

THOMSON REUTERS STREETEVENETS

# EDITED TRANSCRIPT

BWXT - Q3 2018 BWX Technologies Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 07, 2018 / 1:30PM GMT



NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

## 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*

**Matthew Carl Akers** *Barclays Bank PLC, Research Division - Research Analyst*

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

**Peter John Skibitski** *Alembic Global Advisors - Research Analyst*

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

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

## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by, and welcome to BWX Technology, Inc's. (sic) [BWX Technologies, Inc.] Third Quarter Earnings Conference Call. (Operator Instructions) Please note, this event is being recorded. I would now like to turn the call over to our 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, Nicole, and good morning, everyone. We appreciate your joining us to discuss our 2018 third quarter results, which we reported Tuesday afternoon. Copies of our press release and investor briefing, including details related to today's discussion are available on the Investors section of our website at [bwxt.com](http://bwxt.com).

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 securities laws. Forward-looking statements involve risks and uncertainties, including those described in the safe harbor provision at the end of Tuesday'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 to GAAP in Tuesday'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 that these measures help to facilitate comparisons of operating results with prior periods and assist in understanding BWXT's ongoing operations.

With that, I will now turn the call over to Rex.

---



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

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

Thank you, Alan, and good morning, everyone. Yesterday, we reported third quarter earnings of \$0.40 per share with revenue growth of 1.5%. Our results include an incremental reserve for missile tube rework, resulting in a \$0.21 negative impact to our third quarter reported figures and a \$0.23 negative impact year-to-date.

We saw a good growth in orders, primarily in nuclear operations, which resulted in consolidated backlog growth to over \$3.8 billion.

Let me briefly give you some third quarter highlights across our 3 reporting segments. In nuclear operations, we were awarded a 6-year \$505 million contract for downblending of highly enriched uranium as anticipated. This is the single largest contract in the history of the Nuclear Fuel Services business, creating additional substantial backlog and providing visibility through the middle of the next decade.

We also continue negotiations on the next multi-year pricing agreement, which is on schedule to be completed in the first quarter of 2019. Based on discussions and scenario planning with the customer, we believe that accelerated work scope related to the 2 carrier procurement, which has been appropriated by the Congress, to be more likely than not.

In the Nuclear Power Group, we continued our trend of double digit revenue growth and superb margins. We completed the medical radioisotope acquisition for \$213 million, which includes approximately \$50 million of future cash tax benefits.

In the first hundred days since the close, we have transitioned the employees to BWXT, transferred 7 of 8 nuclear regulatory licenses and integrated the financial systems. Most importantly, we've utilized the expertise of our new employees to further develop detailed infrastructure plans for the moly-99 product line. Notably, we accomplished all the foregoing without disruption to ongoing operations.

We've included a summary of the medical radioisotope transaction in our investor briefing. The business generated about \$8 million of revenue within the NPG segment in the third quarter, and we expected to generate between \$40 million and \$50 million in the first year.

Intangible amortization will run approximately \$6 million annually, and we now expect the business to be slightly accretive in the first 12 months.

Finally, in Nuclear Services, BWXT was awarded an \$850 million, 30-month contract extension at the Portsmouth Gaseous Diffusion Plant in Pike County, Ohio as well as a multiyear commercial nuclear steam generator servicing contract. We continue to demonstrate the capacity for long-term growth and see positive secular trends in every aspect of our business.

Year-to-date, NOG and NPG revenues are up a combined 6.2%. Our year-to-date earnings per share increase is driven by \$0.17 from revenue growth and operational improvements, coupled with \$0.19 of tax rate benefit. These gains are offset by \$0.23 of missile tube reserves and \$0.05 of interest cost and other investments, including R&D.

We've updated our 2018 guidance to reflect year-to-date performance, including the missile tube reserve and now expect earnings per share in the range of \$2.23 to \$2.27 on revenue of about \$1.8 billion.

During our Investor/Analyst Day in October last year, we offered a long-term guidance of low double-digit compounded earnings per share growth off of 2017 over a 3- to 5-year period. We are 10 months into this time frame and our long-term guidance remains intact with positive traction and all of our pillars of growth and line of sight to a variety of organic growth initiatives. We expect an order for Columbia and the next multi-year pricing agreement coupled with some potential upside from a 2 carrier buy. And while this ramp takes the better part of a decade, we continue to see positive signals for incremental growth in this market.

