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Spirit AeroSystems Holdings, Inc. (SPR)

Q3 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

I would now like to turn the presentation over to Ryan Avey, Director of Investor Relations. Please proceed.

Ryan Avey

Director-Investor Relations, Spirit AeroSystems Holdings, Inc.

Thank you and good morning. Welcome to Spirit's third quarter 2018 earnings call. I'm Ryan Avey and with me today our 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 yourself 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 in 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, Ryan, and good morning everyone. Welcome to Spirit's 2018 third quarter earnings call. Before I get started, I'd like to introduce Ryan officially as the new leader of our Investor Relations team. Most of you are probably already familiar with Ryan from his previous roles in IR. He brings a broad experience from working in a number of different functions at Spirit which makes him a great fit for this position. We are delighted to have Ryan in his new role and he looks forward to extending his relationships with those of you he already knows and meeting those of you he does not.

Turning to the third quarter. Our main focus was on improving deliveries to support our customers which we did. We made great progress continuing to improve the consistency and efficiency of Boeing 737 deliveries during the quarter and are now fully recovered to our delivery schedule.

In supporting our customers during Q3, we did spend more than anticipated but for very good reasons. Our focus now and for the rest of Q4 is on improving efficiencies, reducing overtime, avoiding expedited freight, and reducing contractors for surge capacity.

We are shipping Boeing 737 fuselages out of our factory on master schedule every day and in sequence requiring no expedited freight cost. We have rebuilt, upgraded the system, so there is no risk of disruption to the customer.

I want to take a moment to thank our Boeing 737 team for all their hard work and dedication this year, recovering schedule in a large scale high rate manufacturing environment like the Boeing 737 fuselage, while we are transitioning from the energy to the NG to the MAX is no small accomplishment. I'm very proud of the performance of our operational teams.

We've also seen significant improvement in supplier shortages. While we are still working with a handful of suppliers, we have dual source or in-source work to eliminate most disruptions. Our out of sequence traveled work is now down to our targeted levels in routine control limits. The improvement in these two key metrics provides us with line of sight to a balanced factory with reduced overtime and contract labor costs in Q4 and for 2019.

Another main focus for the second half of the year has been preparing for rate increases across multiple programs including the Airbus A320, Boeing 787 and importantly the Boeing 737, which is ramping to 57 aircrafts per month next year. We are taking lessons learned over the last year and applying them internally and in our supply chain to ensure a smooth transition. Specifically on the Boeing 737, we have increased training time for new employees and have already brought on 90% of the employees required for 57 aircrafts per month. By getting these employees in early, we can ensure they receive the proper amount of training and on-the-job experience to hit the ground running at higher levels of productivity when we transition to 57 aircrafts per month early next year.

In addition, we have increased our due diligence with suppliers, proactively in-sourcing or dual sourcing parts to protect against any shortages. With this level of preparation we are very confident in our ability to execute a smooth rate break to 57 aircrafts per month.

One other factor which gives us confidence in the rate break of 57 aircrafts is our experience with producing the Boeing 737 MAX. A major driver of some of the challenges we experienced this year was the transition from the NG to the Boeing 737 MAX. While both derivatives flow down the same lines in our factory, the Boeing 737 MAX is about 35% different. It has different work instructions, different processes, different tools and different parts. And so there was a learning curve in our factory and in our supply chain.

Next year, production will shift significantly to the 737 MAX, so over 90% versus about 50% this year which will help to minimize any model mix disruption. Also at 57 aircrafts per month we will have three balanced lines each producing about 19 per month with built-in surge capacity. This balanced production system will lead to increased productivity and efficiency. We are also on track on our Boeing 787 program to achieve 14 aircrafts per month next year. Our Airbus A350 fuse-led factory in Kinston, North Carolina is also performing well. Hurricane Florence caused significant disruption to the region a couple of months ago, but our team was able to manage through the situation effectively. We shut the plant down in an orderly manner for three days and then reopened it. While we experienced some minor disruption, the buffer we had built up in previous months allowed us to avoid any air shipments. Our team is now working to rebuild the buffer which we depleted recovering from the hurricane. With the buffer in place, we will be able to mitigate major factory disruptions and avoid air freight in the future.

We also continue to work on closing the Asco acquisition. During the chorus of the Phase 1 review, the European Commission identified issues that it requires to be addressed regarding the transaction. These issues do not involve any divestitures, nor do we anticipate they will impact the economics of the deal. We remained confident that we will close the deal, and we continue to be very enthusiastic about the strategic bit of Asco with the rest of our operations.

Turning to some additional accomplishments in the third quarter. We announced the creation of a new research and development complex at our Prestwick Scotland site to open next year. Innovation efforts will focus on infusion processes for composite materials, assembly automation, rapid prototyping, and virtual and augmented reality. We also announced research on efforts to commercialize a new proprietary method reshaping titanium raw material and elevated temperatures which can replace more expensive techniques such as die forgings and extrusions.

Spirit has trademarked this process, which we call Joule Forming. Additionally, we are working with Norsk Titanium to initiate qualification of Spirit's first additive manufactured titanium, structural components for the Boeing 787 program. We expect to have the first 3D printed part flying by the end of the year. These accomplishments highlight Spirit's unique capabilities that make us the partner of choice for current and future aerospace programs.

Innovation is an important priority for Spirit. We're very excited, proud and honored last week to receive the Best-in-Class Award for innovation from Airbus at their Annual Supplier Conference in Montréal. Finally, we delivered the sixth and final system demonstration test article, CH-53K to Sikorsky. This is an important program in our growing defense portfolio, we've already started on the first low rate initial production unit.

