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MANAGEMENT DISCUSSION SECTION

Cai von Rumohr
Analyst, Cowen & Co. LLC

We're going to move on. Our next company is Spirit AeroSystems, and we're delighted to have with us, Tom Gentile, Chairman and CEO; and Jose Garcia, their new CFO. Tom?

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

Thank you very much, Cai. Just before we get started just want to give our Safe Harbor statement. So, any of the statements that we make today could involve risks and those are detailed in our regulatory filings. So, I wanted to just highlight that.

And before we get started perhaps a few introductory remarks. Really pleased as we had a strong finish to 2018 at Spirit AeroSystems. We had some challenges earlier in the year with disruptions in our supply chains from shortages. It caused travel work, which in turn drove some overtime, the need for contractors and also expedited freight, and that created a lot of headwinds. But we're very pleased, the operations teams worked extremely hard, and we were back to master schedule by the fourth quarter, delivering on-time every day and we met all of our deliveries, and that was certainly important last year given the rate increases that our big customers were undergoing.

In addition to that, we had a good financial close to the year. So, we set out at the beginning of the year and we said revenues would be between \$7 billion and \$7.2 billion. They actually ended up a little bit above \$7.2 billion, \$7.22 billion. And then, in terms of earnings per share, we originally said \$6.25 to \$6.50, we ended up at \$6.26. There was a lot of scrambling. We certainly benefited from some tax rates and also from an accelerated share repurchase during the year, but we were pleased that we got into that range. And then on cash flow, we originally guided between \$550 million and \$600 million, we ended up at \$565 million, so a good outcome to the year. We're very pleased with that.

And then, right at the end of the year, we were able to announce a major new deal with our largest customer, Boeing, which essentially established pricing on all of our major programs out to 2030, and for the [ph] Boeing 787 out to (02:04) line unit 2205 which will occur around 2028, so well into the next decade for all the programs and that was a good outcome. In addition to that, we established the framework for what pricing would be if rates go above or below the currently announced rates. And so, that really provided stability and reduced risk for both organizations and was a good outcome, and I think we'll talk probably some more about that.

And then the last thing is we had announced a new deal last year with Asco, which is a great strategic opportunity for us. They do 5-axis machining on hard metals, very complex shapes. They focus on wing components. They have a lot of Airbus content, a lot of military content with the F-35, and they bring fabrication capability. So, a very good strategic acquisition for us, meets all of our financial and strategic hurdles. We did have some concerns from the European regulator in terms of the closing of that, they raised those concerns. So we withdrew our application back in October, we addressed the concerns and we were very pleased to be able to re-file our CO application on January 30th. And so after a 35-day review period, we anticipate we'll get the European Commission decision and then if it's positive, we'll be able to close after that probably in the first half of the year. So, very encouraged by that and very excited.

So as we go into 2019, really the number one focus is execute on the rate increases. Both Boeing and Airbus have significant rate increases. We're fortunate to be on all their programs with significant packages and as the Boeing 737 goes up this year to 57 aircraft per month, Airbus A320 goes to 60 aircraft per month, Boeing 787 goes to 14 aircraft per month, our focus is really to execute on those and that will deliver a lot of value.

And then in addition, we want to finalize the Asco acquisition, close it and then integrate it successfully. So that'll certainly keep us busy. And as we look at the financial guidance this year with the rate increases and also with the recovery of the Boeing 777 program and Boeing 787s going up in rate, revenue is going to go up about 13% this year to \$8 billion to \$8.2 billion.

And then in terms of earnings per share, we're guiding this year to \$7.35 to \$7.60, again a significant increase based on all the improvements in rates and also some of the productivity initiatives that we've been driving. And then on cash flow, we're guiding \$625 million to \$675 million. So we want to make sure that we deliver on that financial guidance.

And then at the same time, we've always been focused on shareholder return. Last three years in a row we've exceeded more than 100% of our cash flow in terms – free cash flow, in terms of what we've returned to investors, about \$2.3 billion since 2016. We've retired about 28% of shares. And so our goal this year is in the absence of any inorganic opportunities that meet all of our strategic and financial hurdles, we'll continue to repurchase shares. We topped up our authorization last year to \$1 billion, so we entered the year with a lot of capacity for that as we go forward.