Our commercial nuclear power business in Canada continues to display robust growth as we make our way through the beginning of a long refurbishment cycle. The improving win rate in Nuclear Services is starting to lift the financials for that segment and there remains significant pending opportunities, including the re-award of the Savannah River liquid waste contract, Savannah River management and operations and large opportunities at Hanford and Oak Ridge.



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

Our recent acquisition is off to a strong start, and it enables commercialization of the technetium-99 generator product line. Beyond that, the company is postured to take advantage of both organic and inorganic opportunities. We have a balance sheet that is well positioned to handle rising interest rates and contain sufficient capacity to support additional growth.

Before I turn the call over to David to discuss more financial detail, let me provide you an update on missile tubes. Early in the second quarter, we self-identified an issue related to inspection technique and the quality of missile tube volumetric welds. We halted production on the specific welding and inspection activities and began working with the customer to implement remedial actions.

At the end of the second quarter, we established an early reserve as we began examining the scope and extent of the required remedies. And since that time, we identified several causal factors related to the issue and have implemented corrective actions to prevent recurrence. A comprehensive reinspection of all affected components has been largely completed, and weld repairs have begun.

It is worth noting that none of the affected missile tubes were integrated into a submarine. After completing a joint investigation with our customers, we determined that the issues and the rework effort were more substantial than previously contemplated. Accordingly, we took an incremental \$26.7 million reserve in the third quarter, which we estimate will cover the expected repairs with a reasonable contingency for residual uncertainties in cost. We have performed [extensive] cause and extensive condition critiques and are certain that the issue is restricted to particular types of welds on this product line only. The problem is fully characterized and the required remediations are understood. Our customers rely on BWXT to deliver high-quality complex components that we must operate reliably in challenging environments. And we will take every step necessary to return these missile tubes to a fit-for-service condition and reestablish normal delivery tempo for the balance of the program.

Now let me turn the call over to David to discuss segment results, guidance and other financial matters.

---

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

Thanks, Rex. Nuclear Operations Group generated revenue of \$319 million for the third quarter of 2018, inclusive of a \$14 million negative impact from the missile tube reserve, resulting in a 1.6% decrease from the third quarter of 2017. The year-over-year decrease was partially offset by an increase in naval nuclear fuel and downblending operations.

Operating income for the quarter was \$45.6 million, inclusive of the \$26.7 million reserve for missile tube rework. Excluding the reserve, third quarter NOG operating margins expanded 120 basis points to 21.7% compared to 20.5% in the prior year period. And as Rex mentioned, segment backlog grew to over \$2.9 billion, driven by a contract award for over \$0.5 billion for uranium downblending.

Nuclear Power Group revenue was \$79.2 million for the third quarter of 2018, a 15% increase from the third quarter of 2017, driven by increased fuel manufacturing in the medical radioisotope acquisition. On an organic basis, excluding medical radioisotopes, segment revenue was up about 4%.

NPG operating income was up 7.6% to \$9.1 million compared to the prior year period and was driven by an increase in fuel manufacturing as well as the medical radioisotope acquisition. NPG backlog finished the third quarter at \$868 million.

In the third quarter, the Nuclear Services Group contributed operating income of \$6.5 million, significantly higher than the prior year period. The company's third quarter capital expenditures were up 29% to \$27 million compared with the third quarter of 2017.

Depreciation and amortization totaled \$15 million for the third quarter, up about 10% compared with the prior year period. To date, we have spent \$60 million in capital and continue to expect to spend about \$150 million for the year, although it may be on the lighter side.

At the end of the third quarter, the company's cash and short-term investments position, net of restricted cash, was \$68.9 million. Third quarter cash flow from operating activities utilized \$26 million compared to \$80.7 million generated in the third quarter of 2017. Lower year-over-year operating cash flow change was driven by incremental pension funding of approximately \$118 million. Without the addition of pension funding, operating cash flow was approximately 14% above the prior year period.



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

At the end of the third quarter, the company had gross debt of \$781 million, including \$400 million in senior notes, \$291 million in term loans and \$90 million in borrowings under our credit facility. We also had \$68 million in letters of credit under our credit facility and as a result, have \$342 million of remaining availability.

As noted in last quarter's filings, we completed the purchase of an annuity contract that transferred approximately \$244 million of pension benefit obligations. Our cash pension contributions for the third quarter totaled \$128 million, inclusive of \$118 million of discretionary contributions that supported both the annuity and voluntary prefunding.

In addition to maximizing a favorable corporate tax rate environment, we expect that this incremental cash contribution will pause any material mandatory pension funding requirements on our domestic qualified plans for the next 4 years. At the end of the third quarter, the aggregate pension sits at 93% funded with liabilities at about \$1.2 billion.

