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Spirit AeroSystems Holdings, Inc. (SPR)

Q3 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Spirit AeroSystems Holdings, Incorporated Third Quarter 2019 Earnings Conference Call. My name is Chad and I will be your coordinator today. All participants will be in a listen-only mode. [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 conference over to Ryan Avey, Director of Investor Relations. Please go ahead.

Ryan Avey

Director-Investor Relations, Spirit AeroSystems Holdings, Inc.

Thank you, Chad, and good morning, everyone. Welcome to Spirit's third quarter 2019 earnings call. I'm Ryan Avey, Director of Investor Relations. And with me today are Spirit's President and Chief Executive Officer, Tom Gentile; and Spirit's Senior Vice President and Chief Financial Officer, Jose Garcia. After opening comments by Tom and Jose regarding our performance and outlook, we will take your questions. In order to allow everyone to participate in the question-and-answer segment, we ask that you limit yourself to one question, please.

Before we begin, I need to remind you that any projections or goals we may include in our discussion today are likely to involve risks, which are detailed in our earnings release, and 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. And as a reminder, you can follow today's broadcast and slide presentation on our website at investor.spiritaero.com.

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

Thomas C. Gentile III

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

Thank you, Ryan, and good morning, everyone. Welcome to Spirit's 2019 third quarter earnings call. This is an exciting quarter for Spirit and we have a lot to discuss today. First, we're delighted to announce the planned acquisition of select Bombardier aerostructures and aftermarket sites in Belfast, Casablanca and Dallas. This acquisition aligns very well with our strategic priorities of capturing more Airbus business, expanding our low-cost country footprint, and scaling our aftermarket business with good long-term shareholder returns.

Now, let's take a look at third quarter results and highlights before describing the Bombardier aerostructures acquisition in more detail. Spirit posted solid operational results in the third quarter driven by improved execution and the cost mitigation actions we implemented last quarter to lessen the financial impact of remaining at a rate of 52 aircraft per month on the 737.

The entire Spirit organization embraced the challenge to align our cost structure with the lower volumes that the MAX grounding created for this year. While we make good progress on cost mitigation actions, we must maintain our focus, and operational efficiency and quality improvement to achieve our margin targets.

Boeing continues to work with global regulators to return the MAX to service. We remain very confident in the long-term outlook for the MAX and are proud to be a partner on the program. We are continuing to produce at a rate of 52 aircraft per month as we agreed with Boeing, and currently have about 65 shipsets in storage at our facilities. We communicate with Boeing regularly, and we'll coordinate our production rates with them based on the timing of the MAX returning to service.

Now let's take a closer look at third quarter results. Revenue was $1.9 billion, up 6% over Q3 of 2018. Adjusted EPS decreased 19% to $1.38, which was impacted by the forward loss recognized on the 787 program as a result of Boeing's recently announced production rate decrease, the absence of a recovery of legal fees last year and a higher tax rate in this year's quarter. The 787 forward loss of $33 million resulted in an EPS impact of $0.24. Excluding the impact of the 787 charge, adjusted EPS for the quarter would have been $1.62. Adjusted free cash flow increased 68% to $290 million and included $123 million of a cash advance from Boeing to help maintain our supply chain health and offset working capital headwinds throughout the 737 MAX grounding period.

Normalized Q3 segment margins improved to 16.4% from 15% in Q2. Our focus remains on aligning our resources to the lower production level of 52 aircraft per month on the 737 as we exit the year. We are continuing to take full advantage of this pause in the rate increase to improve quality, factory efficiency and supply chain health. These actions combined with the benefits from a longer period of great stability will help us attain our goal of 16.5% margins for next year.

Although we are most of the way through this year, the fact that the MAX is still grounded means that we have uncertainty on our production rate. Therefore, we are unable to provide guidance at this time until we have further clarity on the timing of the MAX return to service and the 737 production schedule.

Our current expectations are that we will continue to produce at rate 52 in order to burn off the excess stored inventory after Boeing eventually transitions to rate 57. Given current production and storage levels, our expectation is that we will not produce at a rate higher than 52 through 2020, 2021 and possibly into 2022. This level of stable production will enable us to continue improving our quality and efficiency on the program. We expect to issue 2020 guidance as we normally do when we report fourth quarter earnings for 2019 next January. Jose will provide a more detailed financial overview in a few minutes.

Now turning to slide 2 in the presentation. We will talk now about this exciting acquisition of the select Bombardier aerostructures assets. The Bombardier aerostructures deal brings customer diversification, a low-cost country footprint and expanded aftermarket content, all of which are in line with our stated strategic growth priorities.

This acquisition increases our Airbus content on the A220 and the A320neo, both strong and growing platforms. The Belfast site designed and manufactures the wing for the A220, which is a state-of-the-art composite resin transfer infusion wing. They will also product the A320 thrust reverser for the Pratt & Whitney Geared Turbofan on the A320neo.

The acquisition more than doubles our aftermarket business and expands our capabilities in high margin maintenance repair and overhaul content. Representing about 20% of their revenue today, the Bombardier aftermarket business supports recurring work for thrust reversers and other structures serving a worldwide network of airline customers.

The facility in Casablanca broadens our low cost country footprint, providing Spirit with an established base in the growing aerospace hub of Morocco, very adjacent to Europe. The deal also includes life of program contracts on all the Bombardier business jets, including the Global 7500 which recently entered into service.

Now, moving to slide 3, looking at the aerostructures capabilities of this new asset. The sites to be acquired have 4,000 employees with a history dating back more than 100 years and a proven track record of developing aerostructures and significant aftermarket capability. They can provide end-to-end design, certification, production, and aftermarket services. They also have a world-class engineering organization with a long history of innovation, particularly in composite material including resin transfer infusion technology.

The Bombardier aerostructures business we are acquiring has a strong and increasing backlog with long-term contracts for an attractive diversified mix of mature and growth programs. Future revenue growth is driven by the A220, the A320neo, and the Global Express 7500.

The A220 aircraft has already achieved a backlog of more than 430 units and is well-positioned as a growth platform. This business that we are acquiring is the exclusive supplier of the A220 wing. This business also recently won the A320neo Pratt & Whitney thrust reverser package, highlighting the value proposition they bring in terms of operational capability and cost competitiveness.

There aftermarket business has grown at twice the rate of the market since 2006, providing solutions for nacelles, nose cowls, fan cowl doors, aprons, thrust reversers and engine build units. They currently service a mixture of mature and growth platforms well positioned to drive revenue for decades to come.

