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Spirit AeroSystems Holdings, Inc. (SPR)

Q2 2021 Earnings Call

CORPORATE PARTICIPANTS

Aaron Hunt

Director of Investor Relations, Spirit AeroSystems Holdings, Inc.

Thomas C. Gentile III

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

Samantha J. Marnick

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

Mark J. Suchinski

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

OTHER PARTICIPANTS

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Myles Walton

Analyst, UBS Securities LLC

David Strauss

Analyst, Barclays Capital, Inc.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Robert Spingarn

Analyst, Credit Suisse Securities (USA) LLC

Hunter Keay

Analyst, Wolfe Research LLC

Cai von Rumohr

Analyst, Cowen and Company, LLC

George David Shapiro

Analyst, Shapiro Research LLC

Kristine Tan Liwag

Analyst, Morgan Stanley & Co. LLC

Noah Poponak

Analyst, Goldman Sachs & Co. LLC

Michael Ciarmoli

Analyst, Truist Securities, Inc.

Peter J. Arment

Analyst, Baird Equity Research

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome, ladies and gentlemen, to the Spirit AeroSystems Holdings, Inc. Second Quarter 2021 Earnings Conference Call. My name is Grant and I'll be your coordinator today. All participants will be in 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 presentation over to Aaron Hunt, Director of Investor Relations. Please proceed.

Aaron Hunt

Director of Investor Relations, Spirit AeroSystems Holdings, Inc.

Thank you, Grant, and good morning, everyone. Welcome to Spirit's second quarter 2021 earnings call. I'm Aaron Hunt, Director of Investor Relations. And with me today are Spirit's President and Chief Executive Officer, Tom Gentile; Spirit's Senior Vice President and Chief Financial Officer, Mark Suchinski; and Spirit's Executive Vice President and Chief Operating Officer, Sam Marnick. After opening comments by Tom, Sam and Mark regarding our performance and outlook, we will take your questions.

Before we begin, I need to remind you that any projections or goals we may include in our discussion today are likely to involve risks, which are detailed in our earnings release, in our SEC filings and in the forward-looking statement at the end of this web presentation. In addition, we refer you to our earnings release and presentation for disclosures and reconciliation of non-GAAP measures we use when discussing our results. And as a reminder, you can follow today's broadcast and slide presentation on our website at investor.spirit aero.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, Aaron, and good morning, everyone. Welcome to Spirit's second quarter earnings call. We are pleased to see signs of recovery in global air traffic. The US air travel recovery has been strong and has come back faster than some expected. TSA traveler throughput has exceeded 2 million passengers on multiple days during the past two months and some days in July where passenger screenings exceeded the 2019 levels.

A recent International Air Transport Association report indicates domestic passenger markets show improvement, but with demand still down 22% versus June 2019 levels. The situation remains dynamic. We are monitoring the most recent reports of a spike of COVID-19 cases and what impact this may have on air traffic recovery. However, the upward momentum of domestic air traffic over the past few months is an encouraging trend for our industry.

We are pleased to see the rebound of demand for the MAX and the news of large orders from United, Southwest, Alaska Air and Ryanair. Ryanair took delivery of its first 737 MAX 8200 and had positive feedback. With 85% of Spirit's backlog associated with narrowbody aircraft, we believe we are well-positioned to benefit from this domestic air traffic demand and narrowbody recovery.

In the first half of this year, we delivered 64 737 MAX shipsets, compared to 37 in the first half of last year, a 73% increase. We are also on track to deliver about 160 shipsets this year, a 125% increase over the 71 we delivered

in 2020. As we have discussed before, we are trailing Boeing in terms of 737 MAX production rate to burn off the inventory of storage shipsets in Wichita and Tulsa.

This quarter, for example, we delivered 35 units, but shipped 42 to Boeing. We currently have about 125 units in storage, all of which Boeing owns. We expect storage units will decrease to about 100 shipsets by the end of the year. Our plan is that we will reach 20 storage units by the end of next year, which will remain as a permanent buffer to cushion the production system.

Turning to the 787 program. As a result of our ongoing engagement with Boeing, we identified an additional fit and finish issue in the forward section of the fuselage. This issue is related to a part that Spirit receives from one of our Tier 2 suppliers, and we are working with Boeing and the supplier on a resolution. We continue to coordinate with Boeing to ensure that we are performing all necessary rework.

Primarily driven by this issue, we have recognized a \$46 million forward loss on the 787 program. Despite this forward loss, we are maintaining our free cash flow target of negative \$200 million to \$300 million, as indicated on our last earnings call. This amount is net of the \$300 million cash tax benefit which we expect to receive in the second half of this year.

Next, I would like to highlight the fact that we published our first sustainability report in June, outlining Spirit's environmental, social and governance strategy. The report also includes a few of our notable 2020 achievements. For example, by the end of this year, we intend to be 100% wind-powered at our Wichita facility.

Now, our Chief Operating Officer, Sam Marnick, will take you through updates on our acquisition integrations. Sam?

Samantha J. Marnick

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

Thank you, Tom. The integration work streams for our recent acquisitions are progressing well. We recently acquired the assets of Applied Aerodynamics and we've already completed approximately 60% of the 323 identified integration tasks.

