01-Nov-2017

Spirit AeroSystems Holdings, Inc. (SPR)

Q3 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Spirit AeroSystems Holdings Inc's Third Quarter 2017 Earnings Conference Call. My name is Brandon and I'll be your conductor today. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the presentation over to Kailash, Vice President of Investor Relations, M&A and Strategy. Please proceed.

Kailash Krishnaswamy

Vice President, Investor Relations, M&A and Strategy, Spirit AeroSystems Holdings, Inc.

Thank you, Brandon, and good morning, everyone. Welcome to Spirit's third quarter 2017 earnings call. I'm Kailash Krishnaswamy and with me today are: Spirit's President and Chief Executive Officer, Tom Gentile; and Spirit's Executive Vice President and Chief Financial Officer, Sanjay Kapoor. After opening comments by Tom and Sanjay regarding our performance and outlook, we will take your questions. In order to allow everyone to participate in the question-and-answer segment, we ask that you limit yourselves to one question, please.

Before we begin, I need to remind you that any projections or goals we may include in our discussion today are likely to involve risks, which are detailed in our earnings release, in our SEC filings and in the forward-looking statement at the end of this web presentation. In addition, we refer you to our earnings release and presentation for disclosures and reconciliation of non-GAAP measures we use when discussing our results. As a reminder, you can follow today's broadcast and slide presentation on our website at investor.SpiritAero.com.

With that, I would like to turn the call over to our Chief Executive Officer, Tom Gentile.

Thomas C. Gentile III

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

Thank you, Kailash, and good morning, everyone. Welcome to Spirit's 2017 third quarter earnings call. Before discussing the solid third quarter results, I would like to begin by highlighting the completion of definitive documentation for our agreements with Boeing. To remind you, these agreements resolve many open commercial issues between our two companies, including pricing on the 787 and 737 MAX into 2022, while providing Boeing with productivity discounts on the 737 as rates increase and moving to industry standard payment terms.

Spirit is proud to play its role in Boeing's Partnering for Success program. The definitive documentation was a big effort. Teams from Spirit and Boeing spent several weeks drafting agreements, totaling almost 500 pages, to capture and document the provisions of the MOU. Achieving this significant milestone helps reset the relationship with Boeing, who remains our largest customer. This agreement also includes collaboration on new technologies and aerostructures.

Separately, Spirit has established a program office to develop technologies for next-generation aircraft. And we look forward to bringing our ideas and proposals to our customers in the coming months. With the Boeing agreements complete and related uncertainty removed, we can now turn our attention to executing on our commitments and growing the business. As we discussed at our Investor Day in late September, our growth will rely on three key drivers: first, executing on our backlog and increasing rates on the most popular programs. The main driver of demand for our products is traffic growth, which continues to be strong with year-to-date growth of approximately 8% and projected growth of 5% over the next 20 years, in line with historic levels.

This growth underpins the planned rate increases for the 737, A320, A350 and the more recent 787 increase to 14 airplanes per month in 2019, just announced by Boeing. The 787 rate is the highest production rate ever for a wide-body. And we have already began executing to support this key program.

We are fortunate to have significant content on all of the most popular programs that are growing in rate. We are being very diligent in our plans to maximize both the natural cost absorption benefits of these increasing rates as well as other cost reduction opportunities. For example, we are continuing to pursue supply chain productivity, leveraging our clean sheet process.

The second key driver is expansion of our fabrication business. We are already one of the largest manufacturers of machine parts in the world. Currently, we produce parts which cost approximately $500 million annually, all of which we consume internally. We expect to grow fabrication to $1 billion annually through a combination of in-sourcing parts from our supply chain and supplying parts directly to OEMs and other Tier 1 providers, while expanding our current commercial customers to military customers.

We have developed centers of excellence in Wichita for 5-axis machining and chemical processing, and in McAlester, Oklahoma, for 3 and 4-axis machining. In addition, we also recently broke ground to expand our Malaysia facility for assembly. To drive this growth, we've named Kevin Matthies as Senior Vice President of Global Fabrication.

The third and final key driver in growing our business is defense, which we anticipate becoming a $1 billion annual business. We have a healthy backlog in defense that includes several key platforms such as the P-8, KC-46, the CH-53K and the B-21. This strong position in defense aerostructures has attracted a lot of interest with defense primes. And we begun work to bid new work packages, including a recent win with a major prime on a key structural component.

Spirit has a strong value proposition for military customers, including competitive cost manufacturing, application of commercial best practices and design build capabilities. We have appointed Krisstie Kondrotis as Senior Vice President of Defense Programs and Business Development to drive our growth in defense.

We will measure our overall performance with a few basic metrics. We will target 3% to 5% revenue growth, expanding margins, 7% to 9% free cash flow conversion, and balanced total shareholder return that includes dividends and share repurchases.

We've been doing a lot of work on capital structure and deployment following the agreement with Boeing. We have laid out certain goals and objectives, one of which is remaining an investment grade company. Going forward, we intend to maintain robust levels of share repurchases, as we continue to believe that Spirit is undervalued. After purchasing $194 million in shares this past quarter, we currently have $598 million remaining in our repurchase authorization.

We're also looking at deploying our capital toward inorganic growth. We are actively evaluating multiple potential deals in this very dynamic marketplace. As I've mentioned in the past, our M&A target areas are Airbus content, military content, and low-cost country footprint. Any potential opportunity must meet these strategic objectives as well as our internal return thresholds.

Our operating teams have also been working very hard. In Wichita and Tulsa, we have achieved rate 47 for the 737 and are actively executing the next rate breaks on the 737 and 787. In Kinston, North Carolina, our team has done a good job over the last year stabilizing production after Hurricane Matthew and continuing down the cost learning curve.