So, we're really excited to be entering 2019, we're on really great programs with our customers. Rates are going up. We've got a good backlog. Lot of the challenges are behind us, and we're looking forward to a really strong 2019.

So what that, I think we can take questions.

QUESTION AND ANSWER SECTION

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Terrific. Thank you. And congratulations Boeing no longer, sort of, mentions that Spirit is behind. So, that's great.

Thomas C. Gentile III

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

A

That's always good. We've worked very hard to achieve that.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

So, your MOA with Boeing, it looked like a win-win for you guys. I mean, you rescheduled advance payments out, there's no Boeing 737 disruption payments to Boeing, Boeing 787 profitability after the current 1,400 aircraft block. You may get to make some money. That doesn't sound like Boeing. They always seem to get something. What did you have to give to Boeing to get that agreement?

Thomas C. Gentile III

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

A

Cai you underestimate our negotiators really here. But it was a good deal for both parties.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Yeah.

Thomas C. Gentile III

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

A

It was a win-win, and when you look at the breadth of our relationship with Boeing, we're their biggest supplier, they're our biggest customers obviously, but this agreement goes out to 2030. So, it involves a significant amount of revenue over that time period. There are lots of opportunities to exchange value and look at different levers.

And so, if you look at it, it involves pricing on [indiscernible] (06:31) Boeing 777X as well as Boeing 787, it addressed [ph] tooling and capital (06:38), it addressed some of those mutual claims that existed. So, we were able to solve a lot of things. And like anything when you have a negotiation like that, there's gives and takes.

And so some things were favorable for us, some things were favorable for them. But in the end, as you described, it was a win-win for both companies and it really, for us, stabilizes the relationship with our largest customer out till the end of the next decade, which means that we can focus on execution, we can focus on innovation and thinking about the future.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right. I guess what I meant was a win-win for you. I mean I know with Boeing that certainly they got something, but I mean what did they – they always want price concessions or did they get – you're going to make generally more capital investments?

Thomas C. Gentile III

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

A

Right. Well what we get is – one thing is we extended the previous agreement on Boeing 737 went through 2022.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Okay.

Thomas C. Gentile III

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

A

Obviously the backlog extends beyond that. So they were already selling units beyond that to get some certainty on pricing beyond 2022...

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Okay.

Thomas C. Gentile III

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

A

...all the way to 2030, there was value in that. And as we have been working on our productivity initiatives in some of the out years, we now have line of sight to improve productivity and we were able to share some of that with Boeing.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it.

Thomas C. Gentile III

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

A

But overall as you said it was a win-win for both organizations.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So, where are you with regard to the proposed Boeing 737 rate hike to 57 and Boeing 787 to 14?

Thomas C. Gentile III

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

A

Right. We're always a couple of months ahead of Boeing, just because we're further up in the supply chain. So, our back shops for example where we do fabrication, they're already getting into the rate 57 production. We're waiting for official word from Boeing in terms of the exact dates, but we're doing all the preparation.

The other thing that we're doing on 57, this is a little bit new is, we're doing rehearsals, and this was an idea that Boeing had developed and they shared it with us and they've coached us with it to implement. And what it means is that we practice at rate 57 in all of our back shops right through the production system.

And right now at 52, we are delivering three aircrafts one day, then two, then three, so it alternates. With the rehearsals, we will practice three deliveries every day for three days in a row, so we'll stress the system and then we relax back to the normal pattern to see where we need to make improvements. So, we check on labor productivity, we check tooling, we check on the infrastructure and you identify – we've identified some gaps and opportunities to improve.

So, one of the things for example when we look at our panel shops we have dollies to deliver units to the automated [indiscernible] (09:17) machine.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right.

Thomas C. Gentile III

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

A

We discovered we needed more of those dollies to have efficient flow, so that was one of the things that the rehearsals identified. So, we're well on the way to implementing the 57 for Boeing 737. On Boeing 787, we're going from 12 to 14 and that rate break really happens in the beginning of the year, so we are now producing at the rate of 14.