The integration of our other acquisition from Bombardier is also going well. We have completed about 90% of the tasks required to integrate the Belfast, Morocco and Dallas sites. The remaining tasks are largely associated with the information technology Transition Services Agreement and we expect to complete it before the end of the year.

The estimated synergies we're expecting from the deal are tracking to plan. We are seeing good progress on A220 wing cost, supply chain improvements and infrastructure optimization. Airbus continues to have confidence in this aircraft and we expect production rates to continue to improve over time.

Turning to the Belfast pension plan, we have ended our formal consultation with employees and the unions. Subject to the completion of the process, we will close the plan to future benefit accrual and provide a defined contribution benefit plan before the end of the year.

The Bombardier asset acquisition significantly increased our business jet work statement. We also secured the award, the engine nacelle, on the new Falcon 10X. This new growth has established Spirit as a leading business jet aerostructure supplier, a market segment that is recovering rapidly following the pandemic.

These business aircraft inventories are down around 40% year-over-year, highlighting a strong demand. Additionally, US business jet fly activity is about 6% higher than pre-pandemic level, another good indicator of a rebound in this market segment. We believe our capabilities on business jet program position us well to generate \$500 million of revenue at accretive margins by 2023.

Another market segment we are watching closely is urban air mobility, also referred to as electric vertical and takeoff aircraft, or eVTOL. We believe our expertise in composite aerostructure design and manufacturing bring unique capabilities in this future mode of transport. We've been exploring opportunities with a number of companies in this exciting new area and have signed agreements that are already generating revenue.

Now I'll turn it back over to Tom.

Thomas C. Gentile III

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

Thanks, Sam. These two acquisitions have helped us grow our aftermarket and business jet businesses. We're also accelerating our revenue diversification efforts in defense, which we expect will grow by roughly 20% in 2021.

Now I'll turn the call over to Mark to take you through our detailed financial results. Mark?

Mark J. Suchinski

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

Thank you, Tom, and good morning, everyone. I hope everybody is doing well.

We continue to see 2021 as a bridge year for our Spirit and the commercial aviation industry. Domestic air travel in the United States as well as many other regions of the world are starting to recover, which is encouraging, especially for narrowbody aircraft production rates. We are cautiously monitoring the COVID variant and its impact on this recovery, particularly with international travel. We expect international air travel will continue to recover at a slower pace and therefore widebody programs will remain a headwind for the next few years. As we work through the second half of the year, we are starting to see the benefits of increasing narrowbody production rates.

Now, let's move to our second quarter 2021 results. Please turn to slide 3. Revenue for the quarter was \$1 billion, up 55% from the same quarter of last year and approximately 11% above the first quarter of 2021. The revenue increase was primarily due to higher production on the 737 MAX and A320 programs, as well as increased revenue from the recently acquired A220 wing and Bombardier business jet programs. These increases were partially offset by the lower widebody production rates resulting from the continued impacts of the COVID-19 pandemic on international air traffic.

Turning to deliveries, overall deliveries increased to 243 shipsets compared to 159 shipsets in the same quarter of 2020. The second quarter 737 MAX deliveries have increased to 35 compared to 19 shipsets delivered in the second quarter of last year. We still expect to deliver around 160 shipsets during the year. Additionally, second quarter A320 deliveries increased to 96 compared to 69 shipsets delivered in the same period of last year.

Let's now turn to earnings per share on slide 4. We reported earnings per share of negative \$1.30, compared to negative \$2.46 per share in the same period of 2020. Adjusted EPS was negative \$0.31, compared to EPS of

\$2.28 in the second quarter of 2020. Adjusted EPS excludes acquisition costs, restructuring costs, noncash voluntary retirement plan charges and deferred tax asset valuation allowance.

Looking at the operating margin, we saw improvement in the second quarter to negative 10% compared to negative 57% in the second quarter of 2020. The cost reduction actions we've taken over the last year along with increasing production rates have contributed to the improved results with lower costs and expenses, including excess capacity, restructuring and abnormal COVID-19 costs. We also recognized lower forward loss charges compared to the same period last year.

In the second quarter, we recognized forward loss charges of \$52 million, primarily driven by engineering analysis and rework on the 787 program, compared to forward loss charges of \$194 million in the same period of 2020. Additionally, the increase in other income is primarily related to Belfast pension plan in the absence of voluntary retirement expenses recognized in the second quarter of 2020.

I do want to mention that there was a reevaluation of deferred tax assets during the second quarter of 2021 due to a future increase of the United Kingdom's corporate tax rate. This resulted in an income tax benefit of approximately \$55 million. This benefit is included in both GAAP and adjusted EPS. The reevaluation of deferred tax assets, along with the adjustments related to tax law changes and other state tax impacts, resulted in incremental adjustments to the valuation allowance. As a reminder, the valuation allowance is a noncash item.

Earlier this week, Spirit received the latest 787 program demand from Boeing. Based on our preliminary assessment, we expect to incur an incremental forward loss of approximately \$40 million to \$60 million in the third quarter of 2021 due to the impact of reduced production volumes and the corresponding amount of fixed overhead absorption applied to lower deliveries. Due to the timing, this is considered a subsequent event and is not reflected in our second quarter financial statements.

Now turning to free cash flow on slide 5. Free cash flow for the quarter was negative \$53 million, compared to \$249 million negative in the same period of 2020. This year-over-year improvement is primarily due to cost reduction actions, increased production volumes and favorable working capital management.

