

Spirit AeroSystems Holdings, Inc.
Form 10-Q
August 05, 2016
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
Form 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-33160

Spirit AeroSystems Holdings, Inc.
(Exact name of registrant as specified in its charter)

Delaware 20-2436320
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

3801 South Oliver
Wichita, Kansas 67210
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code:
(316) 526-9000

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer Non-accelerated filer
Accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 29, 2016, the registrant had outstanding 129,050,356 shares of class A common stock, \$0.01 par value per share, and 121 shares of class B common stock, \$0.01 par value per share.

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

Spirit AeroSystems Holdings, Inc.

Condensed Consolidated Statements of Operations
(unaudited)

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2016	July 2, 2015	June 30, 2016	July 2, 2015
	(\$ in millions, except per share data)			
Net revenues	\$1,829.9	\$1,698.7	\$3,511.5	\$3,440.9
Operating costs and expenses				
Cost of sales	1,672.0	1,407.9	3,031.0	2,856.2
Selling, general and administrative	70.2	53.8	120.2	105.4
Research and development	4.4	6.7	10.5	13.7
Total operating costs and expenses	1,746.6	1,468.4	3,161.7	2,975.3
Operating income	83.3	230.3	349.8	465.6
Interest expense and financing fee amortization	(23.9)	(12.1)	(35.3)	(30.0)
Other (expense) income, net	(6.2)	8.1	(8.4)	1.7
Income before income taxes and equity in net income of affiliate	53.2	226.3	306.1	437.3
Income tax provision	(8.6)	(71.7)	(90.5)	(101.1)
Income before equity in net income of affiliate	44.6	154.6	215.6	336.2
Equity in net income of affiliate	0.2	0.3	0.8	0.6
Net income	\$44.8	\$154.9	\$216.4	\$336.8
Earnings per share				
Basic	\$0.35	\$1.11	\$1.66	\$2.42
Diluted	\$0.35	\$1.11	\$1.65	\$2.41

See notes to condensed consolidated financial statements (unaudited)

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Spirit AeroSystems Holdings, Inc.

Condensed Consolidated Statements of Comprehensive Income
(unaudited)

	For the Three Months Ended June 30, July 2, 2016 2015		For the Six Months Ended June 30, July 2, 2016 2015	
	(\$ in millions)			
Net income	\$44.8	\$154.9	\$216.4	\$336.8
Changes in other comprehensive (loss) income, net of tax:				
Settlement of swap, net of tax effect of zero for each of the three and six months ended, respectively	—	—	—	1.1
Pension, SERP, and Retiree medical adjustments, net of tax effect of (\$0.2) and zero for the three months ended and (\$0.4) and zero for the six months ended, respectively	0.2	(1.9)	1.0	(1.9)
Unrealized foreign exchange loss on intercompany loan, net of tax effect of \$0.8 and (\$0.6) for the three months ended and \$1.1 and zero for the six months ended, respectively	(3.2)	2.5	(4.4)	0.1
Foreign currency translation adjustments	(23.4)	13.8	(31.0)	1.1
Total other comprehensive (loss) income	(26.4)	14.4	(34.4)	0.4
Total comprehensive income	\$18.4	\$169.3	\$182.0	\$337.2

See notes to condensed consolidated financial statements (unaudited)

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Spirit AeroSystems Holdings, Inc.

