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Spirit AeroSystems Holdings, Inc. (SPR)

JP Morgan Aviation, Transportation & Industrials Conference

CORPORATE PARTICIPANTS

Ghassan Awwad
Executive Director of Investor Relations and Corporate Strategy, Spirit AeroSystems Holdings, Inc.

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

OTHER PARTICIPANTS

Seth M. Seifman
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Yeah. Can you hear me? Guys, can you hear me on the line?

Ghassan Awwad
Executive Director of Investor Relations and Corporate Strategy, Spirit AeroSystems Holdings, Inc.

Seth, are you on the line?

Seth M. Seifman
Analyst, JPMorgan Securities LLC

I am. What if – is there something we can do back in the AV room, maybe they can't hear us.

Ghassan Awwad
Executive Director of Investor Relations and Corporate Strategy, Spirit AeroSystems Holdings, Inc.

They're trying to get in touch with you.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Okay, okay.

Ghassan Awwad
Executive Director of Investor Relations and Corporate Strategy, Spirit AeroSystems Holdings, Inc.

Hello, Mr. Kapoor. Can you hear me?

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

I can hear you, yes.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Okay, okay. Hey, Sanjay, it's Seth.

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

Good morning, Seth.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Good morning. I'm glad we were able to work that out.

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

Oh, thank you. Thank you for being there. And, again, listen, this is a first, I'm sure for you – well, maybe not for you, but certainly for me.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

No, me too, me too. But I would tell you we've got – we just had actually several more people come into the room. So you've got – we can't see you but everyone can hear you. And so, you're online here with a nice crowd in the room. And we appreciate you being with us online. I know it's not what we were expecting to do. But we're glad that you can make time for us anyway. And I'm not sure at the beginning if you guys were able to do the Safe Harbor statement. If not, I'll let you do that now. And then I think you were going to give a brief business update, and then we'll move into Q&A.

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

Yes. I think we did one. We'll do it again.

Ghassan Awwad
Executive Director of Investor Relations and Corporate Strategy, Spirit AeroSystems Holdings, Inc.

Yeah. Okay. Yeah. Good morning, Seth. This is Ghassan Awwad, Investor Relations. Just 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 news releases and our SEC filings.

With that, I'll turn the call over to our Executive Vice President and Chief Financial Officer, Sanjay Kapoor.

Sanjay Kapoor

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

Thanks, Ghassan. And thank you, Seth, and good morning to you, Seth. And good morning to whoever is in the room, and I hope there's plenty of people basking in the sunlight in New York City. And this is certainly a first for me, so this – Seth, if this becomes – this ends up well, I think I might have found a new cost reduction initiative to try and do these things on phone while the government travels to New York.

Seth M. Seifman

Analyst, JPMorgan Securities LLC

You're beating to the punch in saying that.

Sanjay Kapoor

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

But in any case, let me do this. For people in the room, some of who may have heard our story and others who may not have, let me just give you a three- or four-minute story on, at least since I have been at Spirit in the last three or four years, the areas that we have been focused on, what we have been able to achieve and the long road we have ahead of us and some of the focus areas we have for 2017 and beyond. So Spirit obviously is the largest aerostructure provider in the world outside of the OEMs, and we do a lot of work for primarily the two OEMs in Boeing and Airbus, but we also do work for other manufacturers. Boeing happens to be our largest customer, and the majority of our activity is, fortunately for us, on the narrow-body both for Boeing and for Airbus.

In the last three years, the company has been very focused on making sure that our performance improves, and this is not just in the areas of cost but also in the areas of quality and delivery, and I think we have been able to achieve a lot of that. Hopefully, our customers will tell most people the same thing. And much of that has come through everything between centralization, working on our cost structure internally, and improving that, as well as finding ways to derisk our company. Three years ago, when I came in here, we had some issues with some businesses that we have been able to divest, particularly our Gulfstream businesses.