As we mentioned last quarter, we are now fully recovered from the impact of that hurricane. During the period of disruption, we booked $32 million of costs associated with the storm, for which we submitted a claim to our insurance carriers. You may have seen, in the last quarter, that we filed suit in a dispute with those insurance carriers over that claim. We remain confident in our position to recover our extraordinary expenses related to the flooding and disruption from the hurricane.

Now, let's take a look at third quarter results. These results reflect the continued solid execution of the day-to-day business. For the quarter, we reported revenue of $1.7 billion, up 2% year-over-year. Net income was $147 million, up 1% year-over-year. Reported earnings per share were $1.26, up 9% year-over-year.

Operating cash flow was $291 million, up 9% year-over-year, with strong free cash flow of $240 million, up 12% year-over-year. Our backlog at the end of the third quarter was $45 billion, with work packages on all the commercial platforms in the Boeing and Airbus backlog. Sanjay will provide you with more details about these strong third quarter financials in a moment.

Now, turning to 2017 guidance; our 2017 guidance remains unchanged. We expect 2017 sales to be between $6.8 billion and $6.9 billion and adjusted earnings per share between $5 and $5.25. Free cash flow is expected to be between $500 million and $550 million. For 2018, we plan to provide full guidance during our fourth quarter earnings release. For now, we expect that free cash flow will be better than 2017. And, as we highlighted at our recent Investor Day, we have increased our target from 6% to 8% free cash flow as a percent of sales to 7% to 9%.

With that, I'll turn it over to Sanjay. Sanjay?

Sanjay Kapoor

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

Thank you, Tom, and a very good morning, everybody. I hope everybody has recovered from the Halloween candy last night, and also Game 6 [World Series]. All right. So, first, I will summarize our third quarter financial results and our full year outlook. And then, we will open it up for your questions.

So, let's start on slide 3. The revenue for the quarter was $1.7 billion, up slightly from the same period of 2016, driven by higher production deliveries on the 737 and the 787 programs, as well as increased defense-related activity, but offset by lower production deliveries on the 777 program and decreased aftermarket activity.

For the quarter, we delivered 404 shipsets including 137 737s, 15 777s, 37 787s as well as 146 A320s and 18 A350 shipsets. We continue to meet our customers' needs as well as meet the challenges of rate changes across our factories and supply chain.

Moving to slide 4, third quarter reported earnings per share was $1.26 compared to $1.16 in the third quarter of 2016, up 9% year-over-year. These results reflect yet another quarter of solid performance. And I want to thank the entire Spirit team for once again meeting our commitments to our customers, to our shareholders and to ourselves.

Earnings per share in the quarter benefited from a lower share count, as we aggressively executed our share repurchase program. As you will recall, our board had already increased our authorization last quarter. Operationally, the impact on margins due to lower deliveries on the 777 program and lower aftermarket activity was offset by increases on the A320 program and the 737 program, including some non-recurring activity. And, as always, we continue to focus on all aspects of cost reductions in our own factories as well as in our supply chain.

Turning to free cash flow on slide 5, free cash flow for the quarter was $240 million compared to $214 million in the same period last year, reflecting a 12% increase year-over-year. The strong cash was driven by operational performance and some timing of working capital. Capital expenditures for the quarter were $51 million compared to $52 million in the same period last year. We continue to ramp up our capital investments to prepare for rate increases, as well as for some of our new initiatives in fabrication in-sourcing and transfer of work into our Malaysia facility.

We will also see some inventory build in the fourth quarter, due to timing on rate increases as well as timing on [ph] work package (12:38) transfers associated with our supply chain optimization strategy. As we have previously stated, converting revenue to free cash flow at a rate of 7% to 9% is a key component of our strategy and an important metric of how we measure our performance.

Turning next to capital deployment on slide 6, in the third quarter, we repurchased 2.7 million shares for $194 million. And year-to-date, we have repurchased 6.3 million shares for $402 million and now have $598 million remaining under the current authorization. In addition, our Board of Directors declared another quarterly cash dividend of $0.10 per share to be paid in January.

So, now, let's look at our segment performance. For our Fuselage segment results, let's turn to slide 7. Fuselage segment revenue in the quarter was $957 million, up 9% from $880 million in the same period last year, primarily due to higher production deliveries on the 737 and 787 programs, as well as increased defense-related activity, partially offset by lower production deliveries in the 777 program and lower aftermarket activity.

Operating margin for the quarter was 15.5% as compared to 16.2% in the same period last year, primarily due to lower aftermarket activity. On a normalized basis, after reversing change in estimate impacts recognized during 3Q 2017, Fuselage segment margin was 15.8%.

On the A350 program, we delivered 18 shipsets in the quarter compared to 16 shipsets in 3Q 2016. Deferred production balance on the A350 decreased by $17 million in the third quarter. The overall program is tracking to plan. The focus for us in the Fuselage segment is to seamlessly manage our numerous rate increases, as well as the shift in mix on the 737 between the MAX and the NG.

Multi-disciplinary teams are working diligently on this and executing plans to smoothly transition these changes. This is hard work, but we remain on plan.

Now, turning to slide 8 for our Propulsion segment results, Propulsion segment revenue in the quarter was $408 million, down from $453 million in the same period last year, primarily driven by lower production deliveries on the 777 program and decreased aftermarket sales, partially offset by higher production deliveries on the 737 program. Operating margin for the quarter increased to 18.2% compared to 17.4% (sic) [17.1%] (15:41) during the same period of 2016, primarily driven by higher non-recurring activity. On a normalized basis, after reversing change in estimate impacts recognized during 3Q 2017, Propulsion segment margin was 17.3%. In the quarter, the BR725 team reached a major milestone with the 300th delivery on that program to Rolls-Royce; our congratulations.

For our Wing segment results, let's turn to slide 9. Wing segment revenue in the quarter was $382 million, up slightly from $377 million in the same period last year, primarily due to higher production deliveries on the 737, A350 and A320 programs, partially offset by lower production deliveries on the 777 program.

