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Spirit AeroSystems Holdings, Inc. (SPR)

Q1 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Spirit AeroSystems Holdings, Inc's. First Quarter 2018 Earnings Conference Call. My name is Jamie, and I'll be your coordinator today. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please also note today's event is being recorded.

At this time, I'd like to turn the presentation over to Kailash, Vice President of Investor Relations, M&A and Strategy. Please proceed.

Kailash Krishnaswamy

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

Thank you, Jamie. Good morning, everyone. Welcome to Spirit's first quarter 2018 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

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

Thank you, Kailash, and good morning, everyone.

Welcome to Spirit's 2018 first quarter earnings call. This quarter is an exciting one for Spirit, and we have a lot to discuss, including all of the items on slide 2. Most importantly, we are delighted to be announcing an agreement to acquire Asco Industries, a company we have been watching for a long time. Asco has many great features that align very well to the strategic priorities we have discussed, including expanding our Airbus content, growing our defense business, and strengthening our fabrication capabilities. We will say a lot more about this exciting transaction in a moment.

In association with the Asco transaction, we also intend to refinance some of our existing debt to capture more favorable cost of borrowing, extend our maturities, and bring our leverage in line with industry peers. In addition, we intend to continue actively buying back our shares, which we feel remain undervalued. Our board has authorized us to initiate an accelerated share repurchase program of $725 million on top of the $75 million of share repurchases we made in Q1. We are very bullish on our stock, and we will continue to invest heavily in it.

Finally, our board has authorized a 20% increase in our quarterly dividend to $0.12 per share in recognition of our commitment to return capital to our shareholders.

Before I describe these exciting announcements in more detail, I'm going to start with first quarter performance on slide 3. We reported revenue of $1.7 billion, earnings per share of $1.10, operating cash flow of $167 million, and free cash flow of $118 million, a 66% improvement from 2017.

During the quarter, we worked very hard to enable our customers to meet their deliveries as production rates are increasing for key programs including a model mix shift from the Boeing 737 NG to the Boeing 737 MAX. We are pleased to see those efforts were successful as our largest customer, Boeing, announced strong results last week.

Due to supplier disruptions, rate increases, and these model mix changes, meeting these delivery schedules caused us to incur additional costs in Q1 related to overtime, expedited freight, and surge resources. To offset these items, we have put recovery plans in place, including experts SWAT teams deployed to those troubled suppliers, additional training and coaching for new employees, and a dedicated end of the line team to expedite deliveries.

We are seeing the impact of those actions and expect to be fully recovered to schedules by mid-year. We are also seeing some residual impact in Q2, but the recovery plans will offset these challenges during 2018. The impact on a quarter-by-quarter basis is what you see because of the shift to the revenue recognition system under ASC 606. To provide some additional color about our progress, I want to talk about a few of the key factory health metrics showing improvement that give us confidence in the recovery plans.

First, we have about 600 direct material suppliers and our focus has been on the 15 suppliers who are struggling that provide parts on the critical path in the Boeing 737 line. Supply chain [ph] kit fill (5:05) rate, which is a measure of the supply chain on-time delivery, and the Boeing 737 line has improved 20% since last year when we put these recovery plans into place. Our line operates very efficiently when we have parts on time.

Second, improvement in on-time supplier delivery has led to improvement in another key metric, out of sequence jobs. This measures the amount of work which does not incur in the normal station when parts are not available on time. Since the recovery plans went into effect, this metric has also improved by more than 20%.

Third and lastly, the need for expedited shipments is gradually reducing as we continue to improve. We expect to be fully recovered to our delivery schedules by midyear as I said. Our goal is to have no late deliveries for the second half of the year and therefore, no expedited freight charges.

Like I mentioned in the past, production rate increases are a great opportunity for us, but they can bring some of these challenges, as I've described. We are taking the lessons learned over the last year or so and implementing robust plans for a much smoother transition as we move to 57 aircraft per month on the Boeing 737 line next year.

One exciting accomplishment during this past quarter was the delivery of our 10,000 737 shipsets to Boeing. Spirit built 70% of the structure for the Boeing 737, including the entire fuselage. This milestone of 10,000 delivery showcases our ability to deliver a world-class, highly successful product consistently to our customer. It takes teamwork, dedication, and commitment across generations of aviation employees to reach such an impressive milestone.

The A350 line also impacted first quarter performance. Severe weather and a declared emergency in January in North Carolina disrupted production and resulted in increased costs from expedited air shipments. The program has now fully recovered and has returned to normalcy shipments. We have a plan build-up of additional product buffer stock this year that will enable us to absorb any similar small disruptions that are in the future.

Now, turning to today's strategic announcements on page 4. As you saw on our release this morning, we are very excited to announce the acquisition of Asco Industries, an exceptional company we have been monitoring for a long time.

On page 4 of this presentation is the Spirit strategy that we shared at our Investor Day last year. Asco is a compelling strategic bid for Spirit as the acquisition expands our Airbus content on A320 and A350 wings, adds new defense content on the F-35, and broadens our fabrication business growth initiative. Asco will also help us strengthen our supply-chain with their specialized capabilities, which will help with our current recovery.

Slide 5 provides an overview of Asco, which has revenues of approximately $400 million per year.

Asco is a high-quality family-owned business based in Brussels, Belgium with a successful history dating back to its origin in 1954 when it was founded to make parts for military vehicles. Today, Asco is a recognized leader in high lift wing devices, large structural parts, and mechanical assemblies offering both design-to-build and build-to-print capabilities. Wing components such as slat tracks and flap assemblies comprise the majority of the revenues, an area that aligns very well with Spirit.

Asco also has a diversified product range of flight-critical structural parts for Airbus and other OEMs. It is highly regarded in every area in which it operates. Asco has a longstanding relationship with major aerospace OEMs, especially with Airbus and Boeing for more than 20 years. The acquisition will enhance Spirit's relationship with our current customers increasing content and strong programs, such as the Boeing 737, Boeing 777 and Boeing 787 and the Airbus A320 and Airbus A350. Asco also opens the door to increased content with other OEMs including Bombardier and Embraer.

