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Spirit AeroSystems Holdings, Inc. (SPR)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Spirit AeroSystems Holdings, Incorporated's Fourth Quarter and Full Year 2020 Earnings Conference Call. My name is Matt and I'll be your coordinator today. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

I would like to turn the presentation over to Aaron Hunt, Director of Investor Relations. Please proceed.

Aaron Hunt

Senior Leader, Sales and Marketing, Spirit AeroSystems Holdings, Inc.

Thank you, Matt, and good morning, everyone. Welcome to Spirit's fourth quarter and full year 2020 earnings call. I'm Aaron Hunt, Director of Investor Relations. 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 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 our presentation.

In addition, we refer you to our earnings release and the presentation for disclosures and reconciliation of non-GAAP measures we use when discussing our results. As a reminder, you can follow today's broadcast and slide presentation on our website at investor.spiritaero.com.

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

Thomas C. Gentile

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

Thank you, Aaron, and good morning, everyone. Welcome to Spirit's fourth quarter and full year 2020 results call. 2020 was one of the most challenging years in aviation history. For Spirit, The MAX grounding and the COVID-19 pandemic created a dual crisis. Our response focused on five critical actions: protecting our employees, restructuring our cost base, strengthening our liquidity, implementing productivity and efficiency projects and diversifying our business.

Protecting employees from COVID became a top priority. COVID represented an unprecedented health care challenge. And as the virus began to spread, we put in place protocols to protect our employees. We referenced best practices and CDC guidance to implement enhanced cleaning measures, air purification, social distancing, mask requirements and extensive testing. All of these measures have allowed us to continue our operations while protecting employees.

We also restructured our cost base to align to lower levels of production. Almost immediately in 2020, we started with the need to react to multiple production rate reductions due to the 737 MAX grounding and then the COVID-19 pandemic impact. After producing 606 MAX shipsets in 2019, we produced just 71 in 2020. We also saw substantial reductions in the production rates of all of our other Boeing and Airbus programs. We moved swiftly to take actions to mitigate the impact of these adjustments to our original plans.

Consequently, through the restructuring of our cost base, we reduced our commercial aviation program head count by more than 8,000 people, trimmed our purchase services and set in motion multiple facility closures as we addressed these significantly lower production rates. Overall, we executed $1 billion of annualized cost reductions or about 40% from the 2019 nonmaterial base.

We also strengthened our liquidity position and, as a result, established a solid foundation to see us through these difficult times. Our initial actions included reducing the cash dividend to a $0.01 per share, suspending the share repurchase program and deferring $120 million of capital expenditures. Boeing also provided a $225 million cash advance and granted a deferral of $123 million repayment until 2022.

In April, we raised $1.2 billion of senior secured second lien notes and paid down our $800 million revolver, which put us at $1.9 billion by the end of Q2. In the last half of the year, we paid down $426 million on our term loan and completed another $900 million capital raise. After negotiating a $225 million discount on the Bombardier asset acquisition, mutually terminating the ASCO acquisition and reducing our cash usage in the third and fourth quarter, we ended 2020 with a $1.9 billion in cash on hand.

The third focus area was productivity. While challenging, the reduced production rates created an unprecedented opportunity to accelerate productivity and efficiency projects that would have been nearly impossible at higher production rates. During 2020, we completed the consolidation of warehouse space across our Wichita campus into our Global Digital Logistics Center and consolidated more than 500,000 square feet of warehouse space into a 7-storey 150,000 square foot facility.

In this new facility, we have leveraged technology similar to what other world-class distribution centers use, which translates into a more accurate and timely part handling and delivery system to the mechanics building product on our factory floor.

On the 737 MAX, we have a new 10-station hybrid, automated assembly line for floor beams. A MAX 8 has 47 floor beams with more than 400 different configurations. This new assembly line will improve quality and our ability to manage all of these configurations. It will be operational by the end of this quarter.

At our Prestwick facility, we have implemented a new state-of-the-art Resin Transfer Molding technology for A320 spoiler production. The team is making good progress on the development of the production line that will efficiently produce hundreds of spoilers per month at peak rate. The most immediate efforts are focused on completing the first part qualification process; then, once that's complete, moving toward production at rate by the end of the first quarter.

Additionally, we have accelerated our company digitalization efforts. Last year, we implemented a Manufacturing Execution System, or MES, on the 737 MAX fuselage line. The system is a digital tool to track data and production metrics, which simplifies many of the reporting activities performed by managers.

As a complement to the MES, we have put in place digital manufacturing operating system boards to give our managers visibility into real-time production process and facilitate discussions in daily meetings. We have also implemented digital workflow solutions to manage part movements across our main Wichita factories.

Another recent change we have started is the deployment of Digital Work Instructions. We have transitioned from a manual, text-heavy set of documents to new Digital Work Instructions that provide graphics, pictures and detailed instructions tied to 3D digital models for our mechanics and inspectors. From implementing integrated tools for operations management to visualization of the fabrication and assembly process, our digitization projects underway are expected to reduce the time needed to build product and enhance quality for our customers.

Another significant project has been improving the production flow in our main 737 MAX factory. We have freed up over 125,000 square feet of manufacturing space in the fuselage factory by shifting subassemblies to new locations. For example, we moved the fabrication of the MAX forward fuselage to a new facility on our campus, where we also build the forward fuselage for the 767. We're also shifting the construction of the MAX wingbox out of the main MAX factory to our Tulsa site.

These moves are enabling a simplified 737 fuselage production flow. Previously, the movement of parts and subassemblies crisscrossed the factory and sometimes the same part traveled a similar path multiple times before moving to the end of the line. The new production flow reduces a number of moves needed, drives a more efficient use of time and improves productivity and quality.

We are also working closely with many of our partners in the supply chain to help them navigate this challenging time in the industry. In the last 12 months, we have provided assistance to hundreds of suppliers. This support includes contract extensions, purchases of finished goods and raw materials, and vendor financing through our partner, Bank of America. Recently, Bank of America secured a guarantee from the US Export-Import Bank, EXIM, to help finance this program. Our suppliers are critical partners to our success. And this level of support is important as we work to secure our supply chain as production rates recover over the next few years.

We are also putting additional emphasis on environment, sustainability and governance, also known as ESG. An additional improvement we implemented last year was to put an agreement in place to power our entire 12.8 million square foot Wichita site with 100% wind power. In addition, water recycling is another area where we have integrated systems and adopted practices to minimize water consumption and improve water efficiency. With our reverse osmosis system, Spirit Wichita recycles more than 2 million gallons of highly purified water each day and recycles 575 million gallons annually, which has enabled us to reduce our freshwater demand by more than 70%.

At our Spirit Belfast site, we have one of the largest roof-mounted solar arrays in the region. In 2020, 70% of the Belfast plant's electricity came from clean energy. At our Prestwick site, where we've just built a new Aerospace Innovation Center, the team installed a second bank of solar arrays to supplement an existing bank at our Prestwick finishing center. 100% of the power consumed on our Prestwick site is from solar or wind power.

Having worked to stabilize the business in 2020, we are also focused on positioning Spirit for the long term. On page 5 of the presentation, we have summarized Spirit's strategy. Our vision is to be a diversified design and manufacturing champion. In terms of where we want to compete, our strategic priorities are to focus on Boeing, Airbus, defense, aftermarket, business in regional jets, and non-aerospace manufacturing where our skills and capabilities translate.

In terms of how we want to compete, our execution requirements focused on make/buy, an advantaged supply chain, world-class manufacturing, seven distinctive technologies, digitization, and talent and inclusion. At Spirit, our DNA has always included a strong emphasis on safety, quality, customer focus and delivery. We augment these basic elements of our DNA with our values: transparency, collaboration and inspiration, with an encouragement to our employees to speak out. Overall, our objectives are to diversify, delever and drive improved margins.