Condensed Consolidated Balance Sheets
(unaudited)

	June 30, 2016	December 31, 2015
	(\$ in millions)	
Current assets		
Cash and cash equivalents	\$800.5	\$ 957.3
Restricted cash	86.4	—
Accounts receivable, net	756.3	537.0
Inventory, net	1,546.6	1,774.4
Other current assets	56.9	30.4
Total current assets	3,246.7	3,299.1
Property, plant and equipment, net	1,936.8	1,950.7
Pension assets	249.1	246.9
Other assets	250.1	267.8
Total assets	\$5,682.7	\$ 5,764.5
Current liabilities		
Accounts payable	\$653.9	\$ 618.2
Accrued expenses	235.7	230.2
Profit sharing	45.3	61.6
Current portion of long-term debt	126.8	34.9
Advance payments, short-term	189.7	178.3
Deferred revenue, short-term	304.3	285.5
Deferred grant income liability - current	13.2	11.9
Other current liabilities	38.4	37.7
Total current liabilities	1,607.3	1,458.3
Long-term debt	1,071.6	1,085.3
Advance payments, long-term	425.6	507.4
Pension/OPEB obligation	70.7	67.7
Deferred revenue and other deferred credits	177.3	170.0
Deferred grant income liability - non-current	73.0	82.3
Other liabilities	258.2	273.5
Equity		
Preferred stock, par value \$0.01, 10,000,000 shares authorized, no shares issued	—	—
Common stock, Class A par value \$0.01, 200,000,000 shares authorized, 129,051,833 and 135,617,589 shares issued and outstanding, respectively	1.3	1.4
Common stock, Class B par value \$0.01, 150,000,000 shares authorized, 121 shares issued and outstanding each period, respectively	—	—
Additional paid-in capital	1,066.3	1,051.6
Accumulated other comprehensive loss	(194.9)	(160.5)
Retained earnings	1,872.6	1,656.2
Treasury stock, at cost (16,582,310 and 9,691,865 shares, respectively)	(746.8)	(429.2)
Total shareholders' equity	1,998.5	2,119.5
Noncontrolling interest	0.5	0.5
Total equity	1,999.0	2,120.0
Total liabilities and equity	\$5,682.7	\$ 5,764.5

See notes to condensed consolidated financial statements (unaudited)

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Spirit AeroSystems Holdings, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)

	For the Six Months Ended June 30, July 2, 2016 2015 (\$ in millions)	
Operating activities		
Net income	\$216.4	\$336.8
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	98.9	88.8
Amortization expense	0.1	0.6
Amortization of deferred financing fees	14.7	5.1
Accretion of customer supply agreement	2.4	1.1
Employee stock compensation expense	28.9	11.9
Excess tax benefit of share-based payment arrangements	—	(10.1)
Loss from hedge contracts	—	1.6
Loss from foreign currency transactions	11.2	2.7
Loss on disposition of assets	3.1	2.2
Deferred taxes	25.4	4.4
Pension and other post retirement benefits, net	0.8	(13.1)
Grant liability amortization	(5.4)	(4.8)
Equity in net income of affiliate	(0.8)	(0.6)
Changes in assets and liabilities		
Accounts receivable	(224.1)	40.1
Inventory, net	184.9	(1.3)
Accounts payable and accrued liabilities	39.5	(12.0)
Profit sharing/deferred compensation	(16.1)	(70.0)
Advance payments	(70.4)	(43.2)
Income taxes receivable/payable	(29.9)	181.5
Deferred revenue and other deferred credits	28.0	185.7
Other	1.2	21.6
Net cash provided by operating activities	308.8	729.0
Investing activities		
Purchase of property, plant and equipment	(104.7)	(115.4)
Net cash used in investing activities	(104.7)	(115.4)
Financing activities		
Proceeds from issuance of debt	—	535.0
Proceeds from issuance of bonds	299.8	—
Principal payments of debt	(9.8)	(17.4)
Payments on term loan	—	(534.9)
Payments on bonds	(213.6)	—
Taxes paid related to net share settlement awards	(14.3)	(20.2)
Excess tax benefit of share-based payment arrangements	—	10.1
Debt issuance and financing costs	(13.7)	(4.7)
Purchase of treasury stock	(317.6)	—
Change in restricted cash	(86.4)	—
Net cash used in financing activities	(355.6)	(32.1)

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Effect of exchange rate changes on cash and cash equivalents	(5.3)	(0.7)
Net (decrease) increase in cash and cash equivalents for the period	(156.8)	580.8
Cash and cash equivalents, beginning of period	957.3	377.9
Cash and cash equivalents, end of period	\$800.5	\$958.7
See notes to condensed consolidated financial statements (unaudited)		

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Spirit AeroSystems Holdings, Inc.