The second quarter cash from operations also reflect an improvement of \$142 million as compared to the first quarter of 2021. Excluding the cash interest payments of approximately \$80 million made during the second quarter, cash from operations was positive \$51 million. We expect the second half of this year to improve as single-aisle production rates continue to increase. Despite the additional challenge of the 787 program, we continue to expect free cash flow for the year to be between negative \$200 million and \$300 million.

Let's now turn to our cash and debt balances on slide 6. We ended the second quarter with \$1.3 billion of cash and \$3.6 billion of debt. In February, we paid \$300 million floating rate notes early and we remain on track to repay \$1 billion in debt during the next three years. The timing will be in line with air traffic and narrowbody production rate recoveries. The cadence of the global recovery from the COVID-19 pandemic could result in fluctuations in our cash flows from period-to-period.

Now let's turn to our segment performance on slide 7. In the second quarter, fuselage segment revenues were \$492 million, up 51% compared to the same period of 2020, primarily due to higher production volumes on the 737 MAX and Bombardier business jet program, partially offset by lower production volumes on the 787 program.

Operating margin for the quarter was negative 7% compared to negative 77% in the same period of the prior year, primarily due to increased 737 MAX production volumes and the resulting decrease in excess capacity costs, as

well as less net forward losses in the absence of a loss on disposal charges. The fuselage segment recorded \$4 million of favorable cumulative catch-up adjustments and \$36 million of net forward losses during the quarter, primarily due to the 787 program.

Propulsion revenue in the quarter improved to \$242 million, up 43% compared to the same period of 2020, primarily due to higher revenue on the 737 MAX program and aftermarket sales, partially offset by decreased volume on the 777 program. Despite the challenging environment, operating margin for the quarter was positive 12%. This is compared to negative 10% in the same quarter of 2020.

Increased 737 MAX production and the resulting decrease in excess capacity costs as well as less forward loss charges were the main drivers to the improvement in the segment profitability. The segment recorded \$6 million of favorable cumulative catch-up adjustments and \$9 million of forward losses.

High production volumes on the 737 MAX, A220 and A320 programs were the main contributors to the increase in wing revenue to \$259 million. Operating margin for the quarter was negative 6% compared to negative 35% in the second quarter of 2020. The increases in segment profitability and operating margin were primarily a result of increased A320 production volume as well as less forward losses compared to the same period of 2020. The segment recorded \$8 million of net forward losses.

In closing, we are encouraged by the recovery in domestic air traffic demand. We anticipate improved performance through the second half of the year as narrowbody production rates continue to increase. Increasing narrowbody rate should also create positive momentum going into 2022. Additionally, we are pleased to see the progress made so far on our aftermarket, business jet and defense diversification efforts. Integrating our acquisitions and expanding our diversification continue to drive long-term growth potential.

Cash flows remain a top priority for our team, and we are actively working on the execution of our cost and working capital initiatives. We are also monitoring the remaining regulatory approvals needed for the 737 MAX return to service and, in addition, we are encouraged by the domestic aerospace recovery from the COVID-19 pandemic.

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

Thomas C. Gentile III

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

Thanks, Mark. We continue to see improvement in domestic air traffic, which has translated to improved production rates for our narrowbody aircraft versus 2020. For the year, we expect to deliver 160 737 MAX shipsets, up from just 71 in 2020. This quarter, we also continued work with Boeing to address fit and finish issues on the 787 program, and we'll continue to coordinate with them to complete all necessary rework.

The recovery in narrowbody production is supporting better overall performance. We're also encouraged by the continued growth in our aftermarket, business jet and defense programs. We are maintaining our 2021 free cash flow guidance of negative \$200 million to \$300 million.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question will come from Seth Seifman with JPMorgan. Please go ahead.

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thanks very much and good morning, everyone. Question about the 787 and just the degree to which you feel you have all of the, I guess, rework that needs to be done, understood and in hand and that your suppliers do as well. And then following up a little bit more on the quantitative side in terms of thinking about where revenue is going for you guys when the rate came down by two aircraft per month in late 2019 in Q3 and then again in Q4 that was driving charges for Spirit of \$34 million, \$35 million. Is there anything we can read into the size of the \$40 million to \$60 million charge coming in Q3 with regard to where your production is going to go starting in the second half year?

Thomas C. Gentile III

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

A

Okay. Thanks. So, with regard to 787, well, what I would say is we have been working very hard in conjunction with Boeing to review all aspects of the production process to understand what issues might be there. And echoing what Dave Calhoun said on the Boeing earnings call, the latest issue isn't an example of Boeing being hard on Spirit or the FAA being hard on Spirit. It's a question of Spirit being hard on Spirit.

We took a very hard look at all of our production processes and we did identify an issue with a part in the forward fuselage that comes from one of our suppliers. And as a result of that, we've done some additional work and identified some rework which we will be completing. And that's what really drove most of the forward loss in this quarter.

And so, have we gotten everything? We've looked at it very hard. We've scrubbed it very hard. So we're confident that the issues that we know about we are addressing. And we will continue to look at it and work closely with Boeing. We do have a good handle in terms of the fixes required. We outlined some fixes in the last quarter. Those are underway. In fact, the repairs and the rework are more than half finished on the ones that were previously identified.

