

Spirit AeroSystems Holdings, Inc.

Form 10-Q

November 05, 2007

Table of Contents

**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 September 27, 2007

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

(State of Incorporation)

20-2436320

(I.R.S. Employer

Identification Number)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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 October 31, 2007 the registrant had outstanding 102,563,955 shares of class A common stock, \$0.01 par value per share and 36,863,876 shares of class B common stock, \$0.01 par value per share.

TABLE OF CONTENTS

	Page	
<u>PART I FINANCIAL INFORMATION</u>		
<u>Item 1.</u>	<u>Condensed Financial Statements (unaudited)</u>	3
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	28
<u>Item 4.</u>	<u>Controls and Procedures</u>	28
<u>PART II OTHER INFORMATION</u>		
<u>Item 1A.</u>	<u>Risk Factors</u>	29
<u>Item 6.</u>	<u>Exhibits</u>	30
<u>Signatures</u>		31
	<u>Certification of CEO Pursuant to Section 302</u>	
	<u>Certification of CFO Pursuant to Section 302</u>	
	<u>Certification of CEO Pursuant to Section 906</u>	
	<u>Certification of CFO Pursuant to Section 906</u>	

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

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

	For the Three Months		For the Nine Months Ended	
	September	Ended	September	September 28,
	27,	September 28,	27, 2007	2006
	2007	2006		
	(\$ in millions, except per share data)			
Net revenues	\$ 967.5	\$ 829.7	\$ 2,880.4	\$ 2,355.9
Operating costs and expenses				
Cost of sales	804.7	677.7	2,388.2	1,926.7
Selling, general and administrative	42.9	59.9	142.3	160.0
Research and development	13.3	14.6	37.4	85.1
Total operating costs and expenses	860.9	752.2	2,567.9	2,171.8
Operating income	106.6	77.5	312.5	184.1
Interest expense and financing fee amortization	(9.7)	(11.9)	(28.1)	(34.8)
Interest income	8.0	6.9	22.8	20.9
Other income, net	1.3	0.7	5.1	3.6
Income before income taxes	106.2	73.2	312.3	173.8
Income tax expense	(22.6)	(39.2)	(90.9)	(87.6)
Net income	\$ 83.6	\$ 34.0	\$ 221.4	\$ 86.2
Earnings per share				
Basic	\$ 0.61	\$ 0.30	\$ 1.65	\$ 0.76
Diluted	\$ 0.60	\$ 0.28	\$ 1.59	\$ 0.71

See notes to condensed consolidated financial statements (unaudited)

Table of Contents

Spirit AeroSystems Holdings, Inc.
Condensed Consolidated Balance Sheets
(unaudited)

	September 27, 2007	December 31, 2006
	(\$ in millions)	
Current assets		
Cash and cash equivalents	\$ 105.4	\$ 184.3
Accounts receivable, net	247.2	200.2
Other receivables	92.3	43.0
Inventory, net	1,198.4	882.2
Prepaid expenses	14.8	20.8
Income tax receivable		21.7
Other current assets	59.6	68.3
Total current assets	1,717.7	1,420.5
Property, plant and equipment, net	937.7	773.8
Long-term receivable	141.0	191.5
Pension assets	231.5	207.3
Other assets	138.1	129.1
Total assets	\$ 3,166.0	\$ 2,722.2
Current liabilities		
Accounts payable	\$ 374.9	\$ 339.1
Accrued expenses	229.2	198.5
Current portion of long-term debt	22.8	23.9
Other current liabilities	19.8	8.2
Total current liabilities	646.7	569.7
Long-term debt	582.5	594.3
Advance payments	638.5	587.4
Pension obligation	56.6	53.7
Other liabilities	101.7	58.1
Shareholders' equity		
Preferred stock, par value \$0.01, 10,000,000 shares authorized, no shares issued and outstanding		
Common stock, Class A par value \$0.01, 200,000,000 shares authorized, 102,563,955 and 63,345,834 issued and outstanding, respectively	1.0	0.6
Common stock, Class B par value \$0.01, 150,000,000 shares authorized, 36,890,084 and 71,351,347 shares issued and outstanding, respectively	0.4	0.7
Additional paid-in capital	917.2	858.7
Accumulated other comprehensive income	74.0	72.5
Retained earnings/ (deficit)	147.4	(73.5)
Total shareholders' equity	1,140.0	859.0

Total liabilities and shareholders' equity	\$ 3,166.0	\$ 2,722.2
--	------------	------------

See notes to condensed consolidated financial statements (unaudited)

