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BWXT - Q4 2016 BWX Technologies Inc Earnings Call

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David Black *BWX Technologies, Inc. - SVP & CFO*

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to BWX Technology (sic), Inc.'s fourth-quarter 2016 earnings conference call and webcast.

(Operator Instructions)

I would now like to turn the call over to our host, Mr. Alan Nethery, BWXT's Vice President, Investor Relations and Corporate Procurement. Please go ahead.

Alan Nethery - *BWX Technologies, Inc. - VP of IR and Corporate Procurement*

Thank you, Daniel, and good morning, everyone. We appreciate you joining us to discuss our 2016 fourth-quarter results, which we reported yesterday afternoon. A copy of our press release is available in the Investors section of the website at BWXT.com. Joining me this morning are John Fees, BWXT's Executive Chairman; Rex Geveden, President and Chief Executive Officer; and David Black, Senior Vice President and Chief Financial Officer.

As always, please understand that certain matters discussed on today's call constitute forward-looking statements under federal securities laws. Forward-looking statements involve risks and uncertainties, including those described in the Safe Harbor provision at the end of yesterday's press release and the Risk Factor section of our most recent 10-K and 10-Q filings. These risks and uncertainties may cause actual Company results to differ materially, and we undertake no obligation to update these forward-looking statements, except where required by law.

On today's call, we may also provide non-GAAP financial measures that are reconciled in yesterday's earnings release and our Company overview presentation, both of which are available on the Investors section of our website. BWXT believes the non-GAAP measures provide meaningful insight into the Company's operational performance and provide these measures to investors to help facilitate comparisons of operating results with prior periods and to assist them in understanding BWXT's ongoing operations.

With that, I will now turn over to John.



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John Fees - *BWX Technologies, Inc. - Executive Chairman*

Thank you, Alan. Good morning, everyone. We had an outstanding closing quarter of 2016 that included several exciting achievements. We delivered on our commitments, including our 2016 guidance which I will discuss in a moment. We continued to produce strong operational performance in each of our segments this quarter and reported consolidated top-line growth and earnings-per-share growth for both the quarter and the full year. In 2016, the BWXT stock price rose 25%, outpacing the S&P 500 by more than 1,500 basis points.

Last year was a great success by any measure. In addition to finishing the year strong, we took a number of actions in the fourth quarter that prepare us for solid 2017. We began to implement actionable items from our strategic plan, closed on the GEH-C acquisition, and completed a CEO transition. We booked \$866 million worth of contracts, and finished the year with a record backlog of approximately \$4 billion. We are understandably excited about the future, and believe we are well positioned to begin capitalizing on significant growth opportunities as we enter 2017.

Operationally, we maintained our focus on execution and delivered improvement on our operating margins in 2016, with a GAAP operating margin of 15.4% and non-GAAP operating margin of 18%. This represents an improvement of 88 basis points and 120 basis points, respectively, over our 2015 operating margins. We also delivered \$1.76 EPS for the year in 2016, which was above our guidance and nearly 24% higher than our 2015 adjusted EPS results.

In addition to our operational results, we demonstrated an ongoing commitment to our balanced capital allocation approach by taking a number of actions during the fourth quarter. First, we delivered on our promise to return capital to shareholders through both our announced quarterly dividend and our share repurchase activities, which included \$293 million of share repurchases in 2016. As I mentioned earlier, we also closed on the strategic GE Hitachi Nuclear Energy Canada acquisition, as we planned for the fourth quarter.

For the year, the Company achieved 9.5% consolidated revenue growth. Consolidated revenues for the quarter increased 11%, to \$404 million, compared to \$364 million in the fourth quarter of 2015. Consolidated operating income in the quarter was \$46 million, compared to the prior-year period of \$9.6 million.

We completed a smooth and seamless transition as Sandy Baker announced his intention to retire and passed the reins to Rex Geveden. I'd like to congratulate Sandy for an outstanding career with BWXT that spanned over 45 years, for guiding BWXT through the spin transition, and for strongly positioning the Company which is in today -- the position the Company is in today and for his support of Rex during the transition.

Rex spearheaded last year's strategic planning process, and he moved quickly to implement key initiatives that were developed. The Board is excited about growth opportunities that the press has captured and the increasing likelihood of additional demand for our products from the United States Navy. Our future continues to look bright and our growth opportunities are expanding.

Before Rex provides more detail on our operations and our 2017 outlook, let me turn the call over to David who will discuss the segment's fourth-quarter and full-year results and other financial matters. David?

David Black - *BWX Technologies, Inc. - SVP & CFO*

Thanks, John. The Nuclear Operations segment's fourth-quarter 2016 revenues were \$331 million compared to \$300 million in the fourth quarter of 2015. Revenues for the segment came in higher than fourth-quarter 2015 results due to increased component manufacturing activity. Fourth-quarter 2016 operating income was \$77 million compared to \$66 million in the fourth quarter of 2015. Nuclear Operations delivered a strong operating income margin of 23% during the quarter.

