Corrected Transcript

14-Mar-2018

Spirit AeroSystems Holdings, Inc. (SPR)

JP Morgan Aviation, Transportation & Industrials Conference

CORPORATE PARTICIPANTS

Seth M. Seifman
Analyst, JPMorgan Securities LLC

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

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

MANAGEMENT DISCUSSION SECTION

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Okay. Very good. Welcome back to JPMorgan Aviation, Transportation & Industrials Conference. On the aerospace defense track, we're very pleased to have with us Spirit AeroSystems this morning, and CEO, Tom Gentile; CFO, Sanjay Kapoor; and from IR, we have Kailash Krishnaswamy and Ryan Avey. So, we got the whole group and we're very glad to have them. Tom's going to kick it off with a little bit of discussion about the company, and then we'll go into Q&A.

Unverified Participant

[indiscernible] (00:00:46)

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Okay. There you go.

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

All right. Just the standard safe harbor statement as what we're going to discuss has some forward-looking activity and it's I think you're all aware of that common phrase.

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

So, well thank you very much. It's a pleasure to be here. And what I thought I'd do is just start with a brief overview of where Spirit is right now. As you all know, we split off from Boeing back in 2005, and back then the rate on the 737 was 21 per month, today, it's 52. And so, we're fortunate is that we are a very focused aerostructures business and we have work packages on all the airplanes in the backlog for both Boeing and Airbus, so all roughly 13,000 aircraft we have significant work packages. And so our backlog right now is $47 billion, which is almost seven years of production.

And again, we're fortunate is that we have significant work packages on the biggest programs that are going up in rate. So, for example the 737, we make 70% of the structure for the 737. We make the whole fuselage, we make the flaps and slats on the wings, we make the pylon as well as the thrust reverser, and our programs with Boeing are our life of program that includes the derivatives.

And so, as rates are going up on those programs, we're in a very solid position. So, just on the 737 for example, we just passed a huge milestone with Boeing, We delivered the 10,000th fuselage on the 737 that goes back to 1967. So, it's been 51 years that we've been building in Wichita, the 737. But at the current announced rates of production, it will only take us 15 years to build the next 10,000. So, it just gives you a sense of how the rates have ramped up and the narrow bodies have been really selling very well.

Last year, the book-to-bill in the industry for the narrow bodies was 1.6, so the backlog actually increased. And with our strong work packages on the 737 and A320, that really puts us in a good position. And obviously, if Boeing or Airbus ever decided to go up in rate, that would be very good news for Spirit, because those are our biggest programs, those two.

In addition, we've been performing very well. So, 2017 was a strong year financially in terms of revenue, profit, cash flow. We delivered last year about $537 million of cash flow and that was in the 7% to 9% range that we have been talking about for a long time, which is our target for cash flow. And we've been returning a lot of that cash to shareholders. So, last year for the second year in a row, we returned more than 100% of our free cash flow to our shareholders in the form of share repurchases and also dividends. And so that's the second year in a row that we had done that and we're continuing this year with the board. We agreed that we have $1 billion authorization program in place that we can still execute again. So, we have plenty of opportunity to do that.

As we've talked about our targets for growth, we've focused on organic growth of 3% to 5%, so more Airbus content, more Boeing content, those things we work on every day. But, we're also talking about growing our defense business and our fabrication business, two billion-dollar businesses each. So right now, on defense, it's about 5% of our business today, but we want it to be 10% to 15% in the future. We make the military derivatives of some commercial aircraft from Boeing, so the P-8, which is a derivative of the 737, we make our work package for that, and we also make our work package for the KC-46 tanker, which is a version of the 767.

But beyond that, we have work packages on the CH-53K, the heavy-lift helicopter for the Marines. We also are one of seven suppliers on the B21 that have been named, and we are working with Bell Helicopter on their entry for the future vertical flight, which is V-280, so we make the fuselage for that. So, we're well positioned on current programs to grow in the defense area.

And then in fabrication, today we already make about 38,000 different unique parts. We consume all those internally. It represents at the end of last year about $600 million of annual business. And, we want to start to grow that and provide those parts and services to third-parties. It could be the OEMs, the defense primes or other Tier 1 suppliers. We see lots of opportunity to grow that as we continue to vertically integrate as well. So we have a very robust organic growth program in place.