Bombardier aerostructures also has an exceptional reputation for innovation, quality and on-time delivery. They have a strong and experienced management team with excellent customer relationships. The deal includes three sites shown on slide 4. The Belfast site has a 100-year history of providing innovative aerostructure solutions dating back to the origins of flight. In fact, they signed a contract to produce the first six Wright Flyers, becoming the world's first registered aerospace manufacturer.

Belfast today is a center of excellence for wings, nacelles, fuselages and composite material, with a highly skilled engineering workforce. The site has been a pioneer in composite material innovation dating back to the 1970s through today, highlighted by the technologically advanced A220 wing. They are well-positioned for the next generation of aircraft development with their expertise in resin transfer infusion.

The Casablanca site provides Spirit with an established facility in the growing aerospace hub of Morocco. The site is the best cost solution with a strong track record of successfully introducing work packages and quickly ramping up production, achieving significant cost reductions. The Moroccan government is committed to developing and supporting a world-class aerospace industry.

The facility in Dallas offers MRO and modification capabilities specializing in nacelle and flight control surfaces. It provide extensive aftermarket support in Airbus, Boeing, and Bombardier aircraft to many key flagship airlines.

Now let's turn to slide 5 for the financial details and deal economics. We are acquiring select assets of Bombardier aerostructures for cash consideration of $500 million. In addition, we'll assume $300 million in net pension liabilities and $290 million of government grant repayment obligations for a total enterprise valuation of $1,090 million.

At closing, we'll pay $500 million to Bombardier and make a cash contribution of approximately $130 million toward the pension liability for a total cash consideration at closing of $630 million. This reflects a pre-synergy 2019 EBITDA multiple of 10 times and a post-synergy multiple of 6.5 times. We expect to capture synergies of approximately $60 million driven by supply chain, engineering and administrative costs. Investment returns will exceed 10%, and the deal will be accretive in the first full year excluding intangible amortization. 2019 revenues are expected to be approximately $1 billion.

The acquisition is expected to close in the first half of 2020 upon completion of regulatory approvals and other customary closing conditions. Key approvals include merger approvals required in six regions, customer consents and government grants. We have already received Airbus consent. We expect to fund the acquisition with cash on hand.

And now turning to the status of the Asco acquisition. The cyberattack that we've described in the past that Asco experienced in June caused delays in the data segregation process, which was a requirement to meet the conditions of the European Commission approval. Asco has now restarted the data segregation process and we have agreed to extend the long stop date to April 2020.

We discussed various structures to the deal with the seller. And based on those discussions, we mutually agreed on a reduced price of $420 million and other additional terms, which provide adequate compensation for any potential impact stemming from the cyberattack and for the expenses we have occurred since the deal was announced in May of 2018. Also, we extended the long stop date to provide adequate time to complete the closing conditions.

Following the cyberattack, the Asco team has worked very hard to recover their systems and restore production. The financial forecast of the business remains strong, and we continue to be excited about the strategic fit and financial outlook of Asco. The acquisition expands our Airbus content, adds new defense content, specifically F-35 work, and broadens our fabrication business.

And now, a few other recent highlights. Spirit was recently recognized with the Award for Composite Excellence in Manufacturing: Material and Process Innovation at the Composites and Advanced Material Expo for the development of the advanced structures technology and revolutionary architecture or ASTRA demonstrator panel. It's the same one that we took to the Paris Air Show.

The ASTRA demonstrator is a full scale composite fuselage skin panel that combines advanced manufacturing technologies and revolutionary architectures in carbon fiber to cut roughly 30% of future composite fuselage costs. The National Institute for Aviation Research, or NIAR, at Wichita State University supported the development of this technology by completing hundreds of structural validation tests.

As part of our collaboration with NIAR, we also recently celebrated the grand opening of our offices at the Innovation Campus at Wichita State University. We now have almost 80 scientists and engineers working on advanced technologies to improve manufacturing efficiency. We view innovation in metallic and composite structures as a differentiator and core competency for Spirit.

With that, I'll ask Jose to lead you through the detailed financial results. Jose?

Jose Ignacio Garcia

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

Thank you, Tom. Good morning everyone, and Happy Halloween, or as we say back in Spain [Foreign Language] (00:14:40). Let me summarize our third quarter financials. Please let's move to slide 4 (sic) [6] (00:14:48). Revenue for the quarter was $1.9 billion, up 6% from the same period of 2018. This growth was driven by higher volumes of production on the 777, 787 and A350 programs, as well as higher revenue recognized on the 787.

Let's now turn to earnings per share on slide 7. We reported adjusted EPS of $1.38 per share compared to $1.70 in the third quarter of 2018. Excluding the impact of the 787 forward loss as a result of Boeing's recent announcement to decrease production to 12 aircrafts per month from the prior 14 per month, adjusted EPS would have been $1.62. Adjusted EPS excludes as in prior quarters the impact of expenses related to the Asco acquisition and a small gain related to the voluntary retirement program that we announced in 2Q.

The adjusted EPS decrease year-over-year was primarily due to the forward loss on the 787 program resulting from Boeing's recent announcement to decrease rate, a higher tax rate of 24% this quarter compared to 18% in the same quarter last year, and a non-repeat of a litigation recovery last year. All of these partially offset by improved performance and favorable model mix on the 737 program, and increased aftermarket activity.

The forward loss on the 787 program reflects the impact of fixed cost absorption due to extending the current accounting block by four months. The current accounting block runs through line unit 1405 and will now close in the fourth quarter of 2022.

The benefits of the cost mitigation actions that we announced earlier in the year will continue into Q4 and into next year, as will the efficiency and quality improvements on our largest program from a stable 737 production rate. These gains will be partially offset by price step-downs on the 787 and A350 programs in Q4 and 2020.

As we have previously discussed, this step-downs are contractual and occur at certain milestone [ph] units (00:17:51). These price step-downs of course are already contemplated in our stated margin and cash targets, but can create short-term headwinds in the quarter in which they occur.

For the quarter, normalized segment margins were 16.4% compared to 15% in Q2 this year, reflecting the hard work on cost reduction and more stable operations while we remain at rate 52. While we continue to target 16.5% margins next year, we're likely to see some pressure in Q4 as the customer price step-downs take effect.