What we did is in the last four months of 2018, we produced an extra unit each month. And so, as we get into the current – first part of this month, we are producing one extra unit and using one from 2018 to get to the 14 and then four months into the year, we'll be at 14 production. We [ph] added (09:58) a staggered method to ease into the 14 per month, but we're there now.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So, I guess you mentioned that 92% of the 737s are going to be MAXs this year. I think that was the number you used. So, what was the mix approximately of Boeing 737 deliveries in the fourth quarter?

Thomas C. Gentile III

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

A

Right. If you go back to 2017 when we started delivering the MAXs, we produced 70 in 2017. 2018 we produced about 300, so, it's about half for the full year. End of the year was more in the fourth quarter probably at the 65% rate. As we get into this year, it'll be over 90%. And by the end of the year, it'll be essentially all MAXs with the exception of the P-8 which will remain on the NG platform.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

So I guess you've mentioned that there was – it's 35% different than the Boeing 737. So, is there much more of a learning curve on the MAX, so kind of being at the higher rate and stabilization should be a big plus for you?

Thomas C. Gentile III

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

A

Well, we've gone through that learning curve because we're introducing more MAXs and it definitely took some time to get there. But there is going to be lots of opportunity to continue to drive productivity because we're still in a flux period. We're going up in rate this year as we did last year, so we're not stable.

And the one thing I always say is, we've been producing the Boeing 737 for 53 years now, since 1966 and there's still opportunity for improvement. So even with the MAX, we're only two years into it. There's a long list of opportunities for us as we go forward and we'll really get to drive productivity once we get to a stable situation where we're at the same rate for a couple of years in a row. And right now that hasn't been the case and it might not be the case for a couple of years yet.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So, as you know, Boeing is thinking about possibly going to 63. I think last year you mentioned that going from 52 to 57 should help productivity because you get better balance among your three lines, is a move to 63 even better because then everyone's going at 21 [ph] a month (12:02)?

Thomas C. Gentile III

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

A

Right. Well, go back to 2016, we were producing 42 aircrafts per month. We had two production lines in our main plant, each producing 21 per month and we called them one day lines. So, every day one unit came off of each line, two per day, 42 per month. When we went to 47, we introduced a third line and that was a four-day line. So, one unit came off every four days. At the same time, as we were going up in rate, we were shifting from the NG to the MAX.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right.

Thomas C. Gentile III

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

A

So, there was a lot of disruption. And when we went to 52 last year, we went to a two-day line, okay. And so that's how we were producing 52. When we go to 57, we're going to have three lines each producing 19 per month; and there'll be three one-day lines, each producing 19 per month.

And we'll actually have two days of buffer in there, so that we have surge capacity that will help us reduce overtime and improve efficiency. So we're going to be very balanced, more balanced than we've been since 2015. If they go to 63, we could increase those 19 units per month line, the three of them to 21, which is where we were in 2016. We'll have three lines that each produce 21, that would get us to 63. So the capacity to go up, if they choose to do that, is certainly there and it will remain balanced.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. Okay. So over the years, the suppliers I've talked to say, Boeing has very little interest in value engineering because they have to recertify, there's risk in the recertification, the savings go to the suppliers. You seem to have

solved that problem with your agreement to split costs savings 50:50 with Boeing. What sort of a reception have you had to this proposal? I mean is Boeing saying oh! We got all these ideas or could it be a plus to margins? So, what do you think it'll be?

Thomas C. Gentile III

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

A

Well, in certain programs like Boeing 787, for example, Boeing obviously has a lot of a design authority. And so to make changes to the engineering of parts or to change materials requires engineering effort on their part. And like any big organization, different groups have to maintain their own productivity levels. And so you can't expect them to invest in engineering dollars if they don't get a benefit. And so creating skin in the game for both parties and sharing meant that we could be more assured that we would get the support, the engineering support we needed to make those changes, so that they get a benefit as well.