Asco has a strong military presence with existing work on the Lockheed Martin F-35 program and the Airbus A400M program. We are excited to add the Asco military work to our growing defense programs. As an example of that growth, during this past quarter, we delivered the fifth System Demonstration Test Article for the CH-53K to Sikorsky, an important program for growing our defense work statement.

Asco also has well-established customer relationships in its markets with high value and often sole source products. The company has life of program positions on many of its programs. They also have a strong position on wing products, which is a close fit with the work we do on wings for Airbus and our other customers.

The company has a strong management team that has cultivated its customer relationships to grow work content and several large commercial and regional aircraft growth platforms, while simultaneously driving productivity.

Key Asco senior management, including CEO, Christian Boas, have made commitments to Spirit to ensure a smooth transition. We could not be more delighted that Christian and his team will be joining Spirit. Asco is a critical supplier to OEMs and Tier 1 manufacturers with an exceptional reputation for innovation, quality, and delivery. Asco also adds strength to our R&D efforts by bringing in product intellectual property to complement our process IP on both existing programs, as well as next-generation aerostructures.

Turning to slide 6, much like Spirit, they benefit from having a concentrated footprint with four highly-automated fabrication sites with capacity to support rate ramps and new business growth. Asco employs about 1400 people across these four manufacturing sites, comprising over 1.5 million square feet, including Vancouver and Stillwater, Oklahoma in North America, Gedern in Germany and its headquarters in Zaventem, Belgium in Europe.

These are highly automated state-of-the-art facilities with scale to support rate increases in future growth. These facilities and the commercial capabilities that Asco has with a demonstrated ability to win new work will accelerate Spirit's efforts to grow our fabrication business.

On that front, during this past quarter, Spirit officially unveiled both our five-axis machining center of excellence in Wichita and our three- and four-axis center of excellence in McAlester, Oklahoma in support of plans to grow our fabrication capabilities to more than $1 billion annually. Our investment in fabrication capabilities through the acquisition of Asco and these new centers of excellence improves our competitive advantage for global fabrication work and also helps alleviate some of the supplier bottleneck issues that we've had in our supply chain.

On slide 7, you can see a summary of the deal to acquire Asco. The $650 million purchase price is inclusive of the assumption of debt. The EBITDA multiple was 9.3 times based on 2018 results. The return on investment exceeds our internal threshold, and the effective EBITDA multiple on the deal, after giving effect to $15 million of expected synergies, is less than 8 times EBITDA and less than where Spirit currently trades.

The deal will be accretive to adjusted EPS in the first full fiscal year. We anticipate the transaction to close in the second half of 2018 upon the completion of regulatory approvals and other customary closing conditions. Asco will operate as part of our Wing segment. Detailed integration planning is already underway to ensure smooth transition.

Now turning to our capital financed plans on slide 8. We intend to fund the acquisition with new debt as part of a broader debt plan that takes advantage of the current interest rate environment to lower our cost of borrowing and extend our maturities. We intend to refinance some existing debt, and our anticipated new debt structure will place our leverage more in line with industry peers at about 2 times debt-to-EBITDA, which leaves us comfortably within our desired investment-grade rating.

We also intend to use a portion of the proceeds of our refinancing to fund a $725 million accelerated share repurchase plan during the second quarter of this year in addition to the $75 million of shares we repurchased in the first quarter of 2018. These actions will bring our total repurchases to $800 million out of our current $1 billion share repurchase authorization. Our stock remains undervalued, and we have confidence in our long-term outlook.

At the same time, we are investing in Asco to grow our business, we see an opportunity to invest in ourselves. We have outlined our capital deployment strategy on page 9. We do not anticipate making any additional share repurchases in the remainder of this year beyond what I've just described. But we will be using the cash that we generate over the rest of the year to pay back some of our shorter maturity new debt and to keep our debt-to-EBITDA ratio at a target of around two times.

As I said earlier, we incurred substantially higher costs in the first quarter related to supplier disruption over time, expedited freight and surge resources. Some of which will carry over into the second quarter as we continue to recover to our production schedule. We are maintaining our full-year guidance as these operational challenges are offset by our remedial steps in the ASR. In addition, we will continue to drive our operational recovery plans and we'll update you throughout the year on their progress.

Finally, our board has authorized a 20% increase in our quarterly dividend to $0.12 per share, that supplements a robust capital deployment plans and is in line with our strategy of gradually growing our dividend over time as part of maximizing total shareholder return, further demonstrating our confidence in our long-term outlook.

This capital plan leaves us with sufficient flexibility to fund any organic growth investments or to pursue value-creating acquisitions, if we can find them, while continuing to drive total shareholder returns. Our plan for financing leaves us with plenty of flexibility to use our cash flow to retire debt as well.

In summary, the Asco acquisition is a terrific win for us. We are delighted with the company and its team. Asco combined with our debt refinancing plans and our ASR share buyback initiative, as well as our increased dividend exemplify Spirit's commitment to a balanced capital deployment strategy as well as our confidence in our long-term outlook.

The Asco acquisition is a compelling strategic fit that expands our Airbus and military content and also adds world-class R&D and manufacturing capabilities, positioning Spirit for long-term growth. The fact that Christian Boas, whose family built and has owned Asco for more than 50 years, will remain with us following this acquisition is an additional benefit of the deal.

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.

Thanks, Tom, and good morning, everybody. Let me summarize our first quarter financials, as well as our outlook for 2018. So with that, please turn to slide 10.

Revenue for the quarter was $1.7 billion, up 2% from the same period of 2017, primarily driven by higher revenue recognized on the Boeing 737 program due to increased recurring and non-recurring activity, the adoption of ASC 606, higher production deliveries on the Airbus A320 program, and increased defense-related activity, partially offset by lower production deliveries on the Boeing 777 program, and lower revenue recognized on the Boeing 787 program due to ASC 606. Backlog stayed consisted at $47 billion which provides top line stability and growth in the future.