Turning to the third quarter financials, we reported revenue of $1.8 million, earnings per share of a $1.59 or $1.70 adjusted for the impact of the Asco acquisition and debt refinancing, an increase of 35% compared to the third quarter of last year. Operating cash flow was $170 million and adjusted free cash flow was $130 million.

At this point I'll turn it over Sanjay to lead you through the detailed financial results. Sanjay?

Sanjay Kapoor

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

Thank you, Tom, and very happy Halloween to everyone. And let me just add my own welcome to Ryan. Many of you know Ryan. Ryan's a young father to two young kids. And even though Tom and I have plenty of time on the call today, Ryan actually had a hard stop and he's going to move this call along, take his kids trick or treating. All right.

Let me summarize our third quarter financials as well as our outlook for 2018. So with that please turn to slide 3. Revenue for the quarter was $1.8 billion up 4% from the same period of 2017, primarily driven by higher deliveries on the Boeing 737 program and increased defense activity, partially offset by lower deliveries on the Boeing 777 program and lower revenue recognized in the Boeing 787 program as a result of the adoption of the ASC 606.

For the quarter, we delivered 431 shipsets, including 160 Boeing 737s; 11 Boeing 777s; 33 Boeing 787s; 165 Airbus A320s; and 19 Airbus A350 shipsets.

Moving to slide 4. Third quarter adjusted earnings per share was $1.70 compared to $1.26 in the third quarter of 2017. As a reminder, adjusted EPS excludes all the costs associated with the Asco acquisition. This includes transaction costs, interest on debt associated with the transaction, and the impact of the derivative instrument, and also excluded is all debt financing costs.

The increase in adjusted earnings per share was primarily driven by a lower share count and a lower tax rate, and recovery of legal fees related to a recent court decision. In addition, we had increased volume on the Boeing 737 program, adoption of ASC 606 on the Airbus A350 program offset by a reduction in production deliveries in the Boeing 777 program, and increased costs related to the schedule recovery of the Boeing 737 program.

But as Tom mentioned, now that we are on schedule, we are focused on improving our cost. So we expect continued cost improvement on the Boeing 737 program in the fourth quarter with declining levels of overtime and contract labor, and elimination of expedited freight. We also expect to close on some supplier and other claims in the fourth quarter.

Now turning to free cash flow on slide 5. Adjusting for the impact of the Asco integration, adjusted free cash flow for the quarter was $130 million compared to $240 million in the same period last year driven by Boeing 787 pricing terms and a cash payment associated with a risk-sharing agreement on that program, higher cash taxes, timing of working capital, lower deliveries on the Boeing 777, and offset by increased deliveries on the Boeing 737 and of course lower advance payments.

I want to further explain a couple of the items impacting free cash flow in the quarter. The Boeing 787 contract includes a risk-sharing agreement which incentivizes both companies to work jointly on cost reduction efforts.

In certain years, the supplemental payment is made annually based on cost in relation to price either by Spirit to Boeing or by Boeing to Spirit. Based on these calculations from 2017 results, Spirit made a cash payment to Boeing this quarter.

And affecting to reduce our exposure on the euro currency fluctuations, we entered into a foreign currency forward contract to protect the purchase price of Asco. The initial contract settled on September 27, which resulted in the cash payment of approximately $15 million which is excluded from the adjusted free cash flow. That contract was subsequently rolled. Upon closure of the deal or the purchase price will be adjusted with an offsetting amount of the forward currency contract and financing activities based on the fair value at that time.

Turning next to capital deployment on slide 6, the $725 million ASR initiated in the second quarter will conclude by yearend bringing total repurchases in 2018 to $800 million. With the ASR coming to a conclusion and consistent with what we have done over the past few years, the board increased the share repurchase authorization to $1 billion. In the near-term, our capital deployment will be designated towards the acquisition of Asco, but return to shareholders through repurchases and dividends are an important component of our balanced capital deployment strategy, and we remain committed to returning approximately 100% of our free cash flow to shareholders absent any other strategic uses.

So, now let's look at our segment performance and for that, let's turn to slide 7. Fuselage segment revenue in the quarter was $991 million, up 4% from $957 million in the same period last year, primarily due to higher deliveries on the Boeing 737 program, increased defense work, partially offset by lower deliveries on the Boeing 777 program and lower revenue recognized on the Boeing 787 due to the adoption of ASC 606. Operating margin for the quarter was 13.6% as compared to 15% in the same period last year, primarily due to lower margin on the Boeing 737 program, partially offset by higher margins on the Airbus A350 program, due to adoption of ASC 606. On a normalized basis, after reversing change in estimate impact, Fuselage segment margin improved slightly to 14.8% in the third quarter, compared to 14.3% in the second quarter. We expect further margin improvement in the fourth quarter as we improve the efficiency of our production.

Now turning to Slide 8, for our Propulsion segment results. Propulsion segment revenue in the quarter was $442 million, up 9% compared to $408 million in the same period last year, primarily driven by higher deliveries on the Boeing 737 program, partially offset by a lower delivery on the Boeing 777 program and lower revenue recognized on the Boeing 787 program due to the adoption of ASC 606. Operating margin for the quarter was 17.2% compared to 17.7% in the same period last year, primarily due to unfavorable changes in estimates recognized this quarter. On a normalized basis, after reversing change in estimate impact, Propulsion segment margin was 17.9% compared to 15.9% in the second quarter.

For our Wing segment results, turning to slide 9, Wing segment revenue in the quarter was $379 million, down slightly from $382 million in the same period last year, due to lower revenue recognized on the Boeing 787 program due to the adoption ASC 606, lower revenue recognized on the Airbus A350 program due to pricing terms, partially offset by higher deliveries on the Boeing 737 program and the Airbus A320 program.