Operating margin for the quarter was 13.3%, in line with the 13.6% during the same period last year. On a normalized basis, after reversing change in estimate impacts recognized during 3Q 2017, Wing segment margin was 14.7%.

So turning now to slide 10 for our guidance, we are reaffirming our guidance for 2017: revenue to be between $6.8 billion to $6.9 billion; adjusted earnings per share to be between $5 and $5.25; and free cash flow to be between $500 million to $550 million. Our guidance is based on an effective tax rate of approximately 29%.

And before I hand it back to Tom for some closing comments, I would like to summarize a few key points as we close out 2017 and prepare for 2018. First, my sincere thanks to the entire Spirit team for once again meeting our commitments to all our stakeholders. Second, we have now concluded significant win-win agreements with our customers. And this will allow stability and growth for our future.

Third, as we have discussed many times, in 2017, we started to execute major components of our supply chain strategy. This is something that we have been methodically planning for a long time, and it will be a key enabler to Spirit becoming a best-in-class provider of aerostructures in the future.

Fourth, we have continued to focus on free cash flow and show year-over-year improvement in this metric. And while we are not giving guidance for next year, want to reiterate that our goal for free cash flow next year will be higher than in 2017, consistent with our 7% to 9% revenue to free cash flow conversion target.

And lastly, we have aggressively and opportunistically deployed this cash in share repurchases and dividend payments to our shareholders.

So with that, let me turn it over to Tom.

Thomas C. Gentile III

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

Thanks, Sanjay. This quarter is representative of the reliable results we've been working hard to deliver consistently over the last few years. There is great momentum here at Spirit, with the projected industry growth, planned rate increases and stable relationships with Boeing and Airbus. Now, we are able to devote all of our attention to executing production rate increases, achieving cost reductions, driving top-line growth and optimizing our capital deployment.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Peter Arment with Baird. Please go ahead.

Peter J. Arment
Senior Research Analyst, Aerospace & Defense, Robert W. Baird & Co., Inc.

Q

Yes. Thanks. Good morning, Tom, Sanjay.

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

A

Good morning, Peter.

Peter J. Arment
Senior Research Analyst, Aerospace & Defense, Robert W. Baird & Co., Inc.

Q

Hey, Sanjay, maybe I could just focus for a little bit on the CapEx. You're kind of running at about 50% of what your guidance is, and I assume we'll probably see a reasonable step-up in Q4. But, is that, the $250 million to $300 million, still a good number? And if not, is some been pushed into 2018 and we should be thinking about a higher number in 2018? Thanks.

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

A

Sure. Sure, Peter. It's an appropriate question. And I was look at it last night as well. If you remember, I mean, pretty much every fourth quarter across the industry has a high CapEx number, because as these projects close out and equipment starts showing in. By its very nature, this is lumpy and, again, if I just go back in the last couple of years, we had over $100 million in the fourth quarter in 2015 and in 2016. It's very similar this year. We've got a number of projects, obviously, related to our rate increases, like I said in my script, related to some of the expansion plans that are coming on. And so we do expect a high Q4.

Having said that, it is lumpy. It's going to be somewhere in that range of $250 million to $300 million. We'll see where we end up. One thing I can assure you, we're not choking back on capital. We are making all the investments we need to make associated with productivity, associated with some of the rate increases, and so on. So, some of this is just efficiency in how we are doing things, and some of it is just timing. So I still expect it in that range. We'll see where we come in.

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

A

Yeah, I'd also point out the other use that we have for our capital is some of our growth initiatives. We've been investing in some new capital to support our fab business as well as our defense growth.

Peter J. Arment
Senior Research Analyst, Aerospace & Defense, Robert W. Baird & Co., Inc.

Q

Thank you.

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

George D. Shapiro
Chief Executive Officer & Managing Partner, Shapiro Research
Q

Sanjay, two questions, one, if you can provide a little more detail on why the cash flow is going to be so weak in the fourth quarter based on your guide; and then second, if you could sequentially compare the normalized margins between Q2 and Q3 as to why we saw pretty good degradation in all the sectors? Thanks.

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

Sure. Sure. Thanks, George. George, yes, our range for guidance, which we have left unchanged, the $500 million to $550 million for the full year, would naturally suggest that we do about $50 million, $60 million in the fourth quarter. A few things are happening, some of which we just talked about in terms of Peter's question in the investment, but I would also tell you that – and you know this. Boeing announced a rate increase on the 787, for example, from 12 to 14. It's an aggressive timeline. We're also building ahead in terms of the rate increase on the 737 to 52 for next year. We've also got rate increases on the A350.

And then last, but not the least, we've also got a lot of transfer of work activity as we are optimizing our supply chain. And one of the things that I want to be cognizant of, and want to make sure you guys are reminded of, is that we will see some inventory growth as we manage some of these rate increases. And we will also see some of the inventory associated with some of the supply chain activity that we are doing. So there's likely to be pressure. And it's actually good pressure, because these are good things to do to make sure that there are no slip-ups.

One of the things that we pride ourselves in Spirit is to make sure that we always deliver on time. And if you have to manage that by having higher inventory levels, we'll do that. Now, having said all of that, I think I'll go back to what I said at the Investor Day, and Tom will remind me this every day. Internally, we always try and do better than what we guide to you guys, but we will not sacrifice our delivery and our sanctity of ensuring delivery. If you have to go and generate some more inventory, we will do that. So, that's your question on cash flow.

Your question in terms of margins, listen, I know Q3 margins are a little bit down, but, again, for the full year, I'm going to go back to what I've been saying all year, which is: 16% to 17% margin in the Fuselage segment; 17% to 18% in the Propulsion; and 13% to 14% in the Wing. We are quite comfortable with that. Unfortunately, you do have a few things that happen every quarter. This quarter, we did have a little degradation in the Fuselage associated with some aftermarket-related activity on some spare parts.

