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Spirit AeroSystems Holdings, Inc. (SPR)

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CORPORATE PARTICIPANTS

David Strauss
Analyst, Barclays Capital, Inc.

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

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

MANAGEMENT DISCUSSION SECTION

David Strauss
Analyst, Barclays Capital, Inc.

So we're going to move on to our next company, Spirit AeroSystems, with CEO, Tom Gentile and who's been CEO I think since 2016.

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

2016.

David Strauss
Analyst, Barclays Capital, Inc.

Okay. And, Jose Garcia, who is the new CFO as of the beginning of the year. So we're going to kick it off with some opening comments from Tom and then we're going to get into the fireside chat format.

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

Thanks very much, David. Just before we get started, a quick Safe Harbor statement. Some of the comments that we make today may involve risks and those are detailed in our news releases and also in our SEC public filings.

So maybe before we get started, I'll just say a few words to give you a background on Spirit is, we're fortunate to be on all of the airplane program for both Boeing and Airbus. So all 13,500 aircrafts in the backlog, Spirit has significant work packages. Biggest of course is the 737 where we make 70% of the structure, but even on the A320 we make about 60% of the wings.

So we have large packages in all the major programs that are growing in rate. Last year was a challenging year as rates increased, but we ended on a high note. We were on master schedule for all of our programs. We met all of our delivery commitments to Boeing and Airbus as well as our defense customers. And so, we're very pleased about that to be back on master schedule.

Financially, actually ended up fairly strong as well, despite a lot of challenges throughout the year. Revenues were at $7.222 billion, which was a bit above our original guidance. Cash Flow ended up at $565 million, again, right in the middle of our guidance range. And earnings per share came in at $6.26. Margins though were a struggle. For the year we ended up with 15%, a bit below our historic averages, but in Q4 we were at 16.1%, and we did see sequential increases each quarter as we went through the year.

We also were able to close last year a significant deal with our largest customer, Boeing, and that involved pricing on all major programs, many of them, all the way till 2030, and on the 787, we were able to negotiate new pricing after line unit 1405, so that that program would be profitable from that point on. It had been in a forward loss situation for most of its existence.

We also negotiated pricing on the 777X and we've resolved all miscellaneous claims that we had that came out of 2018 from some of the delivery challenges. So, overall, good outcome, a real win-win for both companies.

In addition, last year we announced the acquisition of Asco back in May. We applied for regulatory approvals. We got those in the U.S. and Europe though the European Commission raised some issues, and so we were able to address those issues and we refiled our application for European regulatory approval and we expect to get that in the near future and expect to close in the first half of this year.

So, as we look to 2019, we're very well positioned. Rates are going up again. That's our first and foremost focus this year is executing on the rate increases. 737 goes from 52 aircrafts per month to 57 aircrafts per month. That's over a 30% increase since 2016. And so that's really been a major driver of our financial performance.

A320 this year goes from 57 to 60. Both of those are going through that rate increase right now as we speak and we're executing well to it. Back on the 737, we're doing what we call rehearsals. And so we rehearse what it's like to do 57, which rough translates into three deliveries per day. And then after doing that for three days in a row, we relax back to our 52 rate per month, which is three deliveries, followed by two, then three. So that is going on. On 787, we're going from 12 to 14. A350 is staying flat at about 10 right now. So that's the first focus is focusing on executing the rate increases.

Secondly is really recovering margins back to historic levels. So back in 2016, when we were stable at 42 aircrafts per month on the 737 and had been there for over three years, margins were about 16%. So we'd like to recover to that point, plus get some additional based on the tax reform, based on the change in revenue recognition to ASC 606. So we're targeting about 16.5% margins for 2019 compared to the 15% that we had in 2015.

And then, of course, we want to close the Asco acquisition in the first half of the year and integrate that, so that we can move forward with that asset. And we're very excited about it, it's a great strategic fit. It's more Airbus content, more military content, more fabrication capability.