Let's look at how we've been diversifying Spirit. During the past year, we made excellent progress on our diversification strategy with the acquisition of the Belfast Morocco and Dallas sites from Bombardier, and the acquisition of FMI, a leader in high-temperature materials. After closing the deal with Bombardier last October, our integration team quickly started working with our new team members and created a list of 450 integration tasks, ranging from rationalization of our facility footprint to systems integration to ensure a smooth transition.

Since the October close, they have completed around 65% of the tasks. By the end of the first quarter, we expect to be 75% complete. We have in the room with us today our COO, Sam Marnick, who is leading this overall integration. If you have questions on the integration later, she will be able to answer them.

The acquisition of the Bombardier assets accelerates our diversification. The addition of the A220 wing, which leverages composite resin transfer infusion technology and is fully integrated with all systems and flight-control surfaces, position Spirit as one of Airbus' largest suppliers. With the experience gained on the A220 program, we believe Spirit has the competitive position for future narrow-body aircraft as we build knowledge and expertise on composite wing production.

The acquisition has also roughly doubled our aftermarket business and is very complementary to our current capability. Previously, Spirit worked on Boeing work in North America, and the Belfast site focused on Airbus work in Europe. Our merged team now gives us the opportunity to offer the combined aftermarket capabilities across more products and geographies. We believe we are in a good position to achieve our objective of $500 million in aftermarket revenue by 2025 at accretive margins.

In addition, Spirit's business jet work statement expanded by roughly 4 times with the acquisition and we have become one of the largest suppliers to Bombardier. From the midsize to very large business jet categories, our capability and scale as a business jet supplier can provide great value to the manufacturers in this segment of the industry. Our belief is that business jets are likely to recover sooner than commercial aviation following the pandemic. Our objective is to have the business and regional jet work achieve $500 million of revenue by 2023, also at accretive margins.

The Bombardier acquisition has also resulted in a stronger defense business, which we had not previously expected. Our Belfast team recently was selected by the UK to lead Project Mosquito in the prototype design and manufacture of the UK's first unmanned combat aircraft, which is also referred to as a Loyal Wingman. The three-year $41 million deal to develop the aircraft highlights the significant capabilities our new Spirit Belfast colleagues bring to military production.

Overall, we expect that the Bombardier assets will have about $700 million of revenue in 2021 and expect the purchased business to grow at approximately 15% annually with future margins north of 10%. And in the future, the assets of what we have purchased will be included within our existing segments. For this year, it will be wing at about 43%, fuselage at about 28% and propulsion at 29%. The addition of the skilled and experienced team members in Belfast, Morocco and Dallas will position Spirit well for many years of potential growth.

While the Bombardier asset acquisition was our largest, the FMI acquisition, which we completed last January, has opened new opportunities for our defense business. The integration of FMI is complete and we're very pleased with the response we have received from customers. The combination of FMI's high-temperature composite capability with Spirit's industrialization expertise has expanded the products and capabilities to current and potential customers. We now have a very robust pipeline of opportunities, especially in hypersonic weapons.

Most recently, NASA selected FMI to provide thermal protection systems to support several emerging space missions under the Science Mission Directorate. We are thrilled to be selected to support NASA and contribute to the future of deep space exploration. FMI has been a great addition to the Spirit family, contributing to our 20% defense growth in 2020 and projected 15% growth in 2021.

If we look at the programs of record for the programs that we are on, they would generate future defense sales of approximately $6 billion. Our overall defense capabilities, along with our open commercial capacity, will be important elements in our plan to grow our defense business to $1 billion of revenue by the mid-2020s with typical defense margins.

On page 7, we have summarized our revenue split over three years so that you can see the expected benefits of our efforts to diversify Spirit. In 2019, Boeing commercial represented 74% of our revenue. In 2021, we expect Boeing commercial will account for 44% of revenue based on current production rate plans. We expect that in 2021, Airbus will account for 23%, defense for 18% and aftermarket and business jets will each represent about 8% of revenue. Emerging from this crisis, we believe Spirit will be a more diversified company with several new and profitable revenue streams.

We are also focused on delevering. As we recover from the effects of recent challenges, we have begun to work on our current debt level and plan to pay down $1 billion over the next three years. We have started the process by redeeming the $300 million floating rate note, which was due in June of 2021, using cash from our balance sheet. We expect this process to be complete by tomorrow, February 24. From there, our net – next debt maturity is $300 million due in 2023. And by that point in time, we expect narrow-body production rates to be at much higher rates than they are today. Our next maturity after that is not until 2025. We remain committed to regaining an investment-grade credit rating.

Our third objective is to drive margins. As the vaccine rollout continues and air traffic begins to resume, domestic travel will recover first. We expect that this trend will favor single-aisle aircraft, such as the 737 MAX and the A320. They will be the first to recover as they perform the bulk of domestic flights. We believe Spirit will benefit from this trend, because 85% of our backlog is narrow-body aircraft. With all the productivity actions we have taken, we expect our margins will recover back to the historic levels of about 16% once the MAX production rate reaches the low-40s.

While the Bombardier acquisition will be slightly dilutive overall to this level, we still expect to achieve our historic targets in aggregate. Although we expect that international traffic will take longer to recover, which will put pressure on wide-body production, which typically serve those routes, we are actively repurposing our production capacity for wide-body composite aircraft to defense applications. This transition will replace the hours we have lost due to wide-body rate declines and should have a positive impact on margins in the future.

With that, I'll turn it over to Mark to continue through our detailed financial results and our expectations for 2021. 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 and staying healthy. As Tom mentioned in his opening remarks, Spirit, as well as the overall aviation industry, faced one of the most challenging years in aviation history. Throughout 2020, our teams responded by making significant adjustments to adapt our cost structure to lower production levels, putting in place productivity improvements, and working towards diversifying our business through M&A activity and growth in our defense business.

We also took several meaningful actions to strengthen our liquidity position. We began by reducing the cash dividend to a $0.01 per share, suspending the share repurchase program and deferring about $120 million of capital expenditures. We then negotiated with Boeing to receive a $225 million cash advance and defer $123 million repayment to 2022. Then in April, we raised $1.2 billion of senior secured second lien notes and paid down our $800 million revolver.

In the last half of the year, we paid off our term loan and terminated the existing senior credit facility, while concurrently completing a $900 million capital raise consisting of $500 million senior secured first lien notes and a new $400 million senior secured Term Loan B credit facility.

Additionally, we utilized the CARES Act and the UK deferral programs, which were made available in response to COVID-19. This allowed the deferral of $33 million in payroll taxes to 2021 and 2022 as well as the deferral of $32 million of VAT payments to 2022 and a $16 million benefit related to the employee retention credit. These actions have provided us with increased financial flexibility and liquidity and have enhanced our ability to address the potential longer and lower rates of production.

Given the 737 MAX returned to service in many parts of the world as well as the various measures taking place to address the pandemic, we are hopeful that 2021 will start the early stages of a multiyear recovery. Looking ahead to 2021 and beyond, we are focused on our long-term growth and diversification strategies, as Tom just discussed. Now, let's move to our 2020 results.

Please turn to slide 8, revenue for the year was $3.4 billion, down 57% from 2019. This reduction was primarily due to the lower production rate on the 737 MAX, resulting from the continued grounding of the program and the significant impacts of the COVID-19 pandemic. Production rates across all of our commercial programs were negatively impacted by COVID-19.

We delivered 71 737 shipsets during the year compared to 606 shipsets in 2019. Overall deliveries decreased to 920 shipsets compared to 1,791 shipsets in 2019. While commercial deliveries were down, our defense business grew by over 20% in 2020 and is helping with our overall diversification objective.