Moving to slide 11. First quarter reported earnings per share was $1.10, compared to $1.17 in the first quarter of 2017. The decline compared to the same period last year was primarily due to lower margin recognized on the Boeing 737, lower production deliveries on the Boeing 777 program, and net forward losses recognized on the Boeing 787 program, partially offset by higher nonrecurring activity on the Boeing 737 program.

As discussed last quarter, there are two primary factors that impacted earnings per share this quarter. First, the forward loss recognized due to a change in pension accounting. On our overfunded frozen pension plans, we generate pension income that was previously reported inside our segment reporting and now under ASC 715, this is reflected in other income, which has no impact on EPS on most programs, except uniquely on the Boeing 787 program, which is in a forward loss position and thus, we recorded the entire value of this pension change, up to line unit 1,405 this quarter and will recover the corresponding offset in other income on an annual basis over the next few years.

The second factor is the shortened accounting contracts due to ASC 606. We are absorbing a higher percentage of near-term cost increases to support our rate increases, as well as the substantially higher cost incurred due to our recovery efforts on schedule. Under the legacy ASC 605 GAAP, the impact of first quarter cost increases would have been spread out over a longer full-year accounting block.

As Tom mentioned, the Boeing 737 program is recovering, but we have exerted a lot of resources in this process and catching up the schedule has been costly in the quarter. While we continue to make progress, comprehensive recovery will depend on improving our supply-chain health, as well as the collection of subsequent supplier claims.

Turning to free cash flow on slide 12. Free cash flow for the quarter was $118 million, compared to $71 million in the same period last year, reflecting a 66% increase year-over-year. The increase was primarily due to lower advance payments, repayments on the Airbus A350 program, and timing of working capital. While the focus remains on reducing the increased costs due to the Boeing 737 recovery in the next few quarters, we are also relooking at some of our capital investments for efficiencies, as well as targeting working capital improvements, both in inventory and payment terms with our suppliers to meet our cash flow commitments. And we remain committed to our long-term objectives of 7% to 9% free cash flow to sales conversion.

Turning next to capital deployment on slide 13. In the first quarter, we repurchased 900,000 shares worth $75 million and also paid $12 million to shareholders through dividends. Today's announcements, the Asco acquisition, the $725 million accelerated share repurchase plan, and the 20% dividend increase are in line with the balanced capital deployment strategy we have been communicating over the last couple of years. We plan to reset our capital structure shortly and are making meaningful investments in the purchase of Asco, as well as plan to purchase a significant portion of our stock.

We are also committed to maintaining our investment-grade rating and thus we'll repay some of the proceeds used to accelerate our share purchases during the remaining of this year. This strategy should keep us in line for approximately 2 times leveraged to debt-to-EBITDA and is consistent with conservative industry averages.

Now, let's look at our segment performance. So, for the Fuselage segment results, please turn to slide 14. Fuselage segment revenue in the quarter was $963 million, up 5% from $917 million in the same period last year, primarily due to higher revenue recognized on the Boeing 737 program due to ASC 606, higher production deliveries on the Airbus A350 program, some increased defense work, and nonrecurring activity on certain Boeing programs, partially offset by lower production deliveries on the Boeing 777 program, and lower revenue recognized on the Boeing 787 because of ASC 606.

Operating margin for the quarter was 12.4% as compared to 15.9% in the same period last year, primarily due to lower margins recognized on the Boeing 737 and the Boeing 777 programs, in addition to the net forward loss charges recognized on the Boeing 787 program related to the pension accounting change. On a normalized basis after reversing change in estimate impact, Fuselage segment margin was 14.1%.

Now turning to slide 15 for our Propulsion segment results, Propulsion segment revenue in the quarter was $395 million, down from $406 million in the same period last year, primarily driven by lower production deliveries in the Boeing 777 program and lower revenue recognized in the Boeing 787 program due to ASC 606, partially offset by higher Propulsion delivery on the Boeing 737 program.

Operating margin for the year was 13.4%, compared to 17.7% on the same period last year, primarily due to lower margins recognized on the Boeing 737 and the Boeing 777 programs. On a normalized basis, after reversing change in estimate impact, Propulsion segment margin was 14.4%.

On our Wing segment results, let's turn to slide 16. Wing segment revenue in the quarter was $377 million, up from $369 million in the same period last year, primarily due to higher production deliveries on the Boeing 737 and the Airbus A320 programs, partially offset by low production deliveries on the Boeing 777 and lower revenue recognized in the Boeing 787 because of ASC 606.

Operating margin for the quarter was 13.5%, compared to 15.8% in the same period last year, primarily driven by favorable changes in estimates that were recorded during the first quarter of 2017. On a normalized basis after reversing change in estimate impact, Wing segment margin was 14%.

And so, finally on slide 17, we are reaffirming our guidance for 2018 with revenue to be between $7.1 billion and $7.2 billion, earnings per share to be between $6.25 to $6.50, free cash flow to be between $550 million to $600 million, and an effective tax rate of 21% to 22%. Clearly, the first quarter results were significantly impacted by the extraordinary measures we took to ensure our delivery commitments to our customers and the disruption we absorb due to our supplier issues.

Guidance is now dependent upon [ph] after (24:22) accomplishing a sustained recovery of the Boeing 737 production line, which we have planned for the middle of this year, and the subsequent productivity initiative both internally, as well as in our supply base that are necessary to recover to our long-term plans.

Guidance also includes both of costs we incurred in the quarter, as well as the favorable impact to our planned ASR. Also, our guidance does not include any impact of the Asco acquisition, or the costs associated with that transaction, including financing costs. We will adjust for those as we conclude that activity, which is likely to be later this year.

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

Thomas C. Gentile

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

Thanks, Sanjay. We have summarized our key messages on slide 18. While it was a challenging first quarter due to rate increases and disruptions in our supply chain, our recovery plans are being implemented and are getting us back on track to our delivery schedules.

We continue to work with all of our customers to enable them to grow their production rates to meet the significant long-term 5% annual growth in air traffic. With sizable work packages in all the major programs for Boeing and Airbus, Spirit is well positioned to benefit from these positive long-term trends for the industry. The acquisition of Asco that we announced today will enable Spirit to accelerate our growth with Airbus, expand our military sales, increase our fabrication business and strengthen our supply chain to support our recovery plans.

