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BWXT - Q1 2018 BWX Technologies Inc Earnings Call

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CORPORATE PARTICIPANTS

David S. Black *BWX Technologies, Inc. - Senior VP, CFO & Treasurer*

M. Alan Nethery *BWX Technologies, Inc. - VP & Chief IR Officer*

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

CONFERENCE CALL PARTICIPANTS

Joshua Ward Sullivan *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

Kristine Tan Liwag *BofA Merrill Lynch, Research Division - VP*

Leszek Sulewski *SunTrust Robinson Humphrey, Inc., Research Division - Associate*

Michael Frank Ciarmoli *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Peter J. Arment *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Peter John Skibitski *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Robert James Labick *CJS Securities, Inc. - President*

Robert Michael Spingarn *Crédit Suisse AG, Research Division - Aerospace and Defense Analyst*

Samuel Joel Pearlstein *Wells Fargo Securities, LLC, Research Division - MD, Co-Head of Equity Research & Senior Analyst*

Tate H. Sullivan *Sidoti & Company, LLC - Research Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to BWX Technologies, Inc.'s First Quarter Earnings Conference Call. (Operator Instructions) Please note this event is being recorded. I would now like to turn the conference over to your host, Mr. Alan Nethery, BWXT's Vice President and Chief Investor Relations Officer. Please go ahead.

M. Alan Nethery - *BWX Technologies, Inc. - VP & Chief IR Officer*

Thank you, Andrew, and good morning, everyone. We appreciate your joining us to discuss our 2018 first quarter results, which we reported Friday afternoon. We'll also be discussing our medical isotope technology, which we announced early this morning. A copy of our press release and investor briefing, including details related to today's discussion, is available on the investor section of our website at bwxt.com and may be beneficial for you to refer to during this call. Joining me this morning are 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 security laws. Forward-looking statements involve risks and uncertainties, including those described in the safe harbor provision at the end of Friday's press release and the Risk Factors 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 will also provide non-GAAP financial measures, such as adjusted earnings per share, which are reconciled in Friday's earnings release and our investor briefing presentation. BWXT believes that non-GAAP measures provide greater insight and transparency into the company's operational performance and provides 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'll now turn the call over to Rex.



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

Thank you, Alan, and good morning, everyone. BWXT was strong out of the gate to start 2018 as we continued to execute our 5-pillar growth strategy. Demand from the U.S. Navy remains very strong, and we are working with our customer on the next multiyear pricing agreement, anticipating a completion around the first quarter of 2019. Navy demand was bolstered by the bipartisan budget agreement for 2018 and 2019, which included positives on the strategically important programs that BWXT supports. The Consolidated Appropriations Act of 2018 significantly raised the national defense budget from 2017 levels, one of the largest increases in the last few decades. In particular, the bill supports the Navy's most recent and more aggressive 30-year shipbuilding plan and establishes a baseline of 2 Virginia class fast-attack submarines annually, in addition to a step up in funding for Columbia class ballistic missile submarine, which will ultimately be produced at a cadence of one per year. Additionally, we're continuing to see bullish signs in offering nuclear propulsion programs. For Columbia, early design and development continues to ramp as we approach full production of the first ship. For carriers, we are actively working to support the possibility of a 2-carrier buy and perhaps an order cadence acceleration in the longer term.

And lastly, on Virginia, authorizers in Congress continue to support a third ship procurement in the years in which a Columbia is not procured, resulting in the possibility of orders for 3 subs per year moving forward. We are conducting scenario planning activities that accommodate such a schedule and are willing and able support our customer should that possibility materialize.

We are encouraged that the budget caps were raised for both 2018 and 2019, and the Congress has provided debt ceiling relief until March of next year. The President's '19 budget sets up a positive trend line for continued growth, providing our customers with much-needed funding stability in the near term, and importantly, continues to support the projections in our long-term low double-digit earnings per share growth.

In Canadian Nuclear Power, market growth remains robust and superior execution continues to drive record results for the NPG segment. This growth is exemplified by the recent contract award to supply all the steam generators for the Bruce Power Life Extension program valued at CAD 642 million. This is the largest contract in the history of the nuclear power segment. We also continue to make advancements in technology, driving future growth and market share gains. In April, we were awarded a \$5.4 million contract from the DOE to develop additive manufacturing technology for nuclear reactor components. This is part of an advanced nuclear technology development initiative by the Department of Energy. This strategically significant award augments our internal research and development efforts and will accelerate this important new business thrust. We also received a 5-year, \$5 billion extension to the Idaho National Laboratory management and operations contract, of which BWXT is a major participant.