In addition, we continue to scope the market for any inorganic opportunities. And what we're looking for there are things that would provide us with more Airbus content, more military content or more low-cost country footprint that can help us get our cost base down. And if we can find companies that meet those strategic criteria and then also meet our return thresholds, we'd also consider inorganic opportunity. And with our cash on the balance sheet as well as the strength of our balance sheet, we have quite a bit of firepower where we could execute acquisitions of some size in order to further the strategic goals.

So we feel that Spirit is very well positioned right now in terms of we're on the right programs, we're very focused on aerostructures, we've got a very consolidated manufacturing base with significant scale. We've been doing a lot of work on productivity to bring our costs down. We've got good design engineering capabilities to compete for the next generation of aircraft. We're expanding our defense platform, growing in fabrication. We feel we're very well positioned for the future.

So maybe with that, we can go to some questions.

QUESTION AND ANSWER SECTION

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Excellent. Thanks. Well, maybe I'll start off with a few questions, but anyone in the audience, please, raise your hand at any time, we'll bring the mic over and take questions. We'll talk about some big picture stuff, but maybe we'll start off looking at something that's a little bit more immediate, which is in the fourth quarter, we saw a charge on the 737 and the ramp up there is pretty aggressive right now in terms of the pace of change in rate, the introduction of the MAX. So, maybe you could tell us a little bit about how you guys are getting that production process under tighter control moving forward?

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

A

Right. So, fourth quarter was what was challenging in that we were starting to see more MAXs come through the system. And so, the challenge right now with the rate increases is that you have rate going up overall. So, it went from 42 to 47; this year we're going to 52, next year we're going to 57. But within that, you've got the MAX starting to ramp up. So last year was the first year we started producing an appreciable number of MAXs and that's continuing this year.

And then you've got the NGs going down. So you have five or six [ph] versions (00:07:43) of the NG. We're going to have four versions of the MAX. So there's quite a bit of movement. And we today – there's tens of thousands of different parts that we put together for the 737 and we have 600 major suppliers. And it's fair to say that the suppliers experienced some difficulty going up in rate that created some disruption in our factories in the fourth quarter, so there were some charges. So what we've done in the first quarter is we've really put a lot of resources against that. We've put a lot more people out into the supply chain, working with the suppliers to ensure that they can get up to rate and to smooth it out.

So the good news is, we're getting control of those operational challenges, we're seeing very good results in the factory, it's getting more into balance. We'll still see some stress in the first quarter as we work our way through that. But, for the year, the guidance is intact, we're right on track, and we're very pleased with the performance of the factory.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

All right. Okay. Excellent. And so as you look ahead, I guess do you feel like you have things sized to get to, let's say, from 42% to 47% or do the resources that you're putting out there are going to kind of preclude this from happening later this year when the rate goes up to 52 and then ultimately to 57.

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

Right. So we did put in some surge resources to help with that here in the first quarter to address some of the challenges, but we feel like we're on track overall. One of the things that we learned last year is that we need to hire more in advance to get up to rate. And so we did that at the end of last year; we're going to do that again at the end of this year, so that we are better on track. We also put some more resources into, for example our distribution center, because with rates going up, obviously more materials coming in, we need to make sure we get it stocked and onto the floor more efficiently. So we made a lot of those adjustments. We also beefed up some of our activity in certain sections that were bottlenecks.

The other thing is, we've significantly improved and enhanced our training program. So we work a lot with the local technical college to get people that can come in and hit the ground running a bit more. But in addition, we have now a five-and-a-half-week training program for new hires. So, we put them through all the basic skills of drilling, filling, deburring, sheet metal, assembly. We put them through all of those in the first six weeks. And then when we put them on the line now, we've also brought back some retirees to serve as coaches, on-the-job coaches. And so we have that as well. So, we're absorbing the increases in hiring, I think, much better than we were before.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

And then within your supply chain, among the 600 suppliers, without obviously naming anyone, but you feel like the major points of stress are you've kind of mitigated that and are ready to move forward those hired?

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

Right. We certainly identified them. We know where there are challenges. We've put teams, SWAT teams out at more than a dozen of the suppliers. We have senior executives now lined up. And the thing about the supply chain is, it's two-thirds of our cost, but it's also critical, of course, that our supply chain partners are performing so that we can meet our commitments. And so we have very close partnerships. I talk with the CEOs of all those companies on a regular basis, we have a lot of engagement best practice sharing. Their success is critical to our success. And so we work very collaboratively to ensure that. So, in the case of all the suppliers that have been behind, we have action plans, we will review those on a daily basis. I see them at least weekly. I talk regularly with the CEOs of those companies. So, it's a very collaborative process and we feel we're getting on top of it.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Right. Excellent. I guess just to – unless there any further questions, just to wrap up on this point, you know, it seems like there's going to be a bit more friction on 737 in the first quarter, but you guys feel quite confident and comfortable with the cash flow and earnings guidance that you've given for the year?