For 2016, Nuclear Operations revenue was \$89 million and operating income was up \$11 million compared to 2015. For the year, the effective increased manufacturing was partially offset by higher G&A expenses. At the end of 2016, this segment's backlog was more than \$1 billion higher than a year ago, at a record level of \$3.5 billion, excluding negotiated but unawarded options of approximately \$900 million.



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For the fourth quarter of 2016, the Nuclear Energy segment increased revenue by 18.7% over the prior-year period, reaching \$49 million compared to \$42 million in the fourth quarter of 2015. Revenue growth in this segment was primarily due to higher volume in the equipment business related to steam generator design and manufacturing work. Operating income in the segment was \$3.6 million compared to \$1.6 million for the corresponding period of 2015, driven by the increase in our nuclear equipment business. For the year, revenue increased \$34 million, to a total of \$189 million.

GAAP operating margin for this segment was 20.3%. Operating income for 2016 increased by \$37 million, from \$1.7 million in 2015, due to the growth in the Canadian nuclear service and equipment business, lower selling, general and administrative expenses, and a \$16 million gain related to a favorable ruling in a legal matter. For the third consecutive year, we booked more than \$200 million of work for this segment and ended the year with backlog of nearly \$500 million.

Our Technical Services business contributed operating income of \$2 million in the fourth quarter and \$16.5 million for the full year, in line with our guidance. Operating income for this segment was lower in the fourth quarter compared to the prior-year period since the segment transitioned off an Idaho joint venture project in May 2016 and we increased business development costs related to the timing of our proposal activities.

As John mentioned earlier, we finished the year with consolidated backlog of \$4 billion, which does not include the additional \$900 million in negotiated options. These options are primarily related to the awards we announced in April for our Nuclear Operations segment and represent the value of unexercised options which are expected to be exercised periodically through 2018, subject to annual Congressional appropriations.

For the year, the GAAP effective tax rate was 28.6%, lower than our 2016 guidance of 34% to 36%, primarily due to a change in our assertion regarding the undistributed earnings of our foreign operations, as well as a nontaxable gain related to the deconsolidation of our mPower joint venture earlier in the year. The Company's cash and investments position net of restricted cash as of December 31, 2016, was \$149.2 million, an increase of \$81.9 million compared to \$67.3 million at the end of the third quarter of 2016.

Fourth-quarter cash flow from operating activities was approximately \$147.4 million. Year-to-date cash flow generated from operating activities totaled \$239.9 million compared to \$335.2 million in the prior year-to-date period. It is important to note that the prior year-to-date period includes cash flow from our pro-forma power generation business as well as \$95 million of proceeds received from a legal judgment in the third quarter of 2015. BWXT's cash flow is typically highest in the fourth quarter due to receipts of contract retention payments.

The Company's capital expenditures were \$22 million in the fourth quarter and \$53 million for the year, just below our guidance. Depreciation and amortization were \$13 million and \$51 million for the fourth quarter and the full year, respectively. On September 2, 2016, we entered into an amendment to our existing credit facility to add a new US dollar term loan of up to \$112.5 million and Canadian dollar term loan equivalent to \$137.5 million for a total amount of \$250 million.

As of December 31, 2016, we had \$285 million borrowing under our original term loan, \$246 million under our new term loans made available under the September amendment, \$0 drawn on our revolving line of credit, and letters of credit totaling \$155 million. As a result, the Company had \$245 million of remaining availability under our credit facility, excluding the addition of \$250 million accordion provision.

Now I'll hand the call over to Rex for a discussion of the operations and the outlook for 2017. Rex?

Rex Geveden - *BWX Technologies, Inc. - President & CEO*

Thank you, David, and good morning. John and David have already discussed our accomplishments for both the quarter and the full year, and I will now provide some operating details from 2016 before we turn our full attention to 2017 and the exciting growth we see beyond 2017.

First, we reported impressive consolidated margins for both the quarter and the year. These improvements are due principally to the realization of margin improvement initiatives in the Nuclear Energy segment and additional overhead absorption due to higher volume. The Nuclear Energy segment outpaced our 10% margin guidance for the full year by 180 basis points, finishing the year with an adjusted operating profit margin of 11.8%.



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We also posted impressive year-over-year revenue growth of 22%, driven mostly by our Canadian Nuclear Power business. Margin improvements were also attributable to the Nuclear Operations segment, which continues to execute well and achieved operating profit margins around 21% for the year on near-record volume. This segment's revenue increased more than 10% versus Q4 of 2015, and full-year revenue was up 7.6%, or \$89 million, compared to 2015.