On the new issue, we do have a repair. The engineering analysis did not show that it was a safety of flight issue. So we don't know that there's going to be anything required on the fleet, although we'll continue to do analysis and that might require more inspections in the future. But there is rework required on the units that Boeing hasn't shipped and that's what we are in the process of doing. But we have the repair, we have delivered the first units and the rework has begun.

Now with regard to the rate outlook, the subsequent event was really a result of getting a new indication of program demand from Boeing and looking out over the next several years to see what impact it could have on our position. As you know, we're in a forward loss and our accounting block goes all the way up to line unit 1405. So we're taking into account a very long period of time.

And I have to say that the situation is extremely dynamic. We have information that we're learning more every day. And the situation is likely to change and we'll respond accordingly. But we didn't want to give an indication of

a subsequent event because the program demand is changing, as we all know. And over the next three months, as we get more information and we do more analysis, we'll have an update in terms of what the actual impact is.

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Okay. Thanks very much, Tom.

Thomas C. Gentile III

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

Thanks.

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

Myles Walton

Analyst, UBS Securities LLC

Thanks. Maybe I'll just follow-up on that. You've taken about \$100 million forward loss charges between this quarter and next quarter on the 787. How much of that is cash you're absorbing in the guidance for this year versus future years? I don't know who wants to take that one.

Mark J. Suchinski

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

Hey. Good morning, Myles. As we indicated, we took a \$29 million forward loss on 787 in the first quarter. We identified some issues that we're going to require some rework in our factory and help supporting Boeing. And then Tom just described the situation that occurred here in the second quarter, the additional \$49 million.

We expect that – as you factor in the impacts of lower production rates, a portion of the costs are cash and noncash in nature. We don't – I would say the majority of the cash should be expended this year, the cash component of it. I do think that some of that cash consumption and the continued rework will continue into 2022, as Boeing indicated on their call, and they expect to deliver about one-half of the units that they have stored here in 2021.

And so, the rework that we have to do, we have to coordinate with Boeing, get access to the airplanes. And so it's hard for me to be specific because it's a long and involved process where we work with Boeing, we get access to the airplane, we have to have our mechanics do the work, get the parts in there. But I would anticipate the rework costs that we have, knowing that about half of those aircraft will be delivered next year, we'll be incurring that cash impact both in 2021 and 2022. I wouldn't quite say it's 50/50. It's probably more heavily weighted to 2021. But there will be some cash headwinds in 2022 as we continue to rework those airplanes to allow Boeing to deliver to their airline customers.

Myles Walton

Analyst, UBS Securities LLC

Okay. And Tom, you mentioned the liquidation of about 80 MAX inventory in 2022. I guess, that would imply you producing, I don't know, just under 300 MAXs next year maybe. Is that going to swing materially based on the Boeing production schedule or is the idea you definitely want to get liquidated and so your production will be kind of a swing item?

Thomas C. Gentile III

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

A

No it will definitely depend on Boeing's production and we'll coordinate closely with them. And the current plan in terms of the buffer is based on outlook and scenarios that we've discussed with Boeing, but that could change. For example, Boeing has indicated that China's recertification of the MAX will likely influence their future production schedule. So, that'll be one of the factors that we continue to monitor closely.

Myles Walton

Analyst, UBS Securities LLC

Q

Okay. Thanks, again.

Operator: Our next question will come 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

Morning.

Mark J. Suchinski

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

A

Morning, David.

David Strauss

Analyst, Barclays Capital, Inc.

Q

I think a question for Mark. Mark, can – I guess is the guidance for 2022 still a return to positive free cash flow? And if so, can you help us bridge that difference or that gap between the, call it, \$500 million to \$600 million ex the tax benefit that you're talking about burning this year? And are you still – what exactly are you assuming for working capital for this year and next? Thanks.

Mark J. Suchinski

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

A

Sure, David. Yeah, I mean we've communicated our goal and objectives. And based on the information that we have over the last couple of quarters that, on an operational basis, we think that we can get to cash flow positive. I think the – when you think about what are the tailwinds that will help us in 2022, obviously the number one component will be the increasing 737 MAX production rate. And I will tell you that that is the single biggest driver to the cash flow improvement in 2022.

And so we have some baseline assumptions on what the delivery rates are, but as you know here, Boeing is still working with China and have given indications that production rates above 31 are highly dependent on the China certification. So the number one priority for us or the number one factor is our assumptions on where the 737 MAX production rates are going to go in 2022, and Boeing does. We do have preliminary schedules but those can change over time.

The second item I would say is we'll continue to have some tailwind benefits on the working capital side. We've built up a lot of inventory. As you can see, this year we're doing a good job of working and destocking some of our inventory. But the amount of inventory days on hand that I expect us to have at the end of the year as well as what we're turning our inventory is nowhere close to our historical levels. So we should continue to receive working capital benefits, particularly on the inventory side.

There'll be some headwinds on the AR side just as the revenues increase. But I would say that those are the two biggest components. It's the 737 MAX. Obviously, Airbus is talking about significantly higher production rates next year on the A320. That will be a nice contributor for us as well. And less rework on the 787, we should see less cash consumption on that. And those are the major drivers. But we have a bunch of other initiatives that we're working behind the scenes to go drive cash flow improvement. But I would say that the majority of the improvement, as we're going to see between 2021 and 2022, is tied specifically to narrowbody production rate increases and the continued destocking of inventory, which gives us a really good chance to get to operational cash flow in 2022.