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

Yes, absolutely.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

That's fully intact.

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

A

The first quarter as I said will be a little bit more challenging because of the surge effort we put to get control of the 737. And then, Sanjay, maybe you can talk a little bit about some of the other economies...

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

A

Listen, Tom talked about the operational issue that we are fixing. But, as a gentle reminder, when we did our earnings call and we gave you guidance for this year when we were reporting last year, there were a couple of accounting changes, obviously 606 will be implemented, you'll see some of that activity this quarter. But there was also a pension change. And if you recall I had mentioned in the earnings call, in our script last year, that in the first quarter we will be taking a charge associated with the 787, which is in a forward loss situation where the pension change was fundamentally a geography between cost of goods and below the line.

So, on all programs, it doesn't really matter, except when you have a forward loss program, then you do recognize the pension expenses for the entire block and record that activity in the quarter and the year, whereas you will recover that long-term over the execution of that program, it doesn't change cash flow, so it doesn't change anything, and it was incorporated into our guidance. But Q1 will be impacted because of that as well, so just FYI.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Excellent. Okay. Maybe stepping way back and looking at the market more broadly, and your main market, which is structures, we had another company here yesterday, Triumph, talking about the evolution of the structures market and the idea that there is probably in excess of capacity in the structures market that's maybe not economic, and at the same time the need maybe for some more capacity, that is, newer, more state-of-the-art, and more efficient, and that could lead to some underlying changes in the market over the next 18 months was the way it was phrased, but let's just say in general, I wonder what you think about that assessment and you know how you think Spirit is poised to play if that is in fact the state of the market right now?

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

A

It really depends on the programs. And if I look at it, if you're on, say, the 747 or the A380, those are your primary programs and you have sites dedicated to that. Those programs are going down. That would create an overcapacity situation. If you're on 737-A320, the A350-787, those programs are all going up in rate and there's essentially a shortage and it's very confined. So our situation is, we're extremely concentrated, we only have six sites, but all of our sites have massive scale and the ability to spread fixed cost out. So let's just take our Wichita site.

The 777 is going down in rate for a period of time at the bridge before the 777X goes up. 747 is going down in rate. But, that's all being built on the same site as the 737. So we're simply moving those programs out of our [ph] big plant 2 (00:14:46) into other buildings on site so that we can go up and rate on the 737 and the whole campus basically is able to absorb those downs and ups, because we have that scale.

So we're in a slightly different situation than others, but I do agree that we could see more consolidation in the structures industry. It's quite fragmented. And so we've been looking at different inorganic opportunities that would help us increase our Airbus content, our military content or strengthen our low-cost country footprint.

So we feel with our balance sheet that we can be a consolidator in that process. But it's important to maintain scale and concentration in terms of the facilities. There's no doubt structures depends a lot on cost and you have to be low cost, which means you need massive scale. We have that. The other thing is, from our standpoint on costs, it's all about supply chain. And over the last few years, we've been developing our capabilities on supply chain quite significantly. So we have a very structured approach with our suppliers. I've said that they're critical to our success. We work with them, but it's important that they're all world-class. And so we start off with what we call our clean sheets and we reverse engineer every part we buy. So we understand what this should cost is and we've done now more than 70,000 of those.

We then have a very structured process to work with our suppliers with gates and deliverables and dashboards and a clear operating mechanism to try to get down to the should cost and we work with the supplier to provide them a lot of support. So, whether it's engineering or processing or logistics or material buying, we try to get them down to the should cost. If they don't, we have the ability to in-source. I said we make 38,000 different parts, but we've been investing in new capacity in fabrication.

So, we've built a three-axis and four-axis center of excellence in Oklahoma, we built a five-axis center of excellence in Wichita. We can in-source parts to get to those should costs. And where we can in-source to get to the should cost, we've been doing, we call them hypercompetitive negotiations, we'll pick a group of parts, we'll invite 20 or 30 suppliers in, and over the course of the week, we'll go through seven or eight rounds of bidding and we'll launch it on Monday, we'll award the work on Friday, and then we have a very rigorous transfer of work process when that's what we need to do.