Now turning to slide 8, free cash flow. Adjusted free cash flow for the quarter was $219 million compared to $130 million in the third quarter of 2018. This reflects a 68% increase year-over-year. Adjusted free cash flow excludes the impact of the Asco acquisition. The adjusted free cash flow includes $123 million cash advance from Boeing. The purpose of this advance was to fund increased inventories from suppliers while we were reducing our rate to 52, during the period of the MAX disruption. As agreed with Boeing, this cash advantage will be applied against future deliveries.

Let's now turn to capital deployment on slide 9. As you know, we post our share repurchases pending further clarity surrounding the regulatory approval of the MAX return to service. Given our solid operational performance, we ended the third quarter with a very healthy cash balance of $1.5 billion. Additionally, we paid $12 million in dividends in the third quarter. Our commitment to a disciplined and balanced approach to capital deployment remains unchanged.

Now, let's look at our segment performance on slide 10. For our Fuselage segment results – please turn to slide 10. Fuselage segment revenue in the quarter was €1 billion, up slightly from the same period last year. This was due to higher production volumes on the 787 and A350 programs, as well as higher revenue recognized on the 787 program.

Operating margin for the quarter was 10.5% compared to 13.6% in the same period last year, primarily due to the 787 forward loss recognized as a result of Boeing's announced decrease to 12 rate, and higher costs related to the 737 program largely resulting from being part of the MAX grounding. On a normalized basis, after reversing changes in estimates from prior periods, Fuselage segment margins improved sequentially to 13.8% in the third quarter compared to 13% last quarter.

Now turning to slide 11 for our Propulsion segment results. In the third quarter, Propulsion revenue was $521 million, up 18% compared to the same period last year, primarily driven by favorable model mix on the 737 program and higher production volume on the 777 program. Operating margin for the quarter was strong at 21.4% compared to 17.2% in the third quarter of 2018, primarily due to favorable 737 model mix.

On a normalized basis, after reversing change in estimate impacts, Propulsion segment margin was 21.9%, up 400 basis points compared to the same period of last year. We have done a lot of work on driving improvements in Propulsion margins, and those efforts are starting to deliver results.

For our Wing segment results, let's turn to slide 12. Wing revenue in the quarter was $391 million, up 3% compared to the same period last year, driven by higher production volume on the 777 and 787 programs. Operating margin for the quarter was 13.8% compared to 15.5% in the third quarter of 2018, primarily due to the 787 forward loss that we recognized as a result of Boeing's announced production rate of 12. On a normalized basis, after reversing change in estimate impacts, Wing segment margin was 15.4%, up from 15% in the same period of last year.

As Tom mentioned, with the MAX still grounded, there is still uncertainty around production rates. And we will not be providing full year outlook for 2019 at this time. We expect to provide full year 2020 guidance on our next earnings call in late January when we have more clarity on the MAX return to service dates and Boeing's associated production schedule.

In closing, the third quarter results reflect good progress especially on the actions to reduce cost and improve working capital to partially offset our challenge on fixed cost absorption from lower production rates on the 737. Having said that, there is still more work to do in terms of improving quality and efficiency in our factories. Our improved execution on all these items will enable us to meet our margin commitments next year.

With that, I will turn it back over to Tom for some closing comments.

Thomas C. Gentile III

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

Thanks, Jose. And now I'll make some closing comments before we take questions. The acquisition of the Bombardier assets is a transformative deal for Spirit, aligning perfectly with our stated strategic goals of capturing more Airbus business, expanding our low cost country footprint and scaling our aftermarket business.

Post-synergies, the acquisition price represent 6.5 times 2019 EBITDA, which trades below where Spirit currently trades and delivers investment returns in excess of 10%, the criteria that we've always discussed. In addition, this quarter we restructured the terms of the Asco acquisition to reflect the delay in closing the transaction and agreed with the sellers to a purchase price of $420 million. We remain confident in the strategic fit and financial outlook of Asco, and look forward to closing the deal early next year.

Operationally, following the MAX grounding, we've taken actions on cost control and working capital to mitigate the impact and have made good progress. We made solid progress on our cost mitigation targets this quarter. And even as we made investments in improved quality and efficiency, we are starting to see some of the benefits of a stable production rate in our factories. Our focus for the remainder of the year will be the sustained progression towards optimizing our factories to deliver on our margin targets next year.

That said, normalized margins this quarter were 16.4% and we remain on track to achieve 16.5% next year, even taking into account the customer price step down that will start in Q4 2019 on the A350 and some other programs.

Cash flow this quarter was $290 million and year-to-date is $620 million, demonstrating solid execution even during the MAX grounding.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] At this time, we will pause momentarily to assemble our roster. Our first question will come from Sheila Kahyaoglu with Jefferies. Please go ahead.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Hi. Good morning. And thank you for the time.

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

A

Good morning.

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

A

Good morning.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Tom, just a question for you. I mean, clearly, two deals in the past 12 months. I guess, you're focusing on your goal of diversifying away from Boeing. How do you think about the Bombardier assets? And in the past, it's been a struggle with the jets and the Gulfstream business. How is this pack – how is this asset different? How do we think about the contract structure, the work package?

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

A

Well, first of all, we don't have a goal of diversifying away from Boeing. Boeing is our largest customer. We have tremendous respect for them. We want to continue to grow with Boeing. At the same time, we do want to grow some of our other customers faster. And so we stated that Airbus content, military content, fabrication are our key goals.

So, as we look at the Bombardier assets for aerostructures, you mentioned that they're in business jets, and they are, and it's true that Spirit has struggled in the past with some of its business jet programs. But the thing about the Bombardier Global Express in particular, where a lot of that structure is built in Belfast in terms of some of the control surfaces around the empennage, is is that represents a – really, a state-of-the-art aircraft. It's got the longest range of any business aircraft. It recently completed a trip from Sydney, Australia to Detroit, Michigan, my hometown. And that was a world record. So, it's got great orders and it's really a great platform for the future. So, we're very confident of that. And we have life of program contracts with Bombardier on that at very good pricing in terms of the deal economics. And when we start to combine what we do in terms of engineering and design, operations and particularly supply chain, we think we can bring even a lot more value to it.

So that's the business jet side of it. The other thing that the Bombardier assets have is a very significant work package on the A320 – excuse me, the A220. They make the entire wing with the resin infused technology for carbon fiber composites. This is a state-of-the art wing. We think it will give us a great head start in terms of future wing programs with Airbus. And the A220 is off to good start itself. It's got over 500 orders in total, 525 orders in total, and it's got a backlog of about 435 aircrafts. So it's in a very strong position. And again, Belfast makes the entire wing. So that is very attractive.