Operating margin for the quarter was 15.5% compared to 12.8% in the same period last year, primarily driven by higher margins on the Airbus A350 program due to adoption of ASC 606. And again on a normalized basis after reversing change in estimate impact, Wing segment margin was 15% compared to 14.4% in the second quarter.

And lastly, turning to slide 10 for our guidance. Our updated guidance for 2018, revenue to be between $7.2 billion to $7.3 billion, adjusted earnings per share to be $6.10 to $6.35, adjusted free cash flow to be between $550 million to $575 million, and a new lower effective tax rate of approximately 20%, due to the transition tax, associated Tax Reform increased R&D tax credits related to 2017, which was finalized during the third quarter and higher state tax credits on investments at our Wichita facilities.

We have incurred substantial cost this year recovering from supply disruptions on the Boeing 737 program, but factory performance has continuously improved over the last two quarters. So our focus is now on continued cost reduction in the fourth quarter and preparing for a smooth transition to 57 aircrafts per month next year. The fourth quarter alive and continued factory stability and supply chain health, but as Tom mentioned, we have high confidence on those key factors. However, we rely on becoming more efficient, which leads to lower contractors, reduced over times, especially in the holiday month as well as modest recognitions of settlements and supply recoveries.

As a reminder, our guidance does not include any impact of the Asco acquisition including transaction cost, interest expenses, impact of derivative instruments, and the costs associated with all the debt financing.

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

Thomas C. Gentile

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

Thanks, Sanjay. 2018 has been a challenging year from an operations perspective, as we transition to new models and higher rates of production and recovered from supplier disruptions. Throughout the process, we kept intent focus on deliveries and meeting our customer expectations. We spent more on items like over time, expedited freight and contractors over the course of the year than we expected, but for good reasons. We are absolutely committed to being a trusted partner to our customers.

Now that we are fully recovered to schedule on all programs, we are working on improving the efficiency of our deliveries driving productivity and recovery margins, while we also focus on continuing to improve quality. Our backlog grew to $48 billion at the end of the third quarter, reflecting the strong demand in commercial aerospace driven by traffic growth. It is an exciting time to be at Spirit and the commercial aerospace market. We are fortunate to have significant content and the best programs in aerospace. We are diligently planning for rate increases across many of these programs next year, which will drive continued top and bottom line growth.

With that, we will be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Today's first question comes from Jon Raviv of Citi. Please go ahead.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

Hey good morning and thanks for taking the question.

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

A

Good morning.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

Tom and Sanjay, I was wondering if you could speak a little bit more to the idea of what you think a normalized margin looks like whether you think you would have approached that or achieved that in 4Q and to what extent you can maintain or improve upon that while you're raising production rates next year?

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

A

Right. Well, we've always thought that a normalized margin would be what we had when our production line was balanced and we were operating in a very stable mode. [indiscernible] (00:21:18) is 2016. Back then we've been at 42 aircraft per month for about four years. Things were stable. We were producing one type of model, the NG; and so margins back then were about 16% on a normalized basis, 16.2%. So that's what we think is kind of the normalized margin overall.

Obviously since then, there have been some changes related to ASC 606, and revenue recognition, tax reform. And so, as we think about that the margins naturally should be higher now based on – on what they were back then. As Sanjay mentioned, our overall segment margins did improve in Q3 over Q2. So overall, they were about 15.6% for Q3 2018, and we do expect to see some additional improvement – modest improvement in the fourth quarter. We're back on schedule. We don't have any more expedited freight. Overtime is starting to come down and we're reducing contractors. So those we'll see an improvement in the margin in Q4 going into next year. So as we go into next year, where we end up at the end of this year, it's going to be again be in about the 15% range. We would say normalized margins next year would probably be 150 basis points above that, reflecting the fact that, we won't have the headwinds that we encountered this year with some of the disruptions we had across the different programs.

So we are expecting to see improvement. You'll see continued improvement in Q4 building on the modest improvement we had in Q3 going into next year and we think that's going to be roughly in line with the margins that we had back in 2016, when we were balanced taking into account some of the changes that have occurred since then.

Now that gets us back to flat and what we've always said in this industry, you have to run very fast just to standstill. Obviously, we're trying to offset escalation and things like material and labor, new tariffs, increases in material prices as well as customer price step-downs, productivity discounts and the like, and so all of our cost reduction programs and productivity efforts are meant to offset those and keep margins about flat to where they were back in 2016.

Jon Raviv

Analyst, Citigroup Global Markets, Inc.

Q

Thank you very much.

Operator: And our next question comes from Seth Seifman of JPMorgan. Please go ahead.

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Q

Thanks very much and good morning.

Sanjay Kapoor

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

A

Good morning, Seth.

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Q

Sanjay, a small question but just -- so that we're all on the same page in terms of our expectations for next year. I think when you announced the Asco deal, you talked about it being accretive on an adjusted basis, and that there'll be some, purchase accounting costs associated with that. Should we be thinking about next year as a GAAP number or should we be thinking about next year as an adjusted number that excludes those that purchase accounting impact.

Sanjay Kapoor

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

A

Yeah, Seth, that's a good question. Again, there's been some question including the second quarter about whether we should have adjusted for certain things or not. The challenge for us has always been trying to find the timing of the acquisition so that we can then include the benefits that you're describing, the accretion associated with what they bring to the table and so on. And that's been the challenge for us.

Now, you've obviously seen that we are so confident about the acquisition. Obviously, we are working in terms of trying to get it closed as quickly as possible but the timing is the challenge here. We will make sure that when we give you guidance in 2019, we will provide as much clarity as we can associated with this acquisition. Again, while we are confident on making this thing happen, these things are always difficult to predict in terms of timing and that's why I'm hesitating a little bit.

