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Spirit AeroSystems Holdings, Inc. (SPR)

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MANAGEMENT DISCUSSION SECTION

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Good afternoon, everyone. I guess good afternoon, bordering on good evening. Thanks for joining us on the aerospace defense track here at the JPMorgan Industrials Conference for 2021. And we are going to wrap up the aerospace defense track tonight with Spirit AeroSystems and I'm very grateful to have Mark Suchinski here, CFO. And he's going to speak with us for a little while about the company.

Mark, maybe I'll hand it over to you kind of for a brief introduction and then we'll get into some Q&A.

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

Sounds great, Seth, and good afternoon to you. And good afternoon to everybody that's on the virtual call here. Let me first start with a quick Safe Harbor statement. I need to remind everyone that any projections or goals we may include today in our discussion are likely to involve risks, which are detailed in our news release and our SEC filings. Sorry we had to take care of that business first.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Yeah.

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

Just some opening comments, obviously 2020 was a really challenging year for commercial aerospace for Spirit in particular with our heavy concentration on the B737 MAX, dual challenges of the grounding of the MAX and COVID that hit earlier last year, we feel like we reacted fairly quickly. We first started with rightsizing the business to the lower levels of production. Production deliveries were down more than 50% in 2020.

We also took quick actions to address liquidity. That was a really important factor as I stepped into this job to make sure that we had adequate liquidity to run the business during the lower levels of production. At that time, there was a lot of uncertainties related to the length of the downturn in the industry and that still is a big question mark today.

In addition to that, not only did we rightsize the business and address our cost structure by attacking our non-labor base of about a $1 billion. We focused on liquidity, but we also didn't forget investing into business, investing into the future. So, we spent a lot of time working on productivity initiatives, automation in the factory. We know that there will be a recovery. People will fly. It's not a matter of if; it's going to be when. And so we know single-aisle range will recover over the next couple of years and Spirit needs to be in a situation, where we can take advantage of those higher levels of production. So, we focused on really in improving the business, the productivity, a lot of digitization, automation to help improve our factory during future rate of recovery.

We also focused on diversification in 2020. We were dealing with lower rates of production on the commercial side. But we did the FMI acquisition in January of 2020. It's a small defense company that focuses on hypersonics, and missiles, and space. We're really happy to have them part of the Spirit family. It's opened up quite a few doors on the defense side for Spirit.

In addition to that, we closed on the Bombardier acquisition in October. Belfast site, Morocco and Dallas with – it's our biggest acquisition since we acquired Prestwick, Scotland in March of 2006, added to our Airbus content, it added to aftermarket and to business jets. And so, it really hit the mark on our strategic initiatives as it relates to diversification.

As we look forward into 2021, there's still a lot of uncertainty, airlines are starting to recover now. I would say, I feel more confident about our production rates in 2021 than I did just 60 days ago. Traveling – travelers – there's more travelers being accounted for through the TSA. We're hearing some airlines stating that potentially March could be a breakeven cash flow. And so, first and foremost for our business to recover, we need people to travel, we need people to be comfortable to travel. And that starts with vaccinating and lowering the COVID situation that we have in the marketplace.

Once people get comfortable to travel, that will help the airlines. If the airlines are financially healthy, they'll order more aircrafts from Boeing and Airbus and that will help us. We think the recovery will first start with narrow-bodies and it will start with domestic travel, regional travel. More than 80% of our backlog is single aisle aircraft like B737, A320.

And so I think that positions Spirit well as things recover. There are rays of sunshine here. We're seeing the virus really slow. We're not out of the woods yet. We still have to stay vigilant on fighting the virus, get people vaccinated. But we see some good signs here. The Biden administration has done a good job of getting the vaccinations out. We're starting to see more people travel and get more comfortable. And so, we're feeling more confident in the recovery in the back half of this year. We feel more confident that single out production rates will start to increase as we move into 2022.