Let's now turn to earnings per share on slide 9. We reported earnings per share of negative $8.38 compared to positive $5.06 per share in 2019. Adjusted EPS was negative $5.72 per share compared to positive EPS of $5.54 per share in 2019. Adjusted EPS excludes the impacts of the acquisitions, restructuring costs, the non-cash voluntary retirement plan charges and the deferred tax asset valuation allowance.

2020 operating margins declined compared to 2019 as a result of costs incurred related to the low rate of MAX production, including excess capacity cost of $279 million, as well as lower production rates across all of our commercial programs due to the impacts of COVID.

We recognized forward loss charges of $370 million, primarily driven by lower future production rates announced on the 787 and A350 programs, and we incurred costs due to the COVID-related factory closures of $34 million. Additionally, we recognized restructuring expenses of $73 million for cost alignment and head count reductions to support lower production rates as well as a non-cash voluntary retirement program charge of $87 million.

During the fourth quarter of 2020, a valuation allowance on deferred income tax assets of $150 million was established. This non-cash valuation allowance was recorded based on the required accounting analysis to assess recoverability of our deferred tax assets against future taxable income. This is an accounting assessment, which places emphasis on our recent losses.

I want to remind everyone that this valuation allowance does not limit our ability to utilize deferred tax assets in future periods. It also does not change our outlook on future results and has no impact on cash flows or future tax returns. Once income generation returns, we can expect to see the allowance reverse resulting in an increase to reported earnings.

Now, turning to free cash flow on slide 10, free cash flow for the year was a use of $864 million, including the acquired Bombardier assets compared to a source of $691 million in 2019. The free cash flow usage of $864 million is in line with what we discussed in the third quarter earnings call of $800 million to $900 million for the full year, which excluded Bombardier.

This year-over-year decrease is primarily due to the negative impact of working capital requirements, significantly lower deliveries across all of our commercial programs and $73 million of restructuring costs, partially offset by $215 million received as a result of the February 2020 MOA with Boeing as well as some favorable cash tax.

As we discussed on the last quarter's call, we expected free cash flow use in the fourth quarter to be higher than in the third quarter. Cash flow usage in the fourth quarter was $181 million, primarily driven due to higher cash tax interest payments of $80 million on additional debt, the absence of some favorable timing on deliveries as well as cash outflow of about $50 million related to the Bombardier acquisition, which included onetime cash outflows of approximately $26 million for restructuring activity and $11 million related to equipment, lease buyouts at the purchased Bombardier sites.

Looking at cash from operations, if we exclude the interest paid on debt and the consolidated cash use of Bombardier, cash from operations improved $44 million from the third quarter to the fourth quarter of 2020. This reflects our continued improvement in our operating performance. As a reminder, our cash interest payments are more heavily weighted in the second and fourth quarters of the year. We expect cash interest to be $200 million in 2021.

Looking ahead into 2021, we expect our free cash flow to be negative, but significantly improved from 2020. In addition to the operating cash flow, we have a planned payment of approximately $135 million for the Bombardier pension, which we expect will be offset by cash tax benefits due to our operating losses recorded in 2020. As discussed in last quarter's call, we are expecting this cash tax benefit to be approximately $300 million as a result of the carry-backs permitted by the CARES Act.

We anticipate the first half of 2021 to be our most challenging with improvements as we progress into the later half of the year as single-aisle production rates increase, as projected. As we have previously indicated, we expect cash flow to be positive in 2022.

Let's now turn to our cash and debt balances on slide 9. We ended the fourth quarter with $1.9 billion of cash on hand and $3.9 billion of debt. The balances reflect the significant liquidity actions I previously described, including those taken during the last half of 2020, including the payoff of the $430 million term loan under the prior credit facility, a capital raise of $900 million in new senior secured debt, and the payment of $275 million for the Bombardier acquisition.

The new Term Loan B credit facility provides us with increased flexibility, as it has less restrictive terms than our previous credit facility, which we terminated during the back half of 2020. We believe this liquidity position and increased flexibility puts us in a good position to navigate future challenges within our industry.

Additionally, as Tom mentioned in his opening remarks, we have been assessing our cash and debt levels, and have made a plan to delever the company over the next few years. This delevering process will start by using cash on hand to redeem the $300 million floating rate notes, which mature this June. We expect the redemption to be completed on Wednesday, February 24. Lastly, as we have stated in the past, we remain committed to regaining an investment-grade credit rating in the future.

Now, let's turn to our segment performance on slide 12. Fuselage segment revenue in the year was $1.7 billion, down compared to 2019, primarily due to lower production volumes on the 737, 787 and A350 programs. Operating margin for the year was negative 26% compared to positive 11% in the prior year. This decrease was primarily a result of forward losses recognized on the 787 and A350 programs, lower profit recognized on the 737 program, including excess capacity costs of $175 million, and restructuring expenses of $41 million for cost alignment and head count reductions. The fuselage segment recorded $18 million of unfavorable cumulative catch-up adjustments and $274 million of net forward losses during the year.

Propulsion revenue in 2020 was $785 million, down compared to the previous year, primarily due to lower production volumes on the 737 and 777 programs. Operating margin for the quarter was negative 5% compared to positive 20% in 2019. The segment recorded $8 million of unfavorable cumulative catch-up adjustments and $37 million of net forward losses. The decrease in segment profitability and operating margin were primarily a result of lower margin recognized in the 737 program, including excess capacity costs of $61 million and the reduction in production rates on the 777 program.

And finally, wing revenue was $799 million, down compared to 2019, primarily due to lower production volumes on the 737, A320 and A350 programs. Operating margin for the quarter was negative 9% compared to a positive 14% in 2019. The segment recorded $59 million of net forward losses. The decreases in segment profitability and operating margin were primarily a result of forward losses recognized in the 787 and A350 programs, lower margin recognized in the 737 program, including excess capacity costs of $43 million.

I also want to discuss the purchase accounting treatment for the newly acquired Bombardier assets. This transaction, which requires us to apply business combination guidance under ASC 805, which resulted in an evaluation of the fair value of the underlying assets and liabilities that were acquired. We have completed our initial assessment and certain adjustments were required related to inventory; property, plant and equipment; intangibles, goodwill, liability balances, and forward loss liabilities. Per the business combination rules, the assessment will be completed within 12 months of the closure of the acquisition. The preliminary assessment resulted in goodwill of $487 million and intangibles of $188 million. The non-cash intangible expense will amortize on a straight-line basis of approximately $11 million per year.

Also as part of the opening balance sheet adjustments, we established a forward loss liability on the balance sheet of $282 million, primarily related to the A220 program, which had an impact on the goodwill balance. The establishment of the forward loss liability was impacted by the change in the A220 production schedule, which is primarily driven by the COVID-19 pandemic and the associated fixed overhead costs within the factories, the deterioration in the performance between the time the deal was announced and when it was closed as well as other factors. The liability represents anticipated losses for expected customer orders over the next three to five years.

Of the $282 million, approximately $56 million in non-cash was due to business combination guidance on the evaluation of the fair value of underlying assets and liabilities, which will be unwound from the forward loss liability as units are delivered over the next five years. In addition, the forward loss liability includes approximately [ph] $15 (00:34:55) million of non-cash depreciation. This is our initial assessment and we continue to focus on capturing synergies, including analyzing each site's capacity and structure to reflect the current production rate environment as well as maturing our cost reduction projects, which will help improve our profits on the programs.

In addition, as our business recovers from the effects of COVID-19, we expect each of these programs to benefit from our cost reduction efforts and result in improved margins. As we announced last quarter, we negotiated a $225 million purchase price reduction to the original acquisition price, taking into account market changes driven by the COVID-19 pandemic. In addition, we've always said that this acquisition was a three-way negotiation, including Airbus, who were supportive in these discussions to make sure we could come to a mutually agreeable outcome.