One of the things I have tried to do this year whether we agree on completely or not, we have tried to be very transparent on what we are including and excluding, so that you can then go back to our core and measure us in terms of our core performance with and without Asco, including some of the transaction costs, some of the accretions that we will see next year and so on. So, we have that goal to make sure we provide the complete transparency in terms of how we report and show you that in our guidance. But you'll have to wait unfortunately, Seth, until we conclude this deal, so that we can all truly be on the same page, and that would be the best time to have that discussion.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Got it. Got it. Thanks. And then maybe one more that's modeling oriented. Just I think last year when you started to move up from 47 aircrafts to 52 aircrafts a month that happened in the fourth quarter of 2017 and so in terms of thinking about your pace of production on Boeing 737 and when you start to make that move higher and when you expect it to be at 57 aircrafts in a steady state. Is there any additional color you could give about when that rolls out?

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

A

Well, just like this year. We start first with our fabrication businesses because they're a couple of months ahead; that's in the early part of the year. And then we start to get into the assembly part of the 57 aircrafts more toward the middle of the year. And again a little bit ahead of Boeing because of obviously the deliveries of the fuselages [indiscernible] (00:26:56).

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Got it. Thanks very much.

Operator: And our next question comes from Rajeev Lalwani of Morgan Stanley. Please go ahead.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning, Tom. Good morning, Sanjay.

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

A

Hey, Rajeev.

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

A

Good morning, Rajeev.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Tom, I want to come back to some of the comments you made on margins. Would it be fair to say that that 15% segment margin going to 16.5% would be a number that you see in the first quarter of next year or is this sort of you have to just continue to improve and maybe you'll get there or be ahead of it in the back half of the year? And then a quick follow up.

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

Right. Well, we're going to continue to improve on the margins in Q4 as I mentioned, and that will all carry over into 2019. When we actually get to the 16.5% or so, we will see. But it should be in the first part of the year that we start to get up to those levels because we've got some momentum as we go into the year. Don't have an exact date yet, but it will be in the first part of the year as opposed to later.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

Okay.

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

And we'll get up to that level.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

Got it, And then, Sanjay, quick one for you. You talked about the risk sharing agreement with the Boeing 787. I don't think you throw out any numbers. How material is that or was that in the original guide? Shouldn't we be carrying that going forward?

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

Yeah. So I try to describe the best way I could, Rajeev, in terms of the risk sharing arrangement with the scores back into -- on a cash basis. If your costs are better than your pricing and there are some sharing and this thus goes back to how we describe the agreement that we made with Boeing which is I think a win-win from both sides which is everybody contributes towards ideas and if ideas span out that reduce cost from what was negotiated then there are some sharing in it.

And the reason I put it out in my prepared comments was, again, there are some questions associated, but I was trying to explain the cash flow deltas between Q3 of last year and Q3 of this year. And while there are many moving pieces in there, there are significant including cash taxes that obviously had less advances, that's a tailwind; cash taxes are headwind. There is obviously Boeing 737 volume. But the big delta in that explanation is the Boeing 787. There is no secrete we have price step downs in the quarter, but I didn't want everybody to suddenly walk out like there was a huge price step-down et cetera. The cash delta is broken up into both a step-down as well as a one-time risk-sharing payment that we made in the third quarter that obviously will only repeat or not repeat, if depends on how the cost profile goes in the future.

Irrespective, all of these, just so you're also clear was baked in into our guidance. So this is not a surprise at least for us. You're right. I can't give you specifics in terms of how much was the step-down and how much was risk-sharing. The reason I wanted to mention it, they're both approximately the same. So don't walk away thinking that the price step-down was significant to carry on in a different way in the future.

Ryan Avey
Director-Investor Relations, Spirit AeroSystems Holdings, Inc.
A

But it was part of the guidance.

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

A

Yes it was part of the guidance, absolutely.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you and congrats, Ryan, on the new role.

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

A

Thanks.

Operator: And our next question comes from Sheila Kahyaoglu of Jefferies. Please go ahead.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Hi, good morning and thanks for the time.

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

A

Good morning, Sheila.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

And not sparing us off, Sanjay, so appreciate it. In terms of just the step up to 52 aircrafts a month, it seems like model mix was a big factor. Can you maybe talk about other things that you could improve as you step up to 57 aircrafts a month. And just as you do that, how would that be different than the current step up that you just went through in the transition and maybe what the biggest risks are if they are the mix transition?

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

A

Right.

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

A

Well, I'd say the biggest lessons learned were probably getting out ahead of this a little bit more, particularly with our suppliers. I mean some of the supplier disruptions really tilted us and got us off balance which created some of the disruptions. And so one of the things that we're doing to mitigate that risk is we are doing a lot more outside assessments of the suppliers to assess their capacity, their hiring, their overall readiness and we're also looking to dual source and multi-source more of the parts, so that there's less concentration risk, sometimes we insource that, sometimes we put it in other parts of the supply chain, but that really gives us a lot more confidence that we can manage the increase in rate next year, because there's sufficient capacity in part because of that dual sourcing and multi-sourcing.

A second thing is hiring. We were hiring people as we needed them as we went into 52 aircrafts. And there's always a learning curve, there's training. They were learning how to do the MAX, but they're also learning the basics of our production system. And so one of the things that we've done this year is we've done the hiring now for 57 aircrafts way in advance. So, we're about 90% complete for what we're going to need at 57 aircrafts, and by the way, that's going to help us reduce our contractors right now as well. But it also gives us more time to train those people and give them on-the-job experience, so that as we go into 57 aircrafts, they know how to produce the MAX, they're very familiar with our production system and they'll be much more effective and efficient. So, that's the second thing.