We continue to utilize mergers and acquisitions as part of our growth strategy as we announced the completion of an agreement to acquire Sotera Health's medical isotope business last month. And finally, we remain focused on our strategies to enter the medical isotopes adjacency and continue to invest in targeted R&D to commercialize that technology. This morning we published details surrounding our breakthrough medical isotope manufacturing, which I will discuss later, but first, let me briefly touch on first quarter results.

First quarter non-GAAP earnings per share were \$0.67, up 22% from the prior period, along with 7% revenue growth, driven primarily by record results in the Nuclear Power Group. As expected, bookings were light for the quarter related entirely to timing. We will continue to consume some backlog as we approach the next multiyear pricing agreement with the Navy early next year. We are today reiterating our 2018 guidance with earnings per share of \$2.45 to \$2.55 and total company revenue of \$1.75 billion to \$1.85 billion. We are also reaffirming our long-term low double-digit earnings per share guidance over the 3- to 5-year period following 2017, reinforced by continued progress on our growth strategy, including medical isotopes. Let me turn the call over to David who will now discuss the segments' first quarter results and other financial matters.

David S. Black - *BWX Technologies, Inc. - Senior VP, CFO & Treasurer*

Thanks, Rex. As a reminder, on January 1, 2018, we adopted multiple new accounting standards. The first is to reclassify certain pension and other post-employment benefit planned elements from segment operating income to other income. Our first quarter 2017 results has been restated to include this accounting change, and the investor briefing includes a pension slide containing pro forma figures and NOG margins with post-pension reclassification for 2015, '16, and '17. The second standard is related to revenue recognition, which we adopted for all of our contracts utilizing the modified retrospective method. This results in historical changes reflected on our opening balance sheet as an accumulative catch-up adjustment.

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And although the net effect was immaterial, this results in variability when comparing 2018 figures to the prior year, which is reported on the old standard. For more information regarding these changes, please reference our most recent 10-Q SEC filing.

Now moving to segment results. Nuclear Operations Group revenue was \$317 million for the first quarter of 2018, a 2.6% decrease from the first quarter of 2017, due to timing of contract activities. Operating income for the quarter was \$68 million, about flat compared to the first quarter of 2017. NOG delivered first quarter operating margins inclusive of CAS pension reimbursements of 21.4%, a 50 basis point increase from the prior year period. This segment's backlog at the end of March was as expected at just over \$3 billion. Nuclear Power Group revenues were a record \$113 million for the first quarter of 2018, a 45% increase from 2017. And since the BWXT Nuclear Energy Canada acquisition closed at the end of 2016, all of this growth was organic, driven by favorable material timing on a China steam generator project that will not recur in future periods and increased service activity due to outages. Operating income was up a robust 68% to \$21.8 million compared to the prior year period and was driven by favorable mix as well as some items that were accelerated into the first quarter. Segment backlog was up versus the prior year period to \$550 million. And as Rex mentioned, following the close of the quarter, we received a Canadian dollar value, CAD 642 million contract from Bruce Power for steam generators and drums, resulting in an incremental adjustment of more than CAD 460 million from the original contract received in 2016.

In the first quarter, the Nuclear Services Group contributed operating income of \$1.2 million. We continue to work with the customer and our partners on the Savannah River Site liquid waste services contract, which has been delayed longer than we anticipated. We now expect a final decision by the end of September this year. This results in transition beginning no earlier than fourth quarter, putting some pressure on our anticipated \$20 million of operating income for the current year.

The company's first quarter capital expenditures were up 29% to \$18 million compared with the first quarter of 2017. We continue to expect capital expenditures in 2018 of approximately \$150 million, primarily to support Navy growth in Nuclear Operations. Depreciation and amortization totaled \$14 million for the first quarter, about flat compared with the prior year period. As of March 31, 2018, the company's cash and short-term investments position, net of restricted cash, was \$144 million. First quarter cash flow from operating activities utilized \$19 million compared to \$55 million utilized in the first quarter of 2017. The company also had \$503 million of borrowing in term loans, no borrowings under the revolving line of credit and letters of credit totaling \$74 million. As a result, the company had \$326 million of remaining availability under our credit facility, excluding an additional \$250 million accordion provision.

We continued to review and look for effective ways to optimize our balance sheet, including opportunities to derisk our pension plan. We have also been examining the current interest-rate environment and with anticipated actions by the Federal Reserve and confidence in the economy, we believe interest rates will continue to rise. Therefore, it is prudent for us to explore options around ways to stabilize the variable debt, and regardless, we could see a bit of headwind in the back half of the year through increased interest expense. On May 4, our board declared a cash dividend of \$0.16 per common share, payable in the second quarter of 2018.