Finally, we also recognized $5 million of excess capacity costs in 2020. We expect to continue to incur these excess capacity costs going forward as production rates remain low consistent with the accounting treatment we follow on the 737 program.

So, what I've just described summarizes the accounting treatment for the individual elements of the acquisition. But going back to Tom's previous remarks, we project this acquisition will generate roughly $700 million of revenue in 2021, which we expect to grow at approximately 15% annually with future gross margins approaching 10% or better. Strategically, it has accelerated our diversification with more Airbus content, new defense work and expanded aftermarket and business jet work packages. Overall, we remain excited about this acquisition.

In closing, 2020 was a challenging year that required us to take difficult, but necessary actions to adapt to the changes brought on from both the MAX grounding and the COVID-19 pandemic. 2021 continues to be a complex and dynamic situation. And we will continue to assess potential scenarios to identify areas of opportunity and develop action plans to mitigate risk. Further, we will stay focused on our growth and diversification strategies.

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

Thomas C. Gentile

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

Thanks, Mark. And now, I'll make some closing comments before we take questions. We reacted to the multiple challenges in 2020 by restructuring our cost base and strengthening our liquidity. We also executed on many different projects to drive productivity improvements and continue to diversify our business while protecting our employees.

2021 will be a bridge year for Spirit as we recover from the effects of the 737 MAX grounding and the COVID pandemic. Now, that the 737 MAX has safely returned to service in many parts of the world, we look forward to improve production rates for that program.

We are encouraged by the various measures being taken to address the COVID-19 pandemic and hope to see a much improved environment for air travel as the year progresses. In summary, our focus going forward is to continue diversification efforts, start to delever over the next two to three years, and drive segment margins to our previous targets.

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

QUESTION AND ANSWER SECTION

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

Jon Raviv
Analyst, Citigroup Global Markets, Inc.
Q

Hey. Thanks and good morning here. A question on the margin commentary, just any perspective on the margin performance on an underlying basis in 4Q versus 3Q. And Tom, you said 16%, I think, on the call, just squaring that since, I think, I had 16.5% in my head with the MAX in the 40s, is that the A220 dynamic you just described or wide-body being replaced by military? Just any thoughts on what that normalized margin number should be in our head...?

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

You're right. 16.5% is what our target is. We just rounded it for the sake of the presentation. But 16.5% is what we think is achievable once we get the MAX production rates into the low-40s.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.
Q

Okay. Thanks for that clarification. And just – can you just – sorry, just one question on A220, is that program going to be generating profit at all in the future or only after the 3.5 years to get to that 10% or better gross margin?

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

Well, right now, we've set up the forward loss that goes out three to five years. And so, we expect that during that time we're going to continue to work on all the projects that we have identified in terms of capturing synergies, which we said it would be at about 6% of revenue. While we've identified a lot of those, those projects are not all mature. And so as those projects mature, we should see improved performance on the program.

The other thing is rates are still quite low on the A220 program. Airbus has given us the best guidance they can over the next few years. But again, as we see the market recover and air traffic resume, we expect to see the A220 rates get back to where they were projected to be previously. And that will also improve the profitability of the program. So, after three- to five-year program, absolutely, we expect the A220 to be profitable.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.
Q

Thank you.

Operator: Our next question comes from David Strauss with Barclays. Please go ahead.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Good morning. Tom, can you touch on the MAX and the 787? Obviously, Boeing is sitting on a lot of inventory of both at this point. Do you expect your MAX deliveries actually pickup relative to the 71 in 2020? And how are you thinking about your 787 rate given you're somewhere around seven a month and Boeing's not delivering any airplanes? Thanks.

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

A

Right. Well, with regard to the MAX, Boeing has said that they're going to prioritize the delivery of the units that they have built and not delivered, and they have been doing that. As you saw in December and in January, we were able to deliver upwards of 40 units. So, that's quite encouraging. As I said, we did produce 71 MAX shipsets in 2020. We've got about 130 units stored at our site in Wichita, shipsets. Boeing has paid for those already, but those are in storage. We will burn those down over the next 18 months or so. And we do expect rates to be higher in 2021 on the MAX than they were in 2020.

Boeing hasn't been specific yet. What they have said is that they expect to be at about 31 aircraft per month in early 2022 on the MAX. We are lagging them by about five shipsets per month so that we can burn down the inventory that's here in Wichita. So, that's where we are, but we do expect that the MAX deliveries for us, even though Boeing is going to be delivering out of their inventory, we expect the MAX deliveries, for us, will be higher in 2021 than they were in 2020.

On the 787, Boeing has indicated that they are going through some extensive reviews of the build process and the units that has delayed some shipments. We've continued to ship, but it did impact our shipments in the fourth quarter. We expect that once the reviews are complete, that Boeing will be able to resume shipments of the 787 again and we will continue to ship to our current schedule, which is at about five per month.

David Strauss
Analyst, Barclays Capital, Inc.

Q

All right. Thank you.

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

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Thanks very much and good morning.

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

A

Good morning.

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

A

Good morning.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

I was curious about – good morning. You mentioned the abnormal production costs would continue in 2021, I guess, as we would expect. But relative to that sort of $50-ish million level for the fourth quarter, is there any more color you could give us on how that should proceed through the year?

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

Yes. So, Seth, we had about $280 million of total excess capacity costs that we incurred in 2020 with a modest pickup in 737 production rates, which we'll see later in the year. We'll see some improvements in 2021 compared to 2020. We haven't given out specifics, but I would say we could see a 30% reduction in that number. But we also have to kind of factor in that A220 is going to be in the similar situation where that factory is set up to produce at more than 10 chipsets per month, and we're roughly at four. And therefore, we're going to have a little bit of headwind on excess capacity costs on the A220.

So, overall, we'll see an improvement in excess costs, which will help profitability and will help cash. And as we move through the year, the excess costs will be a little higher in the first half and less in the back half of the year.

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

I think an easy way to think about it is we established that excess cost allowance for production rates that are below 52 aircraft per month for the MAX. And they will be in effect until the MAX rates get back to 52 and above. But as the rates climb, the excess costs will go down in proportion to how close we are to 52 aircraft per month. So, that's just an easy way to think about it.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Great. Thanks very much.

Operator: Our next question is a follow-up from David Strauss with Barclays. Please go ahead.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Okay.

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

Hey, David.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Is there – there's no one else in the queue that needs to ask a question?

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

Well, go ahead, if you have another question, we can take it now.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Okay. All right.

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

A

Jump on in, David.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Okay. So, want to ask about the cash flow and the 2021 walk that you had given us prior, in terms of the $300 million cash tax benefit, offset by [ph] defer, I guess, along with around (00:46:02) $500 million working capital tailwind. Is that all still in place? I mean, I think that arrives – gets us to like a $200 million to $300 million burn in 2021. Is that the right ballpark?

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

A

That's right, David, we're holding to what we communicated in the third quarter. And based on what we know today, we have no change in that view.

David Strauss
Analyst, Barclays Capital, Inc.

Q

And does the – Bombardier pension contribution, is that going to flow through operating cash flow or does that go somewhere else?

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

A

It will flow through operating cash flow.

David Strauss
Analyst, Barclays Capital, Inc.

Q

And that's included in the walk as well?

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

A

That's right.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Okay. Thanks very much.

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

A

Okay.

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

Carter Copeland
Analyst, Melius Research LLC

Q

I made it in. Thanks, guys.

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

A

Hey, Carter.

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

A

Carter, good to hear from you.

