

06-Feb-2024

Spirit AeroSystems Holdings, Inc. (SPR)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the Spirit AeroSystems Holdings, Inc. Fourth Quarter and Full Year 2023 Earnings Conference Call. My name is Prika, and I will be your coordinator today.
[Operator Instructions]

And I now would like to hand the presentation over to Ryan Avey, Senior Director of Investor Relations and FP&A. Please go ahead.

Ryan Avey

Director-Investor Relations, Spirit AeroSystems Holdings, Inc.

Thank you, and good morning, everyone. I am Ryan Avey, and with me today are Spirit's President and Chief Executive Officer, Pat Shanahan; and Senior Vice President and Chief Financial Officer, Mark Suchinski.

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, including those detailed in our earnings release and our SEC filings, and in the forward-looking statements at the end of this web presentation. In addition, we refer you to our earnings release and presentation for disclosures and reconciliation of non-GAAP measures we use when discussing our results.

With that, I would like to turn the call over to Pat.

Patrick M. Shanahan

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

Thank you, Ryan, and good morning, everyone. Today, I will update you on how we are running the business at Spirit. Most of my remarks will focus on the steps we took after the January 5th accident. Mark will address the financials in his comments.

My mandate when I came here was to put our operations and financials back on solid footing. In my estimation, we achieved significant progress toward that goal in the fourth quarter. However, the accident on January 5th demanded a different focus by our team. Consistent with our protocols, our response team was activated within hours. Since that moment, Spirit's focus was on supporting Boeing, its airline customers, the NTSB, the FAA, and our people. The immediate response was taking a hard look at our processes and incorporating any findings into action.

Within days, we enacted countermeasures to include adding in line and ship in place inspections with Boeing that replicated those performed by the airlines to return to service. Leveraging the FAA's Safety Management System to conduct a product safety risk assessment, incorporation of detailed review and observation with Boeing of the mid-entry door plug assembly and installation process to include both Spirit and Boeing operations.

Concurrent with those immediate actions, we have initiated a second wave of actions centered on addressing human factors, nonconformities, product safety, and expanded inspections across Boeing 737 manufacturing. People are at the heart of the company and our manufacturing processes. A significant portion of the Boeing 737 fuselage build is manually performed by our skilled teammates. Repeatability, reliability, and capability in manufacturing is required to produce high-quality conforming products.

The human condition and human factors must be accounted for in any improvement efforts, and through that lens, we are focusing additional actions. The four main levers to mitigate human factors that we are pulling include proficiency of our mechanics and inspectors, compliance to our quality management system, mistake proofing, and observation. We will do more testing and training. We will drive greater discipline to the QMS. We will enable our teammates with better tools, techniques, and technology that is available today.

The goal of any world-class manufacturing company is perfection or zero defects. We aspire to achieve perfection, detecting, correcting and ultimately preventing defects, otherwise known as nonconformities, is the basis for continuous improvement. We are expanding our efforts to integrate more with Boeing's QMS, realigning organizationally to accelerate redesign and process reengineering, and utilizing more advanced data analytics. We are also increasing the number of Spirit performed inspections and Boeing performed inspection, and soon we will integrate these efforts with those of the FAA and customers who have joined us here in Wichita.

That was a brief summary of some of the systemic improvements in our second wave of collective actions. There are additional actions we're taking as well. The point is we are mobilized for implementation with detailed plans and fully aligned with Boeing. Our next wave of improvement will be the deployment of automation and automation for sections of the airplane that remain highly-manual. That is the fundamental solution to zero defects and zero escapes.

On the Boeing 737 fuselage, the front and back sections have the most complex physical geometries and are the most confined workspaces. The build is largely manual. Our eye is towards finding the right balance of using human-assisted technology and automated technology. There is a path to deployment. Broadly speaking, full-scale robotics is impractical. In our research labs, we have significant human-assisted technology that is manufacturing readiness level 6, that we look to accelerate. I have recently reviewed this technology with the team and will ensure it receives the appropriate resources and investments.

I am very proud of how our team has responded to this accident. They have been calm, focused, and moving with urgency. I have a lot of confidence in this team. At this point, the art form is to integrate broad actions with our ongoing operations and not as a one-off project. Our teams across manufacturing and engineering are fully aligned and will implement changes seamlessly.

I believe we will move quickly because of our shift in governance away from being top down. The mindset shift is to understand that the airplane is the boss. The airplane tells us what to do. Our mechanics, sealers, engineers, and inspectors are like surgeons. They tell us in management what they need to perform their operations. Our goal is to give them what they need, when they need it, and resolve issues or make improvements.

Receptivity from our teammates across our facilities, shop floors, and offices has been positive. I also appreciate their candor in telling me what's on their minds. I've heard from every corner of the factory in Wichita and from every shift. Lots of energy, lots of ideas. This does not surprise me. Our workforce at Spirit has a clear understanding of the importance of their work. That commitment is rooted in a long legacy we have in this industry. In the coming weeks, we will learn more from the regulators, from their formal reporting, and we'll respond with urgency and transparency.

Now, I'll shift to a couple other topics I think you have on your mind as well. First, we made significant progress in the fourth quarter in stabilizing the Boeing 737 production line. We briefly paused the line to stabilize, which ultimately allowed us to deliver 104 fuselages, the highest quarterly total in four years. We made investments during the quarter to recover schedule and buffer the production system, which enabled us to start the year with a

balanced factory. Second, we've recognized additional forward losses on the Airbus A350 and the Airbus A220 programs this quarter, which Mark will address in a moment.