As part of the funding for Asco, we are refinancing our debt and bringing our leverage in line with industry peers. We are focusing a portion of the proceeds on an accelerated share repurchase of $725 million and then increased our quarterly dividend by 20% to reflect the confidence we have in Spirit's long-term outlook.

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

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we'll begin the question-and-answer session. [Operator Instructions] And our first question today comes from David Strauss from Barclays. Please go ahead with your question.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Good morning. Thank you.

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

A

Good morning.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Tom, following up on the Boeing 737 issues, can you give us an idea of how many shipsets you're behind? Just kind of eyeballing your deliveries, it looks like maybe you're 20 or 30 units behind as of today.

And what was it about this move that – move from 42 to 47 units, or was it that combined with the derivative model of the Boeing 737? What was it about this move that created the problems that prior move-up – [ph] moves up on rate had on costs (27:32)? Thanks.

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

A

Well, we've got behind as many as 13 to 15 units. We've cut that down to about 5 unit and we'll be caught up by June. So that's just the dynamics of the recovery.

What really caused it, as I mentioned, is that the rate increase is not just going up in terms of the number of aircraft we're producing. And we've gone from 42 to 47 units, now to 52 units. So, we're up 24%. And so that's a significant challenge in itself.

But we're really also shifting from NGs to MAXs. And so, you've got the NGs going down quite dramatically and MAXs are going up. So this year, we will produce about half MAXs. And there's a learning curve as you start to produce, which is effectively a brand-new aircraft. We're getting through that learning curve now as we started to produce more MAXs and we expect a much stronger second half of the year.

And then in addition, this kind of challenges we're seeing, it flows down into the supply-chain and many of our suppliers struggled with new capital that they're trying to get on hiring people and they got behind in their deliveries. And so, as a result, we had more traveled work in our shop. And I mentioned that those out of sequence jobs. So if this part doesn't show up in the station where it's supposed to be, the aircraft, the fuselage has to keep moving or the whole plant would get locked up.

And so then, later we have to go back in to put that part in place down the line. It takes longer to do it at that time. And we also started to get a little bit of a backup at the end of the line. That's why we put in the dedicated team at the end of the line to expedite deliveries.

But those things resulted in more overtime. We had to get some contractors to come in and help us. Boeing sent in, in fact, some of their most experienced mechanics to help us at the end of the line. And then, in addition to that, we had expedited freight. We were shipping late from our plant and so, we had to put them on expedited trains. And so that was really the cause of it and how it manifested itself in terms of additional costs. Now, as I mentioned in my comments, all those things are turning around. We are starting to ship with more lead time that will enable us in the second half of the year to reduce our overtime, release the contractors, and also avoid expedited freight.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Okay.

Operator: Our next question...

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

A

Great. Go ahead.

Operator: Our next question comes from Robert Spingarn from Credit Suisse. Please go ahead with your question.

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

Q

Good morning.

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

A

Good morning, Robert.

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

Q

One for Sanjay and one for Tom. Sanjay, could you give us some sense of the dollar magnitude in terms of the shortfall from the Boeing 737 delays, just some way to quantify what that shortfall was? And then bridge us to why that doesn't impact your guidance especially on free cash, unless it's just contained in the range? And then...

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

A

Yeah...

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

Q

... Tom, I – yeah, go ahead, Sanjay.

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

A

No. No. Go ahead, please ask your questions.

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

Q

Tom, the question for you is what's your appetite for further acquisitions of the type you just did? And what is the ceiling for leverage for Spirit?

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

A

Thanks, Robert. Let me go first and then Tom can jump into the second question that you asked him. At a very macro level, some of the headwinds that we faced in the first quarter are quite similar to what we faced in Q4 last year. So, to give you a magnitude now, we both said in our prepared comments there is obviously a benefit of the accelerated share repurchase on the earnings per share calculation.

Everybody can do that calculation. Obviously, the delta is what you may have assumed we would do it naturally in the rest of the year versus the impact of this acceleration. And that fundamentally is offsetting the headwind that we are seeing on the Boeing 737 costs, both in the first quarter and probably lingering on a little bit into the second quarter.

We expect to be on track by the middle of the year like Tom said. And when Tom, just answering David's previous question, when we say we are about five units behind, we're kind of expediting that. We're not sort of delaying loads or anything like that at our customers. We're just expediting those units so that they get there well in time. By June, we anticipate to be caught up on a sort of a normal basis, which by default has buffer built into it.

Your second question was also associated with cash flow.

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

Q

Before you go there, are we talking about a $20-million, $30-million EBIT shortfall in the first quarter from everything you just described? I'm not talking about earnings per share, but absolute dollars on EBIT and cash flow, and then when that gets recovered and how?

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

A

Yeah. No, it does. It does – that is a range. That's a fair range, Robert. And so the recovery plans that we've laid out to try and get back on track and, as you know, we had built in certain – we have rates going up in the latter half of the year that if we execute should provide a little bit of upside.

Internally, we've created numerous plans to cut back on areas that we think are a little bit discretionary, and that's where I was going to take you with my cash flow comment, because while the impacts to the EPS due to the ASR will offset the impacts to EPS because of the headwind on the Boeing 737.

As far as cash flow is concerned, again in my prepared remarks, I think I was saying we're looking at more efficiently managing our capital expenditure and also got some initiatives around working capital both in terms of managing our inventory better in the latter half of the year as we stabilize, as well as going and working with our suppliers on payment terms and collections and so on and so forth. So that's the initiative we baked in as far as cash flow is concerned.

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

A

And getting to your second question regarding appetite for further acquisition and ceiling for leverage. We remain committed to growth and we're still focused on Airbus content, military content, low cost country footprint as priorities. However, having just completed the Asco acquisition, which is a company that is really perfectly aligned to the strategic objectives that we have outlined, our focus for the rest of the year is really on integrating that acquisition and really focusing on the recovery plans. We've got to make sure we meet our deliveries to our customers. We've got the rate break coming up with Boeing and also Airbus is going up on the narrow body. And we want to make sure we deliver on that. So, our focus for the rest of this year, certainly, is going to be on integrating Asco and recovering to our delivery schedules and meeting our commitments to our customers.