I think the third is that we've balanced our production line. And I mentioned it in my comments is that next year we're going to have three lines each producing 19 aircrafts per month, that's one per manufacturing day. But in that we're going to have two surge days of capacity, so surge capacity. So, if something does go wrong, we're able to absorb it a little bit better. What we had when we were at 52 aircrafts is we had two lines that we're reproducing at 21 aircrafts a month and then a third line which was producing at about 10 aircrafts. And so what that meant was that we had an imbalance. We had two lines that that we called one-day lines and the third line was basically a two-day line, so lots of disruption in the factory. Next year, it's three balanced lines, we'll have less supplier disruption because we've done better readiness assessments; we dual source and multi-source more. And then finally, we hire the people in advance so that they are trained and they have on-the-job experience. So I think all those factors will give us a lot of confidence as we go on the 57 aircrafts next year on the Boeing737 line.

Sheila Kahyaoglu Q
Analyst, Jefferies LLC

Very helpful. Thanks, Tom.

Operator: And today's next question comes from Cai von Rumohr of Cowen. Please go ahead.

Cai von Rumohr Q
Analyst, Cowen & Co. LLC

Thank you very much. So you had a legal recovery, how big was that? You didn't specify. And secondly, on the Boeing 787 risk sharing, was that kind of – did you have a reserve for that or did that flow through the P&L in the third quarter?

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

Yeah. So, Cai, let me take those. So the legal settlement, I think there's enough out there in our footnotes and in our disclosures. This is something that is -- this will be the [ph] heart in a (00:34:28) settlement that happened leads to some of the legal costs associated with that that's obviously finally closed and it's about $12 million; and so that's also on the settlement that happened in the quarter.

The risk sharing arrangement, yeah, it's part of like I said, it's part of our guidance. It doesn't really float to the P&L. There's a zero margin program, this whole program. But, yes, it is accrued and I think, if you want to go through the balance sheet, I think, Ryan would be happy to take you guys through the different areas, where – it's a little messy because right now we have the Boeing787 between the contract liabilities that grow the forward loss provisions that go down over time. So we got to take a couple of line on the balance sheet and add them up, but he'd be happy to take you through that. And yes we do approve for it because we do know what we are likely to conclude and so that's baked it into our routine EACs.

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

A

Yeah, and as Sanjay said, Cai, it's deferred by a year, so it's based on what happened last year. So obviously we have all that information and...

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Right.

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

A

...well in advance of what it's going to be for the following year.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Terrific. Just a quick one, Asco, you basically are going to have to re-file. When do you expect to get that done and what is the issue if it's not related to the divestitures?

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

A

Right, well it's related to some of the historic structures that were established in the early days of Airbus. It's something called Bell Airbus and back in the 1970s Airbus set up these consortiums in each of the countries, so that they would only have to deal with one entity in each country and so when the commission looked at that -- this is obviously a very old structure -- that's what they asked us to look at. So, we've been working very constructively with Airbus on this topic, and we're going to relook at the structure of this Bell Airbus entity, and resolve it and then resubmit. So we want to do that in a timely manner. We understand the issues very clearly, so we don't expect that to be too long. And as I said, we remain confident that we can get the deal closed once we address the issues at the Commission Rights.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Thank you.

Operator: And our next question today comes from [indiscernible] (00:36:48) of Bernstein Research, excuse me. Please go ahead.

Q

Hey, good morning.

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

A

Good morning.

Q

You mentioned that there would be some assertions and recoveries from suppliers. I assume that similarly Boeing will be coming to you looking to make assertions in connection with the Boeing 737 delays and the out of sequence deliveries. Have you been accruing that on your balance sheet? Does a provision for that appears somewhere in the income statement, or is that something that we can look forward to in the future?

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

A

Yeah. Well, we've been in discussions with Boeing related to disruptions. And as expected, they have made a claim, as very typical with these things, so they are very complicated. There's a lot of puts and takes in terms of what the drivers are. So we're going through that process of evaluating with them. And as we usually do, we'll resolve this sort of situation in the context of a very broad deep and long-term relationship that we have with Boeing. We've encountered these sorts of situations before, and that's how we expect to deal with them.

Q

So should I take it as there's nothing in the result that reflects the provision for that then?

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

A

Well, [indiscernible] (00:38:02) obviously a big chunk of how we've been expediting our deliveries, I mean, all of that expediting costs. Remember, we transfer title with Boeing at FoV in Wichita. And so the expediting cost really come back to us after Boeing has a claim, and that obviously has been flowing through the P&L and used up all of that related costs already. Along with all of the people, if you remember earlier in the year, we talked about the fact that there were some Boeing mechanics that really helped us out a lot in our own factory to make sure we have a recovery et cetera, so all of the costs that have been incurred, have obviously flown through the P&L already.

And if there are others, and what I was trying to talk about in terms of claims and supply recovery, I mean we've been quite transparent that we've had significant disruption due to our suppliers, and those discussions are obviously ongoing, and we expect to close in some of them. We have already closed on several, and we expect to close in some more in the fourth quarter. And then also if you remember or may remember we'd had some hurricane related claims with our insurance carriers. While we do not finalize, we expect to close on some of that also this year and we're feeling good about closing on that activity as well.

And I mentioned that, just again so that is the map that we used to make sure we deliver on our results along with the improvements that we assure of that will happen in terms of operationally in our factories.

Q

Okay. Thanks.

Operator: And our next question today comes from the Peter Arment of Baird. Please go ahead.

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

Q

Oh, yes. Good morning, Tom, Sanjay.

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.

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

Q

Sanjay, just a clarification I guess on the legal settlement, that flow through in the SG&A just because it seemed lower than usual?

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

A

Yes it did, Peter. Yes it did. Yes it did.

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

Q

Okay. Okay great. Appreciate that. And then just, Tom, I guess you've had a goal to continue to ramp up defense or some of your defense business. Maybe you could just update us on some of the pursuits there and how that is going. You mentioned the CH-K53 (sic) [CH-53K] (00:40:12) but other efforts.