I'll give you a good example, 3D printing. So, we've been doing a lot of work with a company called Norsk Titanium to produce 3D printed parts. So we produced a near-net shape using a technology called Rapid Plasma Deposition, and then we machine it into a final part. We implemented the first 3D printed part on a Boeing 787 just recently. And what it is, is it's a bracket that helps hold the door surround to the fuselage. It's a very simple part, but it reduces the buy-to-fly ratio significantly. So instead of machining out of a big block of titanium, we print a near-net shape, and then we machine it.

Now to print a near-net shape, you have to get engineering certification [indiscernible] (15:10). The Boeing engineers have been helping us develop those. Now we've done the first part, it took us about five years to get the first part flying. But going forward there's lots of opportunities, there's literally dozens and dozens of titanium parts that we could 3D print, but there's where we're going to need help from Boeing. And so that's a perfect example of where by sharing 50:50, we give Boeing the incentive to provide engineering support to get those [ph] allowables (15:34) approved, so we can get more 3D printed parts on the aircraft.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right. Do you think that will overcome what I've heard of the, sort of, just cultural resistance to doing that, or do you have any evidence [indiscernible] (15:47) really pumped up about this or they're kind of going...?

Thomas C. Gentile III

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

A

No. We've seen it on other programs. We've had a risk share relationship with Boeing on 777 that contract is also a little bit different. And so we've always had good cooperation, but again with skin in the game on both parties that there's an incentive.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right.

Thomas C. Gentile III

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

A

You can't be one sided or you'll never get the support from engineering.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Great. So, as you look at your current book of business where do you think you have the greatest execution challenges? Where are the biggest opportunities?

Thomas C. Gentile III

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

A

Right. Well, as we get into rate 57 or 14 on Boeing 787 or 60 on the Airbus A320, still one of the biggest challenges is the supply chain, making sure we have stable secure access to material and parts. When we have parts, our assembly lines and our fabrication operations perform extremely well.

But where we got tripped up last year was in the supply chain. So we've been working very closely with our suppliers to ensure that they're rate-ready just like we are and providing them with resources and support to help them if there are some challenges. The other thing we've been doing on that is where we identify some risk or some capability that's not where it needs to be. We've been either in-sourcing more work or dual-sourcing it with other suppliers to defray the risk and ensure that we have stable access to parts. And similarly, on the opportunity side, supply chain is about two-thirds of our cost and working with our suppliers to continue to drive productivity and make sure we have world-class cost productivity delivery and quality is probably the biggest area of opportunity as well.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So what's your strategy for getting work on the NMA, if they do it and what areas or sections are you targeting and do you think your share can be anywhere near what you got on the Boeing 787?

Thomas C. Gentile III

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

A

Well, Boeing 787 is, kind of, a typical work package for us with Boeing if there's a typical, but we do the Section 41 which is the forward fuselage, we do the moveable leading edge to the wing, we do the pylon.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right.

Thomas C. Gentile III

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

A

And then on the Boeing 787 we don't do anything on the propulsion [indiscernible] (17:52) where we do on other aircraft. So, as we go forward on the NMA, the recent agreement we reached with Boeing really positions us well to continue to compete for new work with them.

We have a good solid relationship. And on NMA, we feel we offer a compelling value proposition. I think we're extremely good in terms of large complex composite structures. We know how to industrialize those and get those to rate. We've demonstrated on the Boeing 787, also on the Airbus A350. A lot of our military programs are composite. So we've developed, I think very unique expertise. We have the design capability. We have the ability to manufacture at rate. And we also have low cost in terms of our ability to leverage automation, as well as a skilled workforce.

So we bring I think a compelling value proposition, and we will leverage that as we make proposals. The other thing we've done is, since I've arrived in 2016 we've more than doubled our investment in research and development. So, it was in the 20s, this year it'll be close to \$60 million. And in addition to that we're getting a lot of government grants, a lot of sponsorship in collaboration with universities and industry associations. So, it's even effectively higher than \$60 million, but that's allowed us to develop a lot of ideas in terms of the not only the architecture of composites, but also the manufacturing process. We think that could bring value to an NMA proposal.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

So, I mean do you think you'd basically target the same areas, the same types of things that you do on the Boeing 787?