That said, we are working to not only improve these programs in our day-to-day operations, but also are engaged in discussions with Airbus to address the long-term financials. The negotiations with Airbus continue and have been productive. We hope to conclude by February, but we need to ensure all items are addressed. We are converging on operational and financial solutions. I appreciate the partnership and engagement by their leadership. This remains an important near-term priority for me.

I'll now turn the call over to Mark to review with you our financial results.

Mark J. Suchinski

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

Thanks, Pat, and good morning, everyone. We experienced significant pressures in 2023 due to production schedule, volatility, supply chain constraints and ongoing inflation, quality challenges, and increased labor costs. This resulted in higher than anticipated costs throughout the year. However, we also accomplished some major milestones during the year, including reaching a contractual resolution with our largest union, bringing Pat on board to lead Spirit's recovery, and executing a favorable agreement with our largest customer.

We also did a debt refinance and a capital raise, which strengthened our capital structure and increased production rates across many of our major programs. While we expect some of these pressures from 2023 to continue into 2024, we enter the year strongly focused on execution to stabilize and strengthen Spirit, both operationally and financially. Given the latest news around the Boeing 737 MAX production rates in relation to the FAA approval, as well as our ongoing negotiations with Airbus, we are not in a position to provide guidance at this time.

Now, let me take you through the details of our fourth quarter financial results. Let's start on slide 2. Revenues for the quarter were \$1.8 billion, up 37% from the fourth quarter of 2022. This substantial increase year-over-year was primarily due to higher production on our Commercial programs, increased Defense & Space and Aftermarket segment revenues, as well as the impacts from the previously disclosed Boeing MOA executed in October of 2023, which included favorable pricing adjustments on the Boeing 787 program. Overall, deliveries in the quarter increased 16% year-over-year.

Now, turning our attention to EPS. We reported earnings per share of positive \$0.52 compared to negative \$2.32 in the fourth quarter of 2022. Excluding certain items, adjusted EPS was \$0.48 compared to negative \$1.46 in the prior year. Operating margin was positive 11% compared to negative 11% in the same period of 2022, largely driven by the favorable impacts from our Boeing MOA. As a result of the favorable pricing adjustments to the Boeing 787, we reversed \$361 million of total liabilities during the fourth quarter, which included Boeing 787 forward loss reversals of \$206 million, which favorably reduced cost of sales, and reversal of Boeing 787 material right obligation of \$155 million, which flow through the income statement as an increase to revenue.

Fourth quarter net forward loss reversals totaled \$34 million, and unfavorable cumulative catch-up adjustments were \$55 million. This compared to \$114 million of forward losses and \$59 million of unfavorable cumulative catch-up adjustments in the fourth quarter of 2022. The current quarter forward losses relate primarily to A350 and A220 programs and were driven by higher estimates of supply chain, labor and other costs. We also recorded net incremental forward losses for anticipated performance obligations beyond 2025 in the amount of approximately \$30 million. The unfavorable cumulative catch-up adjustments relate primarily to Boeing 737

program, reflecting higher cost required to recover and stabilize the production system, which we have done in the fourth quarter.

Now turning to free cash flow. Free cash flow for the quarter was positive \$42 million compared to free cash flow usage of \$66 million in the fourth quarter of 2022. Fourth quarter free cash flow includes the previously disclosed funding of approximately \$100 million received from Boeing per the terms of the MOA and tooling and capital through 2025 on both the Boeing 737 and Boeing 787 programs. In our effort to stabilize operations, we also made certain working capital investments and accelerated certain capital investments in the fourth quarter of 2023.

Now, let's discuss our quarterly segment performance, starting with our Commercial segment on slide 3. In the fourth quarter of 2023, Commercial revenues increased 43% over the same period 2022 due to higher production across all of our programs, as well as favorable pricing from the Boeing 787 Boeing MOA. Quarterly operating margin increased to positive 17% compared to negative [ph] 8% (00:14:23) in the prior year, primarily driven by favorable change in estimates recorded in the current period. These changes in estimates, which I previously disclosed, included net forward loss reversals of \$48 million and unfavorable cumulative catch-up adjustments of \$51 million. In comparison to the fourth quarter of 2022, the segment recorded charges of \$111 million of forward losses and \$58 million of unfavorable cumulative catch-up adjustments.

Now let's turn to Defense & Space segment on slide 4. Defense & Space grew to \$205 million, up 12% higher than the fourth quarter of last year due to higher development program activity and increased KC-46 Tanker production. Operating margin for the quarter decreased to 2% compared to 11% in 2022, primarily due to higher unfavorable changes in estimates recorded in the period. The segment recorded forward losses of \$13 million and unfavorable cumulative catch-up adjustments of \$4 million, compared to forward losses of \$2 million in the fourth quarter of 2022. The forward losses were primarily driven by higher production cost estimates on the CH-53K program and unfavorable cumulative catch-up adjustments, which were primarily driven by the Boeing P-8 program.

For our Aftermarket results, let's turn to slide 5. Aftermarket had a strong quarter with revenue of \$91 million, up 24% compared to the fourth quarter of 2022, primarily due to higher spare parts sales. Aftermarket has continued to grow with global aircraft recovery and is on track to meet our plan for \$500 million by 2025. Operating margin was strong for the quarter at 23%, compared to 13% during the same period of 2022, primarily due to the absence of a onetime inventory adjustment charge recognized in the fourth quarter of 2022.