We're also focused again in 2021 is diversification, de-levering and driving the improvements in our profitability. And so the acquisitions check the mark on diversification. We talked it on our fourth quarter earnings call around de-levering. We started that with paying off our June $300 million floating rate notes. We paid those off. We've redeemed those in February of this year. And we see a line of sight to paying down roughly $1 billion of debt over the next three years via in cash on our balance sheet and cash flow that we expect to start to generate 2022.

And that will move our leverage down. We'll get back to more like investment grade credit metrics like we were in 2018 and 2019. And then we're going to continue to focus on how do we drive improvements in our business, execute productivity improvements, supply chain enhancements to drive to our targeted margins of 16.5%. And we think that when we get out in 2023 and we're at the low rates of production in the 40s on B737 and higher on A320 that we think that we're going to put ourselves in a good position to achieve those types of margins and get back to generating the type of earnings and cash flow that you saw from Spirit back in 2018 and 2019.

Over to you, Seth.

QUESTION AND ANSWER SECTION

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Excellent. Thanks, Mark. And I think you kind of addressed a few of my questions in those remarks there, but maybe I'll ask some of them anyway in a little bit more abbreviated way just to kind of dig in further and emphasize the points. I guess on B737, which is probably first and foremost on people's minds, you mentioned on the earnings call that the company is producing at about 10 a month. And I think you expressed an intention to be building at a higher rate before the end of the year. And so, I wonder if you could – it sounds like it's increasing, but if you could characterize your level of confidence that that B737 production rate for Spirit is going to be beyond 10 a month by the end of the year. And is that confidence level – has it changed year-to-date? Is it basically – has it risen year-to-date if it is indeed there?

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

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As we mentioned in our 10-K, we expect B737 deliveries to be about double from 2020. In 2020, we delivered 79 B737s. So we expect to double that this year. It's – our production plan is synched up with Boeing. I would say starting the year there was still quite a bit of uncertainty as we saw the market unfolding. Boeing is working hard to deliver on their inventory and stock. And that's their primary focus. But we know that there is a demand out there and they'll continue to produce new aircrafts. So I would say we're getting close to the end of the first quarter. We're in mid-March. Our production plans are on track. We started the year at 10 aircraft per month. We're staying on track. I'm more confident than ever that our production plans of delivering roughly twice as many B737s in 2021 is going to occur.

We've seen travel recover. We've seen Boeing achieve some nice orders on B737 MAX over the last several weeks. Boeing continued to reiterate on their fourth quarter earnings call they expect to go to 31 aircrafts per month on B737 in the early part of 2022. And so I think our production system is synced up with theirs. And I'm gaining more confidence on production rates in 2021. It's a long cycle business for us to adjust our rates. It's about a four- to six-month timeframe from a lead time standpoint. And so we've got a good line of sight for the next rate increase in the middle of the year and then one towards the later this year that will allow us to achieve the deliveries of roughly 160 this year. And based on what we're seeing and what we've delivered so far, I think we're in good shape to hit those deliveries in 2021.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah. Excellent. And I think that's good color and that's helpful. When we think about the – I know it's been a difficult year in terms of workforce. And when you think about having some of the work come back and having some of the workforce come back, what's the production level where you need to start bringing more people on and how are you preparing for – it's probably – it's different than going to a new high rate that you've never gone to before, but these are still significant percentage increases in production and so how do you prepare for that to make sure that you're ready for those increases?

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

A

Well, I think there's – one thing to remember, we are tooled up and capitalized to 57 aircrafts per month on a B737, 60 a month on A320. So, one difference from now to where we were before was we are tooled and capitalized and ready to produce at higher rates. The other advantage that we have as we think about increasing production rate is, today, we're going to be delivering essentially all B737 MAXs, whereas in 2017 and 2018, we were delivering a combination of NGs and MAXs. So it's one model running down the production line.