4

Table of Contents

Spirit AeroSystems Holdings, Inc.
Condensed Consolidated Statements of Shareholders Equity
(unaudited)

	Common Stock		Additional Paid-in Capital (\$ in millions)	Comprehensive Income	Retained Earnings/ Accumulated Deficit	Total	Comprehensive Income/(Loss)
	Shares	Amount					
Balance December 31, 2006	134,697,181	\$ 1.3	\$ 858.7	\$ 72.5	\$ (73.5)	\$ 859.0	
Net income					221.4	221.4	221.4
UEP stock issued	4,812,641	0.1	(0.7)			(0.6)	
Employee equity awards	317,652		27.9			27.9	
Restricted stock forfeitures	(339,188)		(1.1)			(1.1)	
Excess tax benefits from share-based payment arrangements			32.9			32.9	
Unrealized gain on cash flow hedges, net of tax				(4.6)		(4.6)	(4.6)
Unrealized gain on currency translation adjustments				6.1		6.1	6.1
Stock repurchases	(34,247)		(0.5)		(0.5)	(1.0)	
Balance September 27, 2007	139,454,039	\$ 1.4	\$ 917.2	\$ 74.0	\$ 147.4	\$ 1,140.0	\$ 222.9

See notes to condensed consolidated financial statements (unaudited)

Table of Contents

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

	For the Nine Months Ended September 27, 2007	For the Nine Months Ended September 28, 2006
(\$ in millions)		
Operating Activities		
Net income	\$ 221.4	\$ 86.2
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	67.1	30.3
Amortization expense	5.7	6.2
Accretion of long-term receivable	(16.0)	(15.3)
Employee stock compensation expense	26.8	40.8
Excess tax benefits from share-based payment arrangements	(32.9)	
Loss on disposition of assets	0.4	
Deferred taxes	3.8	
Changes in assets and liabilities, net of acquisition		
Accounts receivable	(48.0)	(63.2)
Inventory, net	(312.6)	(171.5)
Other current assets	6.1	(6.1)
Accounts payable and accrued liabilities	18.7	142.0
Customer advances	93.6	300.0
Deferred revenue and other deferred credits	36.4	
Other	36.1	(23.7)
Net cash provided by operating activities	106.6	325.7
Investing Activities		
Purchase of property, plant and equipment	(228.0)	(233.4)
Proceeds from sale of assets	0.2	
Acquisition of business, net of cash required		(135.4)
Long-term receivable	22.8	
Financial derivatives	3.1	3.1
Other	(1.3)	
Net cash (used in) investing activities	(203.2)	(365.7)
Financing Activities		
Principal payments of debt	(14.4)	(10.2)
Excess tax benefits from share-based payment arrangements	32.9	
Equity issuance costs		(3.4)
Executive stock investments/(repurchase)	(1.0)	1.1

Net cash provided by (used in) financing activities	17.5		(12.5)
Effect of exchange rate changes on cash and cash equivalents	0.2		0.2
Net (decrease) in cash and cash equivalents for the period	(78.9)		(52.3)
Cash and cash equivalents, beginning of period	184.3		241.3
Cash and cash equivalents, end of period	\$ 105.4	\$	189.0

Supplemental Information

Change in value of financial instruments	\$ (5.1)	\$	6.6
Property acquired through capital leases	\$ 1.6	\$	10.2

See notes to condensed consolidated financial statements (unaudited)

Table of Contents

Spirit AeroSystems Holdings, Inc.
Notes to Condensed Consolidated Financial Statements (Unaudited)
(\$ in millions other than per share amounts)

1. Organization and Basis of Interim Presentation

Spirit AeroSystems Holdings, Inc. (Holdings) was incorporated in the state of Delaware on February 7, 2005, and commenced operations on June 17, 2005 through the acquisition of The Boeing Company s (Boeing) operations in Wichita, Kansas, Tulsa, Oklahoma and McAlester, Oklahoma (the Boeing Acquisition). Holdings provides manufacturing and design expertise in a wide range of products and services for aircraft original equipment manufacturers and operators through its subsidiary, Spirit AeroSystems, Inc. (Spirit or the Company). Onex Corporation (Onex) of Toronto, Canada maintains majority voting power of Holdings. In April 2006, Holdings acquired the aerostructures division of BAE Systems (Operations) Limited (BAE Aerostructures), which builds structural components for Airbus, Boeing and Hawker Beechcraft Corporation (formerly Raytheon Aircraft Company). Prior to this acquisition, Holdings sold essentially all of its production to Boeing. The Company has its headquarters in Wichita, Kansas, with manufacturing facilities in Tulsa and McAlester, Oklahoma and Prestwick, Scotland and in Wichita.