In addition to the higher revenue in all of our segments we also booked over \$2.75 billion of new orders in 2016 of which \$2.4 billion came from the Nuclear Operations segment. As John mentioned earlier, we ended the year with a record level of consolidated backlog of nearly \$4 billion. The bookings and backlog levels reinforce our view that this is the beginning of a significant growth cycle for us, one that will provide a higher level of organic growth than we previously included in our plans. These are solid opportunities that both justify and require significant investments. To provide the best possible return to our long-term shareholders, we will allocate a greater percentage of capital in 2017 toward these new growth opportunities. Let me provide some additional color.

As we've discussed in the past, the Navy's current submarine build schedule is set to transition to one Virginia Class and one Columbia Class annually by the middle of the next decade. The Columbia Class submarine program remains on schedule and recently passed a Milestone B decision, signifying that it moved from the research-and-development phase into the detailed-design phase.

The Columbia Class is a larger submarine than the Virginia Class and will require additional capital investments in 2017 to realize this growth, starting in 2019. Additionally, in December, the US Navy released its new force structure assessment which calls for achieving and maintaining a fleet of 355 ships from the previous plan level of 308 ships, including increasing the number of attack submarines by 18, from 48 to 66, and for increasing the number of aircraft carriers from 11 to 12.

BWXT has established numerous build-schedule scenarios around this potential, beginning as early as 2019, and will be capable and ready for this increased scope. While timing and availability of Congressional funding for fabrication have not been established, we need to begin capital improvements related to the increased Virginia Class submarine portion of this plan in late 2017 in order to meet the added demand, which we anticipate will start for us in 2019. We included these investment requirements as part of our capital planning guidance and are preparing to support our customer's plans and capture these significant organic growth opportunities.

Missile-tube manufacturing provides another avenue for organic growth in the Nuclear Operations business. We anticipate that at least 320 tubes will be built, split between the Virginia and Columbia Classes for a total market value potentially exceeding \$1.5 billion over the next 15 to 20 years.

We continue to perform well on our initial missile-tube contracts. We received the Virginia payload module, or VPM, development and fabrication awards in 2016 and anticipate a block two of common missile compartment, or CMC, award this quarter. We remain well positioned to capture at least 50% or 60% of the total CMC and VPM missile-tube awards. We continue to invest in manufacturing facilities to support this additional work, including a dedicated production facility in our Mount Vernon, Indiana, plant.

Our Nuclear Energy business delivered another strong quarter, with revenue up nearly 20% and operating income more than doubling from Q4 of 2015. We had solid growth in our equipment business related to the Bruce Power steam generator project and waste container manufacturing for spent fuel and refurbishing of waste.

We continue to expand the Canadian reactor services business in which we experienced solid sales and income growth. The prospects in the Canadian nuclear market remain strong and we are planning for success in this market with a particular focus on the reactor plant life extension projects planned over the next 15 years at Bruce Power and Ontario Power Generation, or OPG, valued at CAD26 billion.

The steam generator replacement project for Bruce Power awarded last year at CAD130 billion is on track, and the units are expected to ship in 2020. We have supplied all the steam generators for the Bruce Nuclear Generating Station since its construction and are well positioned to continue this long-term relationship. As the plant life extension projects continue, we will pursue additional equipment, service, and project work for both Bruce Power and OPG, including supply of waste containers, feeder tubes, and various other refurbishment projects.



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The acquisition of GE Hitachi Canada, which we closed in the fourth quarter and now call BWXT Nuclear Energy Canada, or BWXT NEC, improves both our competitive range and our brand in that market. The business has a solid market reputation and strong relationships with both OPG and Bruce Power.

BWXT NEC has over 60 years of experience operating in the CANDU nuclear products and services industry, and is especially strong in nuclear fuel and fuel handling systems. The nuclear fuel segment of this business provides CANDU fuel bundles and components, while the nuclear services segment provides engineering and specialized tooling services as well as parts for the CANDU nuclear power plants.

We plan to leverage BWXT NEC's capabilities to open up new growth opportunities within the current refurbishment space. Including the amortization of intangibles, we expect this acquisition to be accretive to BWXT earnings in 2017. Margins in this segment will be modestly impacted by the amortization of intangibles, which we estimate to be approximately \$7.9 million annually over the next two years and diminishing after that, as we identified in our 10-K.

The Technical Services segment performed well on its contracts during the final quarter of 2016 and remains very active in the DoE laboratory, national security and environmental management areas, with several near-term opportunities. Results for Technical Services were largely unchanged from the fourth quarter of 2015 and within our guidance for the full year. We continue to invest in a robust pipeline of opportunities in order to return this segment to historical levels of profitability over the next few years.