And then the other program they have in Belfast is the A320 thrust reverser package which Airbus awarded for the geared turbofan on the on the A320neo. And that again represents a state-of-the-art technology on obviously the biggest narrow-body program that Airbus has.

In addition, these assets include Morocco. They have a big plant in Casablanca, state-of-the-art, low cost, but very good technology, excellent workforce, a lot of engineering. And this is going to be a great platform for us as we expand all of our programs in Spirit.

And then finally, I'll just highlight aftermarket. This is really one of the hidden gems of this acquisition. They've got significant MRO capabilities in Belfast and also in Dallas. And this is going to more than double our aftermarket activities. This is scale work. They're very efficient. They have tremendous customer relationships with airlines all over the world, very competitive. And we see this as an opportunity to really accelerate the growth of our aftermarket business. It's always been strong. This enables us to really take it to a completely different level.

So on all those different fronts, we're extremely excited about this acquisition of the Bombardier aerostructure assets.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Thank you.

Operator: The next question will be from Seth Seifman with JPMorgan. Please go ahead.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Thanks very much, and good morning. Tom, I wonder if you could talk a little bit more about the acquisition. In terms of the synergies, I know Bombardier has done a few rounds of cost cutting in the tariff structures business and so kind of where you feel like the synergies come from? And also Airbus has been pretty explicit about looking for price cuts from suppliers, has all of those arrangements been ironed out as part of the deal?

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

A

The answer to that is yes. We've talked with Bombardier and with Airbus, obviously the two largest customers. And we have agreed pricing. And so that's all built into the deal economics, which gives us great comfort. So that is definitely set. When we think of the synergies, we built in about 5% cost synergies and also some revenue synergies, particularly from MRO. So when we look at the MRO business and we look at what we do and what they do, and we put those together, there's going to be some significant revenue synergies.

But on the cost side, it's really about playing to our strengths. And I would say we are very strong in terms of creating a competitive world-class supply base with a strategy that we have employed that has six pillars and starts off with clean sheet evaluations, reverse engineering, literally 100,000 different parts so we know exactly what they cost. As we take our supply chain strategy and overlay it with these Bombardier assets, we see a lot of opportunity to get even more competitive pricing and more competitive supply and delivery.

We also see a lot of engineering synergies. They've got great engineering resources. I mentioned they developed the original Wright Flyer back in the early days of aviation, but they've continued to really be at the forefront of innovation with things like the new A320 thrust reverser, the all-composite wing using resin infusion technology. And so there's going to be a lot of opportunities on engineering. That wing also is really state-of-the-art. And as Airbus thinks about its wing of the future, we think that will give us a great platform to continue working with them.

And then typically in a deal like this in terms of the cost side of things, if we look at facilities and overhead and indirect cost and in functional expenses around the world, we'll be able to get more economies of scale just because of the larger size that we'll be able to bring. So all of those things will help us drive 5% cost synergies and also some significant revenue synergies.

I think I mentioned about $60 million total and post synergies, when we look at the total enterprise value, the EBITDA multiple is about 6.5%. So we're very, very pleased with [ph] that trade flow (00:34:57), where we trade and that was always one of our stated goals in looking at acquisitions.

Seth M. Seifman
Analyst, JPMorgan Securities LLC Q

Okay. Thanks. Congratulations.

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

Thank you.

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

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch Q

Yeah. Hey. Good morning.

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

Good morning.

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

Good morning.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch Q

Maybe two things. How do you think about the impact of 787 on the business in terms of the cuts from going about from 14 to 12? And then how do we think about if it we're to get cut further from that down the road, so when we think about modeling and all that out?

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

A

Right. Well, as you know on the 787, when we announced our first collective resolution at the end of 2017, we announced the $373-million forward loss out to line unit 1405, and that just reflected the pricing that we put in place. Now when we did our collective resolution deal with Boeing at the end of last year, we reset the pricing going forward after the line unit 1405 to be breakeven at that time. And so because we are in a loss position right now, when we went up in rate from 12 to 14 at the beginning of this year, we recognized a gain of about $40 million.

So by going back down to 12, we reversed $33 million of it. And it was just because we'll be – we have been producing at 14 for 18 months by the time they go back down to 12. So obviously there is a an impact when rates go down. If rates go down further, that will create more pressure on our forward loss position. And so we will recognize it accordingly. But Boeing has not made any indications that it will go down below 12 at this point, so we'll obviously watch very carefully and work with them on that. But what we are confident of is that after line unit 1405, the pricing increases to the point where we think we'll be breakeven and a little bit better.

Now, the lower rate will put some pressure on that, about $100,000 a unit. We're confident we can address that and still be positive in terms of our margin after line unit 1405. So the other thing about the 787 is it's a great aircraft, it's got great range, great fuel efficiency, the airlines love it, it's opened up a lot of new city pairs, and we think that we'll have a great opportunity to see that increase its sales and orders in the future. And so I wouldn't be surprised as orders increase if Boeing re-looks at its production rate down the road.

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

A

The only thing I'll add to what Tom explained is in terms of cash, we do have a headwind which is overhead absorption at the lower rate. But because this is a loss contract and cost is above price, we have a tailwind on volume. So, we will pick up some cash as we produce fewer units. It also impacts the repayment and scheduling in some of the advances we had with Boeing. So, net-net on a cash basis, the impact is a lot less than the earnings impact on the forward loss.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Got you.

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

A

And it gives us more time to get the cost below price. We will add four months to the block, so there is a bit more time in getting our cost out structure in the right place.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Got you. And then maybe just one follow on. Related to the April MOU with Boeing, you guys got $122-million advance. If the 737 return to service just takes a little longer like I guess it has or if there's further delays, do you expect to get any more advances from Boeing? Or how does that change that structure?

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

A

Well, the reason we got the advance was just to address the working capital issues because we had already essentially loaded up the plant for 57, not only our own material but also suppliers. And so that was really to ease that. Now, it depends on when the MAX goes back into service what the situation is. Boeing has been very helpful and cooperative in terms of working with us to figure out what's the right solution in terms of production rate and working capital, things like that. So we'll make the decision once we determine when the MAX goes back into service.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Okay.

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

A

It would have to be an impact on rate for us to really justify the need for another advance because it would – an impact on rate would impact inventory, supply chain. So, it would then – it would have to be beyond a delay. It would have to be a decision to change rate.

Ronald J. Epstein
Analyst, Bank of America Merrill Lynch

Q

Okay. Great. Thank you.

