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Spirit AeroSystems Holdings: SPR

Benjamin Bouin

Sector: Industrials
Industry: Aerospace & Defense
Current Price: \$57.06
Target Price: \$ 59.95

Spirit AeroSystems designs founded in 1927, manufactures, and supplies aero structures worldwide. It operates on three segments: fuselage, propulsion and wing system. Concerning the fuselage section, it is an original equipment manufacturer, it also proposes maintenance, repair, and overhaul services. It also produces low observables, radar absorbent rotorcrafts, training, and other military services.

BUY

Current Price: \$57.06
 Target Price: \$59.95
 Market Cap: 6.78B
 Beta: 1.18
 Short Interest Ratio 6.35

- **Catalysts:**
- **Short Term(within the year):** New contracts signed
- **Mid Term (1-2 years):** Increase of the army's budget.
- **Long Term(3+):** Increase of its products line, decreasing its risk

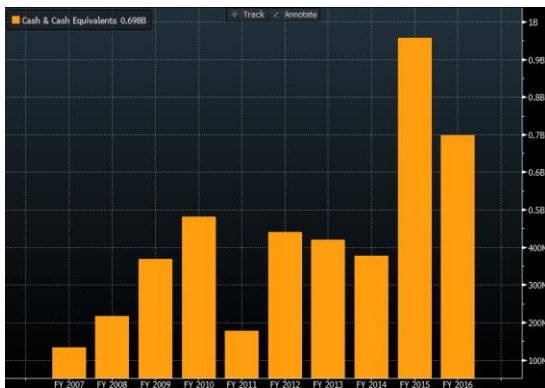
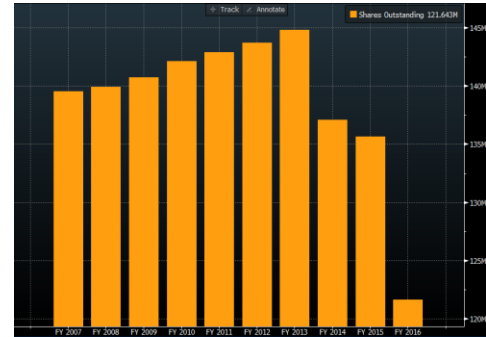


Thesis: Aerosystems' guidance shows confidence into the coming year. In fact, they have let know the investors that the cash on hand is not just in case of a business opportunity but also in order to repurchase some outstanding shares. This will have as effect to increase the earnings per share but also to elevate the market price of the shares. Moreover, in order to increase the value creation, they expect to invest into the segment of the defense, which during this period seem to be a good investment with a lot of business opportunities through the increase of 10% into the budget of the government's defense. Finally, this cash will permit to the company to invest in vertical integration via Tier 2 or Tier 3 in the aerostructure supply chain, which produce an important margin. This will permit to SPR to increase their margins but also to increase their revenue; both combined, means additional company's value. Furthermore, if we look at the WACC and the ROIC, we can see that the company is able to turn investment into profits at higher ratio with less costs than its competitors.

Guidance:

Between 2015 and 2016, Spirit AeroSystems has maintained an important amount of cash on hand. In 2016, this amount represented almost \$700 million of dollars, \$200 million less than in 2015. In fact, this amount of cash has several goals. The first one is to repurchase a certain amount of outstanding shares. In fact, the governance estimates that their shares are at an unfairly low price, underestimated. Indeed, if they repurchase a certain amount, this will lead to an increase of earnings per share but it will also elevate the market value of the remaining shares. Thus, they already had started this strategy, but they still continue to repurchase shares, as we can see on the graph.

The second use of this cash will be used to help them to reconcentrate their business on the defense segment. In fact, the 10% boost of increase for the defense investment promised by Trump, represents a \$54 billion opportunity for



the aerospace & defense industry. In fact, the commercial market continues to represent 99% of their business. This is why they want to invest in order to increase their line of product specifically on the defense market. This will create value since it will increase the revenue, but the defense services have an important margin opportunity. Finally, the cash will also be used for some vertical integration, in order to increase the margins.