We are also benefiting from the fact that, we'll be able to recall workers that previously worked on the B737 production line as we go back up in rate. They have familiarity with aerospace work and production work on the line. We'll have to have them trained. We're going to bring people in 60 to 90 days ahead of time to get them trained up and recertified. So, we have one lever we can pull from our workforce that has been laid off as part of our workforce reductions. But we're also taking advantage of moving some workers from as B787 is going with from 10 a month down to 5 a month, we have some ability to move some workers from one program to another, right, to keep our folks employed, to keep production stable, and to have some level of consistency as it relates to the production rates.

So we're taking advantage of moving some folks around from twin-aisle programs that are going down in rate over to B737 as we need to ramp up in rate. And so right now, we're starting to move people from B787 over to B737. We're starting the hiring process on B737, the recall process. We have some folks that are in training to get ready for the next rate ramp. And so, we're confident enough in next rate break that we're bringing our folks back and getting them trained out and ready for the next rate break.

In addition to those internal efforts, we're spending a lot of time with our supply base. Rate readiness reviews. We're reviewing our critical suppliers to make sure that they're ready as the market starts to recover. They've been challenged just like we have on reducing the workforce. Many of them have inventory in stock. They've been overstocked. And so, we're spending quite a bit of time, value our critical suppliers making sure that in some instances we have a dual sourcing in place, making sure that our internal fabrication organization could step in, in case a supplier went down.

I think it's really important that as we go back up in rate that we do it – execute it flawlessly, [ph] low hours of (00:14:18) overtime. We've been there before. We bring back the folks, we train them. We stay in sync with the supply chain – our supply chain making sure that raw material's ordered, our suppliers are bringing their employees back. And so, we're spending a lot of time not only on our factory to make sure we're ready for the rate ramp, but also making sure that our suppliers are prepared to deal with the production rate increases that we expect to occur later this year and into 2022.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay. And then when we think about the inventory of fuselages at – in Wichita but owned by Boeing, there's probably – I guess there's probably about 100 in excess versus what you would want to have there. How do we think about that inventory coming down? Is that something that happens, let's say, over the course of 2021 and maybe through the first half of 2022 and then you feel like you'll be set in that regard?

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

A

Yeah. I mean, what we've said previously is that we expect to burn that – those additional units down by about the middle of next year give or take. And so really as the rate ramp starts to occur, our production system will lag Boeing's by about five aircrafts per month until we sync up with them around the middle of next year. And so, the middle of next year we'll be synced up with Boeing's production and then our suppliers will be synced up with us. And so it's going to take about 18 months or so for us to get the two production systems in alignment. But we're sitting at around 130. That's what we said at our earnings release. We're probably going to need 20 or 25 in buffer.

So, we have about as you said about a 100 that need to burn off as our production increases. We should lag Boeing just a little bit. So when Boeing hits 31 aircraft per month in the early part of 2022 which is what they've indicated in their earnings call, the fourth quarter earnings call, we'll be probably in the 26 to 28 range, lagging them just a little bit. And so we expect that our production system and theirs to kind of sync up in the middle half of 2022.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. Okay. Okay. And then when we start to see those, so I guess, should we expect by sort of the next reporting period we'll start to see those excess inventory sort of burn down and see that happen during all consistently throughout 2021 here? Or is it something that happens more later on?

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

A

It'll start to occur in the latter half of the second quarter and you'll really start to see it come home in the third and fourth quarter of this year.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay. Well. Okay. I guess, you guys highlighted the $1 billion of cost takeout that you've done over the past year or so. I wonder how much of that would you classify as kind of a variable costs versus how much is fixed costs?