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

Carter Copeland
Analyst, Melius Research LLC

Q

Hey. Good morning, gents.

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

A

Hey, Carter.

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

A

Good morning.

Carter Copeland
Analyst, Melius Research LLC

Q

Just wondering if you might help us kind of understand the progress that's happened in the Bombardier assets you're acquiring. I mean there are some public financial statements out there that kind of point to pretty low levels of profitability and you're obviously looking at a pro forma number pre-synergies that has a lot of improvement there. I wondered if you might give us some color on what's happened in those assets, if that's related to volume or changes in cost or one-time item just to give us a sense of the maturity or what's going on with those assets before you take them in.

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

Right. Well, overall, the good news if you look at the top line especially because they're getting into some new programs with the A220 starting to ramp-up in rate and the A320 thrust reversers not yet even into production, as we look out the growth rate is actually quite good. It's going to exceed 10% on a compound annual growth rate. So, that's very strong.

The other thing is you look at the aftermarket assets for example, very strong margins as you typically see in the aftermarket. They've got very efficient operations in Belfast and in Dallas. They do specialized repairs. They've got a great customer base. And so the margins in the aftermarket are quite good.

The other thing is we talked about business jets earlier. These are mature programs that they've been building for Bombardier for quite some time. They still have some CRJ work. They also have some Global Express work as well as Challenger work, and those are at very, very good industry margin levels because they're mature and there's a lot of efficiency.

And then as we look forward onto the A320 program, there's a lot of opportunity to continue improving the margins on that. They have their Morocco facility and a lot of work for some – especially some of the new packages that they're winning are planned to be done in Morocco, which has a very competitive labor force, very highly skilled labor force. And so that's another way to drive the margins.

And then beyond that, we talked a bit about synergies and whether it's supply chain or engineering or functional, we see a significant opportunity to bring synergies. I mean this is a structures business, world structures business. We're the largest structures business in the world. And so we can bring significant economies of scale to drive synergies. As I mentioned, it's 5% cost synergies and a couple of points of revenue synergies. So, that's another way that we can drive the margins.

And then as I mentioned on the A320neo, there's no revenues yet. But that's a new program. It's part of Airbus' effort to insource the nacelle. They've certainly got a strong stake in seeing that being successful. And we're really pleased to see that the thrust reverser is a part of that work package in these Bombardier assets.

So as we look across all the programs, the top line growth is very good and margins are very good in some of the programs. And with the scale and the efficiency we bring as a global aerostructures business, we'll be able to drive significant synergies to improve the margins further.

Operator: The next question will come from Rajeev Lalwani with Morgan Stanley. Please go ahead.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

Hi. Good morning, Tom. Good morning, Jose.

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

Good morning.

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

Good morning.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC
Q

A couple of questions around the timeline, some of the things you laid out today. Can you provide some color on when the synergies start to flow in from the Bombardier assets, the liabilities that you've assumed beyond that payment you're going to make when deal closed. When do those have to go out?

And then on the Boeing side, you highlighted the dollars coming in, but can you give more clarity around the timeline again of those dollars coming out over the next years that you highlighted?

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

Okay. Well, let's start with the Bombardier deal. The synergies really would start immediately upon closing. We would be able to start to leverage our supply chain expertise, and that's – we expect to close sometime in the first half of 2020. We'll get the synergies really starting immediately. We'll do a lot of integration work in advance in terms of functional and engineering and indirect cost and labor opportunities and then the supply chain opportunity.

So, the first full year of 2021 we expect to be accretive. And we'll get probably a third of the synergies that I mentioned, the 5% cost and the 1.5% or 2% of revenue kind of a third per year in 2020, 2021, 2022. So, that's kind of how we're thinking about the synergies.

Now, the two liabilities that we're inheriting, the pension liability, we're zeroing out the pension deficit that currently exists today. So, we start with a clean slate, and then we'll work with the union and the pension trustee in the UK and the pension regulator to determine the path forward to mitigate the ongoing expense of the pension. And so, we have a lot of expertise with pensions in the UK having dealt with our Prestwick site. And several people on our team are extremely knowledgeable about pensions. And we also work very closely with the union, Unite, which is in Prestwick and is also in Belfast.

The other one is a series of government loan incentive repayment obligations. And these are paid off over time on every A220 delivered. So the UK government provided incentive funding to build some of the facilities and the capital equipment to enable the A220 wing to be produced in Belfast, and those get repaid over time. Again, once we take ownership, we'll work with the UK government to figure out a way to mitigate those and make them the most efficient. So, we're very confident on that.

And then Rajeev, you said something else about other timing on Boeing. Could you just repeat that part of your question please?

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Yeah, that's exactly right. You got the advantage from Boeing with the [indiscernible] (00:46:17) working capital. And you actually have to start paying that back. I think in your...

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

A

Right.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

...comment, you said several years or something like that. But [indiscernible] (00:46:25).

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

A

Yeah, it really is tied to when we go back to 57 is what we've talked about with Boeing. It's still so – we're still working out all the details, but what we've agreed is it would be after we go back to rate 57 which could be end of 2021, early 2022. And then we would pay it off on a per unit basis.

Rajeev Lalwani
Analyst, Morgan Stanley & Co. LLC

Q

Perfect. Thank you.

Operator: Our next question comes from Jon Raviv with Citi. Please go ahead.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

Thank you very much. Just kind of a bigger picture one question that maybe has some different pieces to it, but I'll let you guys go where you want on that one. You've previously talked about free cash flow margin target approaching 9%. Is that achievable as you take on these sorts of liabilities, whether it's 737 advances, the Bombardier items, et cetera?

And I guess embedded in that is a real more specific question around, is Bombardier cash going to be able to keep up with the sales growth based on maybe some CapEx cycle there and some new programs ramping up? Thank you.

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

A

I'll take this one. So, Jon, yes. The free cash flow target for us is 7% to 9%. Obviously the acquisition of Bombardier in the first two or three years is going to be heavily dependent on both the A220 and the A320 CapEx demand. So, it's going to be somewhat dilutive to that 7% to 9% or to the 9%. The high-end of the range. We still plan to be within 7% to 9%. So, it will put pressure on the 9% but we think we're solidly within the 7% to 9%.

Now, once we get through this investment cycle on these faster growth programs, we're really on a steady state on both the A220 wing and the A320. So, I think the CapEx needs will moderate and will only be tied to rate, similarly to what's happening with our with our core business here, where we see in the next two to three years without rate increases as an opportunity to really moderate the CapEx and get a tailwind on that.