Carter Copeland
Analyst, Melius Research LLC

Q

I didn't know if I was going to make it in there. We're already going to follow-ups. So, Tom, I'm going to cheat slightly and just ask you a two-parter clarification. Just for extra color on two of the things you talked about. One, the integration timeline and tasks that you laid out with respect to the Bombardier assets, and just some color on what sorts of integration tasks you've completed and what remains, just to kind of give us a sense of what the various risks are there.

And then, the other is on all of the stuff you talked about on the MAX line moving around the workflow, all of those efforts, are there any metrics you can give us on what you anticipate that means for direct labor or what it means for flow times, what it means for – anything that you've looked at and kind of zeroed in on and said, this is what's compelling about that particular change or some other particular change. Thanks.

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

A

Okay. Good. All right. So, to start on the integration question, let me turn it over to Sam Marnick, who is our Chief Operating Officer. Sam is leading the integration and can provide you some color on the type of tasks that we're undertaking and what's been completed. So Sam?

Samantha J. Marnick
Executive Vice President & Chief Operating Office, Spirit AeroSystems Holdings, Inc.

A

Yeah. Hi. Good morning, Carter. So, as Tom mentioned previously, on the integration, there's about 450 activities. And really, they're organized into 22 functional work stream areas, typical work stream areas that you'd imagine, like accounting, IT, human resources, all of those kinds of things. By the end of Q1, we should be about 75% through the integration activities, Carter. There are some activities that will take quite a bit longer. So, an example of that would be some of the accounting that needs to be done. Another example would be IT and the Transition Services Agreement. So, we have a Transition Services Agreement for 18 months. Obviously, we're going to try and get off of that quicker, but that will be a longer integration activity.

At the same time as doing the integration activities, obviously, we're also simultaneously doing the synergy activity work streams as well, and they both of feed each other. And the integration activity is where we've seen a lot of successes because this is very much a business that we're used to, Carter. The teams are very much already integrated in terms of things like metrics and cadence. So, we're all working from the same kind of measures already.

We're also really making some great progress on some of the combinations. So when Tom talked about the aftermarket business, for example, already we're doing repairs in Dallas, we're doing repairs in Belfast, traditionally done out of the Spirit Wichita site. So, all in all, we're seeing some really good progress on the integration. Hopefully, that gives you a little bit of color. There are some activities, though, that will spread out into the latter part of the year that will take longer to come off systems, for example.

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

Great. Okay. Thanks, Sam.

Carter Copeland
Analyst, Melius Research LLC
Q

Yeah. Sam, just as a quick follow-up to that, are there any LTAs that the previous organization was engaged in that you want to make your way out of or is that not an issue of significance?

Samantha J. Marnick
Executive Vice President & Chief Operating Office, Spirit AeroSystems Holdings, Inc.
A

Those are all things that we're working through on the integration activities. There are some things that, obviously, we'll be looking at, whether that's supply chain or other such agreements, as we're working through our position for the future here. We'll be addressing all of those and seeing which makes sense for them which don't, and as well working through the synergies, for example, as we make decisions over make/buy. And that impacts those types of agreements. We'll look at those as they come up, Carter.

Carter Copeland
Analyst, Melius Research LLC
Q

Okay.

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

And one thing I would say, sometimes long-term agreements, Carter, might be in place. But with Spirit, we have a lot of scale. We have lot of new programs and opportunities to work with suppliers to create win-win situations where we can get what we're seeking and they can get something that helps them as well. So, we're confident we can manage through any situations that exist.

Let me get to your second question, which is you asked all these things that I talked about in terms of automation and robotics and digitization of the factory floor and process redesign, how that will translate into metrics and what the benefits will be. And so, the type of metrics that we are going to see improve primarily will be looking at things like, first of all, labor productivity.

We measure realization. So, in other words, how many hours do we perform versus how many hours do we have available. With all the disruption that we've seen in the past few years, realization which should be close to 100% has obviously dropped a lot. With all the changes that we're making, we expect to see our realizations start to approach the 90% to 100% level again.

The other big area is really about quality. All the changes we're making, ultimately, are going to drive better quality performance. So, fewer defects, less scrap and rework, less repair, fewer escapes to our customers, all the ways that our customers measure quality, we will be able to see significant improvements. And that also translates into dollars. I mean, if you reduce scrap and rework, obviously, that helps out the bottom line as well.

The other thing we'll see in terms of labor productivity is a reduction in overtime. When the factory is disrupted and it's not performing and work gets out of sequence, you have to work harder at that. That creates a lot of overtime. We're expecting overtime to be less than 8% going forward. We had time periods in the last couple of years as rates were going up, where overtime could even reach into the 30% range. So, that's going to be a significant reduction.

And then, we're going to see improvement in some of the line items, like things like perishable tools and shop supplies. Ultimately, though, all of those things will translate into margin. And so, when we say we're going to get to 16.5% margin, this is one of the ways that we're going to get there, is by making all of these improvements to our production system.

Carter Copeland
Analyst, Melius Research LLC

Q

Great. Thanks for the color, Tom.

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

A

All right. Thanks, Carter.

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

Myles Walton
Analyst, UBS Securities LLC

Q

Thanks. Good morning. Based on the comments that defense is growing 15% and is, I guess, going to stay at 18% of sales, I guess, the implication is $4 billion of 2021 sales is sort of your benchmark target, which would imply that the Bombardier sales come through and the rest of the business sort of is flat year-on-year. Is that the way you're thinking about it that the wide-body declines are being offset fully by the narrow-body growth?

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

A

Yes, effectively.

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

A

Myles, definitely, we're seeing a lot of pressure on the twin-aisle, in particular, 787 and 777. And so, that's going to be a pretty big headwind coming into the year and we are seeing some single-aisle recovery on top of it. So, I would say, maybe a little bit of benefit above and beyond the headwind on the twin-aisles. But roughly speaking, the single-aisle improvement is going to be offset by the twin-aisle reductions on the 777 and the 787.

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

A

And the point I was making was that with the wide-bodies down, particularly in the composite aircraft, we have open capacity. We have automated [ph] part (00:54:31) replacement capacity, trim and drill capacity, nondestructive inspection capacity, and we can repurpose that toward defense programs. And we've been doing that. We've been winning defense work. And that's why I mentioned, in terms of the programs that we're on now, the program of record has future sales of over $6 billion. So, we're very confident that the growth of the defense business can help offset some of the wide-body softness right now and will also create a very profitable revenue stream for us going forward.

Myles Walton
Analyst, UBS Securities LLC

Q

And on that, I know that the head of the B-21 program actually publicly in Air Force Magazine talked about Spirit, in particular, switching supply of workforce over to B-21 from other commercial assets. And I'm just curious, [ph] coming to (00:55:17) the program specifically, but the profitability of defense, in general, how is that trending? Where is that relative to your mature commercial programs and where's that – when you do get to $1 billion in sales, where is the profitability profile of defense relative – against your more mature programs?

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

A

Well, what we said is, defense programs have typical defense margins. So, that's in the kind of 12% to 14%. But those tend to be very stable, very long term and less cyclical than you see on the commercial side.

Myles Walton
Analyst, UBS Securities LLC

Q

Okay. All right. Thanks.

Operator: Our next question comes from Greg Konrad with Jefferies. Please go ahead.

Greg Konrad
Analyst, Jefferies LLC

Q

Good morning.

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

A

Good morning.

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

A

Good morning, Greg.

Greg Konrad
Analyst, Jefferies LLC

Q

You gave some helpful color around kind of the [ph] counting (00:56:06) from Bombardier, but it looks in Q4, you added back about $51 million of cash usage. And I think on the last call, you talked about expecting Bombardier to be a positive contributor to cash. You mentioned margins and kind of revenue growth. But how do you kind of view the cash profile of that business going forward?

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

A

Yeah. So on our third quarter call, we knew that when we acquired, at the end of October, that there was going to be some severance-related costs that would be a headwind on cash in the fourth quarter. And based on our current look here into 2021, we expect the Bombardier assets, Belfast, Morocco and Dallas, to be a positive cash flow contributor in 2021.