So as we look at this year, revenues look very strong, $8 billion to $8.2 billion is our guidance, up about 13%. EPS, we're looking at $7.35 to $7.60, which is about a 19% increase. And cash flow, we're targeting $6.25 to $6.75, which would be about a 13% increase at the midpoint. So, again, with rate increases driving a lot of embedded growth will result in strong financials for Spirit in 2019. So with that, David, maybe we can go through some questions.

QUESTION AND ANSWER SECTION

David Strauss
Analyst, Barclays Capital, Inc.
Q

Great. So you touched on the extension on the Boeing agreement. The news that came out of the holidays certainly caught me by surprise, given that you had an agreement that ran through 2022, I believe. What was the catalyst to do another extension on the existing contract?

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

Couple of things. First of all, the 777X is a derivative of 777. Now, Spirit is fortunate to have life-of-program contracts on all of our programs with Boeing, including derivatives. But with the MAX a couple of years ago, when that changed, there were some changes in the work scope and we needed to negotiate new pricing.

Same thing on 777x. The biggest change there is the propulsion. So the 777-300ER has the GE90, which is 115,000 pounds of thrust, but its 128 inches in diameter. The new GE9X only has 105,000 pounds of thrust, but it's more efficient, got a bigger bypass ratio, it's a 132 inches in diameter.

So we make the whole propulsion package for this 777x, so the pylon as well as the nacelle and the thrust reverser. Given the much bigger dimensions of the engine, it required a lot of changes on the propulsion. And so we needed to renegotiate pricing on the 777x. And as that's getting through the final stages of its development, that was really the catalyst. And as we got into that, we also started looking at all aspects of our relationship with Boeing, which is obviously quite extensive. And on the 737, even though the contract went to 2022, the backlog if you look at it, goes out beyond that, it goes out 7, 8 years, and they're already taking orders very, very late beyond that.

And so, there was a need – they were interested in securing pricing further out than the 2022 timeframe. And as we looked at it – and then of course also as both Boeing and Airbus are considering higher rates, there was a question of, well, what would be the pricing if rates did go up and how do we deal with capital and tooling and all those things. So we just decided to do what we call the collective resolution across a lot of different issues, including then 787 pricing, because we had pricing out to unit 1405, but they're already taking orders beyond that. And so they wanted to know what their pricing would be on that. And we agreed to that.

And the 787 program, as you know, there was a forward loss. So the costs were above price from line unit 1003 to 1405 for us. And we said, going forward from 1405, we both agreed that the program should be profitable. And it's an open book contract on 787 with Boeing. So they know exactly what our costs are in our projections. And so we agreed a price that would be above cost out at line unit 1405. Now we can do better than that if we drive productivity, but at least we know it's going to be profitable from that point forward.

So those were really the catalysts for driving the decision. And as any negotiation with Boeing and us, very complex, very broad, I mean if you look at the amount of revenue covered between 2019 and 2030, it's over $75 billion. So it's significant.

But we came to an agreement on a lot of different issues, closed them off. We felt that was a good deal for Spirit. I think Boeing feels like it was a good deal for them. And it really solidifies the pricing and the relationship, so we can focus on execution. Right now with Boeing 787 going up in rate, 737 going up in rate, we both want to make sure that we execute on those key programs.

And so this takes a lot of the commercial issues off the table. It solidifies that it takes risk out of the equation and allows us to both focus on operation.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Okay. Couple of follow-ons on that. So you talked about on 787 beyond 1405 generating – being positive beyond 1405. Is that based on kind of current course and speed, 14 a month or?

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

Yes. We based it on what the current announced rates are, which are 14. If they go down, there's going to be some pressure in terms of fixed cost absorption that we will have to offset. But we're confident that we can do that.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Okay.

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

And by the way, I mean, when we look at the projections. We think that 14 looks like it can hold for quite a while.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Okay.

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

So, we're right now already producing at 14 per month.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Right.

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

And so we're confident that we can meet all those expectation.

David Strauss
Analyst, Barclays Capital, Inc.
Q

And volume-based pricing, when I first started following the company, you had volume-based pricing on certain programs and not volume-based pricing on certain. You now have, in terms of all the programs that kind of matter to us, in terms of both Boeing and Airbus, you've got volume-based pricing across.