We are obviously – as part of the integration, we're going to work on working capital as we do in our own business here. We have a very good playbook on days to pay with suppliers. We're now at 60 days. We picked up six to seven days in the last year. 60 days is still short compared to industry standard. So, we have quite a bit of runway there.

And on inventory we're still on – obviously the MAX grounding didn't help in 2019. So, we have a big plan to work our inventory levels and increase terms to the tune of half a term per year in the next few years. So, we will apply that playbook to the integration of the Bombardier assets, and that will help us fund some of the short-term CapEx needs that we see here.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

Thank you very much.

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

Robert Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Good morning.

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

A

Good morning.

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

A

Good morning.

Robert Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Tom, if Boeing were to reduce rate again, in other words, if this RTS just takes a bit longer and they have to go down to whatever the next natural rate might be, maybe something in the low 30s, do you drop there or do you drop below because of your excess inventory? How do you guys think about this? I understand it's a draconian kind of scenario, but I imagine you have planned for it.

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

A

We have. We've run scenarios at all different levels of production. And it really depends on when the MAX goes back into service and how Boeing decides to manage its production schedule. Obviously, we're producing at a higher rate than Boeing right now, and so we're storing those additional fuselages in a buffer. And they're there anywhere from, say, 15 to 25 days before we ship them to Renton which is near Seattle.

And so we've run those different scenarios. If Boeing goes down more, we would sit down and talk with them about what's the appropriate production level for us. That's why we didn't give guidance for the rest of this year. We still don't know when the MAX was going to go back into service. And we'll work closely with Boeing to determine what the right production level is.

Now, what I would say, though, is that this period of time where we're at 52 gives us a chance to achieve some stability that we haven't had for a while. So going back to 2016, we were shifting from the NG to the MAX. We're hiring lots of new people. We're going up 10% a year in terms of our rate, from 42 to 47 and 52 then getting ready for 57. So as you can imagine, a lot of disruption, a lot of extra cost as we were going through those learning curves.

Now we're going to be at 52 for an extended period of time which will allow us to get more stable and allow our supply chain to get healthy. And that will mean not only more stability but also opportunities to improve quality which is so important now in the industry, probably more important than it's ever been.

Robert Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Given that stability is so important, is a pause if it's needed better than a lower rate?

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

A

Well, yes, I think it is. Especially with our production system which is fairly complicated. I think you've been here to the factory and you've seen it. The fuselage itself is 33 manufacturing days, there's 450,000 fasteners in each one and quite intricate. And so our production system gets disrupted if you go up or down. And so we take that into account and when we discussed what Boeing is – what is the right production level for Spirit to be at to make sure that the whole production system operates smoothly and efficiently during this whole period where the MAX goes back into service and Boeing delivers the aircraft that they've already built and not delivered and gets the aircraft that are grounded back in the air.

Robert Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thanks very much.

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

A

Thank you.

Operator: The next question will be from David Strauss with Barclays. Please go ahead.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Thanks. Good morning.

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

A

Good morning.

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

Good morning.

David Strauss
Analyst, Barclays Capital, Inc.
Q

I wanted to ask you on the margin target, the 16.5%. I think you had previously said you thought you could get there in Q4. It sounds like you're backing off that now on the 787 step downs, which I would have thought you would have known about those when you gave the 16.5%. So, I guess that's the first question. What's changed there with regard to Q4?

And then, Tom when you talk about 16.5% for 2020, are you talking about that you're going to get there at some point next year or you expect to average 16.5% across the across the full year 2020? Thanks.

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

Well, thanks for the question, David. First off, this quarter if you look at our normalized margins, we were at 16.4%. So, pretty close to that target. And Q4, we are going to see some pressure from the planned A350 step down. So, you're absolutely right. We did know that was coming. We didn't know that we were going to be at rate 52. We had planned originally to be at rate 57.

So – but the plan is in Q4 as we stabilize is we want to end the year, we want to leave the quarter at about the 16.5% rate. It probably won't average that for the quarter, but that's where we want to get to by the end. And the goal would be for 2020 to average 16.5%, absent any purchase accounting that would result from the Bombardier acquisition.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Okay. And just as a follow-up, I think you had talked about a 5% reduction in fixed costs to kind of achieve this. So, how far are you into achieving the 5% at this point? Thanks.

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

We're making some good progress. We did a couple of things this year to help us move in that direction. For example, we are taking down contractors and looking at our indirect head count. But one program we did this year was a voluntary retirement program right after the MAX grounding back in April. And we identified 200 people that took that program. And it was a good program for them and really helps us to start to reduce our fixed costs.

So we're going to make a bigger effort on the fixed cost. I mean when we were to go to 57 by backing off to 52, that's basically taking what's half our revenue down by 10% which means we want to take 5% out of the business. That's where we came up with the 5% number. Voluntary retirement programs helped. This year we did have a furlough for 10 days for all of our salaried staff. That doesn't repeat next year, but it helped this year. And then next year we will have the full impact for the full year on the voluntary retirement program.

And then we're going to look harder at our indirect costs and figure out how do we get more productive given that we're going to see this 5% pressure for a prolonged period of time, for at least a couple of years. And so that's what the plan is for next year is to continue working toward that 5% target.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Great, thanks.

Operator: Our next question will be from Myles Walton with UBS. Please go ahead.

Myles Walton
Analyst, UBS Securities LLC

Q

Thanks, good morning.

[indiscernible] (00:56:07)

Myles Walton
Analyst, UBS Securities LLC

Q

Hey, Tom, I was wondering, could you – you have obviously a nice step down in the price for Asco. Has there been any significant change in the underlying business there in terms of revenue run rate kind of first as a clarification?

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

A

The answer is no. The outlook that they've given us for their financials for next year and beyond are still very robust, very strong. And it has the kind of growth that we were originally looking at. The cyberattack that hit them in June did require a significant effort to recover. And they were down for several days and they got behind in their production. So they've had to put in some additional resources to recover.

The good news is they are on their recovery plan, they're meeting all of their customer delivery requirements. And so they've gotten the production back on track. And what that's done then is enable them to refocus their attention toward meeting the European Commission conditions to segregate all the data so that we can close the transaction.

But the financial projections still look very strong. And again, it's a great fit, a lot of Airbus content. They're really the leading supplier for the slat tracks and flap tracks for Airbus. They also have some significant F-35 content, so they bring a lot of military content. And then they bring a lot of fabrication capability. They've got a great workforce that has outstanding productivity, good engineering, and also very strong commercial capabilities on fabrication. So, it's going to be a nice fit with our business on all of those fronts. And as I've said, the financial outlook still looks very strong.