As Rex mentioned, we are reiterating our 2018 long-term guidance. For 2018, we still expect NOG revenue of \$1.3 billion to \$1.4 billion and margins in the high teens with upside potential from pension reimbursements; NPG revenue of \$300 million to \$350 million and margins of approximately 12%; NSG operating income of approximately \$20 million; R&D costs of approximately \$15 million; corporate unallocated cost of approximately \$20 million; other income of approximately \$30 million to \$35 million; a tax rate of 22% to 25%; capital expenditures of \$150 million, primarily to support growth in the NOG segment; and depreciation and amortization of approximately \$60 million. And with that, I'll hand the call over to Rex for a discussion on our medical isotope technology. Rex?

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

Thank you, David. This morning, we announced more details around our breakthrough in nuclear manufacturing technology for medical isotopes. In combination with our pending acquisition of Sotera Health Nordion medical isotope business, we have set the course for a superior solution to manufacture North American molybdenum-99 and supply its derivative product, technetium-99, to the market. Molybdenum-99, or moly-99, is the most widely used isotope for nuclear medical diagnostic imaging, but supply continuity is a continuing problem. Furthermore, the current production process requires enriched uranium targets. Not only is this a proliferation concern, but it is also highly inefficient -- highly inefficient, yielding only 6% of useful product and generating costly fission waste. As it stands today, all the radiation sources for moly-99 are outside of North America, and all are regularly shut down for refueling and other unscheduled maintenance. With a globally dispersed and extremely aged



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infrastructure, producing a product that loses value as it decays, logistics are burdensome, to say the least. Although the current production environment is characterized by expensive unstable supply producing complex radioactive waste streams and creating proliferation risk for the U.S., our breakthrough technology addresses all of these problems. At the core of our differentiated process -- at the core, our differentiated process utilizes a natural moly target. These targets are irradiated and placed through our proprietary radiochemical process to create the moly-99 radionuclide. Our moly-99 will then be used in a BWXT-designed technetium-99 generator that is under development. Our unique and proprietary process employs neutron capture and, therefore, does not require uranium targets. This crucial innovation entirely eliminates high-cost fission waste, giving us a significant advantage while reducing environmental impacts and eliminating proliferation risk. We believe that a dependable North American base supply of moly-99 will increase confidence in availability and in turn drive clinical demand and accelerate growth in a market which is currently seeing mid-single-digit annual gains. We anticipate entering the market through generator sales to radiopharmacies, which we estimate to be more than \$400 million globally. Our initial focus will be on the North American market, and we anticipate having sufficient production capacity to satisfy all of the current North American demand for moly-99. We are presently working to finalize agreements that will provide us with a long-term and stable irradiation supply of moly-99 and other medical radioisotopes from multiple sources.

Another key feature of our offering is that BWXT-designed technetium generators are being designed to integrate naturally into the existing configuration and processes of radiopharmacies. Upon FDA approval, the generators will be a plug-and-play solution with no special hardware or adaptation needed by radiopharmacies.

In April, we announced a definitive agreement to acquire Sotera Health's Nordion medical isotope business, and we will use its capable assets and employees to bring this moly-99 product through the commercialization stage and the BWXT technetium generators through the FDA approval process. Furthermore, we expect to bolster Nordion's existing portfolio of products as we employ this technology to develop other medical isotopes following the introduction of the moly-99 product line.

In addition to 150 employees in radiopharmaceutical expertise, the business brings 2 licensed production centers, critical transportation and storage containers among other assets. We plan to adapt their current facilities to incorporate moly target processing and technetium-99 generator manufacturing. Nordion's existing capabilities as a radiochemical manufacturer will streamline the implementation of our technology and establish a platform for future global expansion. Through a combination of these efforts, we will be a vertically-integrated medical isotope manufacturer, in a position to capture significant value in the supply chain. We plan to introduce this technology by the end of 2019, subject to regulatory approvals. With the acquisition of Nordion, we also see an opportunity to apply our technology and expertise to neutron capture or cyclotrons to bring dormant product lines to market and create other revenue streams in addition to the moly product line.

As we move forward, we intend to expand into the manufacturing of other medical, industrial and national security isotopes. And lastly, I will reiterate that our new technology is cost disruptive, giving us significant pricing and competitive advantages in the market. In combination with the pending Nordion acquisition, we maintain the expectation that this new business will be accretive to BWXT's consolidated margins. And with that, I would like to open the line for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Bob Labick of CJS Securities.

Robert James Labick - CJS Securities, Inc. - President

So I just wanted to clarify, last fall you mentioned there was -- you had \$1 billion market opportunity for your first of, I think, 17 isotopes. And then, today in the release and just moments ago, you talked about the \$400 million market opportunity for generator sales. Can you reconcile the difference and just help us understand the 2 numbers?