We also returned \$79 million in cash to shareholders in the third quarter, inclusive of \$63 million in share repurchases and \$16 million in dividends.

On November 6, our board declared a cash dividend of \$0.16 per common share, payable in the fourth quarter of 2018, and also approved a new \$250 million share repurchase authorization. This results in a total share repurchase authorization outstanding of \$337 million.

Turning to guidance. As Rex mentioned, we have updated our 2018 guidance and now expect non-GAAP EPS in a range of \$2.23 to \$2.27 and revenue of about \$1.8 billion. Our guidance contemplates missile tube reserves, the medical radioisotope acquisition, increased interest expense and year-to-date performance. In NOG, we now expect revenue of approximately \$1.3 billion with expected margins in the high teens, inclusive of cash pension reimbursements and the missile tube reserve.

In NPG, we now expect revenue of approximately \$370 million, inclusive of the medical radioisotope's acquisition. Margins are expected to be higher than typical this year at approximately 14%, driven primarily by a surge in outage service work related to commercial nuclear power in Ontario. The acquisition is expected to contribute to income in 2018 but is largely offset due to deal amortization. But as Rex said, it is slightly accretive in the first year.

All other components of 2018 guidance remain unchanged, except our effective tax rate, which we expect to be between 22% and 23% for the year. We will provide more formal 2019 guidance in the fourth quarter call, but let me give you color on some moving parts as we approach the beginning of the year.

We see 2019 top line growth in the mid-single digits. In NOG, we expect growth from the first Columbia order. Since the execution for nuclear core is 6 to 8 years, we will essentially be moving from processing in average about 15 cores to about 16 cores.

In NPG, we should see growth from the medical radioisotopes acquisition, and the power business will be going through a cyclical swing in field services as outages are anticipated to be lower than 2018. We also expect low double-digit EPS growth off of our revised 2018 guidance, which includes the missile tube reserves.

From a nonoperational standpoint, we will face EPS headwinds from continued interest rate pressure in the first half of the year, along with noncash EPS headwinds from lower pension income as a result of the purchase of an annuity to transfer pension obligations. 2019 effective tax rates are expected to be largely in line with 2018, and we see higher total company capital spend with continued elevated spend for Navy growth along with capital for our technetium-99 commercial product line as we build out the facilities.

And with that, I'll hand the call back over to Rex for some closing remarks.



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

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

Thank you, David. We remain excited about our entry into the medical radioisotopes market. With the acquisition, we have a more detailed understanding of the facility modifications required to stand up the moly-99 product line. And through continued discussions with our irradiation services provider, Ontario Power Generation, we have refined our schedule for the provision of reactor tooling.

Few weeks ago, we had a formal type C meeting with the FDA and have validated our planning assumptions and regulatory pathway for the technetium generators. Based on all the foregoing factors, our revised baseline schedule is to introduce the product in the first quarter of 2021.

Let me briefly take you through our milestones and what has changed over the past few months. Our path forward has 3 major components: one, reactor access equipment to support irradiation; two, the manufacturing product lines; and three, the regulatory process.

For the reactor access equipment, we are undertaking some necessary modifications to the tooling design. We intend to complete design work by the spring of 2019 and manufacture the equipment by next fall. Pending CNSC approval, we will install the equipment during a first quarter 2020 outage. On the manufacturing side, completing the medical radioisotope acquisition, enable design concept refinement for the radio chemistry and radiopharmaceutical process lines. Our future milestones call for final equipment design in the summer of 2019, facility modifications by the end of next year and final installation by the spring of 2020.

And lastly, on the regulatory front, we are pleased with our interactions with the FDA. We expect to irradiate moly-99 reference batches in the summer of 2020 and anticipate FDA approval of our technetium-99 generator, supporting first revenues in the first quarter of 2021.

For the overall business, we continue to anticipate long-term growth in all segments as supported by our robust backlog, our introduction of new technologies and our superior competitive positioning. In the near term, we remain focused on capitalizing for nuclear naval growth, an entry to the medical radioisotopes market, pursuing promising opportunities in Canadian commercial nuclear power and in the nuclear technical services space while laying the groundwork for new opportunities in space nuclear power and propulsion, nuclear materials processing and small modular reactors.

And with that, I would like to open the line for questions. Operator?

### QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from Pete Skibitski of Alembic Global.

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

Rex, if I heard you right, did you say the tube issue was \$0.21 in the quarter and another \$0.02 in the fourth quarter? Did I hear that correctly?