We then also were able to resolve a long-standing cost structure around the Airbus A350 program last year, which we believe was a good outcome for both sides and fundamentally have been focusing on generating free cash flow. Having started a very small number in 2013 of less than $60 million of free cash flow, we articulated a plan to deliver about 6% to 8% free cash flow conversion to revenue, and this year, our guidance is in that range of $450 million to $500 million of cash. So, our focus on cash flow has obviously been key, and as that has been generated, we've also deployed what we call as a balanced capital deployment. Over the last two years or three years now, we bought almost $1 billion of shares.

We've been very opportunistic about that. We have a current share repurchase program of additional $600 million that is authorized by our board that we're going through. And lastly, we also initiated a small dividend as our first step. So that's been the focus on cash flow and the focus on cash flow deployment. Our current focus obviously is on making sure that we achieve the rates that are, in some cases, going up particularly in the narrow-body and also in the A350 and other programs, but at the same time also managing the challenges around rates that are going down. Some of the announcements that people may have seen on, for example, the B777 or the B747 and maybe even the A380.

So the rates going up and down has been a focus for us right now. The second area of big focus for us our supply chain strategy, what we make, what we buy, what we make where, what we buy where and that's something that we have started at least a couple of years ago and we're in the midst of executing portion of that strategy, which will take some time to execute and certainly will take some time for the benefits to reap. But in the long-term we believe that will put Spirit in the right cost structure to compete and win new business. So with that, the new – the third area of focus for us obviously is our growth. Now that we believe we've stabilized our corporation and the growth for us are in areas such as defense. We were fortunate to be one of the seven contractors on the B21 bomber program.

We also have articulated our ambition to try and grow in fabrication. We are one of the largest fabricators in the world and almost $0.5 billion of fabrication and almost 40,000 parts for ourselves. We believe that that scale and size and capability and capacity can be leveraged to do additional fabrication activity for other defense primes or other OEMs. And that's an area that we are certainly exploring right now. We also believe we can grow organically particularly in the rates that are going up, but also in new business that we may be able to bid with both the OEMs and we're going through a few of those activities as we speak. And then last thing is inorganic growth. We believe we have a good balance sheet that gives us the flexibility if something opportunistically shows ups.

We want to be cautious how we do that. We will be very disciplined in how we do that. But we want to always keep an eye out for inorganic growth as well. So with that, I think, just to reiterate, our commitments for the year in terms of our guidance that we gave earlier in the year, our revenue of $6.8 billion to $6.9 billion, our earnings per share of $4.60 to $4.85, and our free cash flow of $4.50 (sic) [$450 million] (07:29) to $500 million.

Just a small additional note, I was looking at it this morning. The first quarter typically, and I was going back to 2014, 2015, 2016 and 2017, the number of workdays in the quarter have declined a little bit. This is just a calendar, in 2014 there's 66 days, 2015 there's 65 days, and this year it's 63 days. That does have an impact in terms of how much – what our percentage is in the first quarter. And obviously, the ramp up that are happening in the 737 are in the back half of the year. So that will be the profile of our earnings per share this year. It's a little different than in previous years. But overall, our guidance is intact at the numbers that I just articulated.

So with that said, I'm going to turn it over to you, and I'd be happy to take any of your questions or anybody in the audience.

QUESTION AND ANSWER SECTION

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Great. Thanks. Well, I'll start off with some questions and then we'll open it up to the room. Apologize, but we'll start off with a topic that I'm sure you're tired of talking about, which is the Boeing pricing agreement, but I'll start off with it so that we can ask maybe just a few very specific questions and then move on to talk about other things. So, starting off with that, and this is just my impression, but when you've spoken about this recently in other appearances including on the earnings call, my impression from your recent commentary has been that when we eventually see a deal here, we should not look for some kind of epic margin reset that Spirit is still going to aim to convert 6% to 8% of its sales to free cash flow and that your margin targets for segments might move around a little bit. They might move around for a particular year, but they probably won't be dramatically different after we see a deal. Is that a fair way to interpret the message that you guys has been sending out in recent months?