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

Sure, Bob. Let me try to explain all those numbers. And this is an apples-to-apples comparison in this case. We -- if you look at the global market for this radioisotope, at the point-of-sale from the radiopharmacies into the hospitals, that global market is about \$3 billion altogether. But a fraction of that is the revenue that's associated to the sale of technetium generators. And we would enter the supply chain as a supplier of technetium generators, as we said in the call here today. So we will make the moly product. That moly product goes into a generator. There is a process for, as the moly decays, it produces this metastable technetium-99 that we mentioned. And the way -- and the generators are used to extract that technetium-99, those generators are sold in the radiopharmacies. And so if you enter the supply chain at that juncture, about 15% of that \$3 billion is available in terms of revenue. So that's where we get the \$400 million number globally. The North American market for that is about, let's call it, 40% of that \$400 million or around \$160 million today. Now as we see that market evolving, we're offering a product that is going to be at a better price point with a supply stability that has heretofore been unavailable for decades. And so that market, as it expands, we expect to see demand increases for this product because of the stability and the price point. And we see it over the course of years becoming a market that could be, let's say, in that \$1 billion range.

Robert James Labick - *CJS Securities, Inc. - President*

Got it. Okay. Thank you. That's helpful. And then just in terms of current moly sales, does the acquisition you acquired have any sales of moly-99 currently? And is that potentially the sales you're talking about in '19? Or are the initial sales forecasted at the end of '19, all you need to BWXT and not from the acquired sales?

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

Yes, so the revenues would be new revenues. Nordion has been historically a supplier of -- for decades, a supplier of medical radioisotopes of various types, including moly in the past. But that business stopped producing moly-99 when the Chalk River research reactor shutdown in Canada. So that product line is limited compared to what it was historically. It does produce a handful of very interesting isotopes, 4 of them are -- through synchrotrons at the Vancouver site, used for various medical applications, none of those are moly. And there is also a contract medical manufacturing -- a contract radio manufacturing capability that exists up in Kanata, up near Ottawa. So there are interesting products in that portfolio, but none of them include moly right now. So what we -- what our concept with that acquisition was, first off, that business itself is an interesting business, and it's a growing business with a variety of interesting products, most of them manufactured in synchrotrons. We would take our technology, apply it to that business and to that infrastructure if you will, and so we will take full advantage of the existing facilities, the extant infrastructure, including hot cells and materials and methods for handling radiochemicals and also the shipping containers and other infrastructure around that. So we would apply our technology to that business in order to derisk that business, in order to exploit the channels to market that are available there and to increase our scale more rapidly than we would have been able to do otherwise.

Robert James Labick - *CJS Securities, Inc. - President*

Great. If I can sneak one more in. On the energy revenue guidance, it calls for pretty strong growth off an already high base. Could you just clarify, is there a significant amount of Columbia class coming into this year? Or is that still expected in '19 and beyond?

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

Yes. So we're starting to see some -- the additional volume that you see or additional sales that you see in 2018 are related to 2 principal components. One is, we've got a higher run rate on missile tubes this year, just based on where we are in the award -- the contract awards that we've had in the past few years. But the second component is, we are ramping in Columbia and that has to do with the industrialization of that product line. We have engineering support, and we have obviously some capital spend going on around that. But preparation for that new product line has led us in revenue increases -- significant revenue increases into 2018.



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Operator

The next question comes from Rob Spingarn of Crédit Suisse.

Robert Michael Spingarn - *Crédit Suisse AG, Research Division - Aerospace and Defense Analyst*

I just wanted to ask you about the competition in the moly market. There is another company out there called NorthStar, I believe, which also has FDA approval for non-uranium source. I'm wondering how we would think about them or you in context of them being out there. Or am I mistaken in comparing the 2?

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

So there are a number of players that are in that market right now, who make moly-99 using the traditional technique with uranium targets and a number of potential entrants to the market, and they include NorthStar and SHINE and others. And they have different techniques for manufacturing their product. I would assert that our technique -- our technology is simple and very cost-effective and has no radio-waste streams to deal with. And so we like what we're doing relative to both the current supply approach and also the potential entrants.

Robert Michael Spingarn - *Crédit Suisse AG, Research Division - Aerospace and Defense Analyst*

Okay. And then, if I missed it earlier, could you speak more to the margin accretion that you've talked about here with this medical isotopes business and the timing on that?

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

Well, so on the -- from a timing perspective, as we said in the call here, we expect to get that product certified and ready to go, our hope is by the end of 2019. There are some risks with that kind of a schedule because you have regulatory approvals and other things that are a little less predictable. But the technology is completely proven. We've proven the technology at full scale, and we have no questions around that. So it's all about, at this point, about commercialization, licensing and implementation. So...