David Strauss

Analyst, Barclays Capital, Inc.

And Mark, does that include the \$120 million or so advance you have to pay back to Boeing on the MAX in 2022 in terms of thinking about positive free cash flow?

Mark J. Suchinski

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

Well, I really view that as a onetime isolated repayment that is tied to an agreement that we had with Boeing back in 2019. Obviously, that's a big headwind that we want to overcome as well. But my primary goal is working with our teams to get to a point where operationally income-wise we're generating positive cash flow in 2022.

David Strauss

Analyst, Barclays Capital, Inc.

Okay. Thanks very much.

Operator: Our next question will come from Doug Harned with Bernstein. Please go ahead.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Good morning. Thank you.

Thomas C. Gentile III

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

Good morning, Doug.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Getting back to – you mentioned the – Mark, you mentioned the Airbus rate. I mean, they were very firm last week on their plans to ramp to 64 aircraft a month on the single-aisle by Q2 2023. We've heard skepticism from a number of suppliers on that rate increase. How do you view this? They talked about a linear ramp to that point. I

mean, are you set, including your lower tier suppliers, to execute on this? And then what happens if the demand environment should deteriorate and rates don't go on that trend line? How do you respond to that?

Thomas C. Gentile III

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

A

Right. So the first answer is, yes, we are set. We've been working very closely with our suppliers to meet the demand scenarios that Airbus has shared with us. I give a lot of credit to the Airbus leadership team, including Guillaume and all of his key lieutenants. They've met with the suppliers and they've taken us through their assumptions and all the actions that they're taking to confirm what the rate increases are.

And as they indicated on their call last week, if you look at their backlog and how long it is at different production rates and how long airlines would have to wait for their units, the production rate increases would be justified. So, on that basis, they've shared with us their scenarios and we are working to those and we're working with our sub-tier suppliers to those rates as well. Now, if it changes, then of course we'll take the appropriate action.

But the good news is we've been at these levels before. So, all the infrastructure is in place, all the capital is in place, all the tooling is in place. And we've had all the workers hired and trained. Now, some of those have been furloughed, but they remain available. And as the rates go up, we will be recalling them. And so we're confident that we're going to be able to execute on those. And if they change, we're confident also that we'll have sufficient lead time that we can take the appropriate actions. But we're ready and our sub-tier supplier base is ready as well.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Q

And then just related to that, on the A350, I mean you had taken rate to three aircraft a month and our understanding was that Airbus continues to produce at five aircraft a month and that you'd delivered more fuselages than they could run through final assembly when they cut their rates. And they are now planning for a raise to six aircraft a month. What do you see is the trajectory for your production rate on the A350?

Thomas C. Gentile III

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

A

Again, we mirror them pretty closely. The sections that we make for the A350 are the center fuselage section which they call Section 15 and also the fixed leading edge on the wing. And so, as their production rates go up, we'll go up. I mean there's sometimes some inventory adjustments that go on, but on the A350, we're usually pretty closely aligned. I mean we'll carry a few units in surplus to act as a buffer for the production system. But generally speaking, we're very much aligned to them. And so we don't see ourselves getting far off. It's very close. And our performance and delivery performance this year is quite good. They're pleased with it. And so, I don't see a disconnect there. We'll go up with rate as they go up with rate on the A350 and we'll be very closely aligned.

Douglas S. Harned

Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Very good. Thank you.

Thomas C. Gentile III

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

A

Yeah. Thanks.

Operator: Our next question will come from Robert Spingarn with Credit Suisse. Please go ahead.

Robert Spingarn

Analyst, Credit Suisse Securities (USA) LLC

Hi. Good morning. Tom, I just have a few clarification questions.

Q

Thomas C. Gentile III

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

Okay.

A

Robert Spingarn

Analyst, Credit Suisse Securities (USA) LLC

First, did A320 shipset delivery drop from Q1 to Q2?

Q

Thomas C. Gentile III

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

It did.

A

Mark J. Suchinski

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

It did, yeah.

A

Thomas C. Gentile III

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

We had in Q1 130 deliveries and in Q2 96, and Airbus had in Q2 132 units. So, if you look at it, there was a little bit of destocking going on, inventory adjustments post Brexit. Nothing from our standpoint to be concerned about. Our rate remained the same. It didn't change. It's just they pulled a few fewer units just because they're probably adjusting their inventory levels. So, yes, that was what happened. But as we mentioned, we were up significantly from Q2 in 2020. We only delivered 69 units then. So...

A

Robert Spingarn

Analyst, Credit Suisse Securities (USA) LLC

Do you think you're aligned now or does this play out over another quarter or two?

Q

Thomas C. Gentile III

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

No, I think we're much more in alignment now. So we don't expect to see that kind of deviation going forward. I think it was an aberration in the quarter.

A

Robert Spingarn

Analyst, Credit Suisse Securities (USA) LLC

Okay. Okay. And then just going back to the 787, and I think you said you're still evaluating whether or not the existing fleet needs to be addressed. It sounds like that's a process you're going through with Boeing. I'm still wondering do these conditions exist. Has this been part of the production process the entire time or was there a change where this supplier is doing something differently? Because I would imagine with 1,000 aircraft out there in the fleet, if you have to go there, this is a significantly more expensive problem.