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

A

Seth, that's a fair question, and you're absolutely right. I'm worried that if one can – once we do have a Boeing settlement that most people won't have a question to ask me about. But I've said that because it's usually the first question. Listen, the negotiations that we do with Boeing are based on the following foundations. The first foundation has to be that our performance is good and that our cost structure is very competitive so that we, in fact, bring lots of value to Boeing. I mean, at the end of the day, their success is our success, and they are our biggest customer. So we obviously want to make sure that our customers are satisfied in terms of our performance and our cost structure.

We've always said that the second foundation of our negotiation is that we want a fair, equitable, and balanced solution. We've also said that these are solutions that will be comprehensive in nature. And then the last thing, we've kind of said that facts and data and performance is around the foundation and commitment that we've provided to [indiscernible] (10:29-10:34) everybody, all our investors around the fact that we intend to deliver 6% to 8% free cash flow in terms of converting our revenue. Those are the foundations around which we are negotiating and have negotiating with, not just Boeing but even last year with Airbus. If you remember, when we settled on the A350 program, that was the foundation around which we negotiated.

So to your question now, is it going to be some kind of an epic margin reset, particularly for 2017 guidance or not? Absolutely not. 2017 guidance is consistent with everything that we know and will do in 2017. And again, I'll just go back. The foundation of our negotiation is around those three principles. So there shouldn't be anything dramatically different there. The trick for all of us is to make sure that we find the right balance between cost reduction, our customers' need in the marketplace and their and our ability to invest in these programs and find the right balance between the rates that are going up, the rates that are being flat, and the rates that are coming down.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Thanks. Thanks Sanjay. Just to follow-up on that With one question, fair and equitable, if we assume that the outcome of an agreement is fair and equitable, is part of this negotiation also that just there's a lot of price pressure across the industry and so we look at Boeing, and we look at the pressure that they're under to lower their costs for 737. And even a deal that's fair and equitable, some of that filters down to you because that equation in the marketplace is different than it was when your pricing was set.

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

Yeah, Seth, that's again – fair question, but I will tell you that in the last 10 years, both companies have benefited from this arrangement. Spirit in the last 10 years has had a tremendous value to Boeing, not just in terms of the cost that we've been able to deliver but if you look at the amount of investments that have been made by us in, whether it'd be the 787 program or in other areas, this has been one of those win-win situations for both of the companies. Is there cost pressure in the marketplace? Of course, there is. That's one of the reasons why good partners work together on finding ways to reduce cost overall. And when we do that, everybody wins.

I will tell you that there are a number of people from our – from Spirit at Boeing and vice versa in our factories constantly working to find better and better ways not just to lower the cost of investment but also try and reduce the recurring cost going forward. Some of that is engineering initiatives. Some of that is manufacturing initiatives. Some of that frankly is initiatives in lowering inventory and working capital and things like that. So, all of that becomes cost and we both work really hard to try and reduce our costs, so that we can collectively be successful and have many more aircraft to sell.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Great. Great. Thanks. Last one on this, and it's a super quick one, when this is eventually resolved, how do we find out about it? Is there an 8-K that you publish immediately, or do we kind of find out on the next earnings call?

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

Yeah. Well, again, depending on the nature of the agreement, I will tell you, and I've mentioned this particularly in some prior earnings calls, Seth, just so that everybody is clear, we do on a daily, weekly, monthly basis negotiate and settle a wide variety of things which, frankly, you guys don't see because they are smaller in nature. So, this is a question more about materiality than anything else. And, sure, if you were to have a broad agreement like we've had in the past, I mean, you may have – you may recall and others may recall that when we all went up in terms of 787 rates, we agreed and we announced the broad outcome of that discussion. So, yes, if it requires an 8-K, we will obviously file an 8-K. Those are decisions not based on choice, those are based on facts and law. So, yes, you will find out. But again, there are some decisions and agreements that we make periodically that are small, that you don't see. But if it requires an 8-K, of course, you will see an 8-K.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Great. Thank you. And let's move on to the next topics.