Robert Michael Spingarn - *Crédit Suisse AG, Research Division - Aerospace and Defense Analyst*

I'm sorry. I was going to ask you, from a profit perspective in addition to revenues. In other words, how do we see those 2 flow relative to one another?

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

Yes. So think about our business starting to ramp into 2020 and into future years beyond that. And as we said, we haven't been specific about what the margin accretion is. But we do think it will be accretive to the consolidated margins of BWXT at that time.

Operator

The next questioner is Pete Skibitski of Drexel Hamilton.



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Peter John Skibitski - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

When you guys announce the Nordion deal, you guys going to give us a purchase price or a valuation? Any desire to speak to that today? Or might we learn more in the future on that?

David S. Black - *BWX Technologies, Inc. - Senior VP, CFO & Treasurer*

No, we won't speak to that today. But we will, obviously, provide that data in the future filings. So -- but today, no.

Peter John Skibitski - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Okay. And then -- and Rex, I mean, you work with the government a lot, and so I know you know technical risk levels, TRL levels. Are you saying just in your comments to Rob that basically kind of making the Tc-9 -- excuse, Tc-99 generator and finishing the design and all that, making it work correctly, basically there is no risk to that at this point. Am I hearing that correctly?

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

Yes, that's right. There is no risk to that at all. We've proven everything about that product, including it being able to meet the generic medical specification for radiopurity, moly breakthrough, sterilization standards and things like that. So there's no technological risk left. And so in terms of the technology readiness levels that you reference, Pete, think of this as graduating from 7 or 8 and going into TRL 9. Internally, we run our research and development program around, what we call, a toll-gating process, where we are, at specific intervals, evaluating the business quality, the market conditions and also the technological progress of the effort. And we've graduated from, what we call tollgate 5, and we're moving into this commercialization phase, which is called tollgate 6. And so, just reiterating what I've said before, it's now completely about putting the capability into a commercial configuration, integrating it with the acquired business and getting the product flowing and certified through various regulations.

Peter John Skibitski - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Okay. And I'm not sure, if you answered this in the very first question. But when I look at the pie charts for the market out there, the difference between Tc-99 generators, which sounds like what you're doing versus cold kits, which sounds like -- that looks like the majority of the market there. What's the difference between a generator and a cold kit? And then will you eventually be doing the cold kitting?

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

Yes, sure. So there're a lot of different components of revenue. If you look at the point-of-sale from the radiopharmacy and into the hospitals, there is certainly the cold kit part of it. There's also the charge for sort of mixing the cold kit with the technetium and other components of cost. And so the way we've thought about it, Pete, is we wanted to do what we know how to do, which is radiochemical processing. We had never anticipated getting into, for example, human medical testing or anything like that. The purpose of the cold kits, the cold kits are biochemicals that are mixed with the radioisotope product, in this case the technetium-99, to give a specific uptake property so that it migrates to a particular part of the body, for example, the heart or the lungs or bone mass or a cancer mass. And so those things are -- allow the radioisotope to be targeted, so that when the imaging occurs, it's occurring in the right part of the body. Those are made by large radiopharmaceutical manufacturing companies, and we do not anticipate being in that part of the supply chain. We certainly would imagine partnering with the producers of such things, but that's not where we are. We'll be in the business of making medical radioisotopes or radiopharmaceuticals to the extent that we're not involved in clinical trials and drug development.

Operator

The next question comes from Sam Pearlstein of Wells Fargo.

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Samuel Joel Pearlstein - Wells Fargo Securities, LLC, Research Division - MD, Co-Head of Equity Research & Senior Analyst

You had mentioned this, I guess, multiyear low double-digit earnings growth rate. And I guess, I thought I heard what you said was this isotope is kind of inclusive in that. So does that -- I mean, the generator. Does that change that trajectory at all?

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

No, it doesn't change anything on that, Sam. We've put together our strategic plans for the growth of this business and sort of consolidated that for the first time in the fall of 2016. And there were a number of different components of strategic growth and they included this strong -- this increasing Navy demand signal, included our work on missile tubes. We had some ideas about broadening our national security material processing capability, let's call it. And then, we had some, at that time, some embryonic technological efforts around things like medical radioisotopes. And our view was that take -- you take all that taken together, we could get away from this guidance of high single digit and move into low double-digit with some comfort that as these growth potentials expressed themselves, we had a higher growth trajectory than, let's say, coming out of the spin, and that's what led us to that guidance.

Samuel Joel Pearlstein - Wells Fargo Securities, LLC, Research Division - MD, Co-Head of Equity Research & Senior Analyst

Okay. And then initially you're coming out with generators. Is your intent ultimately to be a supplier of the isotope as well or just the generators?