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

A

Well, production rates dropped dramatically last year, right, and so we saw well over 50% reduction in production rates between 2020 and 2019. So, the first area that we attacked was variable costs, obviously, [ph] touched (00:17:54) labor folks, we had to reduce our workforce to the lower levels of production. And then all of the non-labor costs that were variable in conjunction with that, but we really didn't stop there. We looked at holistically our fixed cost structure. We looked at – we're closing two sites, one in San Antonio and one in McAlester, Oklahoma. It's about 500 employees. That work will be transferred to Wichita and to Oklahoma. And so, we'll be able to absorb that work in our current infrastructure. So, we'll be able to recoup the utilities, property taxes, insurance, all the fixed costs that come with managing the site. And so, those are some permanent fixed costs that we're going to maintain as we move forward during higher levels of production.

But we also attacked – did some reorganization. We combined our supply chain organization and our fabrication organization, renamed it [indiscernible] (00:18:55). There's a lot of synergies by going to do that. We've looked at back office functions. We've looked at our management spans and layers and really tried to optimize our cost structure.

And so, we're going to have to be very disciplined, fiduciary disciplined on as production rates go back up, you have the tendency to add. And so, we need to continue with our vigilance on maintaining our low cost structure. We have to add back to support production. But the areas that we've taken advantage of, we have to maintain those benefits in the higher levels of production. That is one lever that's going to help us get to the 16.5% margins. And our internal targets are to get greater than that. Right? Our team is challenged to achieve margins in the 2023 timeframe in excess of 16.5%. And so the factory improvements, the automation, the digitization, the leaning of the factory, the fixed cost [indiscernible] (00:19:57) that we have, we all believe that all of those things that we've done here and we'll continue to do in 2021 will allow us to get back to 16.5% margins at lower rates of production that maybe we could have historically.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. Okay. Excellent. Well, let's move on to two of the other platforms, looking beyond the B737. And so for A350, where should we think about the production rate where Spirit can be cash flow positive on A350?

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

A

Well, we were just starting to turn the corner on A350 both from a Section 15 and a fixed leading edge at 10 a month. We were moving into the zone of profitability and cash flow generation on that program. Our Kinston site is facilitized up to 13 aircraft per month. And so there's a lot – it's a heavily automated factory. And so there's a lot of fixed costs that are in the Kinston site. Airbus has indicated four to five aircraft per month on the A350 this year. We know that. The twin-aisle airplane programs are going to lag, narrow-bodies on the recovery. I would say we don't need to see a lot of lift on the A350 production rate to get back to cash-flow positive if we exclude kind of the noncash depreciation.

So, if we see a little bit of lift over the next couple years in the 6% to 7% range, we've got a good shot at being cash-flow positive, but we're also taking a look at that factory, is there some additional work that we can put into Kinston to help absorb some of that overhead, and share the fixed cost structure. And so, some opportunities to put some good work in there to take advantage of the factory and the automation that's there. That should also help us, I think, accelerate our ability to get back to cash-flow positive on the A350 program. And so, we're looking at how do we fill up the factory knowing that it's going to take some time for A350 to recover from a production rate standpoint.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah. Okay. That makes sense. And I guess, if we move on to B777, and we think about that rate coming down to something in the two-a-month range, but it's a place where the companies had good profitable content historically. And so, is that a place where you can still be profitable and earn a decent margin even at that low rate?

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

A

B777 has always been a very good, mature, strong program for us, margin wise. I think if you go back to 2015/2016, we were at eight aircraft per month. It was a really good revenue and earnings contributor. I would say, at two aircraft per month, based on the maturity, it's still a good program for us. Obviously, there's a lot less revenue that comes associated with that, but it's still margin – it's double-digit-plus margins. It's cash-flow positive. And so, we're excited to support Boeing as they certify the 777X program and I think we're going to be fine with the B777 program at two or three aircrafts per month.

And, you know, we're supporting Boeing, we got our fingers crossed on the certification in 2023. And if we see the twin-aisle rates recover in 2024 and 2025, that'll be a good contributor to our diversified plan when we get to the middle of the decade.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah. Excellent. Let's now – maybe let's move on – we can talk about the Bombardier aerostructures acquisition, because I think that's pretty interesting. I guess, first of all, if we think about what's contributing there, is it fair to think that of the $700 million of sales that you guys have talked about for that acquisition this year, maybe a little more than half of that is from the A220 and maybe a little less than half is from everything else? Is that – is that a rough – a good rough estimate?