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

Sure. No more Boeing questions.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

No more Boeing questions. So there's a lot of talk. Just broadly, as you read news these days, there's a lot of talk about automation. When we think about it in this industry, we know that that Boeing will be introducing a lot more automation for the 777X. What does automation mean for Spirit in terms of potential savings, in terms of efficiencies, in terms of your investment profile going forward? And as far as you're concerned, are you at the – are we at the cusp of some kind of big manufacturing change? Are we looking at small evolution, something in between? How do you think about these issues?

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

A

Okay. So I think it's a little bit of everything, Seth. Had there been some revolution in certain pockets of areas how we do [ph] rationing (16:00) or machining, yes, there have been. But have there been a lot of evolutionary improvements – of course, they have. Now, here's the outcome why I say what I say is true. One of the things we kind of tout and I've been saying this for the last two or three years, is if you look at our rates in our factories, whether you count the number of people, this will be the both direct and indirect folks working in our factories, they remain confident whereas our output has gone up significantly. That should tell you that there's productivity coming out whether it's evolutionary or revolutionary, it's coming out of that.

The other thing that I've been touting about quite a bit is that, in the last three years, for example, we've been spending about $250 million to $300 million in capital, and if you really add that all up, it's about $1 billion of investment that's gone into our factories in the last three or four years. A lot of that investment has gone and not just to create, automation is a very tiny subset. What you're really trying to do there is to create better efficiently manufacturing [indiscernible] (17:02) and you're trying to create flexibility so that equipment can operate on a wide variety of products. And if you can do that and make sure that those machines not only do some level of automation, but also have some flexibility and also have better utilization and up time and has faster rates, then I think you get, which is everybody's objective is to get our ability to produce things at a cheaper cost. So that's something that's been going on.

The last thing I would tell is that there's a lot of cooperation on – between Airbus, Boeing and Spirit in this effort. We do share a lot of our work that we do together in terms of tooling, in terms of capital and how to deploy that stuff better. And the result of that is when you may have seen that in the last two or three years we've been able to even absorb these rate increases inside our existing footprint. What that basically means is, is that we become, the density at which we produce our product is increasing. And that is a result of these kinds of initiatives. So automation is a very small subset, the very broader kind of a result when you work on a wide variety between, like I said, flexibility, automation, efficiency and so on.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Thanks. If we move on and talk a little bit about M&A. You mentioned that that's an option for capital deployment in the business update, you gave at the beginning of the call. One of the area, and you've talked about a couple of areas in the past. One of those is becoming potentially more vertically integrated. Earlier in the decade, we saw Precision Castparts become very acquisitive in sort of the lower tier area of the Structures business. That effort met, I think with mixed results, but Spirit is a much different company and it has much different capabilities. And so how do you think about the potential for vertical integration and that being one avenue for you to pursue M&A?

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

A

Sure. So, in aerostructures, it is my personal belief that what matters a lot is scale and size. So you need to have enough critical mass and then you need to be – and enough scale and size to benefit, to be successful in aerostructures. That scale and size also needs to find the right balance between what you have been able to centralize and there are certain functions that need to get centralized, whether it'd be engineering or supply chain, a certain core function. And what needs to be decentralized so that you have, I'm just going to call it, high efficiency locations where you actually physically make that product. And then, of course, you have to find the right balance between everything in terms of inventory and logistics to make this machine work across the globe. So that's the trick to find the right balance. We believe we have some good concentration, good capability and capacity to facilitate that.