With that, let's now briefly touch on our full year results on slide 6. 2023 revenue came in at \$6 billion. That's up 20% year-over-year, driven by higher commercial production volumes, as well as higher Defense & Space and Aftermarket segment revenues. 2023 adjusted EPS decreased year-over-year, primarily due to higher interest and other expenses, partially offset by improved operating income during the current year. Other expense for 2023 was \$140 million, compared to other expenses of \$40 million in 2022, primarily due to higher non-cash losses related to settlement accounting for our primary US pension plan, foreign currency and sales of receivables recognized in 2023.

Full year cash flow was a usage of \$374 million compared to a use of \$516 million in 2022. Free cash flow usage was higher than we previously expected, primarily due to factory costs incurred in the quarter to recover schedule and stabilize operations, higher levels of inventory to support rate increases, as well as increased CapEx spend related to the customer funded capital and tooling received as part of the Boeing MOA.

With that, let's now turn to cash and debt balances on slide 7. We ended the year with \$824 million of cash, which reflects the proceeds from the issuance of common stock and exchangeable senior notes during the fourth quarter of 2023. We will use the if converted method regarding exchangeable notes implications to EPS, which results in the shares being dilutive if there is positive net income. If net loss position, they would be anti-dilutive. We ended the year with \$4.1 billion of debt. There are now no significant debt maturities until 2026.

So, with that, we will be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We have the first question on the phone lines from Seth Seifman of JPMorgan.

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Q

Hey. Thanks very much and good morning, everyone. Pat, thanks very much for the comments at the beginning of the call. I guess, maybe to level set a bit where Boeing 737 is right now, you talked about kind of stabilizing the factory in the fourth quarter. Does that mean stabilizing at a production of 38 a month? And if we took it as a given that – it's up to the FAA now when that rate will move higher. But if we took it as a given that that's the rate for 2024, that Spirit is now in a place to produce at that rate through the year and that what we saw – what we've read about over the past few weeks since the Alaska accident and specifically yesterday with the latest miss-drilling issues and Boeing's effort to cut down on traveled work, do you still kind of consider the factory to be stabilized at 38 a month?

Patrick M. Shanahan

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

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Yeah. Good morning, Seth. I would tell you that we are cycling at the 42 a month, but building at 38 a month. And by that, I mean we have a production schedule that allows us to have buffer days, and that's our means of testing our ability to go up in rate. And that buffer, those buffer days allow the factory to, when we talk about stability, minimize traveled work. Have everybody stay in position. So, from that standpoint, we're in a good position and we'll take our guidance from Boeing as to how to adjust our schedules if necessary.

Yeah, maybe I'll just address those two non-conforming holes. Those are not a safety or flight issue and just kind of characterize the normal process. Any time there's a nonconformity, we basically scope and bound it. Engineering does a preliminary look to see if there's a safety or flight issue. Then essentially we communicate to the customers if there's any potential exposure. But we say, here's a heads up and then we do a detailed engineering analysis and work to get a final disposition. And when we have a final disposition, then we can determine a repair and from that, a response. And relative to these two holes, there is not a final engineering disposition. We expect that in the next 72 hours, based on that, we'll determine what the repair might be and any impact associated with that. And then the follow on as a root cause, corrective action.

And maybe just a...

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Q

Thanks, Pat. Thanks very much. I'll...

Patrick M. Shanahan

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

...I think we have about – you bet.

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Seth M. Seifman

Analyst, JPMorgan Securities LLC

Okay. I'll stick to one this morning. Thanks.

Q

Ryan Avey

Director-Investor Relations, Spirit AeroSystems Holdings, Inc.

Thanks, Seth.

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Operator: Thank you. We now have David Strauss of Barclays. You may proceed with your question.

David Strauss

Analyst, Barclays Capital, Inc.

Thanks. Good morning. Quick follow up there. What is the status of the MAX buffer stock as it relates to you matching up with Boeing in terms of your production rate? And then on the Airbus side of things, the \$5 million mark also on the balance sheet. At this point, is that really all A320, A350 [indiscernible] (00:22:49) negotiations conclude with Airbus? Should we expect to see a significant reversal there? Thank you.

Q

Patrick M. Shanahan

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

I'll take the Airbus one on top of the – yeah.

A

Mark J. Suchinski

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

Sure. Hey, David, let me address your second comment in regards to the balance sheet and the forward loss reserves that we have, both short-term and long-term. I think we mentioned this on the last call as it relates to Boeing and the Boeing 787 program. We stated that we would be in a forward loss through 2024, maybe slightly into the first quarter 2025. So, really the short-term forward loss has some Boeing 787 in there. As we come down our unit cost curves and drive that to cash flow positive in 2025, and then it would include the A350 as you indicated and the A220 and a little bit on [indiscernible] (00:23:49) and CH-53K. But I think you got it right.

A

Patrick M. Shanahan

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

Maybe just to answer the question about the buffer or what we refer to as ship in place are 42 available units today to ship in place. We're taking a few extra days. So, think of that as a delay on some of the deliveries to rent and just to make sure we can complete all the inspections related to the mid entry door plug as well as any known rework and doing some – conducting some additional inspections.

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David Strauss

Analyst, Barclays Capital, Inc.

Thank you.

Q

Ryan Avey

Director-Investor Relations, Spirit AeroSystems Holdings, Inc.

Thank you, David.

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Operator: Thank you. We now have Jason Gursky of Citigroup. Your line is open.

Jason Gursky

Analyst, Citigroup Global Markets, Inc.

Great. Good morning, everybody. Let's see...

Q

Patrick M. Shanahan

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

Good morning.