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

A

I would say in 2021 probably around 40% is A220, maybe a little more, and 60% is aftermarket and business jets.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay, that's great [indiscernible] (00:24:36).

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

A

Remember, you know, A220 is probably going to be at about a rate of four to five a month in 2021. And so, we have around two-thirds of the revenue from that acquisition generating solid margins. Aftermarket is going to be – clearly it's going to be accretive to our overall margin plan here and the business jets are going to be solid, call it, low to mid-teen contributions from a gross margin standpoint.

And so, some challenges on the A220 program, we've got the facility there that's tooled up and capitalized to production rates much higher than four aircraft per month. That is going to be a bit of a challenge for us. We need that program, those production rates to increase over the next several years. We were expecting 100-plus aircraft by the time we get into 2022 and 2023. With COVID, it's going to be a little longer to recover, but we have some solid contributors with aftermarket and business jets. A nice small piece of defense work that we just won out of the Belfast site will help contribute a little bit as well.

And so, really what we're focused on is, great diversification from the Belfast acquisition. Good earnings or revenue growth over the next several years. I think the business jets and the aftermarket will be good contributors. We're really focused on the A220 program and the cost side of things. We've got a long list of opportunities that we think we could take advantage of. Stepping in, the list of opportunities to improve the cost over the next several years is a lot – there's a lot more opportunity than I thought when we stepped into it and it's a matter of how do we execute, how do we [ph] staff (00:26:34) it, how do we drive those and meet those points of incorporation over the next several years, to drive that program to, first off, to break even and then to cash flow positivity.

The two major factors to get to positive cash flow on the A220 program, first and foremost, it's rate. We've got to get back to 100-plus, 120, 130 deliveries, which was where things were going pre-COVID, and the second component is execute those cost reduction opportunities that we have. There's a lot of work that we're doing from an overhead, from a site – a footprint standpoint, taking advantage of the supply chain opportunities to consolidate the buy with the larger Spirit buy. And I think that would be good for Spirit. It'll be good for our suppliers to incorporate that supply chain.

So, we're optimistic. We got a lot of work to do – still to do on the A220 program to get there, but it's great technology, it's a fully integrated wing, we understand the technology and that could open some doors as we think about future aircraft. There's a lot of thoughts around composite wings are the way of the future, and so we've got a lot of knowledge now on doing a fully integrated composite wing which we think could give us a good chance of bidding on some new work in the future with either Airbus or Boeing.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah. Excellent. That makes a lot of sense. And I think that's helpful too because they – I think people see the acquisition and they see, okay we close the acquisition and take a forward loss charge on the program, but kind of thinking about that longer term potential, as well as the non-A220 work that came in with it. When you roll it all up, I think you guys talked about a roughly 10% gross margin for this whole book of business. Is the right way to think about it that it's probably somewhat below that right now? As we move forward, you know, hopefully, the A220 production rate increases, but that is – you know, if that happens, it would be good, but it's also dilutive to the margin rate. But at the same time, the aftermarket is probably at a fairly depressed place right now. And so, as that comes off the bottom, that is accretive and is more powerful of the two for the time being and that's what allows you to get towards that 10%.

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

A

I think you hit it right the nail on the head, Seth. We're going to see some recovery on the aftermarket. We're going to see the planes go back into service. There will be more repairs that will be need to be done. There will be more parts replacements and so that revenue lift at the higher margin will be helpful to that business overall. I think, the other thing I would say is, business jets, the Global 7500 that Bombardier [ph] adds (00:29:35) is a great airplane, long, large business jet, and so, the business jet market hasn't been hit as badly as the commercial.