In some cases, vertical integration for us is also to ensure that we maintain, as you're going up in rates, we reduce the risk in our factories and lower the number of suppliers that we have that do this kind of work. So there has been some cases where we actually brought in work into our factories. In some cases, if you have spare capacities Seth, and we've had some of those choices, obviously, it's a lot easier and cheaper to be able to absorb some of those that work in your own factories when you have spare capacity because the variable cost is obviously a lot better. So, I've thrown out a whole bunch of things at you, but we look at it strategically from those lenses in terms of how we do – for us M&A is an outcome. I mean, first, you have to decide what you want to make and what you want to buy based on the comparative advantages that you have as a company. And then you decide whether it makes sense to pass on to the supplier or to acquire or to make it.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Thanks. One of the other areas that you've talked about as a potential destination for M&A dollars is the aftermarket, and it sounds like this involves MRO. And can you talk a little bit about why the aftermarket is attractive and whether there are any changes underway in the aftermarket right now that are making it more attractive for you?

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

A

Yeah. Well, aftermarket is no different than anything else that we've looked at in terms of our growth platforms, Seth, I would say, it's on equal footing, whether it'd be the defense or the organic growth that I talked about or the fabrication growth that I talked about. But the process there is very similar. Again, we think we bring certain size and scale and concurrent manufacturing and engineering capability. Those are the strengths that we bring to the table. So inside that, if there are certain MRO opportunities, and again, there are certain things that other people can do better than us because they're of a certain size and scale that they are more – they're the right people to do. But then there are other components that we believe only people like us can do. When that happens, then that's how we filter what the opportunity for us may be, whether it'd be just growing it naturally or trying to find ways to look for inorganic options. But I would not say that MRO has a different kind of data criteria than any of the other criteria – any of the other growth areas that I just discussed.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

And within the aftermarket, most of the OEMs have talked about doing more in the future, and you have close relationships with both the OEMs. Does that facilitate opportunities for you in the aftermarket? Or does that make it more challenging for you to do more in the aftermarket? Or does it not really have that much impact?

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

No. Again, aftermarket for us is a very small component of our portfolio Seth, and so it's not a game-changer for us. We do enjoy the fact that, again, under the large programs, we do supply all the spare parts for our OEMs. And obviously as they grow, which we hope they do, then that brings better opportunities for us just given the fact that we produce a number of those parts for them. But, no, we don't compete directly with the OEMs. Again, like I said, there are certain repair opportunities that based on say, size and scale, that would make a lot of sense for somebody like us to do. And those are the ones that are attractive for us. But again, it's a small component of our overall business, and it's – frankly, it's not material, so.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Right. Okay, okay. And then thinking about growth in defense, can you point to maybe some of the growth areas beyond the B-21? You have content on the CH-53K helicopter, which should be ramping up in the coming years. There are a couple of other programs out there that are going to be awarded over the next few years. Is there anything that you would highlight in terms of the opportunities? And then also, given the focus at Boeing, on One Boeing these days...

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

[indiscernible] (24:46).

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

...do defense opportunities come up at all in your conversations with them ever and maybe even as part of some kind of global settlement or agreement with them?

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

Sure. So I won't get into the specifics of the global settlement or the negotiations, Seth, I obviously cannot do that or in terms of what we specifically talk to them about. Here's what I can tell you. And we strongly believe that and we believe this is one of the reasons why we are on the B-21 program. If anybody in the audience or you, I know you have been to our factory, you will see our capability and our capacity. Whether it'd be in composites or it be in fabricated aluminum parts or steel, titanium and so on and so forth. That scale and size is also at a cost structure that is very competitive compared to the defense primes today, while historically, based in parts of the country where the cost structure is quite different than the cost structure we have here in Wichita

And obviously, a lot of this work naturally has to be done here in the United States. So, if you are in a highly efficient part of the country and have a good cost structure, then I think you have a competitive advantage to try and attract more and more work for the defense primes in the defense area. The next area that I think is kind of crucial, which we demonstrated when we were doing the V-22 program is to do concurrent design and development activity. And I'm thinking people may remember, in less than 22 months, we have the prototypes ready. That right balance between doing engineering and doing concurrent manufacturing, I think very few people have that capability. So, we think we've got good cost structure.