Thomas C. Gentile III

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

A

That would be the first focus areas, yeah.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. And what sort of new opportunities do you see at Airbus, ex-Asco?

Thomas C. Gentile III

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

A

Right. So, interestingly the biggest opportunity at Airbus for us is probably the Airbus A220, and the reason is because that's the former that's the C-Series from Bombardier and we do the pylon on it. Now, Airbus has said very clearly, they need to get costs down on that aircraft to make it long-term attractive program for them.

So they're going to come after all the suppliers. And of course, we have the pylon, but we don't have any other work packages. So there's a big opportunity for us to get more work packages on the A220 to help out on our Airbus' cost challenge and offset any potential discounts that we'll have to provide on the pylon. That's a good opportunity.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

So, when is Bombardier's agreement up, that you basically could go chase...

Thomas C. Gentile III

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

A

Well, I think with the change of control and as they look at productivity and the continuous improvement that they have some flexibility to move things around to make it more competitive.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So, update us on your military business. I mean you said it's up what \$80 million – excuse me, it's up 15% what \$600 million this year?

Thomas C. Gentile III

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

A

Right. So the goal – last year it was about \$420 million, we ended up at about \$520 million, so it grew 20% last year. This year we're looking at about 15% to \$600 million, really that's largely driven by Sikorsky with CH-53K, the heavy-lift helicopter for the marine, [indiscernible] (20:55) capabilities, three engines that can lift 27,000 pounds off the ground, which is three times what the previous version could lift, it can fly at 180 knots, it can carry 30 troops. I mean it's got tremendous capabilities. It's just now getting out of the development phase into the low rate initial production and will start to ramp up. So, that's really been driving a lot of that growth. In addition, we have our strategic programs that are also advancing through early stages of development.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So, can you get to a \$1 billion from existing programs or do you need new program wins?

Thomas C. Gentile III

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

A

With the existing programs, that'll take us over the \$1 billion mark within the next five years.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Okay. You also said fab is \$800 million, most of that's internal. How much is done with external customers and how big could the external be?

Thomas C. Gentile III

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

A

Right. Right now honestly it's not that much. The majority is internal, because we had a lot of open capacity as we went into 2017-2018, but we've used it to secure supply for the supply chain as the rates have gone up and to lower cost. So, we haven't really had an excess capacity that we could devote significantly to third-party revenue. As we go forward though, some of that internal will ease, so we'll have more capacity that we can devote to third-party and we're going to focus a lot on defense. We think there is a real big opportunity to link the work that we do on some existing programs, like B-21 and CH-53K and the V-280 and the Tanker and the KC-46 as well as the P-8, and try to expand those work packages with detailed fabrication parts. On the commercial side, we actually make 38,000 different parts with our fabrication machining primarily, but also some light assembly, and we think we can take that skill and apply it to defense and grow some of the existing packages that we have.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So, I think your revenue guide of \$8 billion to \$8.2 billion was considerably higher than the Street which is certainly higher than we were. And one of the drivers you mentioned was that the Boeing 737 mix shift from 50% to 92% on the MAX, you get a higher price on the MAX than on the NG. Given that, how much is the price – can you give us some feel roughly in terms of how big the price differential between the two models is?

Thomas C. Gentile III

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

A

Well, the MAX packages is larger than the NG primarily in the propulsion area, I mean, if you look at the CFM56-7B which was the engine on the NG, it was a smaller fan diameter than the LEAP-1B. And so, when we look at

the thrust reverser, it's just bigger, the pylon is completely different. And so, that's part of the mix difference between the NG and the MAX. But if you look at the revenue, that was one element, obviously, a big driver though was Boeing 737 rate, going from 52 to 57 over the course of the year.