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

It was \$0.21 for the quarter and \$0.23 overall, including that reserve that we took in Q2.

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

Right. The \$0.02 was for last quarter, Pete.



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

---

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

I see. And are you going to book it at 0 margin going forward?

---

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

Yes.

---

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

Yes.

---

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

Okay. And -- but you're still going to compete for the next multiyear that I think is going to be awarded in 2019. Is that accurate?

---

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

So the original award schedule was to award in the first quarter of 2019, that's correct.

---

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

All right. And then you're still in the running for that?

---

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

We are.

---

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

Okay. Okay. Just to finish off on the tubes. Rex, can you talk about kind of what went wrong with the welds? Was it a training issue, materials issue, something else? Can you give us a sense of how you guys kind of wrapped your heads around fully characterizing that?

---

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

Yes. So there were 2 kind of factors going on there. One is our inspection technique. An ultrasonic inspection technique was inappropriate, and so we were missing some rejectable weld indications to use the parlance of welding. These are, to give you a little bit of context, very large, volumetric welds. About -- Think of the largest ones as being about 100-inch long and sort of a cross-section the size of a playing card. So lots of weld material, hundreds of weld beads, many weld layers. So they're complex and challenging welds to begin with. And typically speaking, on welds of this size, you're going to have some workmanship issues. Unfortunately because of our inspection technique, we were missing a good number of those. And then -- so that's one part of it. The other part of it is our weld techniques were not adequate for those large volumetric welds, and so we have changed both the qualification standards and intensive training standards for that. So we're screening our welders in a very different way. We're screening our inspection people in a very different way, and so we feel like we're right on top of the problem. Having said all that, these are really challenging welds, a very large volumetric welds, and they are difficult to make.



---

**NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call**


---

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

Got it. And last one for me, and I'll get back in queue. Should we expect you guys, capital deployment-wise, to get a little more active on the repurchase front from here given the new authorization?

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

So we haven't been very specific about that yet, Pete. I would say that, what we have said is that we would use our share repurchase reauthorization to mop up dilution every year, and that's not going to change. We're going to clear up that dilution, probably typically in the first quarter of the year, but we do want that tool available because we do have balance sheet capacity, and as we think about how to deploy capital over the next 2 or 3 years, that option should be available. And if we see a really interesting opportunity and opportunistic situation to repurchase some shares, we will absolutely do it if we think we can create significant value for the shareholder.

**Operator**

Our next question comes from Rob Spinerd (sic) [Rob Spingarn] of Crédit Suisse.

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

I wanted to ask, knowing -- now that you've closed the deal, if you could walk us through maybe with a little bit more clarity or detail on the -- how you get from the existing business to the future business? You talked about 2021, but I want to reconcile what we've talked about as a several hundred million dollar annual market to a business that's doing -- the existing business you acquired is obviously a small subset of that. How should we think about revenues flowing over time as the new product lines come online?

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

Yes. So -- good morning, Rob. Thank you. So the -- first thing, there are about 5 existing business lines there in the business that we acquired. None of them are moly-99, of course, which is the largest volume radioisotope product in the world. But there are a number of interesting product lines there, including TheraSphere and strontium and some other things. And by the way, there will be a couple of new product lines coming online in the next year or 2 in that business organically. What we will do is build the moly/technetium product line into that one using the existing facilities and modifying those, to some extent, the hot sales on the radio chemistry side and then a new radiopharmaceutical side for the generators themselves. We do believe that we have an opportunity to capture a large part of the market in North America for moly-99, and so you can expect that business from a revenue perspective to be increasing very significantly over the next few years as we bring the product line on for moly-99.

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

Is it fair to think about the existing business as \$50 million a year with some kind of a modest growth rate because you said they are already bringing some new products online, and that's what it looks like between now and let's say, the end of '20 or the middle of '21, and then there's a step function when the moly-99 starts to ship?

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

Yes. You've perfectly characterized it. It's -- We've said and -- we've said that it's a \$40 million to \$50 million business over the next 12 months. We are seeing increasing demand signals for the 2 major product lines. And again, these new products are coming on, Indium oxine, for example, a generic infection labeling drug is coming into the product mix which was in the pipeline when we acquired the business and then another one that's an iodine isotope. And so yes, you'll see a step change, a rather significant one when the moly comes on, and that was the -- obviously, the

## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

acquisition thesis. We like the radioisotope market to begin with, but we were interested, of course, in being able to sort of amplify our strategic intentions around the moly line, and this was the enabling acquisition for that.

