cover in our factories. So, so those were just some of the challenges. And, the thing about it is, as I said I'm very confident, we've got these under control. We're on track to meet all of our rate requirements this year. And you have to do both in terms of growing. You have to grow organically and inorganically. So, we are going to manage through the factory challenges on the floor to meet the rate increases and at the same time, we're going to look for opportunities to grow inorganically. It's really [ph] often (00:55:06) and very different people working in those areas and at the end of the day, you have to do both in order to meet the requirements of the future.

And so we think we're well-positioned, we think we have the skills and expertise, we think there's opportunities. And if we find things inorganically that meet our strategic criteria and our return thresholds we feel confident that we can execute on those.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

Thanks so much, Tom.

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

A

Thanks.

Operator: The next question comes from Peter Arment with Baird. Please go ahead.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.

Q

Thanks. Good morning, Tom, Sanjay.

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

A

Good morning.

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

A

Good morning, Peter.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.

Q

Hey, Sanjay, just a quick one really just trying to understand what's assumed in the EPS guidance on from a buyback perspective? And then maybe you could just remind us kind of how you approach the buyback, as clearly the last two years you've been fairly active? Thanks.

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

A

Thanks, Peter. No, listen at this stage on the guidance everything that I know of is assumed into our guidance. And so we've talked extensively during the call today that says we are looking for investment opportunities and if they don't happen certainly we will return the money back to the shareholders and all of that is baked into our guidance. And like we have done in prior years, we'll see how the year develops and we'll certainly update you obviously in terms of what our share repurchase have been and we'll see how we are doing on that towards the middle of the year. But at this stage in the [ph] bounds in the book-ins (00:56:32) of $6.25 to $6.50, I've tried to bake in everything that I know of today.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. That's helpful. Thanks, Sanjay.

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

A

Gary, we have time for maybe one or two more questions.

Operator: Okay. The next question comes from Ken Herbert with Canaccord. Please go ahead.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.

Q

Hi, good morning. Thanks for taking the question.

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

A

Good morning, Ken.

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

A

Good morning, Ken.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.

Q

Tom and Sanjay, I just wanted to follow up just once more on your sort of pull forward or advance of some of the investment spending. Now, I can appreciate, sounds like you haven't obviously changed any of your return hurdles. Sounds like there's an opportunity now, but I think, it is a fair question to at least see if you can provide any more color without specific guidance on sort of post-2018 on returns or how you think these investments perhaps clearly better position you for maybe market share gain, better position you for further cost outs. I mean I know you went through a number of items? But, I think there's a bit of a perception that maybe opportunistic spending and [ph] and after (00:57:36) you're lowering your thresholds at all, but I think it is fair to get a little more detail on how you expect to or what does it mean down the road for the organization?

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

A

Well, Ken, again we're not really projecting out anywhere beyond 2018, so nothing for 2019 and beyond. This is really taking a look at opportunities that we felt we had right now to do two main things. One is drive efficiencies in our factories as we ramp-up in rate.

And the second is to help accelerate some of the growth initiatives that we've been talking about. And so all of the projects I described really do one of those two things. And with the tax reform, we felt that there was an opportunity to just accelerate these initiatives and put them in place right now, so that we can start to reap the benefits. And all of them have very good returns, which will play out in the future.

Now, what we do with the tax reform savings so to speak in the future, we'll determine that going forward. But the decision we made this year was to just accelerate those initiatives and get the benefit. And it was particularly a good time to do it because the OEMs, right now our biggest customers are really thinking through their future development strategies in new aircraft. We probably underinvested in the past in R&D. And so, it's a good time as we standup this engineering team to accelerate some of our R&D initiatives, so that we make sure we have the best in the most innovative ideas for the next generation programs.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.

Q

Okay. Thank you. And it's fair to assume that you do see some benefit from these even in fiscal 2018 perhaps?

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

A

Yes, absolutely. I mean all of the things that we're doing in terms of capital expenditures will help our performance in this calendar year.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.

Q

Okay, great. Thank you very much, Tom.

Operator: Would you like to take one more question.

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

A

Yes. One last question, please.

Operator: The next question comes from Hunter Keay with Wolfe Research. Please go ahead.

Hunter K. Keay
Analyst, Wolfe Research LLC

Q

Thanks for squeezing me in, appreciate it guys. With the Boeing agreement finalized now where are you in the process of harvesting cost savings from the supply chain now that's behind you. And I know we're going to quantify that in percentage basis and how long is that going to take to sort of hit a good run rate going forward?

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

A

Right. Well, as we've always said, it's a little bit like painting a bridge, as you go through a whole wave and then you basically start over again. Our contracts tend to be for about five years and so every year about 20% of those come due. And we've been at this for two years or so. So, we're more than 40% of the way through. I mentioned that we have reset prices on over 20,000 parts and so we're seeing excellent savings in that. At the same time I think we're developing even closer relationships with our partners in the supply chain.

And so many of the suppliers are winning new packages, the ones that have historically been very good in quality and delivery, are the ones who are winning as they get more cost competitive. So, we feel very confident about where we are and going forward. Now, as I said though those savings are going to be helping us offset the headwinds that we face. So, as we negotiate new contracts, we'll see the benefits of those over the next 10 years. But in the meantime, they're offsetting the productivity discounts that we are delivering to our customers as well as the customer step-downs.

So, our goal is to maintain margins and try to expand them, but in principle, trying to offset those headwinds that we see each year. And so far, I would say we've been very successful in doing that.

Hunter K. Keay
Analyst, Wolfe Research LLC

Q

Great. And one more quick one, since I'm last. You mentioned obviously low-cost country manufacturing, maybe a silly question but does the U.S. qualify now with tax reform or is that the commentary on many, many other things? Thanks so much.

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

A

It's better. There's no doubt about it. It's going to be a lot more beneficial to invest in the U.S. in the future. And now I'll just give you one story about low-cost country footprint. We're looking for a low-cost country footprint for three- and four-axis machining and we've looked all over the world in Southeast Asia and Mexico. We actually found a company in Mexico that was very low cost, very competitive, we looked to buy it, we looked to partner, couldn't make anything work, but they were actually willing to sell us the machines. So we bought the machines from the Mexican company, took them across the border and we've put them in McAlester, Oklahoma, which has very competitive workforce. And that's where we've established are our three- axis and four-axis center of excellence.

And I'll tell you why it works. The labor rates aren't necessarily lower in Oklahoma than they are in other parts of the world. But the workforce is a great workforce and what they're able to do is one operator can operate up to four or five machines. And so that really eliminates labor cost as an issue. So it's about productivity, it's about investment. The tax reform definitely helps, but what I would say is, we've got great workers in Oklahoma, in Tulsa, in Wichita and Kinston and so we're going to continue to invest in those areas to grow.

Hunter K. Keay
Analyst, Wolfe Research LLC

Q

Thanks, Tom.

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

A

Thanks.

Kailash Krishnaswamy
Head of IR, M&A and Strategy, Spirit AeroSystems Holdings, Inc.

This concludes our earnings call for today. Thank you all for participating.

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