We are making good progress as we begin implementing high-leverage opportunities within our strategic plan. While we aren't ready to disclose specific details of the plan at this time, we continue to invest in certain technologies and markets that will augment our existing capabilities and produce new growth in areas such as nuclear materials processing and critical national defense component supply. We understand these markets have channels to them, and generally have the people and corporate knowledge to capitalize on them.

As we look to 2017, we expect revenues to grow to the range of \$1.6 billion to \$1.7 billion and for adjusted earnings to be between \$1.85 and \$1.95 per share, including the amortization impact of the BWXT NEC acquisition and excluding any mark-to-market adjustments for pension and post-retirement benefits. With the high level of Navy nuclear propulsion work backlog, we expect revenues from Nuclear Operations to be near the record level achieved in 2016. At the end of last year our backlog contained more than \$1.2 billion of expected 2017 revenue.

We are nearly at capacity at all of our sites and are effectively utilizing our facilities. We expect operating margins in Nuclear Operations to be in the high teens with upside potential. As mentioned in our press release, we are increasing longer-term guidance to better reflect our robust organic growth opportunities and balance sheet capacity. Driven by strong operating income growth, we anticipate our earnings-per-share compounded annual growth rate to be in the low-double digits for the three- to five-year period following 2017.

To support the numerous growth areas previously identified, we are increasing our 2017 CapEx forecast to near \$100 million. The bulk of this spending will be in the Nuclear Operations segment and is recoverable in our future rates. For your reference, a full list of our 2017 guidance is detailed in our Company overview deck available in the Investors section of our website.

Starting with the quarter ending March 31, 2017, we will report results in three realigned business segments. The Nuclear Operations segment will be reported as Nuclear Operations Group but remains unchanged from our current Nuclear Operations segment. The Nuclear Services Group will comprise the Technical Services Group and our US commercial nuclear service business, which includes a portfolio of work in advanced reactors for terrestrial and space power applications. NSG, Nuclear Service Group, operating income is expected to be between \$15 million and \$20 million in 2017.

The Nuclear Power Group will include our legacy BWXT Canadian business and the recently acquired BWXT NEC business. For 2017, we expect NPG revenue to be between \$250 million and \$260 million, with operating margins of 10%, inclusive of the amortization of intangibles. We will provide more details about the Nuclear Services Group and the Nuclear Power Group when we report first-quarter results in a couple of months.

We remain committed to a balanced capital allocation approach, which we demonstrated in 2016, but we see the future allocation shifting more toward investments that will smartly grow the business with less emphasis on share repurchases. We're confident in our numerous organic growth



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prospects and will invest a higher level of capital to support these opportunities. We're also actively working our M&A pipeline and see multiple opportunities that may be actionable. To make sure we are maximizing value for our shareholders, the returns on these growth-focused investments will continue to be evaluated against share repurchases and other capital investment options.

To maintain optionality and to support opportunistic repurchases, the Board of Directors has approved an additional share repurchase authorization of \$150 million that can be used over the next three years, leaving us with a total share repurchase authorization of \$193 million when our existing accelerated share repurchase, or ASR, program completes by the end of this quarter. At this time last year our Board increased the quarterly dividend to \$0.09 per share; however, the ASR limitations require that BWXT maintain constant dividend payments throughout the life of the ASR. Accordingly, our Board approved a quarterly dividend of \$0.09 per share for the first quarter of 2017.

To wrap up, we had a solid fourth quarter that allowed us to deliver on our guidance for 2016. Beyond 2017 the strategic plan that we developed will guide us toward additional growth opportunities that fit our strengths and increase our options to participate more fully in the markets we are currently serving. Our Nuclear Operations Group prospects look brighter than ever. In addition, we believe our Nuclear Power Group is well situated to capture additional business in the Canadian nuclear power market, and our Nuclear Services Group remains on the path for long-term operating income growth.

I have enjoyed meeting several of you at various conferences over the last few months and I look forward to meeting more of you at our Investor and Analyst Day which we anticipate occurring in the first half of October this year.

That concludes our prepared remarks. I will now turn the call back over to the operator, who will assist us in taking your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Bob Labick, CJS Securities.

Bob Labick - CJS Securities - Analyst

Good morning, and congratulations on a nice year.

John Fees - BWX Technologies, Inc. - Executive Chairman

Thanks, Bob.

Bob Labick - CJS Securities - Analyst

Sure. I just wanted to start with, you touch on this before, the \$100 million in CapEx guidance for the year includes some capital for a second Virginia Class. Obviously, you must be at least optimistic that that's going to happen. When will you find out if that is going forward, or when we all find that out? Then, could you remind us also how much additional capital will be needed beyond this year to be invested, if indeed there is going to be second Virginia Class going?