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

So just to be clear about how that works, when you manufacture the isotope, the isotope, in this case moly-99, but there are a broad variety of isotopes we can manufacture with our technology. But the moly-99 isotope is a product that decays, decays in about -- its half-life is about 6 days. So it decays. You put it into a generator and then there's a process, as the moly decays, it becomes technetium-99, metastable technetium-99, which has something like a 6-hour half-life. So that's placed into this generator, and it goes through a process called dilution to pull the technetium-99 out of the moly as it decays. And so yes, we're making both the radioisotope, the moly-99, and delivering also the generator from which the medical -- the ultimate medical product, the technetium-99 can be extracted.

David S. Black - BWX Technologies, Inc. - Senior VP, CFO & Treasurer

But I think as we talk about the market, it's the combined product that we're talking about.

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

Right. So the generator sale is inclusive of the moly-99 sale.

Samuel Joel Pearlstein - Wells Fargo Securities, LLC, Research Division - MD, Co-Head of Equity Research & Senior Analyst

And is it only the FDA when it comes to regulatory approval? Is that what you need to wait for? Are there DOE or any other agencies that get involved?

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

No it's only the FDA for that particular product. Now that facility, that business that we acquired, the Nordion business from Sotera Health has -- we've got to go through a number of regulatory approvals to transfer licenses. And those include not only FDA licenses for the product lines that



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exist there and for those that we intend to stand up there, but also NRC approvals and Health Canada and also Canadian Nuclear Safety Commission. So there are 4 -- at least 4 regulatory bodies that will be making approvals as we transfer these licenses and gain new ones.

Samuel Joel Pearlstein - *Wells Fargo Securities, LLC, Research Division - MD, Co-Head of Equity Research & Senior Analyst*

One last question. Just -- the large shipbuilder that you get involved with in terms of a lot of the nuclear Navy talked about the growth coming but that it would come at lower margins. Is there anything that you foresee in terms of the ramp-up of the Columbia buying 2 carriers at once. Anything like that that should change the margin trajectory for NOG on a go-forward basis?

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

I don't think we're anticipating any margin erosion. I think we will say that. We've said in the past and maybe I'll reiterate here a little bit. We tend to negotiate our pricing agreements at a 15% fee on cost and then -- and drive northward from there into the high teens based upon efficiencies that we can get out of the contract, cost efficiencies, material buys and in some cases, volume adders. But we've got ways of working that margin upward, and we certainly plan to try to keep it in that range.

Operator

The next question comes from Peter Arment of Baird.

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Question on kind of the radiopharmacy supply chain. You mentioned, Rex, just the Nordion assets and the ability to kind of jump start into the supply chain. Can you talk about -- just a little bit about -- because there are a number of other players out there in the Tc-99 generator market, how you'll be able to enter the supply chain with the radiopharmacies?

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

Yes. So I'd say, Peter, on that one, not yet. We certainly are working that and have some very concrete plans around it. But we haven't disclosed anything yet about our relationships in the supply chain.

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, all right. And then you mentioned the regulatory approval. Again, trying to predict the timing, but is it safe to assume this is more of a second-half 2019 when you -- when we're thinking of approvals?

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

Yes, we were saying late 2019 is where we were targeting the approvals. And by the way, we've had good success in the regulatory framework in Canada and in the U.S. We are very accustomed to dealing in highly regulated markets, as you would well understand. And so it's -- we have staff experts for that kind of thing and are familiar with how to get through the process.

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Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. And then just switching gears over. Can you give us an update on maybe the timing around the RFP for missile tube production or any updates there?

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

Yes, sure. So the missile tubes are going into kind of continuous production buys or kind of big block buys, is the way I would put it, and think of it as block buy of about 100 of all missile tube types. There are 3 chunks of those, about 100 each, and they come on about 5-year intervals. The first of those big chunks, the 100-year -- sorry, the 100 missile tube buy, the RFP dropped in Q1, and we are preparing a response to that. There are a large number of pricing options to propose for the common missile compartment, missile tube, the Virginia missile tube and the Virginia payload module missile tube. And so we are looking at and evaluating all of that right now. We will submit a proposal in Q2 on that with -- anticipating an award in -- probably in the first quarter of 2019.

Operator

The next question comes from Michael Ciarmoli of SunTrust Robinson Humphrey.

Michael Frank Ciarmoli - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

So Rex, just to get this straight. Are you guys sourcing your own moly-99? And if you are, in fact, sourcing it, is it materially different from what NorthStar is doing? I think they're doing something along that neutron grab technology. I mean, so you guys are sourcing and if you are -- are producing your own and if you are, how far along to commercialization of the moly-99 are you?

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

Yes, so we certainly would source our own moly-99. It's an industrial metal that's available on the market and so it's that simple. We would use moly metal in our process, and it's no more complicated than that.