We are in the right part of the country. We have good cost structure, and we have the right balance between engineering and manufacturing. If you mix those three things, we think we can add a lot more value to the growing defense business in the United States. And now that we are part of the B-21 program, there are certain structural things that you start to develop around critical mass, around everything from earn value, to disclosure statements, to learning how to work with the government [ph] in the way in (26:59) which you're supposed to. And a number of our management team has come from places that they've had that experience. So, when you put all of that stuff together, we believe that we can find ways to grow defense around that large program. That's how we look at it.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Excellent. Thanks. And we do touch – talk about defense as an organic growth opportunity. One of the other places that you've talked about having opportunities for organic growth is at Airbus, especially on the A320. Is there any update you can give us with regard to that? Or anything you can do in terms of sizing the scope of the opportunity that's there?

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

A

Sure. So, again, I can only talk about some of the stuff that's in the public domain, Seth. There are a few work packages that are at the early stages of being bid out by Airbus as they have their initiatives in what they will call SCOPE+ and their dual sourcing strategies. The core question here though is, the reason we feel good about this, and obviously we will see how successful we are, and in these days, there's nothing game-changing in the near term. But we will always – they all have a longer gestation to it. But the reason we feel good is, if you go back to our A350 settlement last year, there were two reasons why that is important. The first reason was these are stuffs we thought it was a good outcome at the end of the day, and if you look at it going forward, we will be cash positive as we produce the A350 product.

But the basis and the foundation of that negotiation was also very similar to what we are trying to achieve with Boeing based on facts and data. And those facts and data demonstrated that our cost structure was competitive because if you're an OEM – Airbus is no different than Boeing – you want to make sure your partners that you want to grow with are the ones that have the right balance between performance and cost. And we felt that our negotiations demonstrated our ability to compete and produce good product at a competitive price. So, as a result of that, and a result of that teaming and that resetting that relationship, we believe we can bid and hopefully win some work in the future. Obviously, it'll be in the areas that are core to us. Those are structural areas that – again, specific things in terms of what we are bidding, I think that will be best left to Airbus to answer.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay. Thanks. And then at this point, maybe I'll open it up in the room and see if there are any questions from the audience. We have a mic that's available, so Sanjay should be able to hear you if you have a question. But okay, we've got one right over here.

Q

Hi. My name is [indiscernible] (29:51) from Pacific Life. I had a question on your supply chain. You've touted improvements in a long term development in terms of your supply chain and how important that is to your company. With possible changes in both taxation and international trade, how do you view the risk to your supply chain?

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

A

That's a good question. We view risks on supply chain no different than we view our risks on program. For us, what's most important in a supplier is not just cost, but it's make sure that there is no disruption to our – inside our supply chain. The second thing we want to make sure like we are to Boeing and to Airbus is that our supplier has the capability, the capacity to produce good cost, but also good quality and 100% on-time delivery. So as we go through that analysis, it's no different whether it's a supplier in Wichita in the state of Kansas or inside the United States or outside. We want to make sure that they have the capability and capacity to deliver products on time, with high cost of quality, and obviously, have the capability and capacity to ramp up the appropriate rates in the future.

So it's a partnership arrangement. We have obviously a very large portion of what we buy is today made here in – right here in the United States because those [indiscernible] (31:21) are, in fact, doing well. The other thing that we try and do with our suppliers is something that we've said, we work on what we call is clean sheets. We found ways to try and get what's being called as the should-cost of [ph] APOC (31:36). And we work with our partners to find ways that they can, along with us, achieve what is theoretically possible. And that becomes the basis of our discussions with our current and our future suppliers. In terms of taxation, I don't think anybody knows the answer to that today. So obviously, in the absence of that, we make the best decisions given the information we have today.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Thanks. Are there any other questions in the room? I see one in the back there.