Costs/ Margins:

As we can see, the company relies on the performance of different companies such as Airbus but more importantly on Boeing's performances. In fact, 84% of their revenues come from Boeing and 11% from Airbus. The 5% left are from companies such as Rolls Royce, United Airlines or even Mitsubishi Aircraft. Spirit AeroSystems had some difficulties to find a correct agreement with Boeing, which has led to an increase in their costs but also a decrease on their profit margins. This disagreement is mostly solved by senior managers. Furthermore, to be attractive and to gain new contracts, AeroSystems had to decrease their margins on a product, in order to gain new contracts on the production of other components. For example, SPR makes no margin on the A350, but deliver 6 to 7% of cash flow. This zero margin dilutes the Fuselage segment margin. In order to increase the margin, AeroSystems thinks to realize a vertical integration. What they are looking at is a Tier 2, or Tier 3 supply chain in aerostructures, which offer strong margins. This would permit them to reduce their costs but also to increase their revenue.

Name (BI Peers)	EBITDA to Net Sales:Q	EBITDA Mgn 3Yr Avg	OPM LF	NOPAT T12M
Median	15.93%	17.18%	9.72%	214.29M
100) SPIRIT AEROSYSTEMS HO...	14.04%	15.49%	10.25%	515.54M
101) TRANSDIGM GROUP INC	43.62%	44.60%	38.94%	984.28M
102) ROCKWELL COLLINS INC	23.30%	23.81%	18.27%	739.05M
103) HEICO CORP	23.24%	22.84%	18.80%	191.86M
104) MEGGITT PLC	--	24.56%	15.39%	270.71M
105) CAE INC	22.54%	22.45%	14.44%	236.72M
106) B/E AEROSPACE INC	17.83%	21.68%	14.87%	379.11M
107) ULTRA ELECTRONICS HLD...	--	18.98%	12.14%	104.14M
108) THALES SA	--	11.85%	9.60%	1.24B

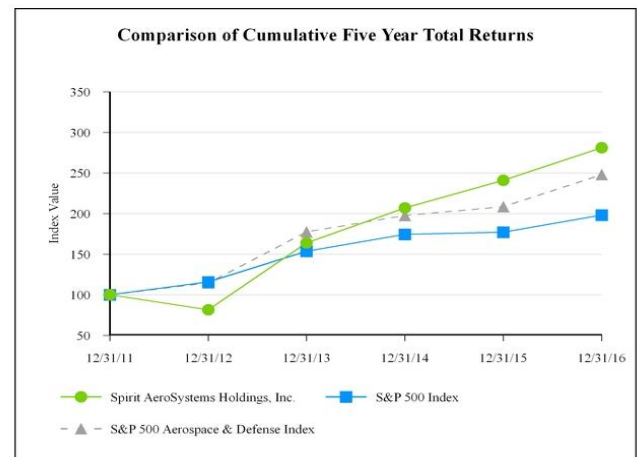
As we can see SPR is under the average margin for the earnings before interest, tax depreciation and amortization by 1.89%, and under all its competitors. If we look at the operating profit margin the company is above the average by 0.53% and if we look at the non-operating profit after tax, AeroSystems is a lot above the average, by \$301.25 million. In fact, we can expect that these ratios become better in a small period since they are going to increase their cost reduction on the supply chain through a vertical integration.

Value Creation:

	ROIC (NOPAT/IC)			WACC	
	History	LTM		History	LTM
spr	19.8%	19.5%	spr	10.7%	10.7%
Competitors	18.4%	13.5%	Competitors	8.9%	8.4%

As we can see, AeroSystems's weighted average cost of capital is higher historically and in the last fiscal year than its competitors by 2.3%. Still compared to its competitors, its return on invested capital is superior by 6%, always in the last fiscal year. These ratios show us that AeroSystems has a better business model ability to create value with lower capital costs than its competitors. Which is important into this industry. In fact, the Aerospace & defense industry has high cost and most of its value creation is made by how the company can control its costs.

Furthermore, this graph shows us how the Company has been able to create higher revenue than the S^oP 500 but also how better it has been on the last five year compared to the S&P 500 Aerospace & Defense Index.