We won't recover back to 2019 levels this year, but I think there are some good opportunities for Bombardier as they're solely now focused on delivering business jets and selling that into the marketplace. I think, there's some good opportunities. We're now Bombardier's largest supplier in the business jet side. So, if they can gain some traction in the marketplace itself, start selling some more commercial – business jets, that would also be helpful from an earnings and from a revenue standpoint.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. Excellent. That gets into a question I wanted to ask. So when you think about putting the Bombardier business and separating it out between Spirit's three segments and we think about how those segments aggregate into the 16.5%. You know, relative to in the past, you know, how do we think about the gross margin in each of the segments?

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

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Well, I don't think it's going to be dramatically different than what you've seen historically. You'll see our Propulsion segment continue to lead with the highest margins. You know, the Bombardier business has a combination of fuselage work and propulsion work and the cell work that will be helpful, but I think, Propulsion will continue to be a couple of points, two, three points higher from a margin standpoint in fuselage and then, the Wing component will be – continue to be, from a margin standpoint, the lowest of the margins.

But we really feel really good about the opportunities to continue to focus on margin accretion with this acquisition, with the diversification in all three of those segments where we'll be more diversified, we'll have higher revenues as we move through the recovery, and that's going to give us a good chance to continue to enhance those margins, and meet the goal of 16.5% and continue to stay focused on our cash conversion of 7% to 9% out in the 2023 timeframe.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah, okay. Yeah the cash brings in the next question that I wanted to ask which was, you guys have given some guidance for free cash flow in 2021. I think that that's fairly well understood and kind of looking to get to cash flow positive in 2022. And you know, obviously the B737 can be a very powerful driver there, but also, versus 2021, there's a tax benefit that's maybe going away. There are some repayments that are needed to make to Boeing. I guess, is there a way – could you help us with the cash walk getting to positive free cash flow in 2022, and maybe not every single piece of it, but the major moving pieces to get you there?

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

A

Sure, Seth. I think it first starts with the narrowbody recovery. So we are expecting B737 and A320 production rates to be higher in 2022 than 2021. And so, as we go up in rate, we'll be able to absorb more overhead fixed costs. We'll see a continued reduction in excess cost or idle play costs that is recurring here in 2021 which will sequentially help improve the overall margins. So, it's – first and foremost, it's higher production rates on the narrowbodies. We expect to mainly see a little bit of working capital tailwind in 2022 as we continue to burn off some of the excess inventory that we have. So, that will help us out. I think the growth on the aftermarket and the business jets will continue to help drive some of the cash improvements in 2022, and so, that, along with the fact that we'll also – due to the size of the pre-tax losses that we booked in 2020, we'll continue to see some tax shield on income in 2022, which will continue to defer some tax payments out.

So, that all leads to incrementally improved margins, as well as projections of cash flow positive. We should see operating cash flow improve nicely between 2021 and into 2022. Depending on the production rates and the focus on us continuing to manage our cost structure, we do have a headwind on a one-time advance repayment of about $123 million that was an advance that we got in 2019 that got moved to 2020 and then got pushed to 2022. So, that will be a headwind, but even with that advance payment, we expect to be cash flow positive.

But, Seth, I really focus on operating cash flow. That's – that will be a good mark as it relates to our ability to take advantage of the higher production rates, manage our cost, and really for our investors to see the value creation that we're generating. We're going to have to deal with the $123-million payment. It's a one-time payment that will have a negative impact on cash flow, but the thing you should be focused on is operating earnings improvement and operating cash flows which we expect to grow nicely in 2022 as compared to 2021.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah. Okay. Very good. That makes sense. You've spoken about diversification and the work that the company has done on – to expand on the military side of the business. I think, probably, the biggest pieces of that right now are the P-8s and the Tankers which kind of come from the work that you do and have always done for Boeing. But can you level-set us on where military revenue is maybe, or the military contribution, X the commercial derivatives, and then, when you talk about incremental military revenue from here, it sounds like the lion's share of that, the vast majority would be not the military derivatives. And so, which are the key programs that are driving that?