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Rex Geveden - *BWX Technologies, Inc. - President & CEO*

Bob, this is Rex Geveden speaking. We have asked our customer to signal by about the middle of this year whether or not we need to begin making the additional capital investments for the additional Virginia build. For us, the first additional Virginia would begin on the ship-building schedule in 2021. The components that we provide are long-lead items, and so our work for that would begin in 2019. We've said consistently we would need to start capitalizing for that additional production capacity starting at about the middle of this year.

We're hoping to get indications from our customer on that, and with an indication we'll begin to make that investment. We've said in the past that it would take about \$100 million in additional capital to set up for that production capacity, and we expect that investment to occur over a two-, three-year period. The 2017 investment is a fraction of that.

Bob Labick - *CJS Securities - Analyst*

Got it. Great. Very helpful, thank you. Then obviously encouraging that you increased your expected EPS CAGR going forward to low double digits. Could you talk a little bit about how much of that is effectively in hand now, or how much you anticipate you'll go out and acquire or is not exactly currently in your portfolio?

Rex Geveden - *BWX Technologies, Inc. - President & CEO*

I would say the growth story was built on, really, on the back of our what we see our organic growth opportunities to be. That's what really came out of our strategic plan and resonated with the Board and management team was, if you look at what's out there before us: Opportunities to capture lots of business in missile tubes. Our Canadian growth opportunity that's well-documented. Obviously, the increased potential demand for the products that we deliver to naval reactors in the Navy. That organic growth picture looks very attractive to us. There's some other components to it that we haven't disclosed yet, some growth opportunities we are investing in internally, so that organic growth picture looks very robust to us. Some things have to go right for that to be fully realized, but it's a very good picture for us.

On top of that we have got balance sheet capacity. On top of that we have a good pipeline of acquisition targets that are very attractive to us that would have the right kind of strategic fitness. I think we have some options to be able to make those more aggressive numbers, but it's fundamentally built on the back of our organic growth scenario.

Bob Labick - *CJS Securities - Analyst*

Okay. Great. One last quick one and I will get back in queue. With you breaking out the Canadian operations now, can you talk a little bit -- and you have it in a little bit, but can you just expand on the opportunity over time? What's a meaningful growth rate off the now \$250 million to \$260 million in revenues from this year?

Rex Geveden - *BWX Technologies, Inc. - President & CEO*

Yes. What we like about the Canadian market, we have been there and we have some reputation in brand in that market around component manufacturing and nuclear services. With the GE Hitachi acquisition, which we now call BWXT NEC, what we got in that business was fuel manufacturing capability for about half the Canadian reactor fleet and also the fuel robotic handling equipment for defueling and refueling, and then fuel channel diagnostics. That's what came with that business.

When you bundle those two things together, our business is outage services, component manufacturing and then projects related to all that refurbishment activity. I would point out that we've got sort of an increasingly interesting stream of recurring revenues there around waste containers for spent fuel and waste containers for the refurbishment projects, The fuel, as I already mentioned, and then maintenance for automated fuel handling. We're building our recurring revenue streams there.



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The native business, the organic business, would be interesting in and of itself because that market is a good market for us and we have been increasing our strength there. What makes it really interesting is that 10 of the 19 reactors in Canada are undergoing refurbishment projects over the next 15, 20 years. As I said in my remarks, that opportunity is CAD26 billion, about \$20 billion, obviously, so think of that market as having a \$2 billion incremental revenue bump per year over 15 or 20 years. That's what we like about -- I'm sorry, about \$1 billion a year over 20 years.

That's what we like about that market is the steady-state business was good, the reactor outage and component manufacturing business was good. But now that market doubled with these reactor refurbishment opportunities. We think we're well-positioned, especially with the acquisition, to go after a lot of those refurbishment projects.

We haven't disclosed a future growth rate for that business, but we will be providing more details in the future on that.

Bob Labick - *CJS Securities - Analyst*

Great. Thanks very much.

Rex Geveden - *BWX Technologies, Inc. - President & CEO*

You're welcome.

Operator

Pete Skibitski, Drexel Hamilton.

Pete Skibitski - *Drexel Hamilton - Analyst*

Yes. Nice quarter, guys.

Rex Geveden - *BWX Technologies, Inc. - President & CEO*

Thanks, Pete.

Pete Skibitski - *Drexel Hamilton - Analyst*

Just unclear on the incremental CapEx spend, the portions, obviously, for the missile tube work, for Columbia. On the Virginia portion, is that just for staying at two Virginias a year or going to three per year?

David Black - *BWX Technologies, Inc. - SVP & CFO*

No, that capital, Pete, was for going to two Virginia's per year. We have evaluated scenarios where you go to the 18 additional Virginias, which would require you to build three in some years. But we haven't built any CapEx planning around that in detail.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. Just because you are already at two per year, but I guess some of your facilities will shift to Columbia, I guess, is the thought?