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

A

Right. Well, as we said the goal is to get it to $1 billion over time. And this year it went from about $480 million last year. This year it will be about $530 million; so we had nice growth this year, but it's the programs that we have, the CH-53K. We are also one of seven suppliers named on the B-21. Obviously, all these programs are in early stages of development but they will continue to grow and get into full rate production in the future.

We continue to work with the primes where we have relationships to see if we can expand our work scope on the existing programs where we have activity. We're also have been doing a lot in our fabrication area to bid on small defense contracts to start to get some tier-2 work as well. And we did have some success on that. Nothing huge or material yet but some small packages that will start to add up. So, we're very pleased with the progress on defense. It remains a priority for us in terms of growth and we are, in addition to the existing programs where we're on, looking also to bid on some of the new programs that are coming up.

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

Q

I appreciate the color. Thanks.

Operator: And our next question today comes from Sam Pearlstein of Wells Fargo. Please go ahead.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

Good morning.

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

A

Good morning, Sam.

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

A

Good morning, Sam.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC

Q

I wanted to just follow back up on Asco and I guess the question is should have we presumed it's going to be running about the same $0.11 a quarter until this closes. And it sounds like this is something that the closures likely early part of next year is that the right way to think about it?

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

A

Yeah, Sam, so at this stage obviously there are two sort of costs – on the three types of costs that are ongoing, whether we agree or disagree, I mean, the interest associated with the acquisition, the $650 million interest expense will be an adjustment at least to the end of this year. And again going back to an earlier question and we'll decide how we baked that into next year, either inside our guidance or keep it separate. But, yes, interest expense will continue.

Then the second thing is the integration related costs whether it'd be legal fees or some of the other diligence that happens. Yeah, that's probably going to be a few million bucks a quarter and so that's going to continue. The one that we can't really predict is we are marking to market the hedge and that obviously depends on where the euro and the dollar do every quarter. But again, that's something that whatever charges we'd take or exclusions that we have are obviously either lows or it doesn't really change the cost at which we buy Asco at the end of the day. So, that's the other one that it's hard for me to predict. But, yeah, broadly at this stage, the refinancing costs are kind of over it's fundamentally the integration with diligence cost and the acquisition-related interest that we are excluding for the moment.

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

A

And what I would say, Sam, is obviously we've slowed down some of those integration costs as we go through this process. But the way we did it was very deliberate. Rather than going into a Phase 2 investigation with the commission, which would have been longer and probably a more significant effort, we elected to withdraw our application, address the issue that they raised and then resubmit it, and when we resubmit we go back into a Phase 1 process which has a 25-day timeline. So we think it was a better way to do it to manage through all the different situations.

And obviously as we get to the end of the year, it's going to be very tight. So it's possible that this does spill over into next year in terms of timing, but it's the commission process and we're just going through it, but as I said we're having very constructive dialogue with all the parties and we're still confident we'll get the deal closed.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC
Q

Thank you, and if I can just follow up? In mid-September when you adjusted the earnings outlook, I guess were these cumulative adjustments the same order of magnitude and with this legal settlement have been included in that update at that point in time?

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

Yes, we took all that into account when we made the adjustments.

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

Yeah, Sam. I mean the legal settlement as you know, this was a legal decision that frankly is quite dated. So we were quite certain about the recovery and so that was baked into our guidance.

Samuel J. Pearlstein
Analyst, Wells Fargo Securities LLC
Q

Thank you.

Operator: And our next question comes from Carter Copeland of Melius Research. Please go ahead.

Carter Copeland
Analyst, Melius Research LLC
Q

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

Hi, Carter.

Carter Copeland
Analyst, Melius Research LLC
Q

Just a couple of quick ones. One, if Boeing elects to go to 63 aircrafts a month in say the early 2020 timeframe, does that have implications for you for hiring that we should be aware of in terms of the margin commentary, you gave around just thinking about that that normalized progression next year, Tom. And then secondly, I know you had talked in the past about going down a couple tiers in terms of your SWAT teams looking at performance of sub-tier suppliers. I wonder if you could just give us some color on maybe some granularity around what real time that's revealing, if it's unchanged or a progress? Any color there I think would be helpful. Thank you.

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

A

Okay. So regarding 63 aircrafts, obviously Boeing has not made any decision on that yet. And so, we continue to look at it and study and be prepared, but it's their decision and we'll wait to see what they decide. With regard to hiring, yes, we would have to hire additional people for 63 aircrafts just because we're going to be – it would require more production. We would make that decision toward the end of 2019, so if 2020 was the day. So we would probably have to hire six months to nine months in advance on whenever Boeing decides that they want to increase rate.

Carter Copeland
Analyst, Melius Research LLC

Q

But you don't envision that, you don't envision that weighing on the margin progression you talked about earlier?

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

A

No, no, no.

Carter Copeland
Analyst, Melius Research LLC

Q

Okay.

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

A

No. So, then with regard to the suppliers in terms of rate readiness, we did deploy SWAT teams to help with some of the [ph] chronic (00:46:53) suppliers; a lot of those have been resolved. But what we've done now is we've taken that team -- and there's probably about 40 or 50 people, and we're using them to really drive rate readiness, so a lot of people are onsite with the suppliers really digging into their capacity and understanding their hiring patterns and how ready they are for 57 aircrafts. So there's always issues to deal with in terms of current production; and having that SWAT team as available, we can deploy them to that, but what we're really shifted them now to is really the rate readiness assessments as we get ready for 57 aircrafts.

Carter Copeland
Analyst, Melius Research LLC

Q

Great. Thanks, Tom.

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

A

Thanks.

Operator: And our next question today comes from Rob Spingarn of Credit Suisse. Please go ahead.