So, we've been able to really drive a lot of supply chain savings and that's helped us maintain our margins in the face of the normal headwinds that this industry sees. So, headwinds in terms of material and labor escalation, there's price step-downs from the big customers, there's productivity discounts and so forth. So – but we're able to offset all of that with our supply chain initiatives and that's I think another source of our advantage by having large scale.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay. Right. I feel fortunate that I don't have to go through hypercompetitive negotiation. When you look at that fabrication work and we think about the – you mentioned the OEMs potentially as customers in-sourcing for yourself, you mentioned other Tier 1s. The returns on that work compared to the returns on most of your existing portfolio, how do those compare?

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

A

They can actually be a little bit higher in some cases in faster growth. It's a shorter cycle business. And so, the key though is really to have a lot of internal demand that that gives us because we buy so much of that internally. It always gives us the ability to absorb it and so that helps us a lot.

And with the supply chain, it's nice to have the capability of lot of in-house production, because when there is an issue, we can always do a [indiscernible] (00:18:19) production internally to help us get through it for a short period of time. So having that ability gets us out of a lot of jams. The margins are good, the growth is good, it's a shorter cycle business, so we can focus on some new programs. Particularly in the defense world, we think that's going to be a big opportunity for us to grow our defense activity.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Maybe going back to the M&A comments, the criteria that you guys have set out, the low cost country footprint, the defense, the Airbus, these are the – I'm sure, you have your financial hurdle so. These are some pretty stringent criteria and we know that Spirit has been interested in M&A for some time. But has it gone ahead and I think that's a reflection of discipline and I think discipline is probably Sanjay's middle name. But, is there, when you tick off those criteria, it seems like there are probably not very many businesses out there that need them. But there's also a lot of smaller things that we're not aware of, do you see real opportunities out there for M&A?

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

A

We do. We've been looking very aggressively and we've talked to a lot of different banks and we've reviewed a lot of different potential proposals. There are not many that meet all the criteria, the strategic criteria as well as financial hurdles, but there are some. And so we're being very disciplined. There's some processes that are going on right now that are not right for us. And so, we're focusing on the things that meet all those criteria, and we expect that in the next year or so we will add to our portfolio. But again, it has to meet our strategic criteria, Airbus content, military content, low-cost country footprint as well as be a good financial investment. Sanjay, maybe you can talk a little bit about how we view that.

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

A

Yeah. No certain again. Discipline, I want to make sure that we've also said M&A is an opportunistic activity and I feel strongly that if you're in aerostructures and you're a company like ours and we've over the last few years de-levered ourselves, we've de-risked ourselves and we have plenty of firepower, so while others have probably used their firepower, we are at the sweet spot right now. And to that extent, we have a little bit of an advantage and we intend to take advantage of that advantage I guess.

But going back to what Tom was referring, we have our own threshold criteria, which we've articulated to you guys. We've said we want to try and generate free cash flow that we've said long term. We've also told you guys that the 3% to 5% top line growth is sort of organically and we should be at the higher end of those numbers if we can do some inorganic activity.

We obviously look at net present values. We have a pretty good idea as to what we are trading at. So, we want to look at other businesses to make sure that it's a better buy for us than what we are doing ourselves. Tom talked a lot about the synergies. We look at these M&A deals also from a synergy perspective because we think that now that we have consolidated and our supply chain is a good process, if that's something we can bring to the table, then that's a good thing and we can apply that.

So listen, M&A in my perspective is about being opportunistic, being disciplined. The strategy is probably more important than the financials, because the financials will happen in a long cycle business over a long period of time, and that's how we're trying to look at it. We're not scared guys, I think we made this point too. I don't want to leave any impression here that we are going to do anything. At the same time I don't want to leave the impression that we're not going do anything. This is something that we don't want to box ourselves into, I won't do something if it's not this kind of a return or that kind of a return or this kind of a company or that. M&A is opportunistic. We are in there and we're going to look at it hard.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Right. Very good. You mentioned scale as something that allows you to drive value. And you look at a lot of other companies out there and they have far more facilities per dollar of revenue than Spirit does. When you think about making acquisitions, given how high production rates are, is there space or capacity in your facilities to take work in or does M&A mean kind of expanding the footprint to a lot more having to think about that?