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David Black - *BWX Technologies, Inc. - SVP & CFO*

The thing there, Pete, is if you -- yes, we are doing two Virginias per year. I think you know the plan was to go to, in certain years, to one Columbia and one Virginia. At the scenario that we are working towards and that we are optimistic about is the scenario in which, even in a year that a Columbia is built, the Virginia production remains at two per year.

Pete Skibitski - *Drexel Hamilton - Analyst*

Yes. Okay. Understood. I had kind of on the timing for you guys on Columbia. If GD starts construction in 2021, and I imagine that goes at least five, six, seven years, and I think you guys have said you'd start working 2019. If you start work in 2019 on Columbia, when would you stop? Would you go all the way -- revenue recognition-wise, would you go all the way to the end of that first ship? Or would you stop your construction on the first reactor, years ahead of the end of the boat itself?

John Fees - *BWX Technologies, Inc. - Executive Chairman*

Pete, we don't give you exact parameters by which -- how long it takes us, but we will start 2019. The amount of time on the Columbia, it's a five-to seven-year period. For each Columbia we start, it's going to be a period of time, a POC, and it'll go over that rough time period to get us to completion.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. Fair enough. I'll sneak one last one in, maybe for Dave again. On your sales guidance, \$1.6 billion to \$1.7 billion, I think you guided close to \$100 million in GE Hitachi revenue?

David Black - *BWX Technologies, Inc. - SVP & CFO*

Correct.

Pete Skibitski - *Drexel Hamilton - Analyst*

If I adjust it out, it kind of implies declining organic sales at the low end. Is there some area of weakness there, or did you build ahead in the NOG unit in 2016? Can you give us some [color] there?

David Black - *BWX Technologies, Inc. - SVP & CFO*

There's a couple things. One, for the Nuclear Power Generation Group, there's less outages, so there's going to be some fluctuation this year versus last year because of the amount of outages for NPG. Then once again, when you look at NOG over time, you have got an inflationary growth there, but as we build in savings that takes away from revenue. So it depends on how the timing of all that is as it flows through the year.

Pete Skibitski - *Drexel Hamilton - Analyst*

Great. It's very helpful. Thanks, guys.



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John Fees - *BWX Technologies, Inc. - Executive Chairman*

Thanks, Pete.

Operator

Tate Sullivan, Sidoti.

Tate Sullivan - *Sidoti & Company - Analyst*

Hi, thank you. You mentioned your strategic plan a couple times. Then, you mentioned I think you're were planning an Analyst Day for October. Is your strategic plan just for TSG or is that something that you've been ongoing for the last year? Then, will you announce the results from that plan, did you say?

Rex Geveden - *BWX Technologies, Inc. - President & CEO*

Yes, Rex Geveden here. No, the strategic plan was comprehensive. It was for all business segments. In fact, it was for the BWXT business writ large, including other considerations. We started that planning at about this time last year in February last year and reported out to our Board of Directors in September of last year, and continue to improve upon that plan. In fact, it's an ongoing activity and we are recycling again this year.

We haven't disclosed some of the competitively sensitive parts of the plan. We have disclosed some other aspects of the plan, such as growth in missile tubes and other things. We will have more to say about that in the future, including at the Analyst Day in October.

Tate Sullivan - *Sidoti & Company - Analyst*

Okay. Thank you. You had a lot of questions so far on the -- you indicated starting the work and starting EPS, I assume, starting to have EPS from the Columbia Class program in 2019. Will you have more revenue from Columbia submarines based on them being about almost two times as long as the Virginia class subs?

David Black - *BWX Technologies, Inc. - SVP & CFO*

This is David. Tate, all we ever say about the Virginia Class versus the Columbia is the Columbia is bigger. So based on the fact that it's bigger, we will have additional revenues in the year 2019 as we start production for Columbia.

Tate Sullivan - *Sidoti & Company - Analyst*

Okay. Thank you very much.

David Black - *BWX Technologies, Inc. - SVP & CFO*

Thanks.

Operator

(Operator Instructions)



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Ron Epstein, Bank of America Merrill Lynch.

Kristine Liwag - BofA Merrill Lynch - Analyst

Hi. Good morning, guys. It's Kristine Liwag calling in for Ron. How should we think about the contract structure of the Columbia Class? Since this is a lead ship, is it generally cost-plus? How does that compare to your overall margins?

Rex Geveden - BWX Technologies, Inc. - President & CEO

Kristine, this is Rex. The Columbia Class submarine will get negotiated into the same kind of contract structure that we have historically with naval reactors. That will include Virginia, Ford and Columbia all together that get negotiated in these market baskets that we often talk about. It should have similar profitability, similar structure to the other work.