Greg Konrad
Analyst, Jefferies LLC

Q

Thank you.

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

Robert Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. Tom, while we're talking about the targets for defense and for biz jet, the $1 billion and the $500 million, could you just give us a general sense of the big programs in there? I assume the biz jet's mostly 7500, but wanted to clarify that. And then, if you could just give us the rank order in defense.

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

A

Right. So, let's just start with defense. The programs that we have for defense right now, we have the military derivatives or the commercial programs from Boeing. So, the P-8 is the 737, and we make 70% of the structure. The KC-46 tanker is a derivative of the 767, and we make the forward fuselage on that. We also have – we build the whole fuselage for the CH-53K, which is a heavy-lift helicopter for the Marines. Then we are one of seven suppliers that was named to the B-21 Raider program, which is an important program for national security. In addition to that, we have won work packages on several new classified programs, which we can't go into in detail in terms of what they are, but that's why we wanted to give you the program of record number of $6 billion.

In terms of Bombardier and – well, that's – in terms of business jet programs, we are on the Global 7500, make the horizontal stabilizer. The Globals 5000 and 6000, we do the wings, the fuselage and the tail. We do the nacelles and the fuselage for the Challenger. We make the fuselage for the Learjet 75. Obviously, that's going to be ending, but we'll do that throughout the course of this year. We make the nacelles for the BR710, which is on several different aircraft. We make the nacelle, well, for the A330, and then we also make the nacelles for the new MC-21, which is the regional aircraft in Russia.

In addition, on the business jet program, we've announced that we're going to be the partner with Aerion for their forward, pressurized fuselage. And then, we won two additional business jet programs, which have not been announced publicly, but will be very significant contributors in the future.

Robert Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. And then, just a clarification, on the A220 and the forward loss, is that calculated on a continued rate of four per month throughout this several year period or does it gradually have the rate rising toward 10 in that number?

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

No. We – yeah, so Rob, we've taken the current outlook that Airbus has given us. And so, we expect over the next couple of years for the A220 production rates to climb higher than they currently are and that's factored into the overall loss calculation.

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

Got it. Got it. Thank you very much.

Operator: Our next question comes from Kristine Liwag with Morgan Stanley. Please go ahead.

Kristine Tan Liwag
Analyst, Morgan Stanley
Q

Hey, guys.

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

Good morning.

Kristine Tan Liwag
Analyst, Morgan Stanley
Q

Mark, for the Bombardier asset to be free cash flow positive in 2021, what integration and synergy milestones are embedded in your outlook?

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

Well, I would say, we have modest assumptions as it relates to the actual synergies. I know that, on the Bombardier acquisition, we talk a lot about the Airbus A220. But I want to remind folks that there are other two important aspects of that acquisition. It's the business jets that Tom just described, we're on a variety of different business jet programs, many of which are nicely profitable programs. And then, the significance, which I continue to say, is really the jewel of the acquisition, in my eyes, is the aftermarket business, which is substantial, doubles our aftermarket business and has margins consistent with our aftermarket peers.

So, although the A220 program is going to be a bit challenging from a cash flow standpoint in 2021, assuming four to five rate per month, we have two-thirds of that business generating profitable growth. And so, that will help us on the margin side, as well as we're going to see some tailwind on destocking of some inventory that we built up on the A220 program in 2020 as we thought those production rates would come up. So, some modest benefits on the synergies, we're looking at a 24- to 36-month timeframe for us to squeeze out fully those synergies. We see nice profitability coming from the business jets in the aftermarket. We're seeing some working capital tailwinds. And that's going to all culminate into some positive cash flow here.

And Tom mentioned it, we've won a nice little piece of defense work in 2021 that's going to help us be cash flow – generate some cash flow on the defense side of things.

Kristine Tan Liwag
Analyst, Morgan Stanley

Q

I see. So if we were to adjust out the working capital tailwind for the year and taking out A220, because [ph] it's its own, I guess, animal (01:02:23), how do we think about the run rate of free cash flow conversion for that two-thirds of the business that's profitable? Is that mid-teens or, I guess, double-digit cash margin? How should we think about that?

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

A

I don't want to guess, Kristine. I haven't looked at it that way, to be honest. We have been really focused on purchase accounting. We're working long hours with our external auditors to get the purchase accounting wrapped up here. We're spending time focused on our 2021 projections, which is the near term. And then, as Sam Marnick talked about, we're starting to tap the longer-term strategy around the synergies and all the cost projects that we have. And I would tell you that a really, really long list of projects on the A220 from site consolidation, overhead reduction, supply chain, we have a whole host of projects that, we think, over the next couple of years, will drive some value on that program to help us get to profitability, along with we've got our fingers crossed that that program will continue to sell well in the marketplace. And if we can see those production rates climb into the 100, 125 and 130, we can be profitable.

And I would just say, if you listen to the Airbus, they're kind of in the same situation that we are. They talked about getting to profitability in the middle of the 2020s. And so, our goal is to get there and try to get there sooner than that. So, sorry, I couldn't answer your question. I just don't have those statistics offhand here. But maybe on future calls, we can we can help clarify that as we continue to get our arms around this business. We've just had it for a couple of months here and we've got a lot of work to do here, but we feel really good about the acquisition.

Kristine Tan Liwag
Analyst, Morgan Stanley

Q

Thank you for the color.

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

Douglas S. Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Good morning. Thank you.

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

A

Hey, Doug.

Douglas S. Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Hi. On the 787, and this has been somewhat of a challenge here with a lot of inspection work going on at Boeing. Our understanding is that the issues around nonconformities extend across a lot of areas, including Section 41 and the forward cargo door. Can you talk about, with the issues on the 787, are there Spirit-specific issues here? Are these instead more a broader process question that extends across suppliers? And how have you worked to help and what's the path to resolution of these issues that you're involved with?

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

A

Well, we've been working very closely with Boeing in terms of trying to understand the whole production system and doing the analysis that they have requested. Our understanding is they're also doing analysis on other sections of the aircraft. But those are not really visible to us. So, we're focusing on our work package with Boeing. And what we're doing is, based on feedback that they've gotten from their own investigations in other parts of the aircraft, they've asked us to perform similar engineering analysis on the sections that we do.

And we're doing that analysis. We are working with them to understand the results. In some cases, it may require rework. We have started some rework just so that they can resume their deliveries sooner. And as we get all of the engineering analysis done, we'll determine in the long term what type of rework is done. But this is – the type of thing that happens is you identify a potential issue. You do the engineering analysis and you understand whether the area is acceptable as it is or if it could require some rework.

In addition, to the extent that we need to change some of our production process in the future, we will do that. We're learning a lot from this engineering analysis in terms of things like tools and processes. And we will make any improvements that we think are necessary as a result of that analysis going forward.

Douglas S. Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Do you have a sense here given that you furloughed people on the program and – give us a sense of what the timeline is based on the work that you're doing to address these issues. Do you see it – when you can get back to what I would call a more normal production?

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

A

Well, the furloughs that we have made on the program really relate to the production rate decreases that Boeing has announced. I mean, we were at 14, then 10, and now we're basically at 5. And so, that's really what drove the furloughs. So, we're continuing to do the work on the program in addition to the engineering analysis that I just described. But the furloughs that you referenced are not due to this, but they're rather due to the production rate declines that Boeing announced for the program.

Douglas S. Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Oh, okay. I see. So – okay. So, these are basically going on in parallel, I guess.

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

A

Correct.

Douglas S. Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah.