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

Right. Well, our current facility, our main facility, say, in Wichita is quite a large campus. And so, there's always opportunity to optimize it to create space. So one of the things we're doing, for example, is, we're building a more state-of-the-art warehousing facility with more automation. And so that was actually one of the projects that we added into our capital budget last year after tax reform, because there was room for it and this was a great return.

So what we're going to do is, we're going to consolidate about $500,000 of current warehousing space on our campus into about 160,000 square feet, so we get massive improvement which will help us go up in rate.

So, from our standpoint, it's very important that you keep getting productivity out of your existing campus. And if you look at our history, if you look at the production and the revenue per person and per manufacturing square foot, we've had massive gains over the last several years as rates have gone up. So it's very important for us. And as we look at other companies that we might acquire, that's something else that we take into account is how much restructuring is required, so that you can create those kinds of economies of scale with more concentrated facilities.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

And maybe you mentioned defense and the opportunity to grow in the defense market, and I think the target that you set out there is for $1 billion sometime in the early part of the 2020s.

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

Correct.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

And that probably means about a little over $0.5 billion to $600 million of growth off of 2017. And when you look at the work that you've already captured I'd think mainly from the B21 and the CH-53K and the V-280, so the B21 and the helicopter programs, is that kind of gets you where you want to go or is there more stuff to go out and win?

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

No. Those programs will get us over the $1 billion. Last year, we were over $400 million. This year, we will be over $500 million. So actually we see quite a bit of growth this year, and that continues with those programs as they get into their development phase and then early production. We will achieve the $1 billion target just with the things that we already have, but obviously we want to grow that by winning work on new programs. One program we're not on that we'd like to be on is the F-35 and we read that there's a lot of challenges on cost and the need to get down on cost, and we think we can bring our commercial capabilities and our emerging defense capabilities to help bring down the cost on the F-35. So that's something that we want to continue to focus on as we go forward.

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Q

Excellent. One question – one thing you haven't mentioned, through all the opportunities to grow, is business jets and it's been my impression that's period that you guys feel like the amount of investment required in business jets relative to the business case and the potential return doesn't necessarily always meet your requirements. Is that a fair characterization?

Thomas C. Gentile III

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

A

Well, the volumes are obviously much lower on business jets and regional jets. But we do a little bit of both. We still do the nacelle and the podding for the G650 with Rolls-Royce. So with the BR725 engine, we provide the nacelle and we do the podding and then deliver that off to Rolls-Royce for delivery to Gulfstream. But the programs, compare to, say, a 737 or A320, are obviously much smaller volume. We do a little bit on the regional jets like the CSeries and the MRJ. And we're open to growing those, particularly in the fabrication area, we think there's more opportunity for us to grow there. It can be good business, but we have to be selective about it.

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Q

I wonder if we could talk a little bit about the new programs at Boeing and potentially middle market aircraft is something that there's a lot of chatter about it in the industry of course. And I think investors kind of take for granted that one of the main drivers for Boeing going ahead with this is going to be that they can get the cost of a plane down low enough to make it appealing to customers. And that means that there is going to be challenges for the supply chain. And so, what are the things that you guys are looking at in terms of technology or the way you can organize production that will allow you to both get on the aircraft and make a good return?

Thomas C. Gentile III

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

A

So, I think a few things there. First of all, cost obviously is important. And having good manufacturing processes is important. I think one thing we've demonstrated, particularly in composite fabrication is the ability to scale and industrialize complex parts and composites. So if you look what we do on the 787, for example, we make the forward fuselages. We call it the Section 41. It's the most complicated part of the aircraft. And so, we have demonstrated an ability to produce that and to continue to work down the cost curve. So we've learned a lot. And so, as we go forward that sort of manufacturing experience and the ability to drive cost out is important. But it's also important to have a lot of innovation and new ideas about how to improve structures for the next generation aircraft. And so, that means things like taking weight out, reducing the amount of fasteners, improving the aerodynamics, using different types of material. So, we're spending more in R&D.

And again, in the fourth quarter, we talked about the fact that we use some of the tax savings to invest more in R&D this year, because this is a big year for Boeing and Airbus as they make decisions about their next moves.

So, Boeing is obviously considering the NMA. We want to make sure that we have our best ideas ready to go when they're ready to discuss those with us. So, we stood up a team of more than 40 engineers, and we're developing our ideas in seven major areas of distinctive capabilities and it's things like tooling, it's composite materials, it's metallic materials, it's thinking about architectural structures, it's thinking about stress analysis tools. So we in different types of materials including thermoplastics. So, we're developing our capabilities in all of those areas and applying to them to different structures, so that we can bring those ideas to Boeing when they're ready to discuss them as they think about who they want to have partners on the NMA, we would like to be on the NMA.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right.