But also, a couple other things, Boeing 787 is a pretty significant increase in revenue going from 12 to 14, and then the other one is Boeing 777. So, last three years, Boeing 777 has actually been a big headwind. So, if you look at 2016, we delivered 96 Boeing 777s. In 2017, that number fell to 70 as the Boeing 777X development started. Last year, that number was 44. So, that's been a big headwind over the last two, three years. This year, the rate start to recover [ph] back to the 5 (24:28) that Boeing was targeting and we'll see how that goes, that aircraft hasn't flown yet, and once it starts to fly and the orders start to stimulate again, we'll see what the rate ends up at. But it's going to definitely improve in 2019 over 2018.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

[ph] Back to 5 is 60 (24:45). That's quite a bit above what Boeing is talking about.

Thomas C. Gentile III

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

A

Well, it's going to get up toward that level.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Okay.

Thomas C. Gentile III

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

A

We'll see where they end up. But as I said, it fell from 96 to 70 to 44 for us. This year, it starts to recover.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. And so, is there any price – is mix an issue, like on the [ph] Boeing 787 (25:05) as they go to more -10s, the Airbus A350 as it goes up to more 1000s, and the basic Boeing 777 to the X, are there any differences of note there?

Thomas C. Gentile III

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

A

Well, again, it's propulsion-related. So, if you look at the Boeing 777-300ER, it's got the GE90 engine, that's 128 inches in diameter. The new GE9X for the Boeing 777X, the Boeing 777-9 is 132 inches. Now, it doesn't sound like a big difference, four inches, but I can tell you the size of the fan cowls is materially different, the pylon is very different. So, you have that sort of mix change in our work package.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

And what about the [ph] -10 on the Boeing 787 (25:45), is that a...

Thomas C. Gentile III

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

A

That's not too different for our work package, because we don't do propulsion.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right.

Thomas C. Gentile III

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

A

The forward fuselage and the movable leading edge and the fixed leading edge of the wing and the pylon don't change that much between the [ph] -9 and the -10 (26:00)...

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it.

Thomas C. Gentile III

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

A

...on the Boeing 787.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

And the Airbus A350?

Thomas C. Gentile III

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

A

The Airbus A350, again, our work package which is, we call it Section 15, which is the fuel box or the wing box section, doesn't change significantly. There's a little bit of work scope, but it's not significant.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. Okay. Super. That's very helpful. So, Boeing 787, is that a big – I mean, if you did 44 last year, is that a big driver for 2019 just percentage wise?

Thomas C. Gentile III

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

A

Boeing 777?

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Yeah.

Thomas C. Gentile III

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

A

It's one of the drivers in terms of revenue increase. So, I think when we announced our guidance for 2019, I think people were a little surprised, the consensus was lower.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

No kidding. Yeah.

Thomas C. Gentile III

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

A

And I think it had to do with some of the mix change on Boeing 737, but also on the recovery on Boeing 777 was one of the drivers.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it.

Thomas C. Gentile III

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

A

And maybe just an opportunity for Jose to comment, because he's now had a chance to dig into the revenues.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Yeah. Okay.

Thomas C. Gentile III

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

A

Jose joined us after 23 years at GE. His last assignment at GE was as CFO of the GE Renewable Energy business based on Paris, France. And so, getting him to go from Paris, France to Wichita, I consider that my greatest accomplishment in 2018. But Jose, maybe you can talk a little bit about the revenue you've had a chance to go through them.

Jose Ignacio Garcia

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

A

Yeah. So, Boeing 737 rate and mix, Boeing 777 volume, there is a little bit of ASC 606 impact on the Boeing 787 as we put forward part of the revenue into 2019, that's basically the story.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. Okay. And so, your margin target of 16.5%, it kind of goes back to I think where you were in 2017, but...

Thomas C. Gentile III

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

A

2016.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Yeah, 2016, but I think – and you had mentioned that sort of I think conceptually that you would be back there, but that was on lower volume. So, given that the volume is higher, does that make it easier to get to that number or maybe why isn't the number higher given that the volume seems to be quite a bit higher than most of us had thought?

Thomas C. Gentile III

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

A

Right. Well, one of the things we always say and I have mentioned a few times is that, in our industry, you have to run very fast to standstill, as we have a lot of headwinds, escalation in material and labor, as well as the customer price step-downs that we've negotiated and productivity discounts that we've provided. We have to offset all of that. Now, last year was an unusual year because we had a lot of headwinds. We had more overtime, we had more contractors, we had expedited freight, we had cost to cover material, and so that created headwinds.