In terms of our capital structure, we've said for a long time that we've thought two times in terms of debt-to-EBITDA leverage was a good target. It's the industry average. We're going to be at that level as we get into toward the end of the year and we feel comfortable in that range. We're committed to being investment grade and we want to stay there. And so, we will work very carefully in determining our future leverage ratios to ensure that we remain in that investment grade area.

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

Q

Thank you.

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

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.

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

A

Good morning, Sam.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

I was wondering if you could talk a little bit more about Asco. If I just look – it looks like a couple of years ago they were running probably 10% higher in sales than what you're showing now. So, can you just talk about what's changed, what that's done to their margins? And then when you think about their capacity, do they have the capacity for higher rates, or do you need to invest more in the facilities in order to drive that – drive these rates higher?

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

A

Right. Well, Sam, Asco has been a very strong performing company over the last few years and they're constantly adjusting their portfolio. They've cut out some of their low profit programs, but at the same time, they've won a lot of new work on very high growth platforms for the future, including the Embraer 190, Embraer 195, the C Series, the F-35.

So, as we look forward from now, from 2018 going forward, we see 10%-12% growth over the next couple of years. So, a very strong order book that's all starting to come in and we're very pleased about that. Very excited to get that team onboard so that we can combine it with our fabrication business and help supercharge the growth of that.

So that's how we're looking at it. Their facilities are extremely efficient. They're highly automated. They're very concentrated. They only have four of them. They do have a little bit of excess capacity. We will be able to fill that up very quickly by absorbing some of our supply-chain activities and helping to lower cost and improves delivery. But beyond that, they do have room in their facilities in terms of bricks-and-mortar for expansion, but we would probably have to make some capital expenditures for equipment as it continues to grow.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

And as part of your strategic look, is there any way you can look at that $400 million in sales and say what is the non-Boeing work, so the military Airbus kind of the Embraer, Bombardier?

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

A

Boeing is about 20%. Airbus is about 50% if you look out a couple of years from now. Military is about 10% and growing. So those are some of the rough numbers. And then they – as I mentioned, they've got some Bombardier and Embraer work as well.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

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

A

You're welcome.

Operator: Our next question comes from Doug Harned from Bernstein Research. Please go ahead with your question.

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

Q

Hi. Good morning. It's actually Finbar Sheehy standing in for Doug. I'm wondering if you can give us any details of the cost synergies you expect to achieve from the acquisition of Asco, how big and where from?

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

Right. We've identified about 15% – excuse me, $15 million of synergies which is about 4%, and that's a fairly typical range for these kinds of acquisitions. The industry average is 4% to 6%, and so we're kind of right in that range. Some of it will come from normal head count reductions as we look at the indirect expense and overlap and some of the functional areas that you would typically see in an acquisition of this.

There is an opportunity in Stillwater to fill up that capacity. That's one of their plants in Oklahoma. We've already identified how we will do that very quickly. So that will generate some synergies. And then a big chunk, as you'd expect, is in supply chain. They're a structured business just like we are. We buy a lot of the same things. We buy it at a much higher scale. And so, we've already looked at their purchases and identified opportunities to bring it more in line with what we purchase things at, and that will be a big chunk of the synergies.

And then there's also some engineering and R&D synergies that we expect to get. So, the synergies that we've built, the $15 million are all cost synergies. We do expect that there will be some revenue synergies, but we didn't count on those in terms of valuing the deal.

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

And just on the number of locations, you mentioned that they had four operating locations. You have a relatively limited number of locations yourself at the moment. How do you think about the management bandwidth requirements of adding four more?

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

Well, four is a very manageable number. They have – first of all, they have a great operating team already, and that we will inherit. So, this will be part of our Wing segment, as Sanjay mentioned, and we will have our Head of Fabrication oversee these plants. We have a very detailed integration plan that we are already developing. They are already extremely automated, well-functioning plans, so integrating them operationally will be very straightforward. And so, we look forward to absorbing them into our overall fabrication activity.

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

Great. Thanks.

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

Jon Raviv
Analyst, Citigroup Global Markets, Inc.
Q

Thanks, and good morning.

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

Good morning.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

What is the path to achieving guidance for this year? It sounds like you have some things that you still have to achieve. Just give us a sense for how much is in your control and not in your control for the year?

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

A

Right. I will give you a high-level view. So, in terms of recovering, the recovery plans that we outlined show that we get to – back to deliveries on schedule by the middle of the year. And at that point, our overtime will start to come down, the expedited freight will go away, and the surge resources will go away. So those things are all critical.

And then as Sanjay mentioned, we've also looked at our discretionary non-labor expenses and really buckle down on those to take out all the discretionary items. So that's really the path on the EPS side. Now, of course, we also have the ASR and that will contribute on the EPS side.

On the cash side, it's really about managing our capital expenditures very efficiently, making sure we are only focusing on the right priorities and that we streamline them as much as we can and maybe even defer something if it's not mandatory.

And then working capital, as we look at inventory, accounts payable, accounts receivable, we have a number of initiatives across each of those areas. So that's how we maintain and recover the guidance for the cash flow. Sanjay, anything else to add to that?

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

A

No. I think, Jon, it's a fair question. I mean, at this stage, everything is sort of in our control other than things like the weather, which sometimes can create havoc, but we have three or four initiatives, primarily the initiatives are in our floors, in our factories, but the second big initiative is making sure that our supply-chain gets healthy.

And like Tom said, we've got SWAT teams deployed out there. We're making some good progress. The good news here is that out of 600-odd suppliers, there are about 15 that need to get back on track. And we are working that whether we are working with them directly or finding ways to offload work that they are currently doing to try and ease the pressure, but those are the things that internally and externally kind of we're working on to make sure that we meet our commitments.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

And just to follow-up in terms of the free cash flow making up for the loss on the costs, those working capital and CapEx initiatives, are those onetime in the sense and then the CapEx goes up again next year, or we're kind of accelerating some of those working capital things you've talked about in the past, with the mind to getting that 10% free cash flow margin over time?