Q

Thomas C. Gentile III

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

A

Right. Well, the answer is, the production process hasn't changed. It was basically the same right from the beginning. It was just we're taking a harder look at it now and putting it under more scrutiny. The analysis showed that there was not a safety of flight issue in the fleet. And so, there's no immediate action required.

Now, we'll continue to do engineering analysis. That could continue to evolve. But right now, there is none. And so we don't have any determination in terms of what the fleet disposition will be. But at this point, because it's not a safety of flight issue, we're looking at more inspections. But because there is a non-conformity, new aircraft can't be delivered if there's a no non-conformity. And so, that's why there's rework required on the aircraft that are not delivered. And I think as Boeing mentioned, there's about 100 787 units that are not delivered right now. And so, that's where we're focusing our rework efforts.

Robert Spingarn

Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. And then just if you do have to take care of some aircraft that are already delivered, is that the kind of thing that can be done in a heavy check or would they have to have a special service call?

Thomas C. Gentile III

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

A

Right. Those would be done in the normal scheduled heavy checks.

Robert Spingarn

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thank you.

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

Hunter Keay

Analyst, Wolfe Research LLC

Q

Hi. Good morning. Hi, everybody.

Thomas C. Gentile III

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

A

Morning.

Hunter Keay

Analyst, Wolfe Research LLC

Q

Thank you. Just a couple from me. You mentioned eVTOL. I was wondering if you could expand on the opportunities there. And you mentioned some revenue, kind of curious where that's coming from, which program. And then second question is, can you give us a rough breakdown of the 54 biz jet and RJs in the quarter and how you expect that to trend over the next 18, 24 months? Thank you.

Samantha J. Marnick

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

A

Yeah. Hi, Hunter. This is Sam. So I'll take the question about eVTOL and what we're doing there. So we're talking with a number of the players in the market. And the kind of work that we're doing with the players right now, and these are yet to be announced agreements and work with those different companies, is generally around – I've got few different areas, but I would say specifically technical consulting services, so engineering services, things like that, but also looking forward to industrialization plans as well. So those are the areas that we're focusing on.

Could you repeat your second question, Hunter?

Hunter Keay

Analyst, Wolfe Research LLC

Yeah. Thanks, Sam. It was about the 54 biz jet and RJ shipments in the quarter. I wonder if you can give us any color on the breakdown there and kind of how you expect that to...

Thomas C. Gentile III

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

Well, let me jump on that one. So we don't break down specifically the business jet deliveries just at the request of the OEMs. But really the increase is driven by the fact that we now have the Bombardier assets. And so, the Challenger and the Global Express are now in these numbers where they, say, were not before. And actually, in this quarter, there might be one layer, the final last layer that snuck in there as well.

Samantha J. Marnick

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

Right.

Thomas C. Gentile III

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

But other than that, we don't break that down into more detail.

Hunter Keay

Analyst, Wolfe Research LLC

Okay. Thank you, Tom and Sam.

Thomas C. Gentile III

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

Thanks.

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

Cai von Rumohr

Analyst, Cowen and Company, LLC

Yes. Thanks so much. So you characterized the 787 rate change as a subsequent event. How much of the \$40 million to \$60 million applies to this year, given that they basically have cut their rate until they get this problem done? And how much of this is in the guide? And do you expect to recover any of the costs if the one supplier had a part that's causing you the heartburn? I mean, are they going to be able to reimburse you for any of that?

Thomas C. Gentile III

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

A

Right. So I'll take that one, Cai. First of all, most of the forward loss would be associated with future years, not necessarily this year, because our block goes out to line unit 1405 and at current production rates that takes us out to 2025. So, not much of it is related to this year. It's just the way the numbers work. But, again, it's a dynamic situation. It's going to change. And so we'll learn more over the course of the next quarter and we'll give more firm indications of what the impact will be.

With regard to supplier recoveries, we've taken into account everything with our current forward losses that we have announced. We're focused right now primarily on the operational recovery. And there'll be future commercial requirements. But we have had discussions with the supplier and they're certainly cooperating. They're working very hard and coordinating with us. And they'll share in the commercial situation as well, but we've taken into account all of that with the current forward loss.

Cai von Rumohr

Analyst, Cowen and Company, LLC

Q

And then you mentioned kind of the overhead absorption issue. Given that Boeing is basically cutting back their production near-term below five aircraft a month, is that going to have any noticeable impact on this year, or at least how much is it in terms of cash this year?

Thomas C. Gentile III

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

A

It's going to create a little bit of a headwind. But as we've indicated, we're holding to the guidance we gave, which is we'll have a cash usage of \$200 million to \$300 million net of a cash tax benefit. So, yeah, it's some headwind but we're actually doing better in some of our working capital initiatives to help offset it as well as some of our cost management initiatives. So we're holding to the guidance that we gave earlier.

Cai von Rumohr

Analyst, Cowen and Company, LLC

Q

Thank you.

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

George David Shapiro

Analyst, Shapiro Research LLC

Q

Yes. Mark, I wanted to ask, if I look at the implied underlying margins in, like, fuselage and wings, sequentially they're actually down despite higher revenues. And I'm just wondering what's driving that deterioration. And I'm taking out all of the onetime things that you talk about.