So, we wanted to offset that and return to the levels in 2016 when we were more stable. So, that got us to 16%. Now, since then there's been tax reform, new revenue recognition with ASC 606. And so, that should get us a little bit higher and that's where we came at 16.5%. That's not going to be easy, that's a significant increase from where we were in 2018 where we ended the year at 15%. But in Q4, our margins were 16.1%. So, we ended the year at a good point. Q1 is always a little tougher than Q4.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right.

Thomas C. Gentile III

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

A

So, we'll see a little bit of dip in Q1. But we feel confident that we can achieve the 16.5% for 2019, and that's really the level we want to stay at as we go forward.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So, Jose, the guide also has opportunity, because you have the Asco interest, but you don't have the Asco contribution, assuming it closes, we're still looking at the end of this quarter or more or less there?

Thomas C. Gentile III

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

A

The first half.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Yeah. How much do you – might it add to your earnings?

Jose Ignacio Garcia

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

A

So, I mean, we're working to make it accretive both on earnings and cash in 2019, given that's three quarters, it's a little tricky, three quarters, maybe two quarters, because we basically don't execute the synergies within the first six months, and especially in Europe, the cycle time for synergies is about 12 months. So, we've announced synergies on an annual basis, which is going to catch up some of the first or second quarter of 2020, but the plan is to make it accretive within the calendar year.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. Okay. And so, also in your guide, you don't include share repurchase, although you, A, have a large authorization and you said you have a strategy to buyback, and I think you've implied you may restart it after Asco. Why not do it in front of Asco? I mean, what's magic about completing Asco [indiscernible] (30:56)?

Thomas C. Gentile III

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

A

There isn't.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Okay.

Thomas C. Gentile III

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

A

So, we will be buying shares back over the course of the year. We have the authorization in place. What we said is, last year, when we announced the accelerated share repurchase for \$725 million back in May is that we wouldn't do anymore share repurchases for the rest of the year.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right.

Thomas C. Gentile III

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

A

And the way we're going to fund Asco is we built up cash in the back-half of last year, so we've got about \$400 million of cash that we can apply toward the purchase, plus we'll leverage some of our term loan which we had drawn down, we'll bring that back up. So, that's how we'll fund the deal. But we'll start generating more cash this year and we'll take advantage of the fact that we're undervalued to make some share repurchases during the course – before Asco closes. Now, the other thing is that, you said is from the standpoint of share repurchases, we feel we've been undervalued, and so taking advantage of that now is prudent in our view.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. Okay. So, if we flip it around, the revenues are so strong this year. It looks like you have less opportunity for comparable growth as you go forward. I mean, we have to be sure we would get the rate hike to – above 57. So, if you get a narrower revenue gain, let's say 3% to 4% in 2021 – excuse me, in 2020, can you get any margin improvement if the revenue growth slows a whole lot?

Thomas C. Gentile III

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

A

Well, that's what we'll have to work on. I mean, if we get stability and there's no rate increases, we'll have the opportunity to drive more productivity, and that's going to be the goal. We always have these headwinds we have to offset. But we'll see what Boeing decides or Airbus decides in terms of rate, and we're certainly prepared if they do make a decision to increase the rate, we've done the preparation, so that we'll be ready to do that.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So Jose, what are your key M&A priorities after you close Asco?

Jose Ignacio Garcia

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

A

So, I mean the company is very disciplined on capital allocation and I think the priorities for 2019 is really to close and integrate Asco successfully as well as execute on the rate increases across the Boeing and Airbus programs. There is a pipeline of opportunities, M&A opportunities. I think the financial thresholds that we have will only trigger some of those, if they're good deals, they have to be over 10% return on investment, they have to be below our EBITDA multiple after synergies. And if we don't find inorganic opportunities, we'll return cash flow to our shareholders like we've done in the last three years, where over 100% of the free cash flow has been used to repurchase equity as well as dividends.