Myles Walton
Analyst, UBS Securities LLC

Q

Got it. And the question I had, I don't know who it's for, Jose or Tom, but on 777, it looks like you're going to deliver 55 shipsets this year, and that's Boeing spend obviously moving more lower than higher on that outlook.

And I'm just curious as you look into 2020 if there were a 10% step down from kind of your current delivery pace, does that have a meaningful impact on you achieving 16.5% margins for next year?

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

A

Well, it'd definitely be a headwind. 777 is a mature program and so margins are better on the mature programs. Right now when we look at the skyline, we're still projecting about flat in terms of units for 777 next year. Obviously, the 777-9 is getting pushed out a bit, but we're seeing more freighters offsetting that. So, from our production standpoint, we're looking at a flat year next year in 777.

Myles Walton
Analyst, UBS Securities LLC

Q

Okay. Thanks.

Operator: The next question will be from Ken Herbert with Canaccord. Please go ahead.

Kenneth G. Herbert
Analyst, Canaccord Genuity LLC

Q

Hi. Good morning.

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

A

Good morning, Ken.

Kenneth G. Herbert
Analyst, Canaccord Genuity LLC

Q

Hey, Tom, I just wanted to ask on the Belfast and the wing capability there. With your contracts with Airbus, are you exclusive if they look to do anything larger or with variants on the A220? And then specifically, can you just – you made a comment earlier in the call about sort of incremental opportunity out of this facility with Airbus maybe on other wings for other aircraft. Can you provide a little more color around that or help with maybe setting expectations on how that could play out?

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

A

Right. Well, we have the program for the A220 as it is. Say if they do a variant, there is no guarantee, but obviously as the incumbent and if we continue to perform well, we would have a very good position. And I think with our engineering from Spirit and the engineering that they have there in Belfast, we'd be able to provide a strong value proposition. So, that's on the A220.

As Airbus thinks about the wing of the future, they've been thinking about composite structures and different technologies, which are out of autoclave like resin infusion. And the thing about the wing for the A220 that's in Belfast is it's a state-of-the-art composite wing that they're already doing. Now, Airbus is going to explore a lot of different options. But the point I was trying to make is that we are going to have experience with a fully developed state-of-the-art composite wing using out of autoclave carbon fiber technology resin infusion for Airbus. And that certainly will position us well as they think about future composite wings for different programs and new programs.

Kenneth G. Herbert
Analyst, Canaccord Genuity LLC

Q

Okay. Just to clarify, it sounds like your – the capital is in place in that facility to support rate increases on the A220 such that incremental CapEx there is just obviously as necessary maybe support incremental higher rate, but there's nothing else you're looking at near-term.

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

A

Well, there – depending on where they finally go on rate, there will be some capital expenditures. That's all built into the model and we've also talked to Airbus about what the appropriate sharing level will be on that. So, we're very set on that. And there's plenty of capacity in the facility to support the future rate increases that Airbus is contemplating.

Kenneth G. Herbert
Analyst, Canaccord Genuity LLC

Q

Great. Thank you.

Operator: The next question will be from George Shapiro with Shapiro Research. Please go ahead.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Yes. Can you explain the difference, Bombardier is saying the assets carrying value is in excess of $700 million and you've got it at $590 million? And then also, over what time will you pay the difference from the $630 million to the $1,090 million that you're going to pay? And last, I want to try the synergies one more time. It looks like maybe this business makes 9% and you're expecting it to go to 15% pretty quickly. I mean what would you – can you actually be doing that Bombardier I'm sure tried to do to be able to get the margin up that quickly?

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

A

Right. Well, the $500 million and the $700 million is really mostly a difference in terms of US GAAP versus International Financial Reporting Standards, IFRS. So, when we had the actuaries value the pension deficit that currently exist, the pension deficit liability, they used US GAAP accounting. And given all of the assumptions in terms of how many people took lump sums and discount factors and all of the accounting technology that went into it, the valuation for us on GAAP was $300 million. When Bombardier looks at it and their financial condition is much different than ours. So, that also plays a factor in terms of credit rating and financial outlook and stability. And so when they valued it using their financial outlook and using IFRS and not GAAP, they come up with a higher deficit liability, which is – that explains the difference between the $500 million and the $700 million.

Now, in terms of the time period, the pension – the deficit gets zeroed out at the deal. So as we start, we'll be neutral. There'll be no net pension liability deficit. Now, going forward, there's a pension and we'll continue to work with the union, as I said, the pension regulator and the pension trustee to manage that in a safe and prudent way as we go forward.

The government loan obligations get paid over time on a per unit based on the A220s delivered. There's a per unit amount that gets paid. And then may be some opportunities for us to frontload that or negotiate different things based on what we're going to do with the assets in Belfast. We've got a lot of ideas for how we can continue to grow those assets. So, that's going to be paid out over time based on the deliveries of the A220 wing.

Now, in terms of the synergies, I think I mentioned it before. As the largest aerostructures business in the world, we have tremendous economies of scale, particularly in the supply chain, functional cost, engineering. And as we bring our business together, I think we are probably the perfect fit for this asset. I mean if you look at what they do, they do fuselages, wings, propulsion and aftermarket. Those are the exact same things that we do. And by combining that scale, we'll be able to drive synergies to achieve the economics that we forecasted.

George D. Shapiro
Analyst, Shapiro Research LLC
Q

Okay. Thank you.

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

Okay. Thanks, George.

Operator: The next question will be from Hunter Keay with Wolfe Research. Please go ahead.

Hunter Keay
Analyst, Wolfe Research LLC
Q

Hi. Thanks for getting me on. The A320 shipset delivery is down from 3Q, is that mainly A321neo? I know you guys don't disclose mix. But is that mainly A321neos and do you expect to pick back up again in 4Q? I'm just basically wondering if Airbus is all caught up with some of the problems they've disclosed. Thanks.

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

Well, I mean there has been fewer A321s than in our original plan as Airbus has rebalanced the line. So, we do see some of that impact. We are completely caught up to the schedule that Airbus has given us in the A320 family. And I think the issues on production schedule at the Airbus level are well-known in the market, and I think they've described those in their communications. So, that obviously filters down to the supply chain like us.

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

The only thing I'll add is there is a little bit of timing. We did accelerate some deliveries earlier in the year to build up buffer against potential Brexit issues. And also on the third quarter, they have a scheduled holiday, Airbus, which slows down deliveries. So, I think the third quarter was just light given timing. For the full year, we're going to be where we planned.