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

A

Yeah, Doug, what really happened here is the original production schedule had us going to from about 10 to 5 a month in April. And then, based on the latest schedule that we got from Boeing that they communicated late last year, that moved the production break or reduction down to five a month earlier in the January-February timeframe. So, we had a plan to kind of transition some of those employees in April over to the 737 program as those rates went up. But due to the fact that the production rate came down sooner, you could see some of the lower deliveries in fourth quarter, our production system is tuning down to five a month – roughly five a month for the full year 2021. And that was the main reason why we had to furlough some employees. We just – production rates came down sooner than we expected, and that we had to reduce the workforce to equate to the current production levels.

Douglas S. Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

So, that was the reason for the forward loss and not the inspection issues in the analysis you're doing.

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

A

That's correct, Doug.

Douglas S. Harned
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Great. That's very helpful. Thanks.

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

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Yes. I wanted to clarify when you say the 16.5% margin you'll get when MAX gets in the low-40s, then you also said that you'll still have excess capacity costs until that gets to 52. So, is that 16.5% include the excess capacity costs or is that what you'd expect as a normalized number without the excess capacity?

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

A

No, George, that would include the excess capacity costs. We think even with the excess capacity costs, we can get to around 16.5%.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

And that's for the whole sector, so that includes the zero margins on the bulk of your other programs.

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

A

That is correct.

George D. Shapiro
Analyst, Shapiro Research LLC

Q

Okay. And then, are there any excess capacity costs for any of the other programs, or the numbers we're seeing are strictly for the MAX?

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

What you saw in 2020 was primarily the MAX. But in 2021, 2022 and into 2023, we'll have excess capacity costs on the A220 program as well. So, it's just contained to 737 and A220.

George D. Shapiro
Analyst, Shapiro Research LLC
Q

Okay. And there's no excess capacity costs on like the 787 rate coming way down, because you're already in a loss position, is that it?

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

No, George, the technical side of it is the new rules that came out regarding excess capacity costs, if Boeing would have told us, hey, we plan to get back to 14 aircraft per month on 787 because our building is capable of producing 14, we would then have excess capacity costs, right? And so, you really have to look at it, what is factory set to produce. And if your customer commits, like they have on 737, that they're going to go back to 52 a month in the 2023-2024 timeframe, therefore, we have to do a separate calculation to put certain costs in excess and certain costs going to the program. But on 787, there is no commitment. Boeing has said, hey, their plan is to get back to seven or eight a month. They've never come out publicly and stated that they're going to go back to 14. And because they're not going to go back to 14, then all of the costs hit the program as opposed to hitting excess. I hope that helps.

George D. Shapiro
Analyst, Shapiro Research LLC
Q

Yeah. That helps. And is that true then for like the A350 program with the Airbus?

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

That's right and 777.

George D. Shapiro
Analyst, Shapiro Research LLC
Q

Okay. That's very helpful. Thanks, Mark.

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

Sure.

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

Hunter Keay
Analyst, Wolfe Research LLC
Q

Well, thanks for getting me in. Mark, just a couple of quick ones for you. Is there any shot that you can obtain some pension relief from the stimulus or is that not applicable in this scenario on a cash contribution, the $135 million? And then, you guys have said, pre-MAX, actually, your minimum cash balance, I believe, was $400 million to $600 million. How do you feel about that now going forward? Thanks.

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

A

Sure. I would say that as it relates to either the CARES Act or any benefits from the UK, I'm not quite sure there's a path forward as it relates to any pension relief. But you are aware of the fact that we do have a pension plan in Belfast and we're evaluating that pension scheme to see if we can come up with a different scheme that would be beneficial to our employees and also beneficial to Spirit. And so, those are some things that we're working on as it relates to our integration and synergies that Sam is leading.

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

A

Yeah. But the $130 million pension payment for this year is locked. I mean...

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

A

Yeah.

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

A

...we're committed to making that and we'll be evaluating the program as we go forward. But there's no chance that that would change. That'll happen in the October timeframe.

Hunter Keay
Analyst, Wolfe Research LLC

Q

Okay.

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

A

And then, Mark, the MAX, the $400 million to $600 million minimum capital – for minimum cash on hand.

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

A

Yeah. And so, the $400 million to $600 million was really when we think about our business as it relates to being a $7 billion to $8 billion company. And so, the amount of cash that we're required to hold just to support the business on a normal run rate basis fluctuates based on our revenues and our cost profile and the number of our employees. So, if we're half the size that we were when we were – needed $400 million to $600 million, we're probably more in the $200 million to $400 million. And so, I think that's the way that you should think about it, Hunter.

Hunter Keay
Analyst, Wolfe Research LLC

Q

Okay. Thank you.

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

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Yes. Thanks so much. So when you did Bombardier, you talked of getting 600 bps of margin improvement over three years. And now, you also talked about gross margin of 10% as we get out there, what was it, 2024. That would imply that, currently, we're doing about 4% gross margin, which wouldn't seem to be consistent with generating any cash. How do I square those two issues?

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

A

Well, I would say this, Cai, I don't think you're the – I know how you did your math to get to the 4% currently, but that's not what we're expecting right now. As time moves on, right, just like the 787, as the revenue mix in the Bombardier assets, more revenue is generated on the A220 program, as those production rates go up, that has a dilutive impact on margins. Today, with where the production rates are, right, it doesn't have as dilutive of an impact here over the next couple of years because of the percent of the overall revenue to that business. We have the aftermarket and business jets that I talked about. But if, at some point time in the future, we're going to go from 40 deliveries a year to 130 deliveries a year and we're going to be generating 0% margins on it, that will drive a dilutive impact on our overall gross margins.

So, what the goal here is, the business is supporting the 10% gross margins currently. As time moves on, the A220 will put a lot of pressure on those gross margins. But as Tom talked about, we've got the synergies and cost reduction projects which, we believe, will enable us, as we move out over the next three to five years, to turn that program, first, to breakeven and then profitable. And once we go do that, that will help us on the gross margin side in the next three to five years. So...

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

A

And the way I would look at it, too, Cai, is once we get that program to profitability and then the rates start to pick up in the back half of this decade, it's going to be a great long-term program for Spirit.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Got it. So, that raises another question. You mentioned that you expected to have destock on the A220 this year. I would assume given the changes that you're going through, destock on the A220, Boeing is essentially producing nothing on the 737 now. So, are you also at nothing and 787 is kind of going through this thing where they talk of 10 per month, but it kind of sounds like they're doing nothing? So, is the first quarter going to be very, very light in terms of the volume?

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

A

No, Cai. I don't want to get ahead of myself, but I would tell you I don't expect the first quarter revenue to be significantly different than what we generated in the fourth quarter.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Got it. Very helpful. Thank you.

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

A

Sure.

Operator: Our next question comes from Ron Epstein with Bank of America. Please go ahead.

Ronald J. Epstein
Analyst, BofA Securities, Inc.

Q

Yeah. Good afternoon. Good morning, guys.

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

A

Hey, Ron.

Ronald J. Epstein
Analyst, BofA Securities, Inc.

Q

On the Bombardier acquisition, did you guys say 15% growth? And if you did, off of what base and over how many years, because Bombardier never got that out of it?

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

A

Right. Well, Bombardier was in the development phase of the A220. So as that goes up, that's what's going to drive the revenue growth. We did say 15% growth. The base is basically off of this year, which will be in the $700 million range over the next five years.

Ronald J. Epstein
Analyst, BofA Securities, Inc.

Q

Got you. And then, on the defense applications that you're using wide-body capacity on, can you say what they are? And what do you do when the wide-body demand comes back with the defense stuff that's using that capacity today?

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

A

Well, unfortunately, they're classified programs, so we can't go into more detail on them. They are, obviously, using composite technology. We have sufficient capacity in our factories, so that when the wide-bodies come back, we'll be able to support those rates, plus the defense. So, we're confident about that. And then, we'll see how far back the wide-bodies come. But we're confident we can do both, even when we see the wide-body volumes return. And by the way, that will be a great challenge for us to address at the time.