Spirit 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 accompanying interim condensed consolidated financial statements include Spirit s financial statements and the financial statements of its majority owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America and the instructions to Form 10-Q and Article 10 of Regulation S-X. All intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying interim condensed unaudited 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 nine months ended September 27, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Certain reclassifications have been made to the prior year financial statements and notes to conform to the 2007 presentation. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. The interim financial statements should be read in conjunction with the audited consolidated financial statements, including the notes thereto, included in our 2006 Annual Report on Form 10-K filed with the Securities and Exchange Commission, or the SEC, on March 5, 2007.

2. New Accounting Pronouncements

In June 2006, FASB issued FASB Interpretation No. 48, or FIN 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109*, effective for fiscal years beginning after December 15, 2006. FIN 48 prescribes the minimum recognition threshold a tax position must meet before being recognized in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FASB Interpretation 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. Previously, the Company had accounted for tax contingencies in accordance with Statement of Financial Accounting Standards 5, Accounting for Contingencies. As required by Interpretation 48, which clarifies Statement 109, Accounting for Income Taxes, the Company recognizes the financial statement impact of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest impact that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, the Company applied Interpretation 48 to all tax positions as the statute of limitations remained open for all of the Company s tax years. As a result of the implementation of Interpretation 48, the Company did not incur any change in the liability for unrecognized tax benefits and does not expect its contractual liabilities to be materially impacted.

The liability for unrecognized tax benefits was \$28.2 at September 27, 2007 and \$21.6 at January 1, 2007. The increase is primarily due to accelerated depreciation deductions. Included in these amounts was \$1.2 at September 27, 2007 and \$0.7 at January 1, 2007 of tax effected unrecognized tax benefits which, if ultimately recognized, will reduce

the Company's annual effective tax rate.

The Company is not currently under examination in any tax jurisdiction. The Company reasonably expects no material change in its recorded unrecognized tax benefit liability in the next 12 months.

The Company recognizes interest related to unrecognized tax benefits in interest expense and penalties in operating expenses for all periods presented. The Company has accrued approximately \$1.3 at September 27, 2007 and \$0.5 at January 1, 2007 for the payment of potential interest and penalties.

Table of Contents

Spirit AeroSystems Holdings, Inc.
Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)
(\$ in millions other than per share amounts)

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measures. It is effective for fiscal years beginning after November 15, 2007, with early adoption encouraged. The provisions of SFAS 157 are to be applied on a prospective basis, with the exception of certain financial instruments for which retrospective application is required. The adoption of SFAS 157 is not expected to materially affect our financial position or results of operations.

In February 2007, FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 11*, which allows for the option to measure financial instruments, warranties, and insurance contracts at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. It is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, *Fair Value Measurements*. We do not presently have any financial assets or liabilities that we would elect to measure at fair value, and therefore we expect the adoption of this standard will have no impact on our financial statements.

3. Inventory

Product inventory as of September 27, 2007 and December 31, 2006 is made up of the following:

	September 27, 2007	December 31, 2006
Raw materials	\$ 151.5	\$ 118.1
Work-in-process	766.0	586.6
Finished goods	21.0	34.2
Product inventory	938.5	738.9
Capitalized pre-production	259.9	143.3
Inventory, net	\$ 1,198.4	\$ 882.2

Inventories as of September 27, 2007 and December 31, 2006 are summarized by platform as follows:

	September 27, 2007	December 31, 2006
B737	\$ 301.1	\$ 280.6
B747	68.4	62.8
B767	24.1	25.2
B777	162.0	152.9
B787(1)	424.1	172.2
Airbus-All platforms	79.5	70.2
Other in-process inventory related to long-term contracts and other programs (2)	139.2	118.3
Balance	\$ 1,198.4	\$ 882.2

- (1) B787 inventory includes \$235.8 and \$143.3 in capitalized pre-production costs at September 27, 2007 and December 31, 2006, respectively.
- (2) Contracted non-recurring services for certain derivative aircraft programs to be paid by the original equipment manufacturer, plus miscellaneous other work-in-process, and capitalized pre-production for other miscellaneous programs.

Table of Contents

Spirit AeroSystems Holdings, Inc.
Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)
(\$ in millions other than per share amounts)

Capitalized pre-production costs include certain costs, including applicable overhead, incurred before a product is manufactured on a recurring basis. These costs are typically recovered over a certain number of shipset deliveries and the Company believes these amounts will be fully recovered.