Mark J. Suchinski

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

A

Well, we probably need to compare notes here, George, because some of our internal looks at – I'm seeing slight sequential improvements from the first quarter to the second quarter, not as much as I would like to see, but the analysis that I have here indicates sequential improvement first quarter to second quarter in all of the segments, fuselage, propulsion and wing.

George David Shapiro*Analyst, Shapiro Research LLC*

Q

My numbers are taking out the pre-tax losses, taking out the cum adjustments, taking out the restructuring and abnormal costs, excess capacity, so I'm taking everything out and I have, like, fuselage going from 8.8% to 8% and wings going from 6.9% to 3.8%. I have Propulsion going up. So maybe I'll check with Ryan or Aaron and we can compare the notes that way then, because you're saying you've done the same analysis and you're seeing the margin up slightly.

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

A

Exactly. Yeah. We're seeing in fuselage somewhere between 100 and 200 basis points improvements in our margins and that's what we're expecting. We'll see, as in narrowbodies, our rates pick up here in the third and fourth quarter, continued focus on our costs and our productivity, and that should continue to allow us sequential improvements in our op margins.

George David Shapiro*Analyst, Shapiro Research LLC*

Q

Okay. I'll check afterwards with Ryan. And then one other quick one. It looked like maybe a \$20 million benefit from Belfast pension income in the quarter where you had this surprisingly large other income. Is that something that continues here or what's actually driving it?

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

A

Yeah. Good question, George. Based on the current market conditions and the actuarial assumptions, we are seeing some tailwinds on pension income as it relates to, I guess, what we'll call the Bombardier or Belfast Shorts pension plan. And so, that's a noncash benefit that's rolling through other income. It's completely tied to market conditions, the interest rates, the valuation of the assets and liabilities. And so, that's a bit of a tailwind. I think we'll continue to see those benefits in the third and fourth quarter as long as market conditions hold.

With the inflation increasing, it's obviously a very dynamic calculation when you try to factor in where your assets and liabilities are going to go. Just from a clarity standpoint, we are in a deficit position on that program. But based on current market conditions, you are seeing some lift in other income and I expect that to continue in the third quarter.

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

A

Yeah. I think the other important point is that, as Sam just mentioned, on that pension program, we have closed it to new entrants and to new accruals in terms of the defined benefit portion of it, and it's going to be replaced with a defined contribution plan. And that will all be complete by the end of the year.

George David Shapiro*Analyst, Shapiro Research LLC*

Q

Yeah. And that's why, Tom, I was asking whether that income continues? I guess, it continues the rest of this year and then it goes away next year with the program or no?

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

A

That right, George. Right. Once we do the formal close-out, we'll have to do a curtailment assessment for accounting purposes. That could be positive or negative. That'll be noncash. But as we move into 2022, the Belfast site will be on a more traditional plan, consistent with Prestwick and our US sites.

George David Shapiro*Analyst, Shapiro Research LLC*

Q

Okay. Thanks very much.

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

A

Thanks.

Operator: The next question will come from Kristine Liwag with Morgan Stanley. Please go ahead.

Kristine Tan Liwag*Analyst, Morgan Stanley & Co. LLC*

Q

Hey. Good morning, guys. On the 787, can you give more details on exactly what the rework entails? Do you have to take it apart? Do you manufacture pieces? And how involved is the testing and rework and how long does it take?

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

A

Right. Well, the rework involves essentially replacing a part. And so, Boeing and FAA will decide on the final fix and then we'll support it as necessary and do the rework. But we've already defined what the fix is in terms of being able to provide a replacement part. And the rework – again, these things always evolve. So it starts off – it might take 8 or 10 days to do the first one and then it gets progressively smaller as the team gets more experienced going forward. But that's the current situation. We've already started it. We've already completed the first few units and we're starting to get down the learning curve as we speak.

Kristine Tan Liwag*Analyst, Morgan Stanley & Co. LLC*

Q

I see. And a follow-up on the 787 too. Since the program is at a unit cash loss, are you better off with fewer units so you're losing less cash? Or does not having economies of scale hurt you more?

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

A

It's the former. It isn't a cash loss position. So the fewer units we deliver for Spirit that means our cash is better.

Kristine Tan Liwag*Analyst, Morgan Stanley & Co. LLC*

Q

Great. Thank you.

Operator: Our next question will come from Noah Poponak with Goldman Sachs. Please go ahead.

Noah Poponak

Analyst, Goldman Sachs & Co. LLC

Hey. Good morning, everybody.

Q

Thomas C. Gentile III

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

Good morning.

A

Mark J. Suchinski

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

Morning.

A

Noah Poponak

Analyst, Goldman Sachs & Co. LLC

Tom, so I just wanted to try to ask you with everything you know and everything you've discussed on 787. If you're willing to make an estimate as to approximately when you're far enough along and rework is done, such that deliveries can resume?

Q

Thomas C. Gentile III

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

Well, I won't be able to give you that information. I mean, really Boeing is going to make that determination probably in conjunction with the FAA. We're focused really on the rework that we do, and then Boeing will take that into account to determine when the deliveries will begin. But as I said, we've identified our fix and we have started to perform that rework. And I think Boeing would be able to give you the best indication about when the deliveries will actually resume.