Conclusion:

Aerosystems' guidance shows confidence into the coming year. In fact, they have let know the investors that the cash on hand is not just in case of a business opportunity but also in order to repurchase some outstanding shares. This will have as effect to increase the earnings per share but also to elevate the market price of the shares. Moreover, in order to increase the value creation, they expect to invest into the segment of the defense, which during this period seem to be a good investment with a lot of business opportunities through the increase of 10% into the budget of the government's defense. Finally, this cash will permit to the company to invest in vertical integration via Tier 2 or Tier 3 in the aerostructure supply chain, which produce an important margin. This will permit to SPR to increase their margins but also to increase their revenue; both combined, means additional company's value. Furthermore, if we look at the WACC and the ROIC, we can see that the company is able to turn investment into profits at higher ratio with less costs than its competitors.

Spirit AeroSystems Holdings, Inc. (spr)

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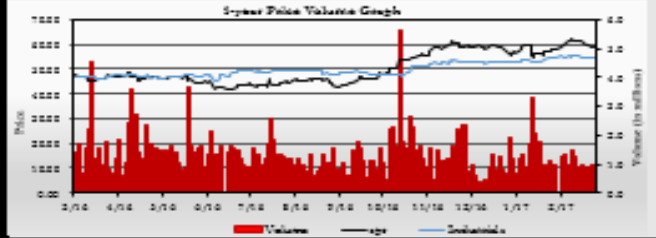
NEUTRAL

Analyst: Benjamin Babin
3/24/2017

Current Price: **\$57.06**
Dividend Yield: **0.0%**

Intrinsic Value: **\$53.23**
Target Price: **\$59.45**

Target 1 year Return: **5.07%**
Probability of Price Increase: **6%**



Description:
Spirit AeroSystems Holdings, Inc., through its subsidiaries, designs, manufactures, and supplies commercial aircraft structure worldwide.

General Information:
Sector: Industrials
Industry: Aerospace and Defense
Last Guidance: November 3, 2015
Next earnings date: N/A
Estimated Country Risk Premium: 5.22X
Effective Tax rate: 35X
Effective Operating Tax rate: 33X

Market Data

Market Capitalization	\$6,356.23
Daily volume (mil)	0.23
Shares outstanding (mil)	113.45
Diluted shares outstanding (mil)	127.88
X shares held by institutions	74X
X shares held by institutional Managers	67X
X shares held by hedge funds	36X
X shares held by insiders	0.40X
Short interest	5.56X
Days to cover short interest	6.56
52-week high	\$62.38
52-week low	\$41.27
Levered Beta	1.32
Volatility	32.23X

Quarter ending

12/31/2015	-4.55X
3/31/2016	-4.45X
6/30/2016	5.64X
9/30/2016	1.82X
12/31/2016	-5.48X
Mean	-1.56X
Standard error	2.4X

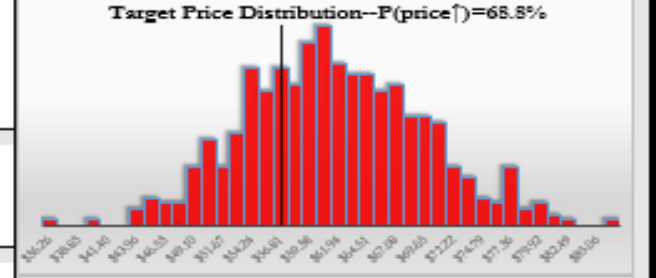
Management:
Griffin, Thomas: Chief Executive Officer, Per
Kapoor, Sanjay: Chief Financial Officer and
Hornick, Samantha: Chief Administrative Officer
Haskins, Deane: Senior Vice President and Co
Lukawiec, Michelle: Senior Vice President and Co
Rabe, Ron: Senior Vice President of Ops

EBITDA

12/31/2015	-12.64X
3/31/2016	8.53X
6/30/2016	-54.18X
9/30/2016	-4.45X
12/31/2016	-5.65X
Mean	-15.83X
Standard error	18.8X