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

A

Well, the working capital in terms of inventory or working with supply-chain, financing, et cetera, obviously, those sometimes have onetime benefits. But frankly, inventory then also helps with slow days, and just makes our own factories a lot more efficient. So, it has kind of double benefits not just in terms of cash flow, but in terms of costs which we execute in our factories.

Capital, just to give you a little bit more clarity. I mean we've got a fairly wide range in terms of capital expenditures for the year. More likely than not, we're going to be at the lower end of those numbers. Now, we're not deferring anything but we are taking advantage of certain sort of leasing opportunities, or we've actually and you may have seen in the press in the last quarter, we benefited from working with the state and the city and the local governments to try and getting an appropriate amount of help, which makes sense because of the employment that we are generating in Wichita and other places.

So, you marry all that together, we think we have some better ways and more efficient ways to still go and execute what we need to. And like Tom said, if there's something that's totally discretionary that would have been a nice to have, we are sort of relooking at that in light of what we need to do to keep our commitments.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.
Q

Thanks so much.

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

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

Hi. Good morning, gentlemen.

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

Good morning, Rajeev.

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

Good morning.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

Would it be fair to say that the costs that you incurred, or are going to incur in the first half of this year are temporary, and shouldn't carry forward? Or should we assume that some of the adjustments that you're making will carry forward and impact margins as we look beyond this year?

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

I think you'd be fair to assume that these are not going to carry forward. These are events that are tied to initial disruptions as we went up in rate. The supply chain disruption caused us to have more overtime, more surge resources and expedited freight. As the schedules get back on track, all of that will go away. So, we're looking at a much stronger second half of the year and a recovery therefore in the margins and in the overall performance. So, these are not going to repeat as we go forward. The corrections and the schedule of recovery that we have will mean the second of the half year will be better than the first half.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

And, Sanjay, you provided some good color on looking at your capital spending, et cetera. Are you in a position maybe to provide some color on post-2018 spend if we're going to go back down to [ph] $250 million (45:44), or so level that we've been talking about before?

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

A

I think my comment there, Rajeev, will be pretty much the same. I mean, as you know, we're going through this lumpy capital right now because for all the right reasons, our rates are going up, and you know that next year, the rates are going up on the Boeing 737 to 57 units. So next year is in line with this year in terms of capital. But I think we've given you some color on the fact that once the rates have stabilized, then our normal CapEx, which is close to our depreciation, isn't this large.

So, over the long term, if the rates were to – listen, we want the rates to keep going up because these are the best programs we have. And we are happy to invest in these programs in terms of capital if the rates continue to go up, and there's always that discussion about further rate increases. But once that's done, our capital – our core capital is, obviously, significantly lower than what we are spending these days.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Very helpful. Thank you.

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

Carter Copeland
Analyst, Melius Research LLC

Q

Hey. Good morning, gentlemen.

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

A

Good morning, Carter.

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

A

Good morning, Carter.

Carter Copeland
Analyst, Melius Research LLC

Q

Tom, I just wanted to ask about – I noticed the change in the proxy in the incentive comp to emphasize free cash flow, and I wondered if you might comment on what do you think that means about the longer-term opportunity you see in cash versus any margins or growth? It was a decent-sized shift, so I'm wondering if you can comment on that.

And secondly, I'll just go ahead and ask the second. Obviously, there's a lot of discussion around narrow-body rate expansion, rate studies, the timing on that. Maybe just give us some color on when Spirit could be ready for a step to higher than announced rates and how you think about the capital steps associated with that, when should we be thinking we'll begin to see that if we get those announcements out of Boeing and Airbus? Thank you.

Thomas C. Gentile A

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

Okay. So, on the incentives, we did put emphasis on free cash flow because that's what we have talked a lot about with all of you and with our investors and with our board is the importance of free cash flow. And we've said that we are targeting 7% to 9% and always, of course, trying to exceed that with our internal targets. But we wanted to get all of our team aligned to those same objectives. And so that's why we put the emphasis on that.

We feel confident in our long-term outlook. Obviously, the first quarter, we incurred some additional costs. But as our schedules recover, those costs will go away and we will have a better back half of the year. So, the margins will get back to their normal levels, and we will continue to push on that. So that's the focus on free cash flow.

With regard to rates, we are focused right now on hitting this current rate break on the Boeing 737, which is getting to 52 units and next year to 57 units. The Boeing 787 is going up from 12 to 14 units next year. So that is certainly keeping us busy. And then, on the Airbus side, similar discussions with the Airbus A320 and the Airbus A350 both going up.

So, we are obviously working very closely with Boeing and Airbus and keeping track of what's going on. The market still looks pretty strong, particularly on the narrow-bodies. If we look at the book-to-bill rate last year, it was 1.6. So, the backlog actually grew quite substantially on the narrow-bodies. So, our focus is making sure we do the current rate breaks well and the next one. It generally takes us about two years to execute a rate break.

We will be working closely with Airbus and Boeing to understand what their plans are, and if they make any decisions, we will absolutely support them. These are – as Sanjay said, these are our best programs. And if the OEMs choose to go up in rate, we will do everything we can to support that. We are very capable of doing it. We have the capital to do it, we have the expertise, and we would look forward to it.

Carter Copeland Q

Analyst, Melius Research LLC

So just to be specific, on – if both guys were supposed to go or are planned to go to 63 a month on the narrow-body to 2020, would that necessitate any investment on your part later this year or early in 2019? Thanks.

Thomas C. Gentile A

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

Well, the rate break, as I said, it takes about two years to effect. From the standpoint of our infrastructure, we have sufficient infrastructure. We have to make some marginal improvements and upgrades. It would require some capital investment, of course, because there would be more rates. We always discuss with our partners in terms of how we split those investments, and those discussions, obviously, haven't happened because there's been no decision yet.

Carter Copeland
Analyst, Melius Research LLC

Q

Okay. Great. Thanks, Tom.

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

A

Thanks, Carter.

Operator: Our next question comes from Noah Poponak from Goldman Sachs. Please go ahead with your question.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good morning, everyone.