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

A

And we want to make sure that we are aggressive in terms of developing our ideas so that we can be competitive when they're ready to talk to suppliers about it.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. And it sounds like you think – I mean there is some concern about investors probably about the entire supply chain including Spirit, no doubt, Boeing has talked about more vertical integration, but it seems like you feel there's certainly a value proposition and a way to work collaboratively on next-generation programs with Boeing.

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

A

Boeing is a big customer, and they're demanding. But one of the things that the negotiations last year did was really strengthened our relationship, right. And so, we agreed to price step-downs on certain programs like the 787. We agreed to productivity discounts on the 737 as rates go up. But in return, we also got a lot of benefits. It was certainly a win-win type of contractual negotiation.

And as a result, we have a stronger partnership. So, we have lean events with them. We leverage the work they're doing on the Boeing Production System and apply it in Spirit. We think of – we look at the whole production system for the 737, for example, and look at how do we optimize it overall from Wichita to [ph] Reno (00:30:22) and make it more efficient. There's lots of opportunities, and they're very generous in terms of providing us with help and support. We exchange ideas. We just had a program on the 787, where they convened all the different suppliers from Japan and from Italy, ourselves, and we exchanged best practices on how to produce. And so, those are different ways that we can leverage our system.

So, they're also on the 787 working very collaboratively with us in terms of cost reduction. Looking at new manufacturing processes, redesigning certain parts, looking at new materials, we're working very closely on 3D printing. We're both working with Norsk Titanium, their rapid plasma deposition process. So, the good news about the negotiations last year is that we set the relationship with Boeing and we're working on all these things. They're helping us get down the learning curve. And I think they're demanding, believe me, they want a lot, but at the same time they're very collaborative and they've been very generous in terms of providing us assistance.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

I was going to ask you about Norsk because Spirit put out some announcements about their work with Norsk. And if you could talk a little bit about the process that they have and the savings that it bring to you and whether that's a key focus of the additive manufacturing that you might be injecting into your manufacturing processes in the future.

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

A

Right. So the focus with Norsk is on additive manufacturing. And most of what we do today is reduction. Okay, so we start with a big block of maybe aluminum or titanium and then we machine it away. So you know some parts we might start off with a 1,500-pound block of aluminum and the final part is 47 pounds. So the buy-to-fly ratio is way out of whack. So what we're trying to do is figure out how you can improve the buy-to-fly ratios so that you have less material waste, that means less transport costs, less storage costs, less material waste. And titanium is the most expensive material that we use and it's very heavy and so all of those things apply.

So with Norsk what we're looking at is a way to 3D print, near-net shapes. So you've heard a lot about some powder-based 3D printing that is either electron beam or laser beam focused. And what they're doing, GE is doing a great job on this. They can print final parts, very intricate parts to doing the fuel nozzle for example and that's the final part. For us, our structures are all very big. We need to lay lots of material and powder-based methodologies don't work so well for us. So what Norsk has is this rapid plasma deposition process where they lay beads of titanium in an argon environment that have very strong structural capabilities and characteristics into a near-net shape. So we don't try to get to the final form, we create near-net shape that reduces the amount of titanium that you need and then we machine it to the final part. So we get an excellent buy to fly ratio; we can save 70% to 80% of the material as a result.

So the focus is on titanium parts. We're focusing first on 787 parts, and then of course, we'll move on to other programs, but there's a lot of opportunity there. And Boeing has been very involved, Airbus is doing some as well, but our initial focus has been with Boeing on this and we'll continue to expand it. But the opportunity is significant. I think there's no doubt in the future and in the structures business, 3D printing and additive manufacturing is going to be important. But we're focusing our efforts right now on these near net shapes that require final machining that can create bigger structures and we're focusing initially on titanium.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

We had Airbus here yesterday and they were talking about the demand of narrow bodies and you got the sense that if they could flip a switch and take the rate up to 70 on the A320 tomorrow, they'd be happy to do it, but there's obviously new engines that are challenging to ramp up on everything, when you think about ramping up from here on narrow bodies what's required from Spirit in terms of capital investment?