A half a point of margin is about $3 or $4 million. These are one-time things. They're not going to repeat themselves going forward. So, we are quite comfortable with where margins will look like in the future.

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

Yeah. The other thing I would say is we've been working quite a bit on our supply chain initiatives and we're making great progress. We probably went through 25% of our parts in just this year alone, but most of those savings are booked over the next several years, starting next year. So, we didn't see the impact of some of those big savings this year, but we'll start to see them next year.

George D. Shapiro
Chief Executive Officer & Managing Partner, Shapiro Research

Q

Okay. Thanks so much.

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

A

It's a long answer, George, but hopefully you're comfortable with that answer.

George D. Shapiro
Chief Executive Officer & Managing Partner, Shapiro Research

Q

Yeah. No. It's a good answer. Thanks.

Operator: Our next question comes from Ken Herbert with Canaccord. Please go ahead.

Kenneth George Herbert
Managing Director & Senior Aerospace and Defense Analyst, Canaccord Genuity, Inc.

Q

Hi. Good morning, Tom and Sanjay.

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

A

Morning.

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

A

Morning, Ken.

Kenneth George Herbert
Managing Director & Senior Aerospace and Defense Analyst, Canaccord Genuity, Inc.

Q

I just wanted to follow-up, you've called out several times a softness in your aftermarket activity across a couple of the segments. I know it's obviously a small piece of the business, but I'd imagine a higher margin piece of the business. Can you maybe provide anymore quantification on what you saw in the quarter specifically and the nature of it, if it was one-time or something structural going on and how we should think about that moving forward?

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

A

Well, as you recall, last year, we had a new agreement with Boeing where we're no longer having a PMA license, so we're not selling directly to airlines. We sell right to Boeing in terms of all of our spare parts. We continue to do some aftermarket repairs, MRO. But the majority of the activity is in the spare parts. And, as Sanjay just said, this quarter, there were some aberrations with a couple of spare parts in terms of the cost of how we sourced those. And so, we're resolving those with Boeing. It was really limited to this year, shouldn't repeat itself. So nothing structural in terms of the aftermarket business, it's just a reflection of making the transition from being a PMA provider to just selling the spare parts directly to Boeing.

As we go forward, we actually expect with Boeing's focus on the service business, the sale of those spare parts should actually go up. So we're quite confident with our position. And after we resolve the aberration on those few parts, we don't expect to see repeat.

Kenneth George Herbert
Managing Director & Senior Aerospace and Defense Analyst, Canaccord Genuity, Inc.
Q

Okay. Thank you.

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

Cai von Rumohr, CFA
Managing Director & Senior Research Analyst, Aerospace and Defense Electronics, Cowen & Company, LLC
Q

Yes. Thank you very much. So, if we take all the adjustments, it looks like it's a negative $5 million and you had been running positive. You say that performance is improving and, yet, having $5 million of negative adjustments might suggest otherwise. Can you walk us through, why did you have that? In which cases are they negative? And looking forward, should we expect to go back to what had been your pattern of, on balance, having positive adjustments? Thanks.

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

So, let me try that, Cai. That's, again, a fair question. Firstly, the $5 million, I know it's a lump number, but it's spread out across our various segments and our numerous programs. Recognize we are going up in rates. Going up in rates is never easy. You do see the benefit – now I'm sort of pivoting to your second part of your question. As we execute these rate increases and generate the productivity associated with that, and, like Tom said, focus on our supply chain and see the results of that, we should see the benefits.

Having said that, our EACs today compared to, if you'll recall, in 2013 or 2014 or 2015, are much tighter because we've raised our booking margins across the board. And so you do see, naturally, every quarter, a few hundred thousand dollars in each program or $0.5 million in each program as risks are realized or opportunities are not, but this is all noise. I can tell you at a macro level going back to what we focus on in terms of margins and then in terms of 7% to 9% free cash flow, we see operationally we are performing well, but you are going to see a few ups and a few downs from here on.

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

And I would just say one of the things is, as we went up to rate 47, obviously, that's a big change and for everybody in the industry. And we had to manage through a lot of issues. So 737, which usually generates a lot of positives, this quarter was more of a challenge. Now, that should all be straightened out next year. We learned a lot from this rate break. And we'll be able to incorporate that for the next rate break, next year.

We also have really been focusing a lot on better quality for Boeing, and we actually had an initiative this quarter, which we called our Flawless Fuselage, and we delivered really one of the best-ever fuselages to Boeing on the 737 program, just in the past few weeks. So, all of those things really create some challenges, but also put us in a better position for next year.

Cai von Rumohr, CFA
Managing Director & Senior Research Analyst, Aerospace and Defense Electronics, Cowen & Company, LLC

Q

Thank you.

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

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Thanks very much, and good morning.

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

A

Morning, Seth.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

It was pretty good progress on the A350 this quarter. Maybe you could walk us through the drivers of that and sort of what implies about the trajectory as we head into the end of the year and into 2018?

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

A

Sure, Seth. I mean at the end of the day, that program, like I said in our prepared remarks, is tracking to plan. And we are obviously in the midst of rate increases as well. We've talked about this in the past, there was a lot of focus on the Boeing A350 program in the context of getting our own productivity in our factories, making the right investments that we learned as a result of some of the hiccups that we had, and when we were dealing with the hurricane issues, and creating appropriate amount of surge capability, all of that is falling in place, getting our supply chain, et cetera, et cetera. From here on, it's execution and making sure that the rate breaks happen the right way. And if that happens, we see everything falling into plan.

We've said this in the past, you know, over the next block size of 800 units, we expect to recover the approximate $450 million of cash in the future, as we execute on that. So, overall, on track, on plan, Seth. I would also say it's [ph] a lot of (31:28) hard work. I'm sure my team that's listening from Kingston recognizes all the hard work that they have to put in to make this happen, but they are on plan.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Thanks very much.