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

A

Good morning, Noah.

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

A

Good morning.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Hey. So, it sounds like no change to the medium- to long-term margin targets by segment that you've given in the past. Is that correct?

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

A

Yes. That's right.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

And I guess in the second quarter of this year as you have some of these challenges lingering, I mean, I know – I hate to ask about long quarter, but just to get us honed in on sort of the transition from first half to second half, any incremental color you could give around where you see the margin transitioning through the second quarter, compared to where you were in the first versus [indiscernible] (51:42) longer-term margins?

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

A

Well, yes, we said some lingering effects in Q2. The recovery plans are still going on. We still have higher overtime in some of the contractors and some expedited freight. That starts to go away in the June timeframe. So, the back half of the year, you'll start to see the improvement.

But we are going to have more deliveries in the second quarter as we catch up to the schedule. So, there's some lingering effects in Q2; the bulk of the improvement you'll see in the back half of the year. But we're very confident in terms of what that looks like as our recovery plans take hold.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And then, Sanjay, just as you're performing ASR in 2Q, and then I guess that is the full-year's repurchase, one, can you just tell us what share count is in your earnings guidance range, and then anything you can tell us about the shape of the share count as you look at what creep you have and the other moving pieces?

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

A

Well, Noah, what I can tell you is we've announced that we're going to execute the $725 million accelerated share repurchase. I mean, something of this magnitude we intend to put in place as quickly as we can. So, we hope to execute that in normal typical time, somewhere around six to eight months and that'll be the profile, you can do [indiscernible] (53:05) ...

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

A

We will initiate it pretty quickly.

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

A

Yeah. We'll initiate it right away, but it will take six to eight months to execute. So, if you're looking for a profile that's – your guess is as good as mine.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

No. That's helpful on the six to eight months.

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

A

Yeah.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Thanks so much.

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

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

Q

Yeah. Thanks. Good morning, Tom, Sanjay.

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

A

Good morning, Peter.

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

A

Good morning.

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

Q

I want to circle back just on the supply chain. Thanks for all the details. In particular, the 15 supplier that were struggling, it sounds like they were just missing on dock dates and it was probably very visible. But how – can you give us some insight into kind of the health of the other 585 supplier? I mean, we're going up in rate. Back to Carter's question, the rates might go even harder – higher. How are you feeling about the rest of the supply chain in terms of dealing with these higher rates?

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

A

Overall, pretty good. We have obviously a lot of interaction with all of our suppliers. We are constantly assessing their rate readiness. So, we're looking at their infrastructure, their capital, their tooling, their staffing, their training plans, all of their programming. And so, generally speaking, they're all keeping up with their schedules and their rate breaks. And so, it's something we monitor very closely.

And the 15 supplier that got behind, some of it was because they ordered their equipment late and it took them longer to get up to speed. Sometimes, it was a difficulty in hiring people. So, there is a whole variety of things.

What we've done is we put SWAT teams with some of our operations experts out at all of those 15 suppliers to help them recover. But that said, this is something that's ongoing. We have to keep working at it every day. Even though the other 585 are going well today, we've got to make sure they stay healthy, and we work with them to ensure that.

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

Q

Yeah. And just as a follow-up, were you able to look at Asco's supply chain and the health of that as we're looking at this transaction?

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

A

Yes. I mean a lot of their suppliers are suppliers that we already deal with. So, we had a very good handle in terms of the health of their supply chain. What I had mentioned in my comments though is because they bring some additional capacity and some specialized capabilities, both in processing and shop pinning and heat treatment and chemical treatment and things like that, is we see it as helping us with the recovery and providing additional support to our supply chain. And so, that's why it's another reason we're very, very happy about the acquisition.

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

Q

Appreciate the color. Thanks, guys.

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

A

Thanks.

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

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Thank you very much. So, you mentioned supplier claims and you also have, I think your insurance claim out for those [ph] of the other (56:07). Give us some color on both of those and how much you expect to get this year to kind of get you home to your estimates?

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

A

Right. Well, on the supplier claims, there has been disruption. And so, we are going to assert with our suppliers to recover some of that when it was through their actions that we incurred them. So that's going to be a substantial amount. And so, I don't want to get into the exact details of that, but it will be a substantial amount.

And it will be something that we'll work on over the course of the year. And by the way, it's no different from what our customers sometimes ask us if we are late. Now, on the insurance claim, the situation there is that we have tried to settle it. We have not been successful. We have initiated legal action, and that is carrying true.

At this point, it doesn't look like we will recover anything from that this year, and so that will be next year. That was some of the pressure that we did incur in this quarter. We are very confident in our claim. We'll continue to try to settle it for a reasonable amount, but we're not going to accept less than we consider fair. And at this point, that's where we are. So, we have initiated the legal action and we will see it through to its conclusion.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

So, the supplier claims, if they're a substantial amount, did you in your numbers in the first quarter or in your guide assume any recovery there, or is whatever you recover net of what you might have to pay Boeing going to essentially be gravy?

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

A

No. No. We assumed that in our recovery plan and so, it's part of our recovery plan. And it's [ph] net (57:52), of course, what we would have other obligations for.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Thank you.

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

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Thanks very much and good morning.

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

A

Good morning, Seth.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Good morning. So just as a quick clarification to start. When you say back on rate by mid-year that means 52 a month, right?

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

A

Yes. So, we'll definitely make the rate break, but it means that we'll catch up all of the behind schedule as well. So, we will be fully on schedule and we will be on track with the 52 units rate break, absolutely.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

All right. Okay. Okay. And then secondly and just one more small question, when you talk about the Asco acquisition being accretive to, I guess, it would be 2019 full-year adjusted EPS, what's the adjustment for there?

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

A

Well, the adjustment piece is all sort of the deal amortization kind of cost. But let me answer that question maybe on a GAAP basis. I think...

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay.

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

A

So, without any adjustments, but then again, I know there's been some Q&A in the early morning commentary about what we are paying, et cetera. Fundamentally, on an EBITDA perspective, we paid about 9.3 times, after synergy at 7.6 times. So, we feel very good at this transaction that we've executed.