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

A

Well, the volume-based pricing really is focused on 737, there are volume-based discounts. So, as rates go up, there is some discounts. Of course as rates go down, then those discounts change as well. So that was something that enabled us to go all the way out to 2030. On 787 and A350, there are some customer price step-downs, which we previously announced and those factor in over time.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Okay.

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

A

But 737 is the only one that has really what I would call volume-based pricing.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Okay.

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

A

And the good news on 737 is that really enables us at this point if Boeing chooses to go up in rate...

David Strauss
Analyst, Barclays Capital, Inc.

Q

Right.

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

A

...we know what the pricing is if rates stay the same, we know, and similarly if they go down. So, it really provides a lot of stability for both companies going all the way up to 2030.

David Strauss
Analyst, Barclays Capital, Inc.

Q

So, [ph] pulling (00:10:51) all this together, I think back at the Investor Conference, the message was we're going to aspire to hold margins relatively flat in this world where we have step-down pricing, volume-based discounts. We're going to work hard from a productivity standpoint to kind of hold things flat. How do you feel about that now obviously that our actual margin might be a bit higher because of rev rec and all that? But how do you feel about that in the context of this new extension with Boeing and kind of [indiscernible] (00:11:25) year, year-and-a-half beyond the investor conference?

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

We still feel good. When we did the deal, the goal was to be able to preserve margins where they are. A lot of work to do, because there were discounts that were involved in step-down pricing. And then also as we look at the margins going forward, there's all sorts of pressures and headwinds. So, you've got not only the price step-downs from the productivity discounts, but you've got material issues, tariffs, you've got labor. Our big negotiations are coming up in 2020. So, we understood that we had to offset all those. Now we have a lot of productivity and programs in place to do that, specifically in supply chain, in our factories, in our non-labor costs. And so the goal is to preserve the margins where they were at the historic levels of say 2016...

David Strauss
Analyst, Barclays Capital, Inc.
Q

Right.

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

...back when we were stable. Now, last year was an unusual year, because there were lots of headwinds. We had traveled work that resulted in overtime, in contractors and some expedited freight. So margins were lower. But as we go forward, we want those to recover to the historic levels, plus the benefits of tax reform and the new revenue recognition.

So, this year we're targeting 16.5%, which we think reflects all that. And the goal is just to maintain that going forward by offsetting all those headwinds with the productivity initiatives and also keeping the cash flow at about 7% to 9% of sales. And that was something that we announced a couple of years ago at our Investor Day. It's something we try to preserve in these negotiations with Boeing and Airbus, and we feel good about those projections.

Now, as we go forward and get stable, we'll obviously keep pushing towards the high-end of those ranges, but we want to make sure we at least keep margins flat and maintain that 7% to 9% free cash flow as a percent sales.

David Strauss
Analyst, Barclays Capital, Inc.
Q

So, in terms of productivity and I guess absent what happened last year on 737, what kind of productivity have you been seeing and what kind of productivity do you need to offset to kind of keep margins relatively flat?

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

Right. Well, if you look at our cost base, two-thirds of it is in the supply chain. And so, we really depend on our suppliers as strategic partners to be able to execute on our customer requirements. And so, we've worked a lot with our suppliers to achieve that. We really have six pillars, we'd say, to our supply chain productivity. The first is clean sheets we call it. So, we reverse engineer every part we buy and we've now done more than 80,000 of these clean sheets to establish what it should cost it.

Then we have a strategic sourcing process where we go through a very systematic methodology with gates and deliverables, dashboards, operating rhythms, to help the suppliers get to those should-be cost. We can provide a lot of support, is the third pillar to them. So we can help with processing. We can help with logistics. We can help with material cutting and material buying. So we can help the suppliers get there. If they can't get there, we now have much more vertical integration capability.

We've established new machining centers of excellence at Oklahoma and Wichita, so we can insource, and with our scale often get lower prices. If we can't get a lower price through insourcing, we then do the fifth thing, which is what we call hotel bids or hypercompetitive negotiations. We'll invite 20 or 30 suppliers and over the course of the week, we'll start Monday, we'll wind the work by Friday, we can drive significant savings.