At September 27, 2007 and December 31, 2006, inventory included deferred production costs of approximately \$52.6 and \$41.8, respectively. These deferred production costs represent the excess of costs incurred over estimated average costs per Boeing shipset for the 887 Boeing shipsets delivered since inception through September 27, 2007, as well as 653 Airbus shipsets delivered from April 1, 2006 through September 27, 2007. Recovery of the deferred production costs is dependent on the number of shipsets ultimately sold and actual selling prices and production costs associated with future production.

Sales significantly under estimates or costs significantly over estimates could result in the realization of losses on these contracts in future periods.

The following is a roll forward of the inventory obsolescence and surplus reserve included in the inventory balances at September 27, 2007:

Balance, December 31, 2006	\$ 15.2
Charges to costs and expenses	4.9
Exchange rate	0.1
 Balance, September 27, 2007	 \$ 20.2

4. Property, Plant and Equipment

Property, plant and equipment, net consist of the following:

	September 27, 2007	December 31, 2006 (1)
Land	\$ 19.5	\$ 19.0
Buildings (including improvements)	165.5	157.7
Machinery and equipment	270.3	219.5
Tooling	348.7	245.4
Construction in progress	282.0	213.4
 Total	 1,086.0	 855.0
Less: accumulated depreciation	(148.3)	(81.2)
 Property, plant and equipment, net	 \$ 937.7	 \$ 773.8

(1) Land improvements of \$3.5 have been reclassified from Land to Buildings in the December 31, 2006 figures to

conform to
current year
presentation.

5. Long-Term Receivable

In connection with the Boeing Acquisition, Boeing is required to make future non-interest bearing payments to Spirit attributable to the acquisition of title of various tooling and other capital assets to be determined by Spirit. Spirit will retain usage rights and custody of the assets for their remaining useful lives without compensation to Boeing.

The following is a schedule of future payments from our long-term and short term receivables:

2007 (September 15, 2007 through December 15, 2007)	\$ 22.7
2008	116.1
2009	115.4
Total	\$ 254.2

A discount rate of 9.75 percent was used to record these payments at their estimated present value of \$226.5 and \$233.2 at September 27, 2007 and December 31, 2006, respectively. At September 27, 2007, the current portion of long-term receivable is \$103.7 of which \$11.4 was billed to Boeing in the third quarter and recorded to accounts receivable. We received the second installment of \$11.4 in the third quarter. Also included in long-term receivable is \$18.2 of B787 receivables not due until Boeing's first aircraft delivery.

Table of Contents

Spirit AeroSystems Holdings, Inc.
Notes to Condensed Consolidated Financial Statements (Unaudited) (Continued)
(\$ in millions other than per share amounts)

6. Other Assets

Other assets are summarized as follows:

	September 27, 2007	December 31, 2006
Intangible assets		
Patents	\$ 2.0	\$ 2.0
Favorable leasehold interests	9.7	9.7
Customer relationships	35.0	33.8
Total intangible assets	46.7	45.5
Less: Accumulated amortization-patents	(0.4)	(0.2)
Accumulated amortization-favorable leasehold interest	(1.7)	(1.3)
Accumulated amortization-customer relationships	(6.6)	(3.2)
Intangible assets, net	38.0	40.8
Deferred tax asset	63.3	39.1
Deferred financing costs, net	12.8	14.8
Fair value of derivative instruments	15.5	24.3
Goodwill Europe	3.8	6.0
Other	4.7	4.1
Total	\$ 138.1	\$ 129.1

Deferred financing costs, net are recorded net of \$10.4 and \$8.4 of accumulated amortization at September 27, 2007 and December 31, 2006, respectively.

7. Pension and Other Post-Retirement Benefits

	Defined Benefit Plans			
	For the Three Months Ended		For the Nine Months Ended	
Components of Net Periodic Benefit Cost	September 27, 2007	September 28, 2006	September 27, 2007	September 28, 2006
Service cost	\$ 1.9	\$ 1.7	\$ 5.7	\$ 3.4
Interest cost	9.2	8.6	27.6	25.5
Expected return on plan assets	(17.1)	(15.0)	(51.2)	(45.0)
Amortization of prior service cost				
Amortization of net (gain)/loss				
Net periodic benefit cost	\$ (6.0)	\$ (4.7)	\$ (17.9)	\$ (16.1)

Other Benefits

	For the Three Months Ended		For the Nine Months Ended	
	September 27, 2007	September 28, 2006	September 27, 2007	September 28, 2006
Components of Net Periodic Benefit Cost				
Service cost	\$			