Operator: Out next question comes from Finbar Sheehy with Bernstein Research. Please go ahead.

Finbar Thomas Sheehy, CFA
Industrials Sector Analyst, Global Aerospace & Defense, Sanford C. Bernstein & Co. LLC

Q

Good morning. On the 777, you had revenues down, obviously, as you reduced the delivery rate to 15, or a 5 per month. I'm just confirming that we should expect a further rate step-down on your end going into next year, as Boeing effectively drops the delivery rate of 777s down to 3.5 per month? And then...

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

Well, our deliveries will be a little bit different because Boeing, the 3.5 deliveries next year are Boeing deliveries to end customers. They're still going to be producing at a rate of 5 for their test aircraft. So we'll still be delivering at the rate of 5 next year to Boeing.

Finbar Thomas Sheehy, CFA
Industrials Sector Analyst, Global Aerospace & Defense, Sanford C. Bernstein & Co. LLC
Q

So we're essentially then at the bottom of the step-down, from your point of view?

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

Finbar, there is a small impact next year as well. Tom is absolutely right. The 777 EDP units that get delivered, but overall there probably will be fewer units next year compared to this year. And we'll bake that into our guidance, obviously, when we talk about 2018.

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

But, yes, the major impact of the rate reduction on the 777 hit us this year.

Finbar Thomas Sheehy, CFA
Industrials Sector Analyst, Global Aerospace & Defense, Sanford C. Bernstein & Co. LLC
Q

Okay. Thanks.

Operator: Our next question comes from Jason Gursky with Citi. Please go ahead.

Jon Raviv
Equity Research Analyst, Citigroup Global Markets, Inc.
Q

Hey, good morning. It's Jon Raviv on for Jason.

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

Good morning, Jon.

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

Morning.

Jon Raviv
Equity Research Analyst, Citigroup Global Markets, Inc.
Q

Following up on that question from Finbar, this 777 headwind kind of goes away in 2018. Can you talk about some of the other drivers to growth accelerating in 2018, whether it's production rate increases offset by pricing step-downs, defense, third-party fab? How do those different buckets fall into that 3% to 5% target sales growth range which you've outlined previously?

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

Right. Well, most of it will still be driven by the rate increases on programs like the 737, little bit on the 787 and the A320. So that's going to be a big driver of it. In addition, in terms of margin, as I mentioned before, our supply chain savings will start to kick-in for next year. And so that will help the margin side of things.

In terms of the growth, in addition to the rate increases, as I mentioned, we're going to be continuing to push forward on our new initiatives in fabrication and defense. And so, while most of it will be the rate increases, we'll start to see some impact from incremental fabrication business as well as incremental defense business.

Jon Raviv
Equity Research Analyst, Citigroup Global Markets, Inc.
Q

Thank you.

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

Carter Copeland
Founding Partner, President & Lead Research Analyst, Global Aerospace & Defense, Melius Research LLC
Q

Hey, good morning, gentlemen.

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

Good morning, Carter.

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

Morning.

Carter Copeland
Founding Partner, President & Lead Research Analyst, Global Aerospace & Defense, Melius Research LLC
Q

Question – I just want to, I don't know, push back, explore a little bit more on this concept of the EAC, Sanjay. The agreement with Boeing in terms of sharing of productivity gains and whatnot over the course of the next several years, should we assume that that has an impact of lowering the amount of kind of risk retirement uppers that you guys can go capture, just structurally speaking, versus what we've seen over the last several years? Am I thinking about that wrong?

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

Yeah, Carter, no, listen. Clearly, we've signed up for productivity improvements with Boeing. But as we all know, there are two attributes that we're working on. Firstly, there's a natural fixed cost absorption benefit associated with rate increases. And we've repeatedly talked about in the context that we've been very cautious and careful about not expanding our brick-and-mortar and our footprint. And we've been very careful about how we invest in CapEx, so that we can, frankly, create that fixed cost absorption benefit to offset the productivity gains that we've signed up with, with Boeing.

On top of that, I think we are quite bullish about how we are going to do on our supply chain execution. And if we execute that well, and we're doing that very methodically, that should more than offset the numbers that we've signed up with Boeing. So, clearly, at the end of the day, like Tom said, we want to maintain these margins, maybe try and do some margin expansion and reflect that in sort of bottom line. So that's how we are looking at it.

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

A

And I'd say the agreement, Carter, was developed in such a way as we locked in those productivity savings for Boeing, so they knew exactly what they were going to get. And then on the other side, we're free now to go after our productivity enhancements, including our supply chain initiatives, to offset those and do a little bit better. So the agreement, I think, is going to work out very well, because we'll be able to keep the results of our productivity initiatives, particularly in supply chain, while delivering a committed fixed amount of productivity to Boeing.

Carter Copeland
Founding Partner, President & Lead Research Analyst, Global Aerospace & Defense, Melius Research LLC

Q

Great. That's helpful color. Just a quick follow-up, you mentioned the military content and Airbus content as a strategic initiative; wondered if you might comment on whether you see any opportunity with Bombardier on the C Series now, given what's happened. Is there some opportunity there given the situation?

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

A

Well, we already do the pylon for the C Series, so we're really proud to be on the program. And I think going forward, the program might do better with Airbus' support, so that would obviously be good. In addition to that, Bombardier is periodically looking to develop its supply base. And so we have received some work packages in the past to bid on and we'll continue to do that. So, that program looks like it has a good future. And we'll bid to participate on new work packages and continue to deliver the pylon that we already supply.

Carter Copeland
Founding Partner, President & Lead Research Analyst, Global Aerospace & Defense, Melius Research LLC

Q

Okay, great. Thanks, guys.

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

A

Thank you.

Operator: The next question comes from Myles Walton with Deutsche Bank. Please go ahead.