Thomas C. Gentile III

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

A

We're going to be very disciplined.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

And do you feel, I mean, like you've been working on Asco for a while, like would you do another deal like within two to three months after Asco, I mean, more than just a little \$50 million niche?

Thomas C. Gentile III

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

A

Right. Look, the priorities for this year are execute on rate increases, close Asco and integrate it. And so, it'd have to be a very compelling deal for us to do something. We'll be opportunistic. Again, if that exists, we'll be prepared to act on it, but again, the priorities this year are execute on the rate increases, deliver quality and meet the delivery schedules, and then close and integrate Asco.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So, I think toward the end of last year, you said at some point, because you've done very well on your cash flow in terms of your 7% to 9% target, you said there's other circumstances you might increase over 9%. You didn't in your guide for 2019. What would it take to get you to the point where you increase above 9%?

Thomas C. Gentile III

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

A

I think if we get to a point where we're stable on delivery and rate for a couple of years, like back in 2016, we were at rate 42 for about 3.5 years. We're able to really drive productivity and lean initiatives, and really improve the margin rate on some of our bigger programs. If we get to that point, I think that would be an opportunity for us to get up to the upper end of the guide range and perhaps succeed it. But that appears to be some ways off into the future, which is a good thing. These rate increases, while they're challenging to execute, we wouldn't trade them. So, we like coming in, we're going to continue to support Boeing and Airbus as they do well commercially in the market, as traffic grows around the world, and as they take more orders, build up a larger backlog and deliver more aircrafts.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. So, Jose, what do you see as the correct financial leverage ratio for Spirit in terms of net debt-to-EBITDA, maybe if there are any particular other rentals there and what level of cash do you think this business should have on an ongoing basis?

Jose Ignacio Garcia

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

A

So, we want to remain investment-grade and we think that consistent with our peers, the right leverage ratio is 2 times gross debt-to-EBITDA.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

2 times gross debt?

Jose Ignacio Garcia

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

A

2 times to EBITDA. That's where we are.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Okay.

Jose Ignacio Garcia

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

A

That's our target. We think we need between \$400 million and \$600 million of cash. So, on a net debt basis, it's more like 1.5 times, so it's lower.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Okay. You think you need \$400 million to \$600 million of...

Jose Ignacio Garcia

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

A

That's what we'd like to have.

Thomas C. Gentile III

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

A

\$400 is what we think as – well, we've agreed with the board that that's a good target. And so, that's where we have been. And so, even as we grow, that's we think is a good number to keep.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. Okay. So, you don't have – I mean, on a pro forma basis at year-end, it looks like including Asco, you're around 2 times. So, taking what you said of the \$400 million – well, that's net debt. So, you're really about where you want to be. It's not like you have lots and lots of financial flexibility or is that...

Thomas C. Gentile III

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

A

No. We feel we're in a good place. We've talked to the credit agencies and we've remained investment-grade even with that higher level of leverage. But if the right deal came up, I think we have balance sheet capacity to go above it, as long as we had a good story about how we get it back down into the range.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Right. Okay.

Thomas C. Gentile III

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

A

So, we feel if – again, if there was a right deal and it met all the criteria, we could go slightly above the 2 times leverage as long as we had a good path back to that, so that we could remain investment-grade.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

Got it. That's great. And when you say 2 times, 2 times gross?

Thomas C. Gentile III

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

A

Gross, yeah.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Q

2 times gross. That's great. So, kind of to conclude, what are the key things that could go better this year? What are the key risks that you worry about most?

Thomas C. Gentile III

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

A

Again, the biggest risk is related to executing on the rate increases. We want to avoid any shortages that create travel work. We want to keep overtime down, avoid expedited freight, and keep our head count within the budget parameters. And in terms of what could go better is, if we execute well and we continue to work on our working

capital initiatives to optimize inventory and payment terms with our suppliers, those are our upside opportunities for us.

Cai von Rumohr

Analyst, Cowen & Co. LLC

Terrific. Thank you very much. That was terrific.

Thomas C. Gentile III

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

Thank you, Cai.

Jose Ignacio Garcia

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

Thank you.

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