Notes to the Condensed Consolidated Financial Statements (unaudited)

(\$, €, and RM in millions other than per share amounts)

1. Organization and Basis of Interim Presentation

Spirit AeroSystems Holdings, Inc. ("Holdings" or the "Company") was incorporated in the state of Delaware on February 7, 2005, and commenced operations on June 17, 2005 through the acquisition of Boeing's operations in Wichita, Kansas; Tulsa, Oklahoma; and McAlester, Oklahoma (the "Boeing Acquisition") by an investor group led by Onex Partners LP and Onex Corporation (together with its affiliates, "Onex"). In August 2014, Onex sold its remaining investment in the Company in a secondary offering of the Company's class A common stock. Holdings provides manufacturing and design expertise in a wide range of fuselage, propulsion and wing products and services for aircraft original equipment manufacturers ("OEM") and operators through its subsidiary, Spirit AeroSystems, Inc. ("Spirit"). The Company has its headquarters in Wichita, Kansas, with manufacturing facilities in Tulsa and McAlester, Oklahoma; Prestwick, Scotland; Wichita, Kansas; Kinston, North Carolina; and Subang, Malaysia. The Company has assembly facilities in Saint-Nazaire, France, and Chanute, Kansas.

The Company is the majority participant in the Kansas Industrial Energy Supply Company ("KIESC"), a tenancy-in-common with other Wichita companies established to purchase natural gas.

The Company participates in a joint venture, Taikoo Spirit AeroSystems Composite Co. Ltd. ("TSACCL"), of which Spirit's ownership interest is 31.5%. TSACCL was formed to develop and implement a state of the art composite and metal bond component repair station in the Asia-Pacific region.

The accompanying unaudited interim condensed consolidated financial statements include the Company's financial statements and the financial statements of its majority-owned or controlled subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and the instructions to Form 10-Q and Article 10 of Regulation S-X. The Company's fiscal quarters are 13 weeks in length. Because the Company's fiscal year ends on December 31, the number of days in the Company's first and fourth quarters varies slightly from year to year. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. The Company's investment in TSACCL, in which the Company does not have a controlling interest, is accounted for under the equity method. KIESC is fully consolidated as the Company owns 77.8% of the entity's equity. All intercompany balances and transactions have been eliminated in consolidation. The Company's U.K. subsidiary uses local currency, the British pound, as its functional currency; the Malaysian subsidiary uses the British pound and the Singapore subsidiary uses the Singapore dollar. All other foreign subsidiaries and branches use the U.S. dollar as their functional currency.

As part of the monthly consolidation process, the Company's international entities that have functional currencies other than the U.S. dollar are translated to U.S. dollars using the end-of-month translation rate for balance sheet accounts and average period currency translation rates for revenue and income accounts.

In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results of operations for the interim periods. The results of operations for the six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. Certain reclassifications have been made to the prior year financial statements and notes to conform to the 2016 presentation.

In connection with the preparation of the condensed consolidated financial statements, the Company evaluated subsequent events through the date the financial statements were issued. The interim financial statements should be read in conjunction with the audited consolidated financial statements, including the notes thereto, included in the Company's 2015 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC") on February 12, 2016 (the "2015 Form 10-K").

2. New Accounting Pronouncements

In May 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-11, Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update)" (ASU 2016-11), which rescinds various standards codified as part of Topic 605, Revenue Recognition in relation to the future adoption of Topic 606. These rescissions include changes to topics pertaining to revenue and expense recognition for freight services in process, accounting for shipping and handling fees and costs and accounting for consideration given by a vendor to a

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Spirit AeroSystems Holdings, Inc.