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Jason Gursky

Analyst, Citigroup Global Markets, Inc.

...maybe I have a two-part question. I apologize for that. Pat, I wondered if you can just – to fix the problem you have to understand exactly how you got here. So, I was wondering if you could just, from your perspective, describe a little bit about the conditions that led us to where we are today. It sounds like you've got a plan to fix some things. I'm just kind of curious to get your input on how we got here?

Q

And then the second part of the question is, once we figure this all out, has anything kind of fundamentally changed on the types of rate breaks that you can do in the future? I know Boeing has got a master schedule out there, and historically you guys have gone up 10%, 15% of different rate breaks and then hold for a bit before going back up again. So, I'm just wondering in the context of all of this, whether things have fundamentally changed in the industry or the industry's view on its ability to go up in rate and whether we go up slower than we have in the past? Thanks.

Patrick M. Shanahan

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

Yeah. Hey, Jason. I think it's hard to go back and look at how we got here. I wish I had that history. But what I would tell you is the basic fundamentals around rate breaks haven't changed. Some of the dynamics around the supply chain have changed. I would offer that some of the work that Spirit has done in the fourth quarter to align the 2024 plan with Boeing's rate schedule has afforded us some more stability. We have used that time to improve the dynamics of the supply chain. We've seen a lot of improvement in the near-term to support rate 42. As it relates to rate 47, we have line of sight on virtually all the issues, five suppliers that we have to give special attention to. But at this point, the majority of the issues are related to raw material and labor availability.

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I think the hardest part of this industry is, given its complexity and breadth, how do you judge how quickly to go up and rate? In the case of the Boeing 737, it's been done before, so there's a playbook that parametrically says this is what you can do, but we have to adjust that for current events in the environment. But I would say that the 2024 plan we laid out is a – incorporates the existing environment and if there are any changes we'll accommodate Boeing's direction.

Jason Gursky

Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you.

Operator: Thank you. We now have Myles Walton of Wolfe Research.

Myles Walton

Analyst, Wolfe Research LLC

Q

Thanks. Pat, you're in a pretty unique position, having been inside of Boeing Vice President of Commercial Airplanes for time and now inside Spirit and you can sort of give the perspective, I think, of what if and the what if is if Wichita were still part of Boeing, would the signals with the Boeing quality, the QMS system, have captured these quality escapes sooner? And if so, does that create industrial logic for some element of re-absorption or is the solution just a greater integration into Boeing's existing QMS?

Patrick M. Shanahan

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

A

I guess, I would respond not so much to the hypothetical, but the fact that we're behaving as if we were part of Boeing and that the coordination and the integration as you referred to is really taking place now. So, if you sat in one of our meetings, people took off their badges, you would not be able to tell which company they worked for. I think because of the trust that's been built recently, some of the feedback loops that existed in the past are being restored and that should allow us to even work better together.

Myles Walton

Analyst, Wolfe Research LLC

Q

So, just to clarify, though, Pat, is that a change of behavior, the tightness of the feedback loop, or is that a reflection of what's always been the case...

Patrick M. Shanahan

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

A

Yeah. I would – I think as a result of the MOA and the shedding of the financial constraints, it opened up the aperture to really work more seamlessly together. And we're seeing that and I think we're surprised every single day how much more quickly people are working shoulder to shoulder. So, I think the MOA was a big change that allowed us to increase the integration between the two companies.

Myles Walton

Analyst, Wolfe Research LLC

Q

Okay. All right. I'll stick to one. Thank you.

Operator: We now have Sheila Kahyaoglu from Jefferies. You may proceed.

Sheila Kahyaoglu

Analyst, Jefferies LLC

Q

Good morning, guys. Thank you. Pat, if I could ask you, in just its current state, how do we think about the Boeing 737 cash profile per shipset, just given potentially additional costs this year? How does that change with a rate break in 2025? Is the FAA does also limit you guys at 38 a cap? I'm not sure. And then into 2026, the free cash flow per shipset just given the step down, so just the cash profile of MAX?

Patrick M. Shanahan

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

A

Yeah, Sheila. I'm just going to think. Yeah, no, no, no. I mean, I – obviously, go up in rates, you can distribute the overhead more broadly. The fundamentals of the things that we're doing in terms of improving cash flow or cost reduction. And a lot of that is through productivity or improvement in quality. So, those things [ph] are (00:31:05) going to change. We've built a plan around achieving support labor or support, I would say, cost that mirrors our performance in 2018. We're working to that regardless of a change in direction from Boeing. So, that might dampen a bit.

Indirect costs, we're going after the same way. Probably the one that wouldn't be affected by rate is working capital, because we just need to optimize that to a much larger degree. Last year we were anticipating being at a much higher rate. So, there's a real opportunity to get there regardless of where the rates stabilize at.

Mark, do you have any other comments?

Mark J. Suchinski

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

A

No, I think you hit it, Pat. Obviously, Sheila, as you go up in rate, you get the leverage from the higher production rates from an absorption standpoint. But at the end of the day, I think the key here is, as we look over the next couple of years, it's about operating the factories efficiently, leaning it out, working on flow, working on the items that Pat talked about. And he's got the teams really rallied around that. And so, we're really excited over the next couple of years as we go up in rate to see that financial benefits of those production rates through the variety of actions that we're working on, including focusing on improving overall quality. So, we do think over the next couple of years we'll continue to drive our unit cost down and take advantage of the higher production rates.