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

And can you remind us how you see the overall market size for the market that you're getting into with your moly-99?

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

So the moly-99, there are various opinions about the future size of that market depending on how you think about spot pricing, availability of product and things like that. We have said we think the global market for moly-99 is around \$400 million, and the North American market is somewhere around \$160 million. There are estimates that say that market is high as \$1 billion. We're a little more conservative in our view of that. But think of it as -- and we are attacking the North American market first, and so think of that as a total accessible market -- addressable market for us of about \$160 million for that single product line.

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

Okay. And then just switching gears a little bit to your mid-single-digit top line growth or color for next year. What are the business lines behind that? How do we think about that because I think that comes in a little bit like -- relative to what the Street might have been thinking?

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

Yes, think of that as mostly driven by the Nuclear Operations Group. We're getting some additional volume with the Columbia order that will be coming in with the new pricing agreement that we're negotiating with our clients at naval reactors. The Nuclear Power Group is -- we'll be benefiting from the acquired revenue in the radioisotope business, but there's a bit of -- there's a negative cyclical in the servicing business. That one has -- the service business is outage dependent, and it cycles kind of plus and 30 minus million a year-ish and so that one swings -- the services business swings negative next year. So think of Nuclear Power Group as in a somewhat neutral revenue position. And then the Nuclear Services Group, we don't think of that as revenue-generating business because we're normally consolidating operating income from our joint ventures, but that business is growing nicely, first, from the Technical Services piece but then also from the Advanced Technology group within that. There's some new revenue-generating businesses coming out of that. So you kind of think of it that way, dominated by growth in nuclear operations.

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

Okay. And then just one last thing on just numbers. This could be for David. But the non-margins in the quarter, excluding operating FAS/CAS and the welding rework charge, could you tell us what those were?

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

I mean, the margins without the missile reserves are 21.7% as we stated there. So once again, the FAS/CAS is 200 to 300 basis points of reimbursement [inside].

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

In the operating piece?



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

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

In the operating piece, still, yes.

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

Okay. And then do you have any trend info on how CAS and/or ERISA contribution should progress over the next few years? Obviously, this is for pension modeling.

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

Right. So -- I mean, as of the last actuarial calculation we got, we felt that we still had FAS/CAS differential on our numbers for the next 3 years, and it would drop in half after that and then go away. So within 5 years, it would go away, but it will start changing after 3. So we'll update you all when we get our next actuarial calculation on that. We also stated some headwinds for next year because obviously, getting rid of \$244 million of pension means we got rid of the assets along with that, which the earnings on that pension would also go away. So there is some headwinds there, but I think getting rid of the liability and the volatility there is important.

**Operator**

Our next question comes from Bob Labick of CJS Securities.

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

And thanks for the initial outlook and color on 2019. Is this -- just curious, is this lower than your initial expectations? Obviously, it's a little lower than The Street. So wondering if it's lower than yours. And if so, what were the changes versus your expectations? Was that tube related? Was it outage related? Or what would cause the difference? And then just in general, also, what will -- what should we expect going forward in terms of the step up of growth rates just to get back to the 3- to 5-year low double digit?

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

Yes. I don't think it's in -- consistent with our internal planning, Bob. We -- in our strategic baseline for this business in that 3- to 5-year period, we had this ramping for the Navy demand, that's consistent with what we're seeing right now. I think we don't suddenly discretely go from 3 cores a year to 4 cores a year or anything like that. As we described in the call, as David described, that revenue builds up somewhat slowly and layers up over time and eventually gets you that, let's call it, that 20% volume increase. And so that's laying up the way we anticipated it to. The Canadian growth story is going the way that we thought that it would. The medical radioisotopes story, we're, today, of course, talked about a little bit more than a year delay in the product introduction there, but that doesn't affect '19 at all because we didn't anticipate much in 2019 for that. So no, I think it's very consistent with our long-term strategic plans. We certainly are going to have to ramp harder in the back end of that 3- to 5-year period to get to that low double digit, but it looks very achievable from our internal thinking.

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

Let me add that when you talk about the 3- to 5-year low double digit, it's EPS growth, so it's not going -- the revenue growth's not going to mimic that. So we -- that's why we push it to the EPS growth because that's where the commitment is.



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

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

Okay. Great. And then can you remind us of your targeted leverage levels in future, maybe 2019 and beyond, levels of expected CapEx? And does the new repurchase authorization suggest you're getting towards the end of elevated CapEx?