Total compensation growth
N/A
15.26X per annum over 1y
-188X per annum over 1y
47.64X per annum over 1y
-11.82X per annum over 1y
N/A

Total return to shareholders
N/A
15.84X per annum over 1y
17.34X per annum over 1y
17.34X per annum over 1y
17.34X per annum over 1y
N/A



Profitability

ROIC	17.8X
NOPAT Margin	8X
Revenue/Invested Capital	2.88
ROE	22.4X
Adjusted net margin	8X
Revenue/Adjusted Book Value	2.33

Invested Funds

Total Cash/Total Capital	19.5X
Estimated Operating Cash/Total Capital	15.2X
Non-cash working Capital/Total Capital	19.4X
Invested Capital/Total Capital	35.5X

Capital Structure

Total Debt/Common Equity (LTM)	0.43
Cost of Existing Debt	5.24X
Estimated Cost of new Borrowing	5.85X
CGPS Risk Rating	D
Unlevered Beta (LTM)	1.47
WACC	18.83X

5 year historical avg

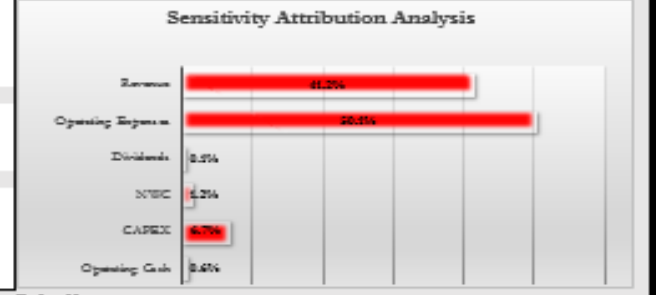
ROIC (LTM)	15.88X
NOPAT Margin	10.2X
Revenue/Invested Capital	1.47
ROE	18.28X
Adjusted net margin	8.6X
Revenue/Adjusted Book Value	2.12

5 year historical avg

Total Cash/Total Capital	24X
Estimated Operating Cash/Total Capital	N/A
Non-cash working Capital/Total Capital	14X
Invested Capital/Total Capital	87X

5 year historical avg

Total Debt/Common Equity (LTM)	0.26
Cost of Existing Debt	4.34X
Estimated Cost of new Borrowing	4.94X
CGPS Risk Rating	C
Unlevered Beta (LTM)	0.77
WACC	8.45X



Period

Year	Revenue growth	Valuation
12/31/2017	2.2X	8.2X
12/31/2018	8.6X	8.5X
12/31/2019	-2.8X	8.1X
12/31/2020	8.2X	7.8X
12/31/2021	3.8X	10.8X
12/31/2022	12.3X	10.2X
12/31/2023	14.4X	10.8X
12/31/2024	10.8X	3.7X
12/31/2025	8.5X	3.5X
12/31/2026	7.8X	3.2X
12/31/2027	5.5X	8.3X
Cooling Period	4.1X	8.2X

Period

Year	Invested Capital	Net Claims	Price per share
12/31/2017	\$5,382.33	\$1,216.87	\$52.73
12/31/2018	\$5,187.41	\$657.82	\$53.56
12/31/2019	\$2,351.62	\$64.38	\$66.62
12/31/2020	\$3,383.27	-648.53	\$73.87
12/31/2021	\$3,273.23	-681.45	\$81.45
12/31/2022	\$3,426.37	-61,381.42	\$83.55
12/31/2023	\$3,443.37	-61,751.73	\$38.42
12/31/2024	\$3,337.56	-62,353.56	\$187.18
12/31/2025	\$3,413.81	-62,353.11	\$116.78
12/31/2026	\$3,637.41	-63,782.65	\$126.66
12/31/2027	\$4,117.14	-64,478.84	\$137.82
Cooling Period			

Valuation

Period	ROIC/WACC
12/31/2017	1.57
12/31/2018	1.56
12/31/2019	1.43
12/31/2020	1.41
12/31/2021	1.38
12/31/2022	2.18
12/31/2023	2.85
12/31/2024	2.88
12/31/2025	1.34
12/31/2026	1.87
12/31/2027	1.88
Cooling Period	1.72