David Black - BWX Technologies, Inc. - SVP & CFO

Kristine, this is David Black. As we go into the Columbia Class, we've done a lot of work on pre-design with the government. I think that as we get into the contract in 2019, our lessons learned, we've gone through the lessons learned with the government and so we don't feel that there's going to be a large impact to our margins there. We feel that we can roll right along into our current contract structure.

Kristine Liwag - BofA Merrill Lynch - Analyst

Great. Just to clarify, does that mean that -- it sounds like you are using similar technology for the Columbia Class that you're using in the Virginia Class, only that the Columbia Class maybe has 1.6 times more displacement than Virginia? Is that a way to think about your technology risks there?

Rex Geveden - BWX Technologies, Inc. - President & CEO

I would say we really don't comment on technology on our platforms that we do for the Navy. I would just say that it's within the framework of our capability, and there's not a new approach that has to be used to be able to deliver those units. We really never comment on technology-related matters. I would couch it in saying that there is no significant technology risk related to the Columbia.

Kristine Liwag - BofA Merrill Lynch - Analyst

Maybe a clarification on the Virginia Class sub CapEx for this year. Do you need to get an order from the US Navy before you spend the CapEx at the end of 2017 to meet the possible second Virginia Class, or will you do it ahead of them without receiving an order?

David Black - BWX Technologies, Inc. - SVP & CFO

Kristine, this is David. We will negotiate and get an order from the government before we will spend our capital dollars. We want to make sure that the plan is going forward, or there is at least a recovery of anything we spend.

Kristine Liwag - BofA Merrill Lynch - Analyst

Thank you very much.



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Operator

Les Sulowski, SunTrust.

Les Sulowski - SunTrust Robinson Humphrey - Analyst

Good morning, guys. It's actually Les in for Mike. I just wanted to start off, if you can provide a little more color on the overall pricing environment on ongoing negotiations with the Navy? Also, if tax reform is implemented, would that have some savings that would be implemented or passed onto a customer?

David Black - BWX Technologies, Inc. - SVP & CFO

Les, this is David. All of our structures with the Navy, once again, we talk about that fixed-price incentive structure. We get a 15% fee. There's, on average, the contracts and there's -- which equates to a 13% margin. We anticipate that every time we go in negotiation, there's a negotiation. Overall, we feel we are comfortable there and that will continue. What was the second part of the question?

Les Sulowski - SunTrust Robinson Humphrey - Analyst

Just on tax reform.

David Black - BWX Technologies, Inc. - SVP & CFO

The tax, yes. Just like every other company, we are watching and waiting, but if there is tax reform and there's lower tax rates, then all that cost will be going through all of our contracts. There will be savings overall to our contracts with that lower tax rate, if that's what so happens.

Les Sulowski - SunTrust Robinson Humphrey - Analyst

Go it. Thanks. On the assumptions for the three- to five-year low double-digit EPS growth rate, can you talk about what you are factoring into that? Is the Navy fleet size increasing, is it sub build rates, organic M&A, share repurchase, various other factors that gets absorbed into this outlook?

Rex Geveden - BWX Technologies, Inc. - President & CEO

Yes. Les, this is Rex Geveden. Yes, it does include the assumption that we'll continue to do well competitively in the missile tube market. It includes the assumption that we would get to this to two Virginia Class rate even in the year in which a Columbia is built. We have some modest assumptions about acquisitions. We didn't, in our strategic planning, factor in share repurchases in that organic growth analysis. It does include the probability that we do well in some of our Canadian refurbishment projects, capture some of that work.

John Fees - BWX Technologies, Inc. - Executive Chairman

Recognize that what we are talking about is really what we -- this is John Fees speaking. What we are talking about is really our base expectation for what we're going to do with the business. So when we factor everything together out of the strategic plan, we look at the things we can readily put our hands on, things that we think we can accomplish and we say, this is what we think are going to achieve with the business.

Recognize that we have scenarios that go beyond that, depending on how things go. It's not really what I would call our stretch plan, it's really our baseline expectation for the business is in that guidance.

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Les Sulowski - *SunTrust Robinson Humphrey - Analyst*

Just a follow-up and last one for me. Are there other opportunities to participate in shipbuilding growth outside of carriers, submarines and missile tubes? Can you perhaps secure other content on other surface vessels?

Rex Geveden - *BWX Technologies, Inc. - President & CEO*

Well, we possibly could. That's been an interesting idea for us in the past. We've evaluated whether we might be able to find content on carriers and submarines that kind of relates to our business and in the strategic sense of high consequence manufacturing, maybe single source kind of things. We have looked at those. They're hard to get, obviously. Our organic growth ideas that are new ideas from the strategic plan are in some slightly different areas having to do with materials processing and component supply.