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

So our leverage ratios, we came out of spin saying that we're comfortable, the customer's comfortable at 2x. Since then, we said we're comfortable with higher than that. We feel that we'll be able to delever it very quickly with the cash generated. So if it's for the right thing, as a return on shareholders, we will do the right thing, and then we should be able to delever very quickly. So as far as capital, right now, we're in a capital year of roughly [150], and we feel that, that will probably be sustained in '19. And then after that, we'll be -- start coming down for capital. We still have the capital growth to finish for the Navy, and we've got the facilitation we want to do on the isotope business. But then once again, when that's over, then that cash spending will go down for that capital amount.

**Operator**

Our next question comes from David Strauss of Barclays.

**Matthew Carl Akers** - *Barclays Bank PLC, Research Division - Research Analyst*

This is actually Matt on for David. I guess, just going back to the missile tubes real quick. I guess, how long do you think it'd take to sort of get back on schedule? And at this point, is your customer delayed, or is there any risk to kind of the overall sub building schedule, or are you far enough ahead that they're not impacted?

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

So we -- our plans call for completing all the repairs next year, call it, middle of next year. In terms of any delays, I think, the Navy can speak to that schedule, but it has been publicly stated that the Columbia, the U.S. boats are -- will not be affected by missile tube delays.

**Matthew Carl Akers** - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. Okay. And I guess just one more on just sort of your overall thoughts on the elections last night. I mean, I think some thought from the Democratic side of the house may be cutting the budget, and it seems like your programs are probably fairly safe and not truly at risk. But just -- how do you think of sort of the upside scenario that you've talked about in the past, potentially a third Virginia class or faster carrier, and what's kind of the latest that you're hearing on some of those scenarios?

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

Yes. So Matt, I think we'll see what the Congress does. I would say, and we have said from the very beginning on this, that even before the presidential election, there was good strong bipartisan support for both the Columbia, which is the top acquisition program for the Navy and this idea of going to a permanent 2 Virginia acquisition tempo, and we saw that playing out here over the last couple of years. That's what we built into our strategic baseline. These upside scenarios around accelerated carrier procurements or around the 13 Virginias that the authorizers approved and the Block V, we never built in that -- built that into our strategic baseline. And so I think our strategic baseline, the 2 Virginias per year and plus normal tempo on Columbia and Ford is a good sustainable way to think about the future of the -- those product lines. I do believe that with the change in polarity in the house, that some of those upside scenarios are less likely.



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

**Matthew Carl Akers** - Barclays Bank PLC, Research Division - Research Analyst

Got it. And I guess just one more, kind of switching over to services. I think your guidance implies pretty good Q4, there's something that's stepping up there. And just given you guys have lots of contracts there this year, what's kind of the outlook for where (inaudible) kind of grow from here. And if you can give us any update on Savannah River, what's the latest there?

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

Yes. So in the services business, the performance lift that we're seeing has a number of different elements to it. One is the site performance where we execute work for the Department of Energy under joint venture, limit the liability companies. We've been seeing good fee performance at all those sites. We've been seeing very good utilization rates for our people, and we being able -- we've been able to accomplish better absorption in the G&A and overhead accounts because of the way we're deploying people. On top of that, we have some revenue-generating growth that's occurring in the advanced technologies group, as I mentioned in connection with an earlier answer, and that helps all of those things. It drives more of the bottom line, gives better absorption and actually gives us a little bit of top line. And then on top of that, we're seeing a bit of an upswing in a small component of that business that does U.S.-based nuclear reactor servicing. We've -- We were awarded a very substantial contract in Q3 in that space, which will help that business very substantially. So sort of all the pieces of that business are working well together right now. We haven't given any color yet on what that business will look like in 2019, but we -- but it's absolutely on an upswing. And so it's -- it will drive some bottom line growth for us next year.

**Operator**

Our next question comes from Michael Ciarmoli of SunTrust.

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

Just maybe on the current year first. The nuclear ops guide of \$1.3 billion. I thought I recalled on the last quarter, we were going to get some second-half strength on Columbia and downblending. The second half relative to the first half of '18 now looks pretty flat. Is that all pressure from missile tubes? Or is -- did something else slide to the right into '19?

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

So yes, Michael, there's some of that pressure, and I would say, the majority of it is related to missile tubes. There's a little bit of timing risk in Q4, which you've accounted for in our guidance here, a little bit of timing risk related to the negotiation of the next pricing agreement. The assumptions that we take when we get to a term sheet influence, our views on revenue and rates and therefore, operating income. So it's those 2 factors.