Ronald J. Epstein
Analyst, BofA Securities, Inc.

Q

Yeah.

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

A

Yeah. Ron, I would say this, and you've been out to our factories before, in many instances, we don't have one single point of failure in the factory, whether it's trim and drill, or [ph] broachies, or lab (01:19:31) machines. And so, we always have a little bit of extra capacity even at the higher rates. And so, really, as Tom said, we're not quite sure when the twin-aisle production rates will come back up, and a lot of our composite automation that we have is very [ph] accruable (01:19:49) to current classified programs.

So, we're going to be able to use up some floor space and we're going to be able to utilize those machines on a couple of these classified programs that are just slowly starting out, but we believe over the next couple of years can lead to some really big things, as Tom indicated, that with the program of record in the future, could contribute to $6 billion-plus to Spirit. And so, that's how we're going to go manage it. And obviously, we're [ph] at what (01:20:18) – we've made a commitment to our commercial customers to support specific rates and we will do that. But we will be able to do that and allow us to grow defense in those highly automated factories.

Ronald J. Epstein
Analyst, BofA Securities, Inc.

Q

Got it .Okay. All right. Thanks.

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

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Hello, everyone.

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

A

Hello.

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

A

Hello.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Just thinking about this $1 billion of annualized costs that you have pointed to being able to extract, and squaring that up with the discussion of a 16.5% segment operating margin if the MAX monthly production rate is in the low 40s, the last time the MAX production rate was in the low 40s for Boeing and for you, Spirit had $1 billion approximately of adjusted segment operating income or total company EBITDA. And so, I guess, I'm wondering, if you – and in that period of time, the segment operating margin was – depending on the exact year and some moving pieces, it was approximately 16.5%.

So, if in the forward – I know the wide-bodies will be much lower, but there's no margin there. You've given us a list of new things that are coming in at a decent margin. So outside of the MAX, you're mixing up, and then the discussion on the MAX is the same rate. If the cost out is literally the size of the entire EBITDA you used to have with similar MAX conditions, why wouldn't that future segment EBIT margin be significantly higher than the 16.5% or what it used to be when you used to be at 42 and up?

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

A

Yeah. No, I would just say, the headwinds on the wide-body are probably a little bigger than you're thinking about right now. I mean if you go back to 2016, the 777 was at 8 aircraft per month, it's now at 2. And back then, the 787 was at 12 and it was still in a kind of a forward loss position, but generating good revenue. And A350 was actually profitable and it was at a rate of about 8 at that time. So, we've got now more the headwinds on the wide-body that we have to offset and we said at a little bit of dilutive time, which we'll have for the A220 during that time. But we think once we get the MAX back into the low-40s, we can offset those and get back to the 16.5% margin targets.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Okay. So, it's just more on the wide-body than what I was thinking, right?

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

A

Well, on the 777 program...

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Okay.

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

A

...it's always been a good program for us, and going from eight to two is a significant headwind.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Right. Tom, you had – in your prepared remarks, you went – it was really helpful, you went through a lot of the specifics of things you've done on the cost side and automation and digitization. It sounded new in that you were detailing it with specificity today, but the targets are the same. I mean, how much of that is new in process right now on top of the costs you had been thinking about before versus you're just giving us the details and the examples of what you were already thinking you were going to do?

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

A

It's more the latter. I mean, these programs are all long-term programs. Like that Global Digital Logistics Center I mentioned, we've been working on that for 2.5 years. It's just coming on line now. The floor beam automation center we've been working on for about two years, it's just coming on line. The spoiler line that I mentioned over in Prestwick again, more than two years, but it's just coming on line. So, it's just a concurrence of events that these things all happen to be coming on line right now, but we've been working on them. And I wanted to provide you the details so you could see the specifics of how we're going to be driving these productivity improvements in the factory that will also help on our quality.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Got it.

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

A

And I mentioned too, while we've been working on these things, some of the process flows, those have really been in the last 12 months. As production rates went down, we looked at our factory, our main factory, Plant 2 we call it, where we build the fuselage for 737, we said, we've got some time now, production rates are low, how could we re-imagine this factory? How could we redesign it since we have the opportunity so that it could be much more efficient in the future? And that's when we moved out the forward fuselage and the wingbox. And we've now started to really completely overhaul the flow in Factory 2. We couldn't have done that if we were at 52 aircraft per month. But at seven aircraft per month, we have the capacity to do it and we went and did it.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Okay. Thanks so much.

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

A

Thanks.

Operator: Our next question comes from Michael Ciarmoli with Truist. Please go ahead.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Hey. Good afternoon, guys. Thanks for...

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

A

Hey, Michael.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

...sticking around and take the question. One quick one, everything that's going on with the 787, I guess, back to Doug's question, does that change or could it potentially change your cash breakeven there? I think it was for line unit 1405. And then, maybe just to tie a bow on all of those commentary, all these moving pieces, do you guys think you can get to positive operating margins or operating income in the second half 2021 or should we be more calibrated into 2022, just given low rates on the narrow-body, still some uncertainty and, obviously, the wide-body pressure?

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

A

Right. Let me take 787, first. You're right, the line unit is 1405. We have a price increase, which will get us up to the level where, we think, our costs will be. That was always the goal. Obviously, with the production rate dropping, it creates more of a headwind. But with the production rate dropping, it also pushes out when line unit 1405 happens and so we have more time to achieve it. So, that's still our goal. One of the ways that we'll offset some of the volume decline on the 787 is what I said earlier is using some of that capacity on defense programs, which will help absorb some of that fixed costs, which will help the 787 profitability. So, the goal is still, when we hit line unit 1405, is that we will be breakeven or better.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Got it.

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

A

Right. Now, your second question, maybe just repeat it, please?

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Yeah. Just thinking about generating positive operating income and positive margins here, just should we be calibrated towards second half 2021, even fourth quarter 2021, or just given headwinds with wide-bodies and maybe modest [ph] great (01:27:16) ramps on narrow, should we be more calibrated towards early 2022?

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

A

Well, I mean, we said we'll be – 2022 is when we're targeting cash flow profitability. Mark mentioned that our interest payments happen in Q2 and Q4, the big interest payments. And so, that gives us a little bit of headwind in Q4. So even if we were seeing some good momentum on the production side, we'll have those headwinds on the interest costs side. So, I think what – we'll stand by, we'll be cash flow positive in 2022.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Okay.

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

A

Yeah, Michael, maybe to be more specific, we should see improving operating margins as we progress throughout the year. If the production rates hold, we should see higher single-aisle rates in the third and fourth quarter. And so, I don't want to get too specific about when we'll see positive operating margins, but I will tell you we should see them pick up nicely in the third and fourth quarter before we break into 2022 where we should see continued benefits of the single-aisle rates, both on the 737 and A320. Don't want to get too specific, but we should see things start to build nicely as we move into the back half of the year.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

No, perfect. That's helpful. Thanks, guys.

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

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

Q

Yeah. Good morning, Tom, Mark. Tom, hey, just regarding all the transformation efforts that you're doing and kind of related to the cash question, do we think about Spirit still as a company that can generate 7% to 9% of free cash flow once volume comes back? Or just given all the kind of metrics and improvements you've been making, should we be thinking about the business differently, particularly given the acquisition, et cetera?

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

A

That's our goal. And even with the acquisitions, that's still our target. As I said, we want to diversify, delever, drive margin. But by doing those things, that will enable us to generate cash. And we think the 7% to 9% range is a good target for when the business is stabilized, air traffic has recovered and our production rates have gone back up.

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

Q

Appreciate all those details. Thanks for your time.

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

A

Thank you.

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