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

Q

Hey, good morning. I guess I have one for each of you. Sanjay, I'll start with you. I just wanted to know if as you go through this process on Boeing 737 and understanding that you did tweak the free cash flow guidance a couple of quarters ago. But are there any working capital inefficiencies that you would reverse or unwind next year? And that's the first question.

And then, Tom, I wanted to ask you, I'm still struggling with the relative significance of switch to MAX supply chain, hiring and inefficiencies with your own hiring getting the right people. How do we think about the relative importance of each of those factors in these delays and which one's fixed first. It sounds like you've already fixed your own hiring for 57 aircrafts, but why was 52 aircrafts such a challenge for the supply chain, did they just not believe in the rate and invest ahead of it?

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

A

Okay. Let me go first. On the Boeing 737 specifically, I would say it's more of a generic answer on the working capital, not just on the Boeing 737 but other Boeing 787 is going up in rate, the MAX and the NG shifting around and the Boeing 777 obviously is coming down. They're across the board in conjunction with if you recall over a two-year period, we've been working on a supply chain and as a result of that we worked on number of new suppliers and shifting work. Tom talked about dual sourcing. So as a result of all of that, we did build up some buffer inventory as rates are going up et cetera. So as we get more efficient in the future, we expect to try and reduce our inventories and become much more efficient with our flow days et cetera. So working capital initiative in that regard will obviously be something that we work on.

In addition to that, again a little bit generically, we talked about this as well. If you recall, we did agree with Boeing the last time to move to industry standard payment terms, and we apply that same principle going down with our supply chain. We made some very good progress this year and that's one of the reasons why we've been able to maintain our cash flows because we've been working on working capital, and we expect to continue to do that in 2019 as well. So I think the working capital initiatives will continue to work and obviously as we become more stable we'll reduce the what we call the min-max buffers that we have to ensure stability in our factory and get working capital improvements from there on.

So that's the answer to the first question, I think, Tom.

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

A

And I'll take the second question is you asked what's the relative significance of some of the challenges that we had this year?

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

Q

Yeah, the various factors?

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

A

Yeah, the risk factors. Between, say, supply chain hiring and then the model mix shift from...

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

Q

Yes.

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

A

...to MAX and NG. And I'd say it probably goes in terms of rank order, supply chain then the hiring and then the MAX. And in supply chain, it's really -- our factory operates very efficiently when we have the parts. And so when we have those disruptions and didn't have the parts, that was a significant challenge, because it created travel work and when the work travels, when the parts finally do arrive, it takes longer to install them. You might have some quality issues that can create delays. You need surge capacity at the end of the line. So that was a big driver.

And so, why was that the case with the suppliers, it is really a number of things. In some cases, they didn't order the equipment soon enough so that they could get it properly installed. In some cases, they may have been moving work around between their factories and it took a little bit longer to absorb that. They have their own hiring issues just as we did trying to find the talented skilled labor and then getting them trained, and also material was a factor. The mills have been stretched because of requirements going up across the industry and in some cases, they were working on that. And then, there could have been operational issues related to IT, things like that. So it was a host of factors, but some managed it better than others, clearly. And as I said, there were, at the beginning of the year, between [ph] 13 and 15 (00:52:06) really chronic suppliers that were challenge for us; and we've worked that down, we dual source and multi-source to offset it, and we're working much more on rate readiness for 57 aircrafts, so that was the supply story.

And then on the hiring, I mentioned that hiring the number of people that we did to go up and ready and getting them trained was a challenge. We're fortunate to live in an area, especially around Wichita, where we have lots of skilled labor, with a lot of mechanical acumen, but nevertheless, it's a big challenge. We've been working very closely with our local technical college called WSU Tech, Wichita State University Tech and they've been great. We've aligned their curriculum to our needs. And about half the graduates are coming out and coming to work for us. But we still have to do additional training.

And then, then the MAX model mix change was fairly significant, it's about 35% different parts. And like anything, it requires a learning curve for everybody to figure out exactly what to do. Now, last year, we only produced about 70 MAXs, this year was about half the production, next year it's going to be about 90%. So we're going to be way down the learning curve and that won't be really a factor as we go forward from here.

But that's how I'd say the three factors ranked: the supply chain, then the hiring and then the MAX model mix shift.

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

Q

Okay. Thank you for clarifying that.

Operator: And our next question today comes from Ken Herbert of Canaccord. Please go ahead.

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

A

Hi. Good morning.

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

Good morning, Ken.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.
Q

Hey, Tom and Sanjay, I just wanted to ask on the manufacturing side, just from one other sort of one different angle, when you look beyond the one off issues, I guess you just identified the extent to which we can call those one off. You've had a steady process around dual sourcing or multi-sourcing, in-sourcing a lot of efforts with the supply chain that's been ongoing for the last few years. As we look to fiscal or look to the next year, obviously you get the tailwind from the one-off issues, you just went through. How much of a tailwind are the other ongoing aspects you've been pushing with your supply chain, or are these really just running to standstill as you look at pricing step downs and other customer pressure?

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

It's more of that. I mean, we're going to get as I said probably 150 basis point uplift next year to where we end this year. But we're going to be making lots of improvements. So the whole system will be operating more efficiently. But I don't expect necessarily that's going to result in higher margins, because we still continue to see pressures, material escalation, labor escalation as well as [indiscernible] (00:54:49) tariffs for example on some of the Chinese goods, some of the aluminum and then we're going to have to offset those in addition to that customer price step downs and in some of the productivity discounts that we've built in. So, we really need the supply chain to be operating more efficiently next year, so that we can deliver and execute on what we said which is to maintain the margins to what they were at historic levels.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.
Q

Okay. So, it sounds like a lot of the 150 basis point improvement next year is really just the inefficiencies you face this year which obviously depressed the margins?