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

Okay. And then just on next year, just to be clear. I guess, it sounds like the core organic NPG revenues will be down, that's offset by give or take \$40 million of Nordion. If the services piece is flattish, maybe NOG, I mean, we should be thinking kind of in that 4% to 7% growth range? Is that sort of -- am I calibrated correct there?

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

That's about the way to think about it, yes.



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

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

Okay. And then just the last one for me, Rex. Just on the medical isotopes, I mean, just last quarter, we were thinking late 2019, I mean -- and I see on the slide you've got out there, you had the -- I guess you had the FDA meeting. But I thought Nordion was supposed to help accelerate this. I mean, what changed so materially between last quarter and this quarter to push out this schedule?

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

Yes. I think -- yes, Michael, so I think there were -- well, first off, we were -- it was an aggressive schedule, and we were acknowledging that all along. But I think there were a number of scheduled uncertainties that were -- that existed throughout the -- through this developmental period, and we basically settled all of those scheduled uncertainties over this last quarter. One of the issues had to do with reactor insertion tooling, that's the equipment that we put at the reactor site at Darlington that belongs to Ontario Power Generation. There was some uncertainty around the regulatory time frame for that and some uncertainty around what design approach we would have to use. And we ended up having to change our fundamental design approach on that, which cost us some months of schedule. We also got to kind of material negotiation point with OPG on the regulatory side and understood in much more detail what to check out and regulatory approval requirements were for the reactor side of it. And then the final thing was we made certain assumptions, maybe aggressive assumptions about the modifications that would be required at the Nordion site itself, the acquired business to implement these 2 components of the processing line, one called the radio chemistry side and one called the radiopharmaceutical side. We didn't really know what we would have to do there. We made certain assumptions about it because we didn't have much access to that during the acquisition, and now that we have the business and can work detailed schedules from the bottom up, we've got a much clearer view about what that is, and we certainly didn't have that view a quarter or 2 ago. So I think what we've done is we've largely eliminated the uncertainties in the schedule and have some room, frankly, for some errors here because that would have some reserve in it and have much more confidence in being able to make that.

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

Just to clarify. I mean, when we did talk about the acquisition, we said the acquisition would not accelerate, but it would derisk and help us derisk. And so I think -- and as we were talking more about it last quarter. We said that the technology risk is pretty much off the table, but timing risk would be -- is still on the table, and it was an aggressive schedule.

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

Got it. Got it. And just maybe the last one on this. Does it change, I mean, as it relates to the competition? I mean, are you now behind the competitors in this marketplace? Does it change any of your go-to-market strategy? And I know they've been talking pretty aggressively, but any view on the competitive dynamic given the slippage?

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

I don't think it changes anything for us. We've always had a very clear view about our channels to market, that is absolutely unchanged. We've got a very clear view about how much of that market we can get, and that is unchanged. I don't believe the competitive context changes for us a bit.

**Operator**

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

## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

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

This is Kristine Liwag calling in for Ron. Rex, we've seen that when some companies expand into different markets, they end up taking their eye off their core business. Keeping in mind the changes in missile tubes and your expansion in Canadian civil nuclear and the medical radioisotope markets, what are you doing to make sure you don't take your eye off your U.S. Navy business, especially as we are in the cusp of what may be the largest U.S. Navy procurement since the Reagan administration?

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

Well, so we definitely don't take our eye off that business. That business remains the most important aspect of BWXT. Even this year, it will generate 80% of our revenue and about -- and a similar fraction of the operating income. And so it's right in the crosshairs of what I work on every day. I'm substantially and materially involved in the capital upgrades and the missile tube issue and things like that. We get very high visibility on that business, not only from The Street but also from our Board of Directors and from -- certainly from our entire management team. I would say that our focus on that has not changed. But I would also say that when we have a business like that, that is that stable with a visible backlog and the cash generation -- [good] cash generation capabilities of it, it's incumbent upon us as an executive team to figure out ways to grow the business as well. So the move towards doubling down in Canada, the move towards diversifying in medical radioisotopes into markets and into businesses that are accretive to the core BWXT is the right thing for us to do, and -- but it does not imply any lack of focus on our core business. It is the gem of our portfolio, and we know it.

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

Okay. And can you provide context regarding your missile tube business and how that could or could not affect your nuclear reactor core for the U.S. Navy? Are these businesses very separate, are they intermingled? And can you give us an idea of whether or not there could be some spillover in terms of operational risk?