Les Sulowski - *SunTrust Robinson Humphrey - Analyst*

Thank you, guys.

John Fees - *BWX Technologies, Inc. - Executive Chairman*

Thanks.

Operator

Tate Sullivan, Sidoti.

Tate Sullivan - *Sidoti & Company - Analyst*

Hi, thank you. I should've asked earlier. On the unchanged dividend and the ASR terms, is the term that you have to keep the dividend unchanged within your revised credit agreement or is it just attached to the accelerated share repurchase agreement?

David Black - *BWX Technologies, Inc. - SVP & CFO*

Hey, Tate. This is David. That's all part of the accelerated share repurchase and what the bank put in the agreement there. We have to keep the dividend unchanged during the period of that, and we said that that would -- the ASR would close in the first quarter.

Tate Sullivan - *Sidoti & Company - Analyst*

Okay. Understood. Thanks. I don't know if this is new language, or -- I'm just wondering if you have a language on possible increases in the build rates of Virginia Class submarines. You talked a lot about it before, but I'm wondering if, just on the public side, what we will hear from the military spending from budget-wise, if they will speed up the construction of the Virginia Class subs that are already approved for funding? In other words, a long-term procurement plan for 40. Could it be that type expansion -- faster pace of builds versus additional builds? Does that make sense?

John Fees - *BWX Technologies, Inc. - Executive Chairman*

I think there's still a little bit that remains to be seen here. What we have is we have -- as we talk about in the remarks -- we have this force projection number that people are talking about up into the 60s for fast attack submarines. Then there's the reality of the budgeting process and what we're



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going to go through. The expectation is -- the baseline expectation that we are professing today is that in the years where Columbia will be built, we'll continue to build at a rate of two Virginias a year. That does not get us to 66. That gets us in the 40s still, and it marginally puts us there.

There is still some additional dialogue that has to happen within government to try to decide, are we going to continue at a rate that's going to put us in the 40s, or are we really going to step up into the 50s or the 60s? And how much money do we have and what we can afford? We think a responsible scenario to be thinking about right now -- and again we have to work out the details with our customer at this particular point time.

But a responsible scenario to think about is just continuing Virginia for the foreseeable future to independent of Columbia coming online. We think that's a good place to land at this five seconds. Again, it is going to change, and it could change more positively if the government leans more towards this higher force level. But we are not professing that at this point.

Tate Sullivan - *Sidoti & Company - Analyst*

Okay. Thank you. If I may throw one more in for Rex. In the segment changes, what have you done for -- in terms of space -- advance reactors or space historically at BWXT, and what are the opportunities there? I see that sentence in your press release for your new NSG Group.

Rex Geveden - *BWX Technologies, Inc. - President & CEO*

For the Space Nuclear Power, was that the question?

Tate Sullivan - *Sidoti & Company - Analyst*

Yes.

Rex Geveden - *BWX Technologies, Inc. - President & CEO*

We're working with NASA on a pretty exciting project now called Nuclear Thermal Propulsion, and the idea is you could have an in-space propulsion stage to ferry cargo or astronauts from low Earth orbit to Mars and back. We are doing -- in that project, we're doing fuel design, we're doing reactor core design, and working with some traditional propulsion and system engineering companies in a coalition to do that work. NASA hasn't chosen its engine architecture for that mission yet. The options really are traditional chemical rockets and nuclear thermal.

The great advantage of nuclear thermal is that it's a very high thrust to weight ratio engine. It would get to Mars maybe in three months when Mars is at closest approach to Earth compared to six months with more conventional means. It's a very attractive option, I think, to a lot of people who are studying it. We are involved in some very, very early work on it. It's not a large business for us at this point, but we have some unique qualifications around that project related to our nuclear reactor work, historical nuclear reactor work. In one form or another, we have done space nuclear projects for probably 30 years.

We were involved in SNPP, we were involved in Prometheus [Gemo], the Jupiter Icy Moons Orbiter program historically. So this is probably the third or fourth major space nuclear program that's been in the BWXT portfolio over the years. I came from the space community, so I'm pretty excited about this one and investing some personal energy into its success.

Tate Sullivan - *Sidoti & Company - Analyst*

Okay. Thank you very much. Have good day.



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Rex Geveden - *BWX Technologies, Inc. - President & CEO*

Thank you.

Operator

As there are no further questions, this concludes our question-and-answer session. I would like to now turn the conference back over to Mr. Alan Nethery for closing remarks.

Alan Nethery - *BWX Technologies, Inc. - VP of IR and Corporate Procurement*

Thank you joining us this morning. That concludes our conference call. A replay of this call will be posted on our website later today, be available for a limited time. If you have further questions please call me at 980-365-4300. Thanks.

Operator

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

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