A

Noah Poponak

Analyst, Goldman Sachs & Co. LLC

Okay. And then, Mark or Samantha, you mentioned in the discussion of next year's cash flow, Mark, I think the wording you used was initiatives behind the scenes. That sounded new. Are those new things you're working in your operational drumbeat? And if so, could you maybe detail what you found or what you're working on there?

Q

Mark J. Suchinski

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

Oh, no, there really – maybe I gave the impression that these are some new ideas that we've come up. I can tell you, we have a very strong operational cadence. We have four or five different specific cost reduction efforts around the Boeing programs, the Airbus programs, our organization, our infrastructure, along with supply chain and some of our growth initiatives.

A

The only point I'm making is, behind the scenes here, we're doing I think a really good job of managing our costs and we're working across all of our businesses as it relates to how do we optimize, improve productivity, lean. Tom has talked before about the variety of automation and digital-type projects that we have. All of those things are being worked behind the scenes. And I truly believe as we move back up in rate, we're going to be more cost-competitive or more cost-efficient than we were previous to the higher rate breaks. And so, all of that should contribute to an improvement in our cash generation as compared to where we were before.

Noah Poponak*Analyst, Goldman Sachs & Co. LLC*

Okay. Thanks very much.

Q

Operator: Our next question comes from Michael Ciarmoli with SunTrust. Please go ahead.**Michael Ciarmoli***Analyst, Truist Securities, Inc.*

Yeah. Hey. Thanks for taking the question, guys.

Q

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

Hello, Mike.

A

Michael Ciarmoli*Analyst, Truist Securities, Inc.*

Just as it relates to – how are you? As it relates to the 787, you talked about the overhead absorption. How do we think about the excess capacity costs? I think you were targeting to maybe reduce that by 30% last year. Does that become a little bit more challenging, just given the lower rates and kind of how you're going to have to manage this program?

Q

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

It puts a little bit more pressure on our overall cost structure here, more specifically in Wichita. But just for the sake of clarity, our excess capacity costs are really tied to what I'll call really kind of three specific areas. It's the 737 MAX program because we're expecting to get back to 52 aircrafts per month. It's our A320 program because we have a line of sight to go back up to, hopefully, 60 aircraft a month on the A320 program. And then the expectations are from our customer on the A320 wing program that we will be producing at much higher rates in the future.

A

And so, those are the three programs that really generate the excess costs and the \$47 million that we reported in the second quarter here. I will tell you, as we go up in rate and we continue to manage our costs, you're seeing improvement in that excess cost. In the first quarter, we incurred \$67 million worth of costs, and it's \$20 million lower here in the second quarter. And that's a combination of higher production rates as well as our continued efforts on making our costs better aligned with our current production rates.

Michael Ciarmoli*Analyst, Truist Securities, Inc.*

Could it step down in the second half just on the narrowbody volume increases?

Q

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

Yes. Exactly. We'll see lower excess costs in the back half of the year and I would expect significantly lower cost in 2022.

A

Michael Ciarmoli*Analyst, Truist Securities, Inc.*

Q

Perfect. And just for clarification, the part in question on the 787, is that your design? Is it a build-to-print? Or does the supplier own the design on that part?

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

A

Spirit has design authority on the part, but it was actually designed before Spirit existed.

Michael Ciarmoli*Analyst, Truist Securities, Inc.*

Q

Okay. Helpful. Thanks a lot, guys.

Operator: Our last question will come from Peter Arment with Baird. Please go ahead.

Peter J. Arment*Analyst, Baird Equity Research*

Q

Yes. Good afternoon, Tom, Mark. Thanks for squeezing me in. Question just, Mark, on CapEx. Question just regarding whether you see that start to trend back up as we get into 2022? I know you'd been previously running at around 3% or 4% of sales. Is that still a good level to think about? Or are you getting some efficiencies on just your CapEx spending? Thanks a lot.

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

A

Thanks, Peter. Specific to CapEx, and I think we've talked about this on a few earlier calls, over the last couple of years, as production rates have climbed essentially across all of our platforms, that's required significant capital investment from a tooling, from an infrastructure. A lot of the capital that we expended are on highly automated programs like the A350 and the 787.

And so, the real benefits that we're seeing – we are managing our CapEx tightly in these very challenging times. But as we move forward into 2022 and 2023, as production volumes come back up, we are not going to have to spend and invest the type of capital, CapEx that we have historically. It'll be our normal maintenance CapEx and some CapEx that go support our diversification efforts as we win organic work on the defense on the aftermarket side. There'll be some capital that'll be required to that.

But really I'm expecting in 2022 maybe a tick up higher than where we are now. But we've indicated we're looking at around \$150 million of CapEx this year. And so, over the next couple of years, we're going to keep a very tight leash around the CapEx, mainly because the business isn't requiring it. And so, what you're seeing now I think over the next couple of years will be fairly consistent and that will also help us as we think about what our cash flow generation is going to be in 2022 and 2023.

Peter J. Arment*Analyst, Baird Equity Research*

Q

Appreciate it. Thanks, Mark.

Mark J. Suchinski

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

A

Thank you.

Operator: Ladies and gentlemen, this will conclude our question-and-answer session. And now the conference has concluded. Thank you for attending today's presentation. You may now disconnect.

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