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

A

Well, the narrow bodies last year had great orders, the book-to-build was 1.6 and so the backlog grew, so I see the huge amount of demand. For us, if you look at the A320, we do a big chunk of the wings for the A320. We do the leading engine, the trailing engine, all the spoilers in our Prestwick facility in Scotland, and we have plenty of capacity there to ramp up in rate, so we're in very good shape as Airbus decides to go up in rate.

On the 737 side, it is more Wichita-based. We do the wing material down in Tulsa. There is some capital in tooling, but we have enough capacity, particularly as we do things like that warehouse project to free up more space up on the campus. So, we're in good shape on both programs to be able to go up in rate. And as I said before, those are our two best programs. And if the rates go up, that will be very good news for Spirit and we'll be ready.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Excellent. And when you think about A320 may be more broadly, I think this was several years ago in disclosing content. I think management at that time had talked about maybe $1 million of content out of that Prestwick facility...

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

A

Per unit?

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Per unit. Is that something you've been able to grow? And as the rate goes up, as a second source or and taking share, is that something where we could see that per unit number go up?

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

A

Well, we're always working to increase that. Organically, we're bidding on several work packages [ph] certainly (00:36:21) to increase it. But we're also looking inorganic to find suppliers that already have work content there that would increase it. So, it's maintained. It's grown a little bit. We won a work package last year to improve the design on the spoilers with Airbus. So, it continues to grow. But, we'd like to do some step level changes on it.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right.

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

A

It's very profitable for us. Maybe, Sanjay, you could comment a little bit.

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

A

Yeah. Seth, it's a good question. I mean, listen, question can be, is the content growing? The answer is yes. But, from your perspective, you should also want, is revenue going to grow? The challenge with that is step downs and cost reduction. I mean, this is an industry that is no secret. Every year, you're trying to do the same amount of stuff for a little bit lower price. So, it's that balance that we try. But like Tom said, we've stated very clearly that we want to grow our Airbus content inorganic and win some contracts in the areas of our expertise. We'll see. If everything magically works and that's something that we'll try and do.

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

And by the way we don't want to imply that, we don't want to grow Boeing content too. We do it's that we already have a lot with Boeing, and we continue to grow and think about new opportunities. It's just since we're relatively smaller on Airbus, that's our focus, and in terms of inorganic activity, that's okay.

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

And the only other thing I'll add there, say, just to complete, it's probably the only contract big enough that we have that is based, not in dollars, but in pounds. We've said that as well. So, the exchange rate does matter as far as that content is concerned.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

And, Sanjay, in terms of the financial guidance that you guys have given longer term and you've targeted the 7% to 9% of sales as free cash flow, and the guidance that you gave for this year, I think, was kind of right down the middle of the fairway. You talked back at the Investor Day in the fall about having an internal target of 10%. Subsequent to that, we got lower tax rates. And so, as we look beyond this year, how do you think about the potential to move out toward that internal target?

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

Sure. So, since we're all talking golf analogies in the middle of the fairway, I mean, I can tell you, Tom and I are – we can golf as we always want to have birdies too, but par is a good score. And so seven on nine I would say is in that par range. We always want to be at the upper end and continue to get birdies and eagle and we strive for that.

You know, every company tries to do better internally and challenge themselves internally compared to what we commit. And the reason for that is quite simple, it's not that we are sort of being conservative or anything like that. This industry is fraught, we just talked about it, rate increases happening, supply chain issues happening, we can have weather events that have happened. And each one of those in this environment can create disruption that size. And I certainly don't want to be in a scenario that we use that as examples of why our guidance is changing et cetera. So, we've always told you we are going to try and see how we do through the middle of the year, and we'll update accordingly. So, we strive to do better every day. I will tell you that 7% to 9% is a pretty good goal in structure. We're trying to convert that level of cash and do it, add to the scale and size, and manage the rates and manage the changes in the MAXs and the NGs et cetera, and find the right balance and making the right investments for today and for tomorrow because there's a balance between how much you try and spend on CapEx today and for the future, so.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Excellent.

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

And we're [ph] flashing zero there (00:39:58).

Seth M. Seifman Q
Analyst, JPMorgan Securities LLC

We're out of time, but...

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

We're getting a whole bunch of new investors in the year.

Seth M. Seifman Q
Analyst, JPMorgan Securities LLC

Thank you. Thank you so much for being here. We appreciate it.

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

Thank you, Seth.

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

Thank you, Seth. We appreciate the opportunity.