Patrick M. Shanahan

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

A

Sheila, maybe just one add on here. I think we have to think about the supply chain. I mean, I think that's the one that if we do change production rates, we have to figure out what do we do with the things that we've already ordered? How do we keep them healthy so that, as things get corrected, we can go back to building fuselages? So, I think that would be the one we still need to sort through.

Sheila Kahyaoglu

Analyst, Jefferies LLC

Q

And just to follow up, given the MAX is the biggest driver of your free cash flow. Do you still expect – do you expect free cash flow to be positive in 2024 without giving any guidance?

Mark J. Suchinski

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

A

Sheila, let me just address that. I think what I would tell you is, with the question marks around the production rate increases in front of us that we had previously planned in 2024, the Airbus negotiations, and then just trying to assess what additional costs may come as it relates to quality and the regulatory oversight. As we said in our press release, we're not in a position to talk about cash flow. We know that it's an important aspect of our business here. And I'm not trying to avoid the topic.

We're working really hard to improve the overall business financially. But give us a little time to digest the current situation here. And in the coming months, we'll be able to give you the answers that you guys are looking for. But I

think we need a little bit more certainty. There's still too much uncertainty here for us to really dial this in and give you a more direct and concrete answer. So, more to come. It's not now, but give us a little while and we'll be able to address those questions.

Sheila Kahyaoglu

Analyst, Jefferies LLC

Sure. Thank you.

Q

Ryan Avey

Director-Investor Relations, Spirit AeroSystems Holdings, Inc.

Thank you.

A

Operator: Thank you. We now have Scott Deuschle from Deutsche Bank.

Scott Deuschle

Analyst, Deutsche Bank Securities, Inc.

Hey. Good morning. Pat, have you priced your content on B-21, yeah?

Q

Patrick M. Shanahan

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

Can you say that one more time? This is on the LRIP?

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Mark J. Suchinski

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

The B-21 customer...

A

Scott Deuschle

Analyst, Deutsche Bank Securities, Inc.

Yeah. Have you priced your LRIP content on B-21, yeah? Yes.

Q

Patrick M. Shanahan

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

We have not. Not yet.

A

Scott Deuschle

Analyst, Deutsche Bank Securities, Inc.

And then, Pat, can you clarify what the operating elements might be with respect to the Airbus negotiations? Are you referencing moving some work over to them or is this something else? Thank you.

Q

Patrick M. Shanahan

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

Well, our focus has really been on price and the focus has really been on understanding between the two companies what is the right level of productivity that should be achieved that they're willing to pay for and what is cost we're all aligned on that is real and needs to be reflected in the price. And our discussions to-date have been

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in substantiating both of those. And along with that, aligning expectations around our performance on the A220 and the A350 in 2024.

Scott Deuschle

Analyst, Deutsche Bank Securities, Inc.

Thank you.

Q

Ryan Avey

Director-Investor Relations, Spirit AeroSystems Holdings, Inc.

Thanks, Doug.

A

Operator: We now have Ken – I apologize. We now have Ken Herbert of RBC Capital Markets.

Ken Herbert

Analyst, RBC Capital Markets LLC

Yeah. Hi. Good morning, Pat and Mark. I wanted to ask on an inventory build. Can you comment on at which rate you're pulling, say, MAX shipments from suppliers at? And depending upon your schedules with Boeing on the MAX, how much inventory are you prepared to build? And maybe how much of a use of cash is working capital this year versus maybe visibility on how much of a savings it can be in the back half of the year?

Q

Mark J. Suchinski

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

Thanks, Ken. Let me take that one. I think Pat briefly mentioned it. As we moved through 2023, we had expected to be at a higher rate at this point in time. We had expected to deliver more than we finished the year out at. And so, we built inventory throughout the year and ordered inventory from our suppliers in anticipation of that. And that caused us to build inventory to help – to support 42 a month. We've also tactically here in the fourth quarter, built strategic buffers at – with critical components for our production system. So, really, you saw throughout the year almost a \$300 million increase in inventory through 2023, and that was in anticipation of higher rates.

A

As we move into 2024 and where our plans are at here, we're not going to have to make that sizable increase because we've got the suppliers tuned up to help support and produce and deliver at 42 aircrafts per month. So, I would say that as we move into 2024, I would anticipate working capital – the drag that we saw in 2023 to be relieved to a big degree. And so, I think in summary, suppliers are delivering to us at 42. Pat talked about what our factory is cycling to. And so, our goal here is to really optimize the working capital as we stabilize the factory. And we think that there's some work for us to go do there. And we think that as we move forward here, that will create a bit of a tailwind to our free cash flow.

Patrick M. Shanahan

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

Maybe just add on to what Mark's saying. There are discrete plans around how we're managing the suppliers and the buffer. So, Ken, one of the things we asked them to do is protect the factory in terms of the critical jobs that need parts to maintain the build of the aircraft. And so, in those critical areas, we've built buffer stock. They're also suppliers when we look at their history that are unpredictable, so those we will continue to work with, but we'll probably build some buffer stock.

A

Then there are the highly reliable, consistent suppliers where we need to maximize inventory turns and the teams are taking those, bleeding down the inventory and trying to balance. There, the suppliers [indiscernible] (00:40:07) turn them off and starve them. At the same time, we've got to kind of optimize way to get our inventory turns up. So, it's a dance and the teams are able to do pull 10 levers, whereas in the past, I think, it was just one order all the parts. So, I expect to see a real improvement in 2024.

Ken Herbert*Analyst, RBC Capital Markets LLC*

Great. Thank you very much.

Q

Operator: We now have Doug Harned of Bernstein.