Notes to the Condensed Consolidated Financial Statements (unaudited)

(\$, €, and RM in millions other than per share amounts)

customer. This guidance is effective for the Company in its first quarter of fiscal 2018 and early adoption as permitted. The Company is currently evaluating the guidance and impact the adoption of ASU 2016-11 will have on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09). ASU 2016-09 identifies areas for simplification involving several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, an option to recognize gross stock compensation expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. ASU 2016-09 will be effective for annual periods beginning after December 15, 2016. Early adoption is permitted. The Company has elected to early adopt these amendments beginning in the second quarter of 2016. Beginning this quarter, excess tax benefits or deficiencies in respect of stock-based compensation are reflected in the Consolidated Statements of Operations as a component of the income tax provision. Previously, they were recognized in equity as part of additional paid-in-capital. Also, beginning this quarter, our Consolidated Statement of Cash Flows now presents excess tax benefits or deficiencies as an operating activity. Accordingly, the Consolidated Statement of Cash Flows for the six months ended June 30, 2016 includes a \$4.4 increase to net cash provided by operating activities. The Company has also elected to account for forfeitures using an expected estimate rather than recording forfeitures as they occur in as permitted by ASU 2016-09. See Note 15, Income Taxes, for information regarding the additional impact on our financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (ASU 2016-02). This update requires recognition of lease assets and lease liabilities on the balance sheet of lessees. ASU 2016-02 is effective for fiscal years and interim reporting periods within those years beginning after December 15, 2018. Early adoption is permitted. ASU 2016-02 requires a modified retrospective transition approach and provides certain optional transition relief. The Company is currently evaluating the new guidance to determine the impact it may have to the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition (ASU 2014-09). This update is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 was supposed to be effective in annual periods beginning after December 15, 2016 and for interim and annual reporting periods thereafter. However, in July 2015, the FASB affirmed its proposal to defer the effective date of ASU 2014-09 for all entities by one year. As a result, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, with an option that would permit companies to adopt the standard as early as the original effective date. Early adoption prior to the original effective date is not permitted. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) and in April 2016, ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, both of which provide supplemental adoption guidance and clarification to ASC 2014-09. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which addresses implementation issues that were raised by stakeholders and discussed by the Revenue Recognition Transition Resource Group. ASU 2016-08, ASU 2016-10 and ASU 2016-12 must be adopted concurrently with the adoption of ASU 2014-09. The Company is currently evaluating the new guidance to determine the impact it may have to the Company's consolidated financial statements.

3. Changes in Estimates

The Company has a Company-wide quarterly Estimate at Completion (EAC) process in which management assesses the progress and performance of the Company's contracts. This process requires management to review each program's progress towards completion by evaluating the program schedule, changes to identified risks and opportunities, changes to estimated contract revenues and estimated contract costs over the current contract block and any outstanding contract matters. Risks and opportunities include management's judgment about the cost associated with a program's ability to achieve the schedule, technical requirements (e.g., a newly-developed product versus a mature product) and any other contract requirements. The majority of the Company's fixed priced contracts are life of aircraft program contracts. Due to the span of years it may take to complete a contract block and the scope and nature of the work required to be performed on those contracts, the estimation of total revenue and costs at completion is complicated and subject to many variables and, accordingly, is subject to change. When adjustments in estimated total contract block revenue or estimated total cost are required, any changes from prior estimates for delivered units are recognized in the current period as a cumulative catch-up adjustment for the inception-to-date effect of such changes. Cumulative catch-up adjustments are driven by several factors including improved production efficiencies, assumed rate of production, the rate of overhead absorption, changes to scope of work and contract modifications. When estimates of total costs to be incurred on a contract block exceed estimates of total revenue to be earned, a provision for the entire loss on the contract block is recorded in the period in which the loss is determined. Changes in estimates are summarized below:

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