And then we have a very rigorous transfer of work methodology, again, with gates and deliverables, dashboards and operating rhythms, so that we can transfer work. And last year, we transferred thousands of parts to enable that productivity, and that's how we're offsetting all of those headwinds that we discussed before. That's been a big part of it.

The other part is really continuing to drive productivity in the factory. We're digitizing our factory. We're continuing to leverage automation. We're looking at various things, even like 3D printing, as a way to reduce the buy to fly ratio, and reduce the material costs. So, those are a second aspect of driving productivity. And then, thirdly, of course, we're keeping our belts tight in terms of all of our discretionary costs, G&A and things like that. That's an aspect as well.

One thing I will say though which is going the other direction is R&D. If you go back to when I joined back in 2016, R&D was in the $20 million range, quite low percentage. We've more than doubled that in the last couple of years. And we think it's a great investment with great returns for the future, not only in terms of driving productivity like 3D printing, but also in terms of positioning us to get on the next generation of aircraft. It's going to be very difficult, with Boeing and Airbus and the defense contractors, to win business on the next generation. And one of the ways we want to do it is to make sure we continue to advance innovation and R&D in aero structures, and we've been doing that.

David Strauss Q
Analyst, Barclays Capital, Inc.

Last one on the margin side of things, so obviously, last year, fuselage stepped down, I think wing stepped up. You put out there these ranges that we should expect to see in terms of margins by the different business segments. Should we see things progress back to kind of that normal, because wings been running well above what had been your previous expectation?

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

Right. Well, wing should settle back into the more historic ranges of 13%, 14%. What you will see though is with mix shift is propulsion probably going up relative to fuselage. And the reason is, because the MAX and the 777X both have bigger propulsion packages. And so as we start to shift to more MAXs and777X, you'll see margin on propulsion go up a bit faster than it does on fuselage, but more or less, it'll be back at the historic levels.

David Strauss Q
Analyst, Barclays Capital, Inc.

Touching on free cash flow, you talked about your guidance this year. You have the benefit from the relief on the 787 advances. So, if you adjust for that, it looks like free cash flow is relatively flattish year-over-year, when I adjust for Asco. Can you talk about what's going on there? And then, you talked about the 7% to 9% target, but I think back at the Investor Day, you talked about an internal target of 10% pre cash flow margin?

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

A

Right. Well, for 787, we did get a relief in terms of repaying an advance that Boeing had given us a few years ago. And it was going to kick in a $750,000 per unit. We'll resume that in 2021, at $450,000 a unit. So, it generates about $100 million incremental cash for this year.

Now, it's not up here. I mean, as you know, the cash is going up from one year over the next. So, we ended this year at $565 million, next year, our target is $625 million to $675 million. You don't necessarily see all of that $100 million just layered into next year's – this year's cash flow for a couple of reasons. One is, we do have the price stepdowns on 787s and even A350. Those are previously announced, but they were still headwinds.

The other thing is last year was a difficult year. The supplier shortages created travel work, which cost more overtime, contractors and expedited freight, and that put pressure on margins and cash. One of the ways we offset it last year is through some working capital initiatives. We worked inventory very hard, and also accounts payables. We used a vendor financing program with our suppliers, just like Boeing did with us, to increase payable days last year. And that was good. It basically brought our supply chain in many cases up to market and industry averages, but those things aren't going to repeat in in 2019. So, some of that, that holiday on the 787 repayments is really offsetting some of the cash initiatives that we took in 2018 and don't repeat in 2019, along with some of the customer price step-downs.

David Strauss
Analyst, Barclays Capital, Inc.

Q

And could you talk about – within that, obviously, we've [indiscernible] (00:19:07) on how Airbus A350 is doing from a cash standpoint. We obviously know – have an idea where the margins are now, but how has that progressed from a cash flow standpoint? Obviously, it went from big drag, I think, last time, we had visibility of this turning slightly cash positive.