Myles Alexander Walton
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks. Good morning.

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

A

Morning, Myles.

Myles Alexander Walton
Analyst, Deutsche Bank Securities, Inc.

Q

Just had one question on margins, but I guess two parts. The first is on the A350 and when you do adopt the new accounting standard next year, this $900,000 per aircraft that you burn down in deferred production, is that about representative of the level of gross margin you'd now be booking? And the second is, I think on the 737, you start a new accounting block next quarter. Is the current accounting block fully reflective of the new pricing? Should we expect any step-down in booking rates into the next accounting block? Thanks.

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

A

Sure. Myles, let me answer the second question first. Yes and yes. I mean, obviously, since we signed the agreement, we reflected that into our blocks current and in the future. And just like I answered Carter's question, our objective here through productivity, supply chain and ourselves is to have lower margin degradation on our primary program. That certainly is what we are working through.

You asked the question on the 606. Actually, the math is a little different. And, again, it's not perfect math, but if you recall, we had said over about 700 units, we'll recover about $450 million. So that's probably around $600,000, $700,000 a shipset. That will get a little tainted naturally because there are price step-downs on the A350 and our curves are a little bit more like curves, where the step-downs are step-downs. So that's something that will get clouded a little bit.

You did bring up in ASC 606. I'm not sure whether somebody else would have that question. Sometimes, I was thinking maybe Carter will ask me that question. So, I actually spent a little time last night wondering if I should put it in my script. And if it's okay with everybody, let me just talk a little bit about 606, because that's also important.

And, obviously, before I delve into the impact on revenue recognition and margin changes on 606, I just want to remind everybody there's no cash flow impact, which is obviously our core measure. So, Myles, 606 on A350 could have an impact, but it's not going to have an impact on what cash flow we forecasted for ourselves. Now, you will see a little bit more clarity on this in our filing on the Q when we do that. But basically, we're going to adopt what is called the sort of modified retrospective method, which means that we will report an adjustment to retained earnings for the cumulative effect upon the initial implementation, which is obviously January of next year.

And at the very macro level, even though 606 doesn't change the methods for forward losses, it's different than GAAP because it recognizes revenue on contracts based on duration and performance, which are either sort of point in time or over time. And both the 787 and the A350 are sort of point in time. The difference is the 350, our forward losses relates to costs and, therefore, performance that's kind of behind us. And on 787, like we've talked in the past, it relates to costs that are in front of us.

So, getting back to your question, the 350 will adjust through retained earnings and then have a positive earnings per share impact going forward. 787, on the contrary, will not, will remain zero margin going forward. But also given some of the step-down on the 787, we'll see some revenue deferred into later years, consistent with that zero margin. And, obviously, all the other programs are kind of broadly unchanged.

So, at the end of the day, whether it be on the 350 or all the programs, we will be providing you results in 2018 that will compare both 606 and 605. So you will get a clean comparison. And I just want to end this one, again, while you'll see some EPS impacts, obviously, there is no change on free cash flow and all of this was baked into our 7% to 9% goal. So, a long answer, but I think this is something that's sitting out there, I just want to get it out.

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

Yeah, and I would just add, on the 350 program, we are on plan to what we announced last year. And so the teams have operationally been doing very well with our learning curves and our supply chain initiatives. And so we are on the plan that we articulated last year for the A350.

Myles Alexander Walton — Q
Analyst, Deutsche Bank Securities, Inc.

Sorry, Sanjay. Just to clarify one item, so when you get to the price step-downs on the 87 out in 2020, it will continue to be zero margin? Or at that point, you'll be booking those losses to the...

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

No, it'll be a zero margin program going forward, Myles, because again, like we said in the last quarter, the $353 million forward loss that we recorded is mainly ahead of us.

Myles Alexander Walton — Q
Analyst, Deutsche Bank Securities, Inc.

Okay.

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

Unlike the 350, where most of those losses are behind us and the cash flows going forward will be positive, whereas the $353 million, frankly, is a cash flow headwind going out into the future.

Myles Alexander Walton — Q
Analyst, Deutsche Bank Securities, Inc.

Understood. Okay. Thank you.

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

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

Good morning.

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

Good morning, Robert.

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

So along the lines of some of the prior questions, I wanted to ask you at a high level, about cash flow over the next several years, from a cadence perspective. You've obviously guided to the 7% to 9%. You're already in that range now, even with the fourth quarter headwinds that you have. To what extent is there a timing element? If we were thinking about the next five years during this agreement with Boeing, how does the cash flow fluctuate between that 7% and 9%, giving all the various moving pieces you just went through, so: step-downs; CapEx, I guess, declining; the 777 headwind; and of course, the positives from the 37 and the 87, et cetera?

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

A

Well, I'll take a first cut and Sanjay can go into some more detail. But the cash flow, obviously, is lumpy over time, but our goal is always to have incremental year-over-year improvement. And so we said next year will be better than 2017. 2017 was better than 2016. So while we've laid out 7% to 9%, we obviously want to incrementally try to do a little bit better each year with our programs. And so, we have a whole variety of things in the Boeing program, also in the Airbus program.

We're constantly dealing with escalations in things like labor and material. And we're also looking at customer price step-downs and productivity discounts, things like that. And all of that we're trying to offset with things like our supply chain initiatives, which are getting great traction and also our other cost reduction initiatives. That's just a high-level view. So Sanjay?

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

A

Yeah, Robert, it's a fair question. I mean this year, you're right, we're in the 7% to 9%, but we're somewhere with a number that starts with a 7. And next year, obviously, if you want to do better, then you want to start hopefully – and again, we are not giving guidance – with a number that's start with 8. And we see – at least I see, between rate increases happening on all the right programs for us, whether it be the 320 or the 37, and improvements on the 350, that we have clearly a path to get there. And then in the out-years, these are the investments we are making today, whether it be in our supply chain strategies or, like Tom's talked about, in the growth areas of fabrication and defense, that'll kick in once those stabilize. And so we see long-term, a good natural progression that always takes us in cash flow better than what we did in current year. And that's how we look at it.