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

Right. It's getting back to the normal run rate margins that we had in 2016, but adjusted for the new revenue recognition ASC 606.

Kenneth George Herbert
Analyst, Canaccord Genuity, Inc.
Q

Got it. Okay. Thank you very much.

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

Thanks.

Operator: And our next question comes from George Shapiro, Shapiro Research. Please go ahead.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Yes. Good morning.

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

A

Good morning, George.

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

A

Good morning, George.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Sanjay, could you provide how much you have included in your guidance for recovery of supplier and other claims in the fourth quarter as well as hurricane cost that you think you're going to recover?

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

A

George, I can't give you specifics and there are two or three reasons for that. I mean, these things -- there are a multitude of negotiations that are going on, like Tom said, whether it'd be with our customers or even with our suppliers. These things take the form of different forms of settlement, sometimes it's a claim settlement in dollars, sometimes it's in cost reduction in the future et cetera. So, we've got a wide range there and then like any program EAC, we do our risks and opportunities associated with that. At the end of the day, Q4 is more than two-thirds the improvement would come operationally, so that we get into 2019 exactly how Tom's described it with margin improvement, lower cost associated with head count over time, et cetera. The reason I mentioned it in my prepared remarks is, yes, there is some improvement in Q4. I can't give you specifics in terms of dollars but there is a little bit there.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Okay and then on the 16.5% margin is that the expectation that you'll average for the year? And also I assume it excludes Asco which is probably at the lower margin?

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

A

Yeah, we didn't include Asco and the impact of Asco like we described earlier in the call, when we closed on Asco and we lay out the differences et cetera. This 16.5% or 150 bps, which it could be a little bit higher than that, is trying to compare apple-to-apple in terms of how we are performing today as a business that we own and run to how we expect to operate in 2019.

And your question about timing, in terms of [indiscernible] (00:57:46), there are two or three things here, guys. I mean firstly remember we have shorter blocks now, so you should see compressed timing and you should see more relevant, but at the same time, unfortunately, Q4 and Q1 are not sort of normal quarters. We've talked about this in the past; they have fewer M days or manufacturing days. There's always a lingering effect of the December when deliveries kind of move around a little bit, and that's the only reason. So the shorter blocks sometimes they get a little bit more volatile. But Q2, Q3, once we are on track you should see some very solid improvements in our margins in the middle half of next year. I mean, we feel quite confident about this. We've obviously laid our plans, very similar to every year prior to this year. This has been a tough year for us. There's no question.

Every year prior to this, if you remember, we've always laid our plans where we've got internal goals that are usually better than what we've communicated to you, guys, and we expect to do the same thing once we are back and stable.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

And one last one if I can. On the A350, you mentioned that the lower revenue since you delivered like 2019 versus 2018, is it fair to assume that the price reduction was around 5% or with percentage of completion accounting, it's not as simple as doing that?

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

A

No, it's not as simple as doing that and again the price step downs again, the differ between the fuselage and the FLE, so that was I would explain to you the Wing revenue delta that was on the FLE.

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

A

Which is the Fixed Leading Edge.

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

A

I'm sorry, yes, the Fixed Leading Edge, yes. Yes. George, hopefully you remember that, but -- so that's what it is, George. It's not necessarily the volume.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Okay. Thanks very much.

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

A

Thank you.

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

A

Thank you, George.

Operator: And ladies and gentlemen, we have time for one more question. And today's final question comes from David Strauss from Barclays. Please go ahead.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Thanks. Thanks for squeezing me in.

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

Good morning, David.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Good morning. So you might have answered this already in various other questions, but the range on the guidance for this year, the $0.25 is that -it's pretty wide heading into the last quarter. Is that supplier, different assumptions around supplier assertions and hurricane recoveries or kind of what puts you at the low end versus the high end?

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

Well, we obviously kept a similar range as we originally had. What will impact the quarter is as we're going along on the deliveries is how much overtime we need, how fast the contractors come down. At this point, we don't expect any expedited freight because we're fully on time, but then we're working a lot of mitigation activities. As you can imagine, there's always a punch list of things we've got our teams working on it, and we'll see how of all those come in in terms of where we end up in that range. But, look, there's been a lot of pressure on the year. We've been offsetting it. We still feel confident that we're in that range. We're going to keep pushing it up as high as we can but still working to address a lot of issues and make sure we execute for our customers.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Okay. And as a quick follow up, George asked about A350 deliveries. Was 2019 the plan? I know it's seasonally slow in the third quarter with Airbus, but was there any impact on deliveries from the hurricane and the shutdown in Kinston?

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

No. No impact from the hurricane because we had a buffer and we were able to eat into that buffer to maintain the delivery schedule, so we're not behind any on the Airbus schedule; that was what was planned. Yeah, it was just a light quarter overall.

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

David, there is one message I think we want to make sure that everybody gets. Is that pretty much across the board on every platform with obviously with the key customers, we [ph] are there (01:01:47) exactly on what their schedule is. So if you see a little bit of movement, just remember that we are on their schedule.

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

And that was a big accomplishment for us this quarter particularly on Boeing 737 was getting back to master schedule on time every day.

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

A

And the teams have worked really hard that we have to thank them. It's not been easy. I know we've spent a lot of money. We expect to recover. There is no question that we will become more efficient and we'll see and hopefully able to see that in the fourth quarter and definitely into 2019.

David Strauss
Analyst, Barclays Capital, Inc.

Q

All right. Good luck. Thanks.

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

A

Thank you, David.

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

A

Thank you.

Operator: And Ladies and gentlemen, this concludes today's question-and-answer session and today's conference. We thank you all for attending today's presentation. You may now disconnect your lines and have yourself a wonderful day