Michael Frank Ciarmoli - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Okay. And then is it materially different than what NorthStar is doing? I mean, I think back in 2011, GE-Hitachi and NorthStar had some sort of framework agreement. So is it similar technology? I mean, is it that materially different? I know you said it's patent pending, but it seems like they're doing the same sort of neutron extraction, I guess?

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

Yes, I think I won't comment on what they're trying to do in the market. But certainly the intellectual property that we have developed, the technology that we have developed is markedly different than anything that's out there.

Michael Frank Ciarmoli - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Okay. And then can you help us -- I mean, can you put some numbers around how much more efficient your process, your generator is in terms of what's on the market now? I mean, can you quantify the cost savings, how disruptive this might be, how appealing this will be to potential buyers?



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

Yes, I mean, for competitive reasons, I certainly don't want to put much color on that one yet. But I would say that we believe that it's very substantially less costly for some of the reasons that we said. I mean, the waste streams are nonexistent in this process or virtually nonexistent. And we're using industrial metal as the input to the process. So there are a number of very significant advantages here that will give us some pricing power, some -- sorry, some pricing advantages. And then I think maybe one of the things I want to emphasize here, again, with our technique is that because of the way we're going to be able to produce this, because of the arrangements we're going to have with the radiation sources, we will be able to supply this product with continuity that's heretofore have been unavailable. So continuity of supply is a big feature in our offering.

Michael Frank Ciarmoli - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Got it. And then once you guys get this up and running, I mean, how much -- what's your capacity in terms of -- I guess, how much North American supply could you meet?

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

We'd have enough capacity for all the North American supply right of the bat.

Leszek Sulewski - *SunTrust Robinson Humphrey, Inc., Research Division - Associate*

All of North America, okay.

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

All of North America.

Michael Frank Ciarmoli - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Okay. And then just totally shifting gears here. Nuclear Power, you still have a pretty wide range, \$300 million to \$350 million. And you're still guiding to 12% margins. I mean, the margins would have to be single digits for the remainder of the year. Is there -- are there still some big unknowns there? I mean, you talked about the China steam order coming in, and I guess, we're not going to see that type of growth. But what are the puts and takes to that guidance range?

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

Yes. So I think -- so David said in his remarks, but we had a great quarter in NPG in Q1. And that -- some of that was timing, right? We had the Chinese steam generator that we pulled forward from future quarter. We also had a really good season for service outages and produced good margins from that service work. In terms of uncertainty, that's the one business in our portfolio that has sort of a book and burn quality to it. Having said that, we haven't booked a lot of the year already. There's still some uncertainty around the unbooked part of it. But we're confident about it. I'd say, from the standpoint of any -- our reluctance to change guidance, we're just 4 months into the year. And so we're kind of, as you know, historically kind of disinclined to change guidance at this point, but the business is performing very well there.

Operator

The next question comes from Ronald Epstein of Bank of America Merrill Lynch.

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Kristine Tan Liwag - *BofA Merrill Lynch, Research Division - VP*

It's Kristine Liwag calling in for Ron. I was wondering, can you discuss your priorities regarding incremental M&A by end market? And how do you view incremental Navy assets that come available for sale, like Dresser-Rand compared to end markets like the medical radioisotopes that you're pursuing right now?

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

Would you repeat the last part of the question, Kristine?

Kristine Tan Liwag - *BofA Merrill Lynch, Research Division - VP*

How are you viewing incremental Navy assets coming to market, like Dresser-Rand, that was acquired by Curtiss-Wright recently compared to pursuing opportunities in medical radioisotopes like you're doing right now with Sotera Health?

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

Yes. So my answer to that one is, we would get all the Navy assets we could get if there were much available. But that market has been largely consolidated over the years. Curtiss-Wright did that acquisition. That's a nice one for them. It probably didn't exactly fit what we do. But yes, we love that market. And there are just a very limited number of targets that are available in that market. I think the way we think about -- I'll maybe paint this with a broader brush. We -- you've seen what we've done so far. We've acquired one Canadian -- we acquired the assets of GE-Hitachi Nuclear Canada, which is now NEC, because that was -- and that was around the strategic growth basis in Canada, and that fits what we know how to do. In this case, with Sotera Health Nordion business, this is a very close adjacency. We've been in this -- we've actually been in this medical isotope market for a long time, but we've been at the bottom of the supply chain, making targets, and it was an opportunity for us to assume the supply chain. So in general, what we're looking for are targets that really fit what we know how to do. And I would say that's the case for the one we closed already in Canada and this second one that we're hoping to close in a few months. Generally, we're not looking for acquisitions that are transformative. We don't think we need to do that with this business because it's very high quality and has a future that we like. And so there is no reason to do anything transformative. And so we're looking for targets of a certain size that fit our competencies in nuclear technology and nuclear operations. Those are the kind of criteria. There aren't a ton of targets that fit all those criteria, but we're also very careful about what we would acquire, so that's -- and that's okay, too.