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

Q

Okay. Fair enough. Thank you.

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

Samuel J. Pearlstein
Managing Director, Co-Head of Equity Research & Senior Aerospace & Defense Equity Analyst, Wells Fargo Securities LLC

Q

Good morning.

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

A

Morning, Sam.

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

Morning, Sam.

Samuel J. Pearlstein
Managing Director, Co-Head of Equity Research & Senior Aerospace & Defense Equity Analyst, Wells Fargo Securities LLC
Q

Tom, you had mentioned that you're evaluating a couple of different opportunities, I guess, from an M&A perspective. Is there anything you can do to help us with kind of the range of the size of companies that you're looking at? And then, just remind us kind of metrics that you would need in order to pull the trigger in terms of when you need to see accretion, how you compare to buyback, et cetera?

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

Right. Well, we're looking at a whole range of different opportunities. And we have obviously a lot of firepower with our balance sheet and with our cash on hand to do deals of some size. But really what I said is we're focusing on, first and foremost, that they meet our strategic criteria, which is that they have to be some more Airbus content, some more military content and low cost country footprint, which will help diversify our customer base, but also help make us more cost competitive. So those are the first and foremost things.

And as we look at each deal, it's got to meet our return threshold. So we're always looking at things in terms of will they be accretive to EPS. And that's important. They've obviously got to be in addition to our weighted average cost of capital. From a multiple standpoint, we'd obviously like to look at businesses where we when we look at synergies in addition to that, they would be at a lower multiple than we're trading at.

So, we have a variety of different methods that we use to evaluate deals. Every deal is a little bit different, as you know, but what we're looking for are deals that are accretive to us and provide strategic advantage that ultimately will make us a more attractive company to help diversify our customer base, improve our cost position and make us a more valuable company.

Samuel J. Pearlstein
Managing Director, Co-Head of Equity Research & Senior Aerospace & Defense Equity Analyst, Wells Fargo Securities LLC
Q

And if I can just follow-up really quickly, the $0.25 range on the EPS still with only two months to go in the quarter, what would be the reason to vary from the high end to the low end in terms of things to think about?

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

Well, I mean, we, obviously, are always pushing toward the high end of the range. But right now, as we get into the fourth quarter, we're looking at all of our cost initiatives and also some of our investments that we may want to look at for next year to improve our productivity position for next year. So there's a whole kind of variety of things that are influencing it. But again internally, we're always pushing to the high end of our range, regardless of it's revenue or EPS or cash flow.

Samuel J. Pearlstein
Managing Director, Co-Head of Equity Research & Senior Aerospace & Defense Equity Analyst, Wells Fargo Securities LLC
Q

Thank you.

Operator: The next question comes from Ronald Epstein with Bank of America Merrill Lynch. Please go ahead.

Kristine Tan Liwag
Vice President, Equity Research, Bank of America Merrill Lynch

Q

Hi. Good morning, guys. It's actually Kristine Liwag calling in for Ron.

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

A

Hello, Kristine.

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

A

Good morning.

Kristine Tan Liwag
Vice President, Equity Research, Bank of America Merrill Lynch

Q

Tom and Sanjay, we want to better understand your $1 billion target for defense. Are these programs something that you've already won that you expect to grow in the next few years or do you expect to take share from other manufacturers in the market?

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

A

Right. With the current programs that we have over time, we'll get to a $1 billion annually. And, as we said, we want to make defense 10% to 15% of our business, but the current programs over time get us to the $1 billion. That said, we are continuing to drive organic growth initiatives, so that we can increase that. But we're fortunate. We're on some great programs, the CH-53K is the heavy-lift helicopter for the Marines. The Marines have said they want to order 200 of those. In addition, they'll be foreign military sales. And so that's a $25 billion program in its own right.

And the B-21, we're fortunate to be one of seven suppliers on that program for Boeing. And that's going to be a very important program for national defense. And we're very proud to be on that. In addition, we have some of the military derivatives of the Boeing programs, like the P-8 and the KC-46.

And so, if you take a look at what we have today in terms of defense programs, we're already at about $400 million. And we'll continue to build on that with the current programs. And we're very actively bidding on new programs. We've got a very robust pipeline of new initiatives with all the major defense primes.

Kristine Tan Liwag
Vice President, Equity Research, Bank of America Merrill Lynch

Q

Great. That's helpful. Can you discuss the operating risk profile of these programs? Are these cost-plus or fixed price and how should we think about CapEx cadence to support this growth?

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

A

Right. Well, they're all typical defense programs and so the margins will be typical of a normal defense program, so nothing new on that. And in terms of the capital expenditure, obviously, as the programs get into their development phases, there will be a significant amount of non-recurring engineering and capital investment, but all that's built into our current guidance for the year. And, as we've said, going forward, we'll be in the $250 million to $300 million range for the next few years, as we work through some of those programs, but it's built into that number.

Kristine Tan Liwag
Vice President, Equity Research, Bank of America Merrill Lynch

Q

That's helpful. Thank you very much.

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

A

Welcome.

Operator: Our next question comes from Sheila Kahyaoglu with Jefferies. Please go ahead.

Sheila Kahyaoglu
Equity Research Analyst, Jefferies LLC

Q

Hi, good morning and thank you for taking my question.

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

A

Morning, Sheila.

Sheila Kahyaoglu
Equity Research Analyst, Jefferies LLC

Q

Good morning. I wanted to ask about the transition from the NG to the MAX. You mentioned it in your prepared remarks. Just sort of where are you in the process? How do we think about the impact to mix next year and maybe some of the positives and challenges that you've seen thus far?