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

A

Right. Well, that's where it is today. If you look at the deal that we originally did with Airbus back in 2016, we had built up a deferred loss of about $700 million and the total forward losses on that program were $250 million. So, the goal was to collect $450 million in cash over the final 700 units.

So, when we went to ASC 606, of course, then the forward loss went away and that program became cash flow positive and margin accretive. So last year, the margins were positive on the A350. We were very pleased with that. There was a little bit of pressure. If you recall, we had a weather storm in North Carolina very early in the year. We were tight on schedule. We went to some expedited freight on Antonovs through April. So, that put pressure on margins last year on the Section 15. The fleet was fine, the fixed leading edge. But overall, it ended up very positive on both programs. And this year, we continue – even though we're going to have some customer price step-downs on the Section 15 in the latter half of the year, we still see a lot of margin accretion in 2019 over 2018 on the A350 program.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Are you talking accounting margin or cash margin or both?

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

A

Both.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Both. Okay. Asco, just update on timing there, and then how you're thinking about accretion from the deal. And how, maybe Jose, how you might report this? Is it going to be pre-amortization? Or are you going to include everything in the cake? How you're thinking about you – how you might report them?

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

A

So, first, just on the deal itself, we're still, as I said, in my opening remarks, very excited about it. When we found it, we were pleased that it would be a good strategic fit. In other words, it has a lot of Airbus. [indiscernible] (00:21:10) about 60% of its $400 million in revenue was Airbus. A lot of military content, including on the F-35. And that should expand as the Belgian military starts to take some F-35s into its own fleet. And then also, it brings a lot of fabrication capability. The price was good at $650 million. It was about 9.3 times their EBITDA. But after synergies of about 4% of sales, that goes to 7.6 times, which is below where we trade.

Now, the issue I mentioned in terms of regulatory approval was one that – there was a structure that was set up in the 1970s by Airbus. And they did this in every country where they did business. They wanted to buy from one entity. So, they set up a consortium. And in Belgium, that consortium was called Belairbus. What the European Commission said is, that structure is really archaic and obsolete. And we would prefer that the contracts are with each individual partner, and that was essentially the issue they raised.

So, what we did is, rather than go into a Phase 2 review of our application, we elected to withdraw the application, fix the issue and then resubmit, which is what we did. So, we withdrew the application. We worked with the partners in Belairbus and Airbus to establish bilateral relationships. And then, we resubmitted at the end of January. So, they'll take 35 business days to review it. And then, if it's a favorable review, then we can move toward closing. So, that's what the process is. We're still very excited about the deal, very enthusiastic about the strategic fit, and confident that we can close it now that we've been able to address the issues that the European Commission raised.

And so, and then in terms of the accounting, maybe I'll turn it over to Jose for that.

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

A

Yeah. So, there are valuable intangible assets in this deal. And some of them are really going to go out almost a decade. So, we're looking at what's the approach in adjusting for some of the amortization on the assets. It's a non-cash, and we're evaluating whether we adjust or not. So, we're kind of getting feedback, looking at peers, see what they'll do. And it will be a decision though that will be with us for a long time.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Right.

Jose Ignacio Garcia
Senior Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

So we...

David Strauss
Analyst, Barclays Capital, Inc.
Q

But you see accretion either way whether...

Jose Ignacio Garcia
Senior Vice President & Chief Financial Officer, Spirit AeroSystems Holdings, Inc.
A

Yeah. So, we expect [indiscernible] (00:23:21) full year, which is going to be go beyond the calendar year to be accretive. And then including these and we're going to work towards it by executing the synergies and making sure that we have good integration.

David Strauss
Analyst, Barclays Capital, Inc.
Q

And then, financing looks like you have some finance. Some piece of it but a lot of financing already.

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

Actually, we did all that financing last year. We issued $1.3 billion in new debt. And the intention was, that would help finance the deal as well as the accelerated share repurchase that we did last year. So, we didn't do any more share repurchases in the back half of last year. We let the cash build out. So, we have about $400 million in the balance sheet. We also had drawn down our term loan, $250 million. So, we'll tap that back up, and then use $400 million of cash, rough numbers, to execute the deal. So, all of the funds for the transaction are already on our balance sheet.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Okay. Can we queue up the audience response system, please? I know you're [indiscernible] (00:24:24).