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

Yes, sure, certainly. Well, first to give it some financial characterization. The missile tube business is about 3% of our total revenues in nuclear operations. So it's actually a small part of the business. It's an interesting growth business for us outside the naval reactors core because of the nature of it, but it's a small revenue generator for us at the present time. It is related to the naval reactors business only in the sense that those components end up on nuclear submarines, but it's unrelated in the sense that our customer is a different customer here. Our customer is General Dynamics Electric Boat, and then, ultimately, to (inaudible) whereas our customers on the other side are naval reactors. So different customer lines. And in terms of any spillover, as I said in my script, we did [extensive] condition, extensive cost critiques. And we are dead certain that this product is -- this problem is restricted to this product line and in fact, it's restricted to this particular type of weld on this particular product line. And so we're very confident there's no spillover effect on the other programs or content in the naval reactors part of the business.

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

And switching gears to medical radioisotopes. With your meeting with the FDA, can you provide more color on what was the most significant hurdle that postponed the time line to your first expected revenue?

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

Yes. I'd say that we've been -- it's been our hope to be able to introduce the moly-99, technetium-99 radiopharmaceutical as generic to the market with the belief that if we meet the existing product specifications and deliver essentially identical drug to the market, we could avoid human trials and a more protracted regulatory process. The way it goes with FDA, you don't get assertions in writing about what the regulatory path is, but we



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

did get a confirmation of our belief that we can approach this as a generic and expect a more accelerated approval time line. We'll see how that goes, and the FDA will have to act upon that. But the meeting that we had with them 3 weeks ago did validate our planning assumptions.

### Operator

Our next question comes from Josh Sullivan of Seaport Global.

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

Just a follow up here on the isotopes. With the new schedule for 2021, can you talk about any contracts' modifications with existing customers? And then maybe could you just give us an idea what your current customer base looks like [in any form]?

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

So Josh, to be clear, you're talking about the existing portfolio and the acquired business?

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

Sorry, on the Tc-99 extended schedule for 2021, with any existing customers, with any modifications, any contracts you had signed?

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

Yes. We haven't disclosed anything about supply agreements or anything of that nature. So I would say, there's no comment on that.

### Operator

Our next question comes from Pete Skibitski of Alembic Global.

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

Few follow ups guys. David, we've got a sense, I guess, on the revenue multiple you paid for Nordion. Can you give us a sense of the EBITDA multiple?

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

About -- I mean, about 13. But I mean, I -- we've provided the data inside the cue that -- and it's about a 13.

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

Got it. Okay, and I appreciate it. And then just on fourth quarter expected cash flow, maybe to think about it on a full year basis. If we exclude the pension contribution this quarter, do you think we'll get close to 1x free cash-to-net income conversion on a full year basis?



## NOVEMBER 07, 2018 / 1:30PM, BWXT - Q3 2018 BWX Technologies Inc Earnings Call

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

I mean, I -- I mean, there's not a lot of detractors left. I mean, obviously, the pensions -- we've put into the pension what we're going to put into the pension and in this case, fourth quarter is usually our best quarter for cash. So other than that, no speculation there, but I think it will be a good quarter for cash.

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

Let me finish with one for Rex. Rex, any update from NASA or [DARPA/TOD] on space reactors? And I was also -- I saw something in the quarter about this NASA, I think it's called Kilopower or KRUSTY, a small reactor. Just wondering how that impacts you if that's maybe a competitor for what you guys are designing?

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

Yes. So the work with NASA, the nuclear thermal propulsion work, continues to progress really nicely. We've been manufacturing some fuel samples and successfully testing those. I would say that the interest from NASA and from DARPA in space reactors is quite high. We also see, by the way, interest from the army for terrestrial small reactors, micro reactors, and we were quite bullish about that entire market. KRUSTY is a small power reactor, 1 to 10 kilowatts. And so its capable of doing a certain class of things, for example, powering a spacecraft, if you ever wanted to move from say, radioisotope, thermal electric generators to a fission reactor. So I don't think of it as something that would be competitive to our interest. For nuclear thermal propulsion, you're talking about 500 megawatt thermal reactors and things like that and for surface power, probably much, much more -- much higher than, say, 10 kilowatts. It's an interesting and capable little reactor that KRUSTY is but not sort of in competition with our aspirations. We are very, very interested in and very excited about the potential for smaller reactors for military and space applications, I would say.

**Operator**

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

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

Thank you, Nicole, 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.

**Operator**

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

#### DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2018, Thomson Reuters. All Rights Reserved.