Q

Hi. I know in a general way your pricing modulates with volumes. Can you – am I right in understanding that pricing on the 737 or mature program shipsets continue to come down as those volumes go up and up and up into the distant future? And then also, will your pricing go up as A380 and 777 rates come down? Thanks.

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

A

A very fair question. Theoretically, the answer is, yes, to both. Clearly, in a capital-intensive business, there is an impact in terms of fixed cost absorption both for volume that's going up as well as for volume going down. Obviously, the management challenge and the reason we work so hard is to find ways to eliminate that or bring it as low as possible. I'm going to give you two or three examples of how we try and achieve that. Again, as many of you who may or may not have visited our factories will see that at the end of the day, we are a cohesive and sort of a seamless organization. One of the ways we try and handle the rates that are going down on the wide-body is to find ways that support staff and support structure gets merged or utilized across programs.

So instead of having a program manager just for the 777 program and a separate one for the 767 and we find ways for quality people, for supply chain people, for basically all the overhead functions, find ways to have common overheads. To the extent that you can do that, you can lower the impact of things that are going [ph] downgrades (34:04). The other area for us to obviously work on this is to find equipment that has the flexibility to do a wide variety of product across programs. In some cases that's easy, and in another cases, it's not that easy. Obviously, there are certain areas of tooling that are unique to a program and the cost of absorption does get impacted as rates go up and rates go down. But if you can move people around and if you can move certain attributes of capital and make things flexible, you can find the right balance so that you're not impacted disproportionately as rates go up and rates go down.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Thanks. That was actually a great question and sort of to follow-up on that, it seems like for 2017, the increase that we're going to see in 737 rates is kind of offset for you to some degree by the decline on 777, more or less. And is there anything you could say maybe qualitatively at this point about how we think in 2018, we're going to have the same situation, we're going to see the narrow-bodies go up again and we're going to see the 777 come down again? How that naps out for you in 2018?

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

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Sure, Seth. And absolutely. I mean, as far as 2017 is concerned, we've been – I think we've been good about making sure that we incorporate into 2017 guidance everything that was announced and known about the 737 and the 777 rates as Boeing and the Airbus [indiscernible] (35:44). So, the guidance for us obviously, includes the announced of 777 and 737 rates. Like I said at the outset Seth, the 737 kicks in towards the back half of the year whereas the 777 rate decline is, frankly, given the announcement that happened, had an immediate effect. That's one of the reasons why the first and the second quarter for us should be lighter quarters compared to Q3 and Q4.

So, again, while our guidance is completely intact, the profiling of that guidance by quarter will be more tilted towards the back end, just given the rate structure. In terms of 2018, obviously, you're not talking about 2018 guidance yet. Everything that we know in terms of 737 should follow the same profile in terms of growth, and we, based on everything Boeing has said publicly, the 777 is stable at the current rates that they have announced. So, to that extent, that will have the appropriate impact, and when we discuss 2018 guidance, we'll talk about that. But, yes, 737 goes up in the back half of this year. 777 started ramping down already just because we're – many – at least a couple of quarters ahead of Boeing as far as those things are concerned, and that's how we see it.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

And then on the investment side, how much more is left to do if we assume that the narrow-body rate can get up to [ph] 57 (37:15) a month at Boeing and [ph] 60 (37:19) a month at Airbus? Is there much more investment left? And similarly, is there much investment for Spirit associated with the move to 777X? And can we fit all the investment going forward within our CapEx profile of let's say, $250 million or so annually plus or minus?

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

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Yes. So the answer is – is there – first question was how much investment was there on the 737. There's a decent amount of investment, and that's obviously as rates go up. There's investment required not just in capital, but also in tooling. The good news here though is that, working with Boeing and us, our teams have worked really hard to find ways to continue to lower that investment. And if you remember, maybe two or three years ago, we would have [indiscernible] (38:08) worried about the fact that we may not be able to do all of that in the same space that we have.