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

A

Well, we've talked about a target of $1 billion of revenue on the Defense side. We indicated at 2020, we grew at close to 20% and expecting our Defense business to grow by about 15% in 2021. I think we also indicated that Defense revenue in 2021 is going to be somewhere in the $650 million to $700 million range. The Tanker, the P-8 do contribute to that revenue, but I would say that $450 million to $500 million is non-derivative revenue. It's our strategic program, the B21, it's CH-53K, it's a variety of [ph] prep-work (00:37:25) that we're doing. We have some additional classified development work that we're working on.

And so, a couple of years ago, we were on three or four different defense programs and we'd tell you right now, we've got contracts and they're in various stages of development, whether it's early development or test units, but we've got about 2020 or 2021 contracts on the defense side. So, we've got a very solid book of business with a projected based on program of record of $6 billion based on business that we have contracts for. And so, we've seen a lot of opportunities come our way. I would tell you, the work that we do on the B787 program and the A350, large-scale composite manufacturing – design and manufacturing has opened a lot of doors on the defense side.

In my opinion, it was one of the biggest enhancers to us, winning the B21 program. Knowing that Spirit has that level of capability and I think that our ability to support that program and do it well, continues to have OEM [ph] and Primes (00:38:39) come to us with our commercial cost structure, and help contribute to them as they continue to focus on growth with the defense. You know, defense budgets aren't seeing dramatic drops. As we've seen at this point in time, there'll probably be some [ph] more (00:38:58) correction over the next couple years, but we think we're on some really solid platforms.

FMI, we acquired last year is in hypersonics and space. That's opening up some doors for us as well. When we think about the Lockheeds and Raytheons, guys who deal with missiles, so that's opening up some conversation for us. So, we really feel good about what our defense team has done and the opportunities that we have in front of us. And so, it's going to be a big, important part of our business that we continue to grow organically, but we'll continue to see if there's some opportunities inorganically to kind of support growth on the defense side.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

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Excellent. Okay. Maybe just – we're running up against the time, so maybe just a last one. You talked a little bit about debt pay down a little earlier. I think the – most of the debt isn't due in the near term, it's due out in 2025 or beyond, but how do you think about the amount of gross debt that you want to carry on the balance sheet from here and what that means for [indiscernible] (00:40:06) cash going forward?

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

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Well, I mean, on our earnings call, we talked about a plan to pay off around $1 billion of debt, de-lever by about $1 billion over the next three years. We started that with paying off the floating rate notes in February. We have $300 million worth of bonds that come due in June of 2023, and then after September of this year, we've had a Term Loan B that can be prepaid without any penalty. And so, that Term Loan B of $400 million, along with the bonds in 2023, give us an opportunity to reduce debt by $700 million in the 2022 and 2023 timeframe.

So, if we can meet that objective by using cash on our balance sheet, as well as using free cash flow in 2022 and 2023, we think that we can pay down $1 billion by the end of 2023 and that would put us in a position where we would be from a gross debt standpoint 2 to 2.5 times levered, which is – would put us in the ballpark of having credit metrics that would be consistent with an investment grade company. And so that's really what we're focused on, getting our credit metrics back, getting our gross net balances to 2.5 times, so that we put ourselves in a position where we can reduce the amount of interest expense that we have, and put ourselves back in a position where we have access to cost of capital that is much lower than it is today.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Very good. Mark, it's been a – I know it's been a long day of meetings and we're up against the time here, so I'm going to let you go. But, I appreciate you being with us and spending your time and for giving us your insight and, yeah, thanks very much. Look forward to being in touch.

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

Seth, look forward to it, and hopefully at some point in time we'll see you at the next conference maybe in person.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

That would be great. Okay. Thanks very much, Mark. Have a good evening.

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

Bye now.