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

A

Well, I would just say, in his remarks at the Boeing earning call, Dennis Muilenburg, who's the CEO of Boeing, outlined the MAX position. And so, what he said is they've delivered 30 [ph] MAXes (51:46) to-date and that it'll be about 10% to 15% of the [ph] 737 (51:50) deliveries for the year. So, obviously, we mirror that.

What I think Sanjay was explaining is that while we're going up in rate from 42 to 47 and then beyond that, it's not a uniform situation, because you got NGs and [ph] MAXes. (52:05) So for the NG, you've got the 700, the 800, the 900. You've got a VIP version. You've got a freighter version. You've got the P-8 version. And now we have the MAX 7, the MAX 8, the MAX 9. So the overall is going up in rate, but the NGs are going down and all the [ph] MAXes (52:22) are going up.

And, as Dennis said, this year it'll be between 10% to 15% of all the 737 deliveries and we're now at 47. So there is a lot of complexity in the factory as you make all those transitions. Now, we're managing through it. We're very experienced, but it is a major operational challenge. And our team in the plant is really working very hard to address that to make sure we don't have any slip-ups and to improve our quality as we go.

Sheila Kahyaoglu
Equity Research Analyst, Jefferies LLC

Q

Thanks.

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

A

Okay.

Operator: Our next question comes from Hunter Keay with Wolfe Research. Please go ahead.

Hunter K. Keay, CFA
Managing Director & Senior Analyst, Airlines, Aerospace & Defense, Wolfe Research LLC

Q

Hey, thanks, guys. Good morning.

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

A

Morning.

Hunter K. Keay, CFA
Managing Director & Senior Analyst, Airlines, Aerospace & Defense, Wolfe Research LLC

Q

Just a little bit more on the M&A, just to be totally clear, you mentioned three priorities and thank you for mentioning, obviously, Airbus, military and low cost country. Is that all three of those boxes need to be checked or is that sort of a priority list in order? And the second part of that question is, as we think about that Airbus component of it, how are you guys thinking about maybe an orientation towards either platform like narrow-body wide-body or maybe even content like OE versus aftermarket? Thank you.

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

A

Great. Well, in terms of the three criteria; those, I really call them hunting grounds. An individual deal doesn't have to hit all three, but it'd be nice if it hit a couple. So those are just the areas that are of most interest. So that's how we're just filtering the different opportunities.

With regard to Airbus, obviously, they're a tremendous supplier of aircraft. We have a pretty good set of programs with them on the A320 and the A350. The narrow-body for the entire industry is really the growth engine. That's where you have the most number of units. That's where you have the biggest growth going into the future. So that's clearly of a priority for us as we think about it.

And we're a structures business. And so our focus has always been on original equipment, rather than aftermarket. I mean, structures doesn't have a lot of aftermarket naturally. I always say we build things right the first time, so they don't need to be replaced. So our focus is on original equipment. And in Airbus, if we had to choose, and we'd like both, but if we had to choose, narrow-body is obviously bigger and growing faster.

Kailash Krishnaswamy
Vice President, Investor Relations, M&A and Strategy, Spirit AeroSystems Holdings, Inc.

A

Brandon, I think we have time for one more question.

Hunter K. Keay, CFA
Managing Director & Senior Analyst, Airlines, Aerospace & Defense, Wolfe Research LLC

Q

Thanks, very helpful.

Kailash Krishnaswamy
Vice President, Investor Relations, M&A and Strategy, Spirit AeroSystems Holdings, Inc.

A

Brandon, we have time for one more question.

Operator: All right. Thank you. Our last question comes from Robert Stallard with Vertical Research. Please go ahead.

Robert Stallard
Partner, Vertical Research Partners LLC

Q

Thanks so much. Good morning.

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

A

Morning, Robert.

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

A

Morning.

Robert Stallard
Partner, Vertical Research Partners LLC

Q

Just a couple of quick ones on the A350. There's been talk about Airbus potentially taking the rate up to 14 a month. Do you think you have the capacity within your existing facilities or the plant equipment to deal with that? And the other thing there's been some talk in the supply chain about Airbus trying to tighten up the level of buffer inventory that's in the chain. I was wondering if you had seen any sign of that.

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

A

On the A350, Airbus has really talked about 10. They've said they can increase that if needed, but they haven't made any indications of how many that would be. So we are capacitized to go above 10. We are capacitized to meet the requirements that Airbus has articulated to us. I've never heard the 14 number. So I won't comment on that, other than to say that we're definitely in line with meeting their goal of 10. And we can increase that as they need going forward. Okay, now the second part your question, could you repeat it, please?

Robert Stallard
Partner, Vertical Research Partners LLC

Q

Yeah, sure. My mistake, it is actually talk about 12, not 14, on the 350. The other issue is regard to inventory, some other suppliers have said that Airbus has been trying to ease down the level of buffer inventory now that the ramp has progressed as far as it has. I was wondering if you had seen any sign of that.

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

Well, we've talked about with Airbus is that they are looking to put some buffer in for the different programs as rates go up, just as contingency and for risk mitigation. And so we've been trying to work with them on that, so that we maintain an appropriate level of buffer so that there isn't any disruption to supply. So really, it's all about risk mitigation.

Robert Stallard
Partner, Vertical Research Partners LLC
Q

You've seen no sign of them actually going the other way and saying there's almost too much inventory in the chain and now it's an opportunity to bring that down?

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

Oh, no. No. I mean with the program, especially A320, A350 going up in rate right now, what we've been talking to them about is making sure we have adequate buffer stocks to avoid any disruptions to delivery.

Robert Stallard
Partner, Vertical Research Partners LLC
Q

Okay, that's great. Thank you very much.

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

Thank you.

Kailash Krishnaswamy
Vice President, Investor Relations, M&A and Strategy, Spirit AeroSystems Holdings, Inc.

Okay. This concludes our earnings call for today. Thank you all for participating.

Operator: The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.