And that we will have to add some additional buildings, brick and mortar, which are always the toughest decisions because that's the kind of cost going back to an earlier question. How do you manage your fixed cost when it's going up and you manage your fixed cost when you're going down. When you add brick and mortar, it usually comes with 30-year depreciation and then you can't really change that [indiscernible] (38:31). So the trick is, how do you find ways to create higher density in your factory and not add more brick and mortar and absorb the rates that are going up. And I would say and we did talk about this. We don't believe we need lots of brick and mortar today, the small amounts but nothing significant to be able to achieve those higher rates.

But there is investment. This is part of a discussions that we do have Boeing. Teams continue to work on how to find ways to lower that investment. But we believe we can handle that going forward. Now, I'm not giving you guidance in terms of capital for 2018 or 2019 or anything like that. What we've had said that, we've got $250 million to $300 million capital guidance last year, this year. It's likely to be in those ranges in the future as well, unless we decide to go and win new businesses, and we believe that when we win new businesses, that will have the ROI that will justify that investment. And we do have a balance sheet that will support that investment. So that's how we look at it.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. And let me just look out – we're down to about a minute here, so let me just look out in the room and see if there are any other questions in the room. And then, I guess maybe the last one is on A350, which we haven't talked about very much yet. There's been obviously outstanding progress on that program at Spirit in terms of reducing unit costs over two years now. And we have a decent profile for the program, I think, based on the agreement you have reached and it's a solid agreement. It does look like we're going to see a bit of a pause this year in terms of the improvement in unit deferred that we've been accustomed to over the past two years. Maybe you can talk about that profile a bit in terms of how this year plays out and then maybe at some point, we reach steady state, when we can expect to reach kind of a steady state level of cash profitability on A350?

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

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Sure. Sure. And, again, Seth, I'm going to remind people and some people who've been inside our [ph] story (40:40) may remember the time that we used to have things like, we call, travel, work, like in any program in the early stages of the program there's a fair amount of disruptive cost and lack of efficiency, and then you start to stabilize. A component of that stabilization and improvement is not just, what we're doing in our factories, but also how we work with our supply chain, move things from spot price to long-term agreement.

The first thing that's kind of key here is to make sure that the rates are – the rates and we achieve those rates in terms of delivery, as well as obviously as everybody knows in the previous question, the rates do have an impact in terms of what your cost is. As all of that is happening as we're increasing our rates, our improvement is manifesting ourselves – itself. Having said that, we've articulated that we expect to recover the balance – in the balance of the block of 800 units about $450 million, and we think we have a good plan to achieve that. Having said that, you will see times when it goes up a little bit and times when it goes down. Some of that is just the nature of the calculation that you see.

When you see deferred per shipset, it's not a perfect – it's a decent representation of what our cost is but it's not a perfect representation because we do have at times in a quarter lump sum settlements or lump sum costs sometimes that can impact that, including things like foreign exchange and so on. So it's a very good trend and we believe we are on the absolute right trend. We also believe we have a good plan to achieve that $450 million of cash recovery in the balance of the block but you will see some ebbs and flows in that profile over the next few years. But again, that – all of that is part of our calculations and our guidance and our commitments in terms of how we intend to execute that program.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Great. Thank you. And with that, we're out of time. Sanjay, we appreciate you being with us under difficult conditions. I think what we'll need in the future probably, so we can put up on the screen is maybe a photo of you, so like on the news when they have someone calling in. You can see it, it'll say, on the phone, Sanjay Kapoor. But thanks so much for being with us. We really appreciate it.

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

Thank you, Seth. And I apologize, we couldn't make it there but this was a challenging time. So I appreciate you taking the call.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Great.

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

And thank you, everybody, in the room as well.