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

And we're completely on schedule for the A320 with Airbus.

Hunter Keay
Analyst, Wolfe Research LLC
Q

Okay, Tom. Thank you.

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

A

Thanks.

Operator: The next question will be from Cai von Rumohr with Cowen and Company. Please go ahead.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Yes. Thanks so much. So, a follow-up on the acquisitions. So, Bombardier you're saying $50 million in cost savings. How much of that is supply chain? Because it's kind of incredible to assume you get all of that right out of the box.

And secondly, you've taken the price for Asco down from $602 million to $420 million. At one point, I think you were suggesting the EBITDA margins were like 17%, 18%. Is it still as profitable? Because if so, you're buying it at like 5.5 times EBITDA.

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

A

Yeah, well, I'll just take the Asco one first. Yes, the price started off at $650 million and then we dropped it to $604 million as the delays continued and now to $420 million. The outlook is still good and the – when you look at the deal economics – we'll sort those out when we finally close. They obviously look a lot better at the lower rates. And so we're very pleased with the outlook for that. And the margins look good. The revenue growth looks good. And they've got great – great presence on the F-35 program as well as on all the Airbus programs. They even do a little bit of Bombardier work. So that's something that we will look to be growing as we continue to develop the relationship with Bombardier.

On the synergies, just getting back to it, the synergies that we're expecting over the time is about $60 million and it's going to be about a third a year over the next three years after the deal closes. And it's going to involve the things I said, it's – supply chain will be a large part of it, but there'll also be some opportunities in terms of functions, administration, infrastructure and facilities. So the normal things that you would see, but a big chunk of it clearly will be the supply chain. In our industry, in structures and in aerospace, about 66% to 70% of our cost base does come from the supply chain. And so that's typically where the most significant savings are.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Okay, just...

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

A

Although we also see some revenue synergies particularly in the MRO area. And I mentioned that before as – that for us is a little bit opposite. They have more scale than us and we can bring our customers, some of our expertise and some of our tooling and benefit on the revenue side on the MRO or the...

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Just a quick follow-up on the Asco, why would a seller give you, like, a 30% discount on price if the outlook was still the same? Are the margin targets still pretty much the same?

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

Margin targets haven't changed materially based on the financial projections that we have. We'll get into more detail once we close. This deal has taken longer for both parties. I think both parties recognize that it's taken longer and cost more. And so, we explored various different structures with the seller and agreed that this new price was the thing that just work best for both parties.

So, again, as I said, we're still very, very excited about the strategic fit of Asco and the financial outlook still looks good. We collaborate very well with Christian Boas who's the owner right now along with his siblings and he's the CEO, and we're looking forward to working with him after we close this deal. He brings tremendous expertise in the fabrication area, and we think we can continue to grow the business with that assistance.

Cai von Rumohr
Analyst, Cowen and Company, LLC
Q

Thanks so much.

Operator: The next question will be from Peter Arment with Baird. Please go ahead.

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

Yeah. Thanks for squeezing me in. Good morning, Tom, Jose.

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

Good morning.

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

Tom, maybe just a clarification. You've given us so much details on the Bombardier deal, probably too early for a pinpoint number. But have you sketched out what you expect for intangibles on this transaction? Thanks.

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

We have not. I mean, we're going to just start integration planning here shortly, and we'll look at what's there in terms of allocating value, excess value to intangibles versus goodwill. We do have an opportunity to do it concurrently to the Asco. So we have experience assessing that. And we will plan to adjust it to earnings once the deal closes. And we'll look at the standards in the industry, and we've seen that most of our peers adjust intangible amortization to earnings. So that's kind of our first path, although we still need to conclude on that decision.

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

Got it. And just as a quick follow-up, Tom, just obviously you expect that Asco to close a long time ago. Just that it looks like both these deals are going to be closing pretty much around the same time. Just thoughts on that, just handling it from just being management stretched too thin. Thanks.

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

A

Right. Well, you're right, they could converge because the Asco deal has taken longer than we expected. But we'd be happy for both of them to close in the first half of next year. So in terms of management bandwidth, and of course, it's always a challenge when you're integrating big acquisitions like these, but these are different teams. The Asco part of the business will be part of fabrication and we have a global team led by a gentleman named Kevin Matthies. And so he will be responsible for integrating the Asco assets.

The Bombardier assets are really Airbus-focused. And it will be run by our Airbus program which is based in Europe, Scott McLarty is the gentleman's name. He's based in Prestwick, has a lot of experience in working with Airbus and working in the UK and with the Unite union. So it'll be a good fit. So it'll be a lot of work but the teams that are working on it will be very different teams and we'll be able to divide and conquer and integrate both of these successfully.

Operator: In the interest of time, our final question today will be from Michael Ciarmoli with SunTrust. Please go ahead.

Michael Ciarmoli
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hey, good morning, guys. Thanks for sticking around. I appreciate it.

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

A

Good morning.

Michael Ciarmoli
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Just maybe, maybe one more time to hit at Carter's initial question and George's on the margins at the Bombardier asset. They've got a lot of aftermarket. Is that lower margin aftermarket, is that more services? Just trying to get a sense of why the margins are currently so low. I mean, is it more new start programs? Is there still a lot of development there? Just maybe if you can give some specific as to why those EBITDA margins are at that 9%, 10% level?

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

A

Right. Well, it's structures and you've got two programs that are really in startup mode, the A220 wing and the – and then the 320 thrust-reverser. So, those are programs that as they mature will naturally be able to improve margins, and particularly as we can bring synergies to them. So that's – I mean I think that's the main reason that you see some of the challenge.

The Bombardier programs, the business jet programs, the CRJs, those are mature. The margins on those tend to be pretty good. Aftermarket is really – they do some spare parts, but what they do is a lot of structural MRO particularly around thrust reversers. So very similar to the things we do. A lot of that is extremely sophisticated work. The margins are quite good on that. And we see a lot of opportunity through revenue synergies to grow that business at a faster rate than it was growing before. And as I said, it doubles our aftermarket and makes it a lot more significant contributor to our economics going forward.

Michael Ciarmoli
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Got it, helpful. Thanks, guys.

Operator: Ladies and gentlemen, this concludes our question-and-answer session and thus concludes today's call. We thank you for attending Spirit AeroSystems Holdings, Incorporated third quarter 2019 earnings conference call. You may now disconnect your lines. Take care.