Douglas S. Harned*Analyst, Bernstein*

Good morning. Thank you.

Q

Patrick M. Shanahan*President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.*

Good morning.

A

Douglas S. Harned*Analyst, Bernstein*

Pat, when you talked about the process redesign, introducing automation as some of the things you're doing to deal with the quality escapes across the company. But I think of this on really two timescales and that can be – and some of those things can be longer term. But at the same time, you have issues that may already be in things that have been done, like the misdrilled holes that came up over the weekend. There's a lot of concern that there could be another incident like the Alaska Boeing 737 MAX 9 incident. How do you make sure that as you do the broader redesign you can also identify any situations that might be an issue in things that have already been essentially produced?

Q

Patrick M. Shanahan*President, Chief Executive Officer & Director, Spirit AeroSystems Holdings, Inc.*

Yeah. No. Good. Doug, thank you for that question. And I remembered the last call you asked me about just the overall quality and maybe we can expand into that. I do think the short answer to that question is our quality management system really looks at product quality. The FAA's Safety Management System looks at product safety. So, our first look at the Boeing 737 has been through the product safety lens. And maybe just in parallel, I think what you'll find is that there – if we drew a Venn diagram, there would be a lot of overlap between the Safety Management System risk assessment and feedback on nonconformities for our QMS, but our first priority has been to look through the product safety lens.

A

We have four discrete categories that we're evaluating. If you look at the installation plans that we have that direct how a Boeing 737 fuselage is built, there are 2,300. Through this lens of product safety, we've distilled it down to 200 that we're going through and doing a detailed examination of to include observations of the mechanics and a review by our master mechanic of the build process. That's in parallel.

I think, Doug, maybe to this broader question of what are you doing now about quality and what are you doing long-term, and the short answer for us at Spirit on quality is less manual, less interpretation, and more inspections. Medium-term and long-term is more human-assisted equipment and technology, more automation. And when we think about, well, where is the focus, it's where most of the manual work is, it's in the forward and rear sections of the airplane. If you're a mechanic working in there, you'd almost have to be a gymnast.

So, we're really looking at, well, how do we address the human factors as some of this other technology is bridging to be implemented, and we're very focused in four areas. The first is proficiency, we got to test more, we got to train more. The second is compliance, and I always think of Bill Belichick here as, do your job. So, part of the compliance piece is people have to show up and do their job. I mean, we will help them do their job, but there's an element of they need to be committed to personal warranty.

The third is there's a lot of things we can do to mistake-proof the build of the aircraft, and probably the last one is observation. It's not just more inspections, but it's our team spending more time on the factory floor. So, that's what – if you were to come here to our war room and look at our plans, you'd see that we're really trying to address human factors in the near-term, prioritized by product safety.

Douglas S. Harned

Analyst, Bernstein

Q

And if I can just quickly follow up. Is there a way to characterize like, where you are on this path? I mean, you've now had a chance to be much closer to this over the last few months. Is there a way to characterize when you feel like, at least in the near-term here, the issues, the escapes that we have seen, that you've got a really solid handle on it and feel confident in what's being delivered, I guess?

Patrick M. Shanahan

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

A

Yeah. I mean that's the question that, I think we all wrestle with, how can we predict the future. It's hard. I don't know how to predict it, but I – some of the things that we just talked about are the best way to do that. So, it's here in short order, making real progress and making these things stick, I think, will give us the belt and suspenders confidence that we can mitigate this.

I'd say the other one is we've been working with Boeing to do more inspections, and more inspections as though we weren't doing a lot of inspections, I think what we're doing a better job of is harmonizing our work together. So, we're looking at it the same way, at the same time, all the time and trying to keep it here in Wichita, and these are – some of them are our interpretation of fastener hider skin quality. But those – when we're working together, mitigate, what ends up being found in [indiscernible] (00:46:44) much more disruptive to fix.

Douglas S. Harned

Analyst, Bernstein

Q

Okay. Thank you.

Mark J. Suchinski

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

A

Thanks, Doug.

Operator: Thank you, Doug. We now have George Shapiro from Shapiro Research. You may proceed with your question, George.

George David Shapiro*Analyst, Shapiro Research LLC*

Q

Good morning. Mark, if I look at the underlying margins that you've had in Commercial, I mean, you had 10.6% as the high in the first quarter and you had relatively high Boeing 737 deliveries. But this quarter, you had the highest Boeing 737 deliveries and the margin was like 8.5%. Now, is that just reflective of the extra work that you mentioned that you put in to try and improve the production process in the quarter, and what would be kind of a normal look as we went forward on this?

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

A

Hey, George. Good morning.

George David Shapiro*Analyst, Shapiro Research LLC*

Q

Good morning.

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

A

I would say just that. I mean, it's hard to assess and state that the fourth quarter is kind of a normalized Commercial margin. We entered the quarter in a very disruptive state, behind schedule. Pat talked about we did a pause in the fourth quarter. And so, there was a lot of investment to stabilize the factory in the fourth quarter, and you saw that come through in the unfavorable cumulative catch-up. We delivered the most deliveries than – fuselages in the fourth quarter than we did in four years. So, there was definitely a big cost investment to stabilize the Boeing 737 production system.

And when we think about jobs behind schedule, all of the operational metrics that we had as we exited the year, we were in the best shape than we've been in a long, long time here. So, I don't want to lean forward here and start talking about what the normal margins are, but they were definitely depressed as it relates to the investment we made to stabilize the operations, and we did a lot of good work in the fourth quarter.