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

Okay.

David Strauss
Analyst, Barclays Capital, Inc.
Q

So, do you currently own the stock?

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

Lots of opportunity.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Absolutely. [ph] Ken (00:24:46), next question, please? General bias towards the stock. Well, lot of positive but not many owners.

Next question, please. Through cycle EPS growth for Spirit relative to peers. [indiscernible] (00:25:23).

Next question, please. Excess cash.

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

Interesting.

David Strauss
Analyst, Barclays Capital, Inc. Q

That's – yeah. I wasn't expecting that.

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

Okay. Your investment banker colleagues will be pleased to see that one.

David Strauss
Analyst, Barclays Capital, Inc. Q

Yeah. All right. Next question, please. What multiple 2019 earning should Spirit trade?

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

Good.

David Strauss
Analyst, Barclays Capital, Inc. Q

All right. Some upside potential.

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

So, really an incentive to come back next year to see how the – can you take?

David Strauss
Analyst, Barclays Capital, Inc. Q

Yeah, absolutely. That's why I'm walking you in. All right. Last question, please. Most significant investment issue for Spirit.

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

Well that's consistent with what we're seeing is, I think last year being a challenging year from an execution standpoint as rates went up, I think investors and our board, our customers really want to see solid execution this year on the rate increases, which should translate into margin performance.

David Strauss
Analyst, Barclays Capital, Inc.

Q

We have a couple of minutes left. If there are any questions in the audience? Sure. Right here. We have a mic. Right here.

Q

Thanks very much. Just a question, if there's a hard Brexit, what's the contingency planning with Airbus? And how comfortable are you that this will not grind to a halt the production system across Europe?

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

A

Right. We're, like the rest of the industry in the world, just waiting to see what the outcome of Brexit will be. And interestingly enough, from our standpoint, we have a significant work package with Airbus on wing components for the A320. We do the leading engine, the trailing edge and on the A350. We do the fixed leading edge. And we do a lot of that work out of our Prestwick facility. Interestingly, we don't export a lot from Continental Europe to Prestwick in terms of supply. A lot of it comes from Asia or from other suppliers around the world, a lot of it from the UK.

And then, our deliveries aren't to Europe directly. They're to the Broughton Airbus plant. So, we don't have a direct impact in terms of Brexit, but Airbus, of course, does, because they ship all of the wing components from Broughton to Bremen or to Toulouse or Hamburg, and so that is where the issue is. What we've done is really built up our buffers in terms of inventory, because if – whether it's a hard Brexit or something else, the big concern is that it could create delays at the border for some period of time, while everything sorts out, which would mean that you would potentially not have access to material or not be able to ship.

And so, what Airbus has requested us to do and what we have done is, we've built up capital – buffers in terms of working capital and equipment upfront, and finished goods on the other side. So our inventories will run a little bit higher in the first and second quarter. And after Brexit is fully through, one way or the other, we'll bring those back down to normal levels. But that's the approach that we're taking on Brexit.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Any other questions? I had one last one I wanted to touch on. In terms of supplier assertions related to 737, so it sounded like last year, you were counting on some of that to coming through. I think ex the insurance claim, some of that did come through in Q4. Is any of that baked into your 16.5% margin target? Is there anything for supplier assertions related to 737 baked in?

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

A

Yeah. Nothing in 2019. We were able to close everything out in 2018. So, some of our suppliers did create disruptions. We had very direct conversations about those. But we were able to resolve everything in 2018. We did have some claims that came through that helped last year to offset some of the costs that we incurred. But we basically wiped the slate clean. We started 2019 fresh with everybody and we're seeing much better performance. So, we don't expect any claims this year.

David Strauss
Analyst, Barclays Capital, Inc.

Okay. Tom, Jose, thanks very much.

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

Thank you, David.

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

Thank you.

David Strauss
Analyst, Barclays Capital, Inc.

Thanks, Tom. Thanks, Jose.

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

Thank you, David.