Kristine Tan Liwag - *BofA Merrill Lynch, Research Division - VP*

That's helpful. And then for the \$160 million North American market that you identified for moly-99, what's a realistic market share that you could get? And how fast can you get there? And lastly, how easy is it for your competitors to replicate your disruptive process?

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

I don't think I'll comment on market share yet. We just haven't disclosed anything on that. In terms of the uniqueness of our technology, I mean, we certainly built an intellectual property moat around it. We have a number of patents pending, and we also have some secret sauce with our technology. And frankly, it's a very challenging technology to master and we spent a number of years getting to this point. And it's -- I think it's extremely difficult to replicate what we're doing.

Operator

The next question comes from Josh Sullivan of Seaport Global.

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Joshua Ward Sullivan - Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst

What are your thoughts on entering the moly or tech-99 market as far as being disruptive? Just looking at the other technologies entering, you've said here that you can supply all of North America. Is price the primary way you're going to gain share here? Or is the value more on the fact you talked about less waste and just how you fit into the supply chain?

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

Yes, I think it's all of that stuff, Josh. It's the fact that we've got some cost advantages. It's the fact that we have some reliability advantages in terms of continuity of supply. And it's also a matter of how you strategically put yourself into the supply chain. I think all of those things work in our favor, and I expect this to be a very robust player when it's all said and done.

Joshua Ward Sullivan - Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst

So can you say whether the pricing power is on the generator side or on the moly production side at this point?

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

Well, I mean, you certainly capture value in both of those places, right? I think if you entered the market just selling the radioisotope, you're limited in what kind of revenues you could produce, probably half of what we've been talking about here. So the generator itself is a nice way to capture some value, and that's the reason that we chose that point in the supply chain to enter is, there's just a lot of value to capture there. And so think of it as sort of half and half. And in that case, of course, we're producing the radiopharmaceutical and not just the radiochemical, and we like that position in the supply chain.

Joshua Ward Sullivan - Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst

Okay. And then just on the radiopharmacy customer side, I think you said you had one MUO last year, and you're saying today you can address 100% of the market. Can you do that with just one customer? Or have you signed up anymore MUOs since last year to update us on?

David S. Black - BWX Technologies, Inc. - Senior VP, CFO & Treasurer

The MOU.

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

The MOU you're referring to. Yes, so we -- so I'm just not going to add any color to that yet. There are some competitive sensitivities that we just have to work around as we enter this market.

Operator

The next question comes from Tate Sullivan of Sidoti.



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Tate H. Sullivan - *Sidoti & Company, LLC - Research Analyst*

David did you mention -- can you give some comments on Nuclear Services side and the guidance for other income of \$20 million. I think I missed something you said. Was there delay in a contract award or work to proceed?

David S. Black - *BWX Technologies, Inc. - Senior VP, CFO & Treasurer*

So the Savannah River liquid waste award that we did receive earlier this year was protested. So that is -- or last year...

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

Q4.

David S. Black - *BWX Technologies, Inc. - Senior VP, CFO & Treasurer*

Q4, was protested and it's delayed, and we anticipate the delay or the announcement of that coming out in late September. So that would give us some headwinds there because the anticipated transition and then earning the income on that during this year is being delayed.

Tate H. Sullivan - *Sidoti & Company, LLC - Research Analyst*

Okay. And then just on the Nuclear Power side too, when you've talked about increasing your market share in the Canadian refurbishment market. I mean, any suggestions for tracking how you're progressing getting that market share? Can you point to getting a different type of order recently as your recent announcement?

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

Yes, I might take that one, Tate. Rex here. So I mean, if you look at the sales progression in that market, we ended 2015 at around -- if I remember, around \$140 million U.S. and the Canadian segment we're guiding to \$300 million to \$350 million this year, obviously. So you're seeing real progress. Now about, let's call it, give or take \$100 million of that increase is due to the acquisition that we did. But that leaves you with some very robust organic growth. And that growth has been around -- we're taking a little bit of market share in services and other places in that market, but that has really been stimulated by the refurbishment programs. And so the steam generator contract that we have with Bruce Power, we supply feeder tubes in the Canadian market to Ontario Power Generation. We're a significant player in the waste containers that are related to the refurbishment market. And so yes, I think you're seeing that organic growth trajectory that you see there is really by and large refurbishment driven. We've got someone making some noise online.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Alan Nethery for any closing remarks.

M. Alan Nethery - *BWX Technologies, Inc. - VP & Chief IR Officer*

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

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Operator

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

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