Anything you want to cover, Pat, on top of that? And in addition, it's not margins, but we also made working capital investments to also stabilize that factory, and that put a little bit of pressure on cash. Although your question wasn't about cash, it was more about the margins. But the goal here is once you have a stable factory, the financials will come with it and that's what we're focused on.

George David Shapiro*Analyst, Shapiro Research LLC*

Q

And one quick follow-up, Mark. The free cash flow that you missed in the quarter, I mean, certainly, it looks like \$30 million or so was CapEx, and you've enumerated a couple of other things. I would think that some of that's actually a benefit to 2024, because you won't be spending that much more on CapEx than what you spent this quarter. Is that a fair statement?

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

A

That's right, George. We'll buy some of that back as we move into 2024 for sure, right. We – as we think about stabilizing the operations and co-investing with Boeing, we did accelerate some of that CapEx to stabilize the system. And so, as you said, some of that will come back as a benefit in 2024.

George David Shapiro

Analyst, Shapiro Research LLC

Okay. Thanks very much.

Q

Mark J. Suchinski

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

Thanks, George.

A

Operator: We now have Gavin Parsons of UBS. Your line is open.

Gavin Parsons

Analyst, UBS Securities LLC

Thanks. Good morning.

Q

Patrick M. Shanahan

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

Good morning.

A

Gavin Parsons

Analyst, UBS Securities LLC

Maybe just following up on George's question there on the end on cash flow, lot of moving pieces in 2023. I think besides the working capital, the pension close out, the MOA, the advances, and the labor contract ratification. What are some of the other moving pieces or are there other onetime items we should keep an eye out for in 2024 or is 2024 a relatively clean year best we can tell?

Q

Mark J. Suchinski

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

As you said, there was several onetime items, both good and bad, in 2023. As we think about 2024, we are not anticipating significant one-offs as we stand here today. I think it's about just running the business. We talked about some of the opportunities to improve free cash flow and what are some of the tailwinds we're working hard, we talked about the operations, but we're also focused on indirect and overhead costs in the working capital side of things. But Gavin, I'm not aware of any of the sizable type items that we saw in 2023 coming back in 2024.

A

Gavin Parsons

Analyst, UBS Securities LLC

Appreciate it. Thank you.

Q

Mark J. Suchinski

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

Thank you.

A

Operator: We now have Noah Poponak from Goldman Sachs. You may proceed.

Noah Poponak

Analyst, Goldman Sachs & Co. LLC

Hey. Good morning.

Q

Mark J. Suchinski

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

Good morning.

A

Noah Poponak

Analyst, Goldman Sachs & Co. LLC

Pat and Mark, what's your latest thinking on your framework of where your free cash flow margin can go in the future, putting any specific year aside, just longer term, at – compared to history at equivalent volumes, right? You used to have a targeted range and then you've had a targeted range for when volumes are back at certain levels. Is there any kind of new way you're thinking about that as you evaluate where price and cost are shaking out?

Q

And then, I'm curious also to hear you talk about how you are going through the process of renegotiating pricing while your costs are such a moving target, right? You're at low volumes where you sort of don't know what the cost per unit is at higher volumes or double the volumes, right? So, how are you factoring that in as you go through these customer pricing renegotiations?

Mark J. Suchinski

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

Okay, Noah. Let me address the second one first, and I understand your point, with fourth quarter here, we just took some additional forward losses, which will put pressure on unit cost as we move forward here. But we've been doing a lot of work as we think about the Airbus A220, Airbus A350 on our long-term unit costs. We've worked shoulder to shoulder with our customer as it relates to where we are now, what the learning curves look like, what benefits we'll get from optimizing the supply chain over the next three or four years. We've done a deep dive internally to assess that as best we can based on what we know now, and that is really the information that we're using as we enter the conversations with our customers, and that's the best way that I would describe that on the Airbus side.

A

As it relates to longer term...

Patrick M. Shanahan

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

Maybe I'll just add on to that [indiscernible] (00:54:19)

A

Mark J. Suchinski

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

Sure.

A

Patrick M. Shanahan

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

A

When we think about like the Airbus A220, for example, a good portion of the cost reduction which allows us to get to the right pricing level comes from a transfer of work. Many of the suppliers that we would transfer the work to, this is coming out of the old Bombardier supply chain are going to Airbus suppliers, and we've jointly evaluated those costs and Airbus has a significant history with those suppliers. So, I feel confident.

In that cost basis, we also have a fairly good understanding of the cost and productivity curves for assembly, particularly in Belfast, so – and that's really 9% or 10% of the cost, but those learning curves hold true. And I would just say on the Airbus A350, there's a history of a higher production. So, that kind of holds as a baseline that we need to get back to, and then there's the normal adjustment for labor and raw material price increases. So, I don't think there's – with these increased rates that it really creates a different cost estimating basis that we're not familiar with.

Noah Poponak

Analyst, Goldman Sachs & Co. LLC

Q

Okay. That makes sense. Appreciate that.

Mark J. Suchinski

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

A

Yeah. And then to address your first question around long term. I don't want to get into the prediction business, but when you think about what this business generated in the past, I think you're referencing the 7% to 9% margins and \$500 million to \$600 million worth of free cash flow in the future. As we go up to the higher rates, that will obviously help from a revenue, and a profitability and a cash flow standpoint. I think that we can get back to those levels. There's some headwinds as it relates to some of the inflationary pressures that we talked about before, like the IAM contract.