And on a GAAP basis, I mean, year one, obviously, there will be some costs to recover that synergy. So, it's probably a little bit neutral but obviously immediately thereafter, it's going to be accretive to our cash, to our earnings per share and so on and so forth. So, I think we are pretty proud of this deal.

One other quick thing while I have you, and I know you asked that question about recovery. And Tom and if anybody else is listening on the call, listen, keep track of the number of deliveries we do. You should see a very healthy improvement in the second quarter of the total number of deliveries that we make particularly on the Boeing 737 program. That will give you guys a very good indication that we're getting back on track.

So not only are we recovering like Tom said to the 52 a month, but we are also going to catch up on all of the ones that did not happen or accelerated – didn't happen in the first quarter. So, you should see a very large spike in the amount of deliveries we do in the second quarter.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Thank you.

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

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Yes. I wanted to pursue the normalized margins, Sanjay, that you talked about in the long term, because the reality is now you've got the shorter pools, you've got more expenses like you said they were. So, can you tell us how long the current pools are, and what kind of the margins might be with the shorter pools relative to the longer-term numbers that you previously have talked about?

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

A

A very fair question, George. I mean, we're all sort of working through sort of the shortened blocks that we have particularly on our sort of contract that we recognized revenue over time.

And this includes some of the high-volume programs like the [ph] Boeing 737 (61:00) and so on and so forth. So, what you see is some very significant volatility in the course of a quarterly result, because these contracts or these blocks are around that – those kinds of timeframes. So, a little bit long, but they're no longer the sort of annual blocks.

So that's why you'll see some margin volatility in the first quarter, probably carrying on to the second quarter. But once these programs are working, they're high-volume programs, and you should see margins more consistent with what we used to do in the past. Now, clearly, also on the ASC 606, there are some benefits and there are some negatives.

On the benefits, as we all know, there's the benefit of that program like the Airbus A350, particularly on the Fuselage segment will generate margin and contribute equally. So, we've got the issue with the pension income that's naturally going to come out this year and next year and forever. So, there are some pluses and minuses. But with all of that, like Tom said, once we stabilize and once we execute to our recovery plan, you should start seeing margins that are consistent with sort of annual numbers that we've done in the past.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

But you're going to be steadily raising rate this year and next year as well. So, does that...

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

A

I agree. That is the tailwind.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Okay. And then just a quick one. You only delivered nine Boeing 777s in the quarter. I thought you were delivering at five a month even though Boeing is delivering a three and a half. So, is there any delays there or why was the numbers so low?

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

A

No. I mean, it's really effectively three and a half is what the delivery rate is right now. As they're going through the transition from the Boeing 777-300ER to the Boeing 777X. So everything is right on schedule. It's just that the deliveries right now are lower. So that's – as Sanjay said in his remarks, that's been a headwind for the year. That will pick up in out years as that program picks up and Boeing 777X gets into the market.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

But Tom I had thought that you were still going to deliver it 5 units, even though Boeing was delivering it three and a half.

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

A

So, George, that's not the case. There's been some communication around that. That's not true. I mean like Tom said, the total deliveries – granted we do do a few more deliveries associated with EDP units, these are the engineering units, but even if you add that, the rates are significantly down and you're not doing five a month.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

But we are perfectly in line with Boeing on the 777 deliveries...

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

A

Yes. Yes. Completely in line.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Okay. Thanks.

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

A

Yeah. Thanks a lot.

Operator: Our next question comes from Robert Stallard from Vertical Research. Please go ahead with your question.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

Thank you so much. Good afternoon.

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

A

Good afternoon.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

And just a couple of quick ones from me. First of all, Sanjay, on the cash flow statement, there's a reversal on the forward loss provision of $36.9 million. I was wondering if you could explain what that is?

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

A

So Robert, there has been a whole bunch of change as you know as part of the ASC 606 because there were certain things that were in our deferred that made into contract assets and contract liabilities. Let me suggest to you, we are actually hoping to accelerate the filing of our Q1 get it out this week. You should see a lot of detail around that. Just to put your mind at ease, there's nothing new in there other than a reclassification from inventory. So, you'll get that it when you read the Q and you'll be able to see the details there.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

And was that previously anticipated in your guidance for the year?

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

A

Yes.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

Yes. Okay. And then the second quick one; on Asco, the cost synergies you've laid out, what sort of timeframe do you think it will take to achieve these synergies?

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

A

We will achieve them over the course of the next year or so. So, we anticipate certainly 2020 we'll have full-year run rate on them, but we'll capture them over the course of the first year. So, if we close by September, a year, we'll be kind of up to run rate by the fourth quarter of 2019.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

Okay. That's great. Thank you very much.

Operator: Ladies and gentlemen, our next question comes from Ken Herbert from Canaccord. Please go ahead with your question.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.

Q

Yeah. Hi. Good afternoon. Just two quick clarifications, really. First, on Asco, what percentage of the business or the mix is build-to-print?

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

A

That's something I don't have right at the tip of my tongue. They do a lot of design-to-build. They have the engineering capability to do that. I think probably most of their work is build-to-print. I don't have the exact percentage. We'll get that for you, Ken, and we'll follow up.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.

Q

Okay. That's helpful. And then just – you made a comment, Tom or Sanjay, in your prepared remarks about some inventory build or buffer stock around the Airbus A350. Is that a material amount, or are we just talking about a few shipsets, or is that – I mean, can you just quantify that as part of the working capital build this year?

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

A

Yeah. It's just a few shipsets. The idea is that we don't want to be hand-to-mouth. And I mentioned that the weather disruption in North Carolina threw us off [ph] kill through (66:34), we have to get back on air shipments, which is expensive. So, what we want to do is have four or five shipsets that are in buffer on the water at the dock. So that if we do get a weather disruption, we can absorb it without having to resort back to air shipments. But it won't be material in terms of inventory.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.

Q

Okay. Great. That's it. Thank you very much.

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

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

Operator: Ladies and gentlemen, that does conclude today's presentation. We do thank you for joining. You may now disconnect your lines.