But I think the single biggest item that we need to work on to help us drive back up to those cash flows, because I think the business is going to drive it, is we're carrying \$4 billion of debt and \$350 million, \$325 million of cash interest. So, over the next couple of years, we need to take that positive cash flow, pay down debt, not only will that help our leverage from a balance sheet standpoint, but it will get the cash interest drag off the books. And if we can drive that interest back down to our historical measures, we can get back to similar to levels that we've had in the past.

Noah Poponak

Analyst, Goldman Sachs & Co. LLC

Q

Okay. Thanks for the detail.

Mark J. Suchinski

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

A

Thanks, Noah.

Operator: Your next question comes from Robert Stallard of Vertical Research.

Robert Stallard

Analyst, Vertical Research Partners LLC

Q

Thanks very much. Good morning. Pat, I just wanted to follow up on a comment you made earlier that you said that Spirit personnel are acting as if they're now a part of Boeing. I was wondering if this has any sort of impact on your relationship with Airbus in particular and perhaps to other customers.

Patrick M. Shanahan

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

A

I don't think so. I guess, the real difference is, I know more people at Boeing than I do at Airbus, but I've quickly come to meet quite a few of the executive leadership through program reviews we've been doing on the Airbus A220 and the Airbus A350, but my Rolodex isn't as great. But I'd say the interaction is just as positive, and the transparency and the focus on driving improvement.

I'll do a number of these Google Meets, we Google Meet and the feedback I get is just as direct as the feedback I get from Boeing, and the working together effort is almost identical. I mean, everybody tries to get the job done the right way. I think with Boeing, I just have a few more tricks in my bag just because of my familiarity with how to navigate their system. But the treatment and the behavior, and the working together spirit out of Toulouse is strong, and we just – we're able to get things done pretty well.

Robert Stallard

Analyst, Vertical Research Partners LLC

Q

All right. Thanks so much, Pat.

Patrick M. Shanahan

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

A

Yeah.

Mark J. Suchinski

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

A

Thanks, Rob.

Operator: Your next question comes from Michael Ciarmoli of Truist Securities.

Michael Ciarmoli

Analyst, Truist Securities, Inc.

Q

Hey. Good morning, guys. Thanks for taking the question. Pat, lots of talk about quality. If the airplane is the boss, we got safety and quality are paramount. If I just – and maybe not to put you on the spot, but if I look at your proxy and I guess you're going to file it next month, compensation incentives looks like only 20% is tied to quality on annual cash comp, nothing tied to quality in the longer term. It seems like everything we're talking about here, cash generation, revenue, EBIT margin, all tied to quality. I mean, are you guys planning on changing compensation to drive some of this behavior towards more of a focus on quality?

Patrick M. Shanahan

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

A

It will be significantly different, and the heaviest weighting will be on quality. And right now, I'm really working to design it, so the system can't be – manipulation is probably too strong a word, but I want to make sure that it drives the right behaviors and we can measure true performance. I'll just do a shout out to Donna Anderson at T. Rowe Price, and she threw out the idea. You got to really look at the utility industry where in their quality metric,

there's a significant penalty for an escape. So, we're really trying to look at how do we measure defect reduction, but also what if there's any type of escape, only one when it drive much in the metric, but it really should. So, the answer to your question is we're changing it fundamentally and we're now making sure that what we put in place works well and drives the right kind of behavior.

Michael Ciarmoli

Analyst, Truist Securities, Inc.

Q

Got it. Outstanding. That's good to hear. Thanks. I'll keep it to one.

Mark J. Suchinski

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

A

Thanks, Michael.

Operator: Thank you. Due to time, our final caller comes from Peter Arment of Robert W. Baird. You may proceed with your question.

Peter J. Arment

Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Thanks, Pat and Mark. Good morning. Pat, maybe just a quick one, just because it's the end of the call.

Patrick M. Shanahan

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

A

Good morning.

Peter J. Arment

Analyst, Robert W. Baird & Co., Inc.

Q

I mean, is there a timing when you expect to price the B-21 LRIP? And then just, Mark, if you could just give a little more color on the CH-53K program. I know you mentioned some of the forward losses there. Just what – any color in terms of the health of the program right now. Thanks.

Patrick M. Shanahan

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

A

Why don't we switch? Why don't you answer the LRIP? I'll answer the CH-53K.

Mark J. Suchinski

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

A

Absolutely. Yeah. Thanks Peter. On the B-21, we're – we expect in the back half of this year to complete the negotiations in regards to the initial LRIP on that program. We're on the tail end of the development side of the program, which is a cost-plus type arrangement. And so, we'll be able to report back more on that later in the year. And obviously, when we think about our customers, our goal here is to sign up for contracts that add value to our company. And so, that's what our focus is going to be as we negotiate that contract later in the year.

Patrick M. Shanahan

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

A

Yeah. I'll just maybe comment on the CH-53K program. We disappointed Stephanie Hill and our teammates at Lockheed Martin in 2023. We're on track to turn that around in 2024, and it personally consumes my time every week, so we can deliver on – not only deliver on the airframes we've committed to, but also get to a higher production rate that supports the needs of the Marine Corps.

Peter J. Arment

Analyst, Robert W. Baird & Co., Inc.

Appreciate all the color. Thanks, Pat.

Q

Patrick M. Shanahan

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

You're welcome.

A

Operator: Thank you. I can confirm we have no further questions and I would like to conclude the call here. Thank you all for joining. And I can confirm the Spirit AeroSystems fourth quarter 2023 conference call has now concluded and you may now disconnect your lines, and please enjoy the rest of your day.

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