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BWX Technologies, Inc. (BWXT)

Q4 2022 Earnings Call

CORPORATE PARTICIPANTS

Mark A. Kratz
Vice President-Investor Relations, BWX Technologies, Inc.

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

Robb A. LeMasters
Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

OTHER PARTICIPANTS

Peter Skibitski
Analyst, Alembic Global Advisors LLC

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Scott Deuschle
Analyst, Credit Suisse Securities (USA) LLC

Peter Lukas
Director Institutional Sales, CJS Securities, Inc

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to BWX Technologies Fourth Quarter and Full Year 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. Following the company's prepared remarks, we will conduct a question-and-answer session and instructions will be given at that time.

I would now like to turn the call over to our host, Mark Kratz, BWXT's Vice President of Investor Relations. Please go ahead.

Mark A. Kratz

Vice President-Investor Relations, BWX Technologies, Inc.

Thank you, Joel. Good evening, and welcome to today's call. Joining me are Rex Geveden, President and CEO; Robb LeMasters, Senior Vice President and CFO. On the call, we will reference the fourth quarter and full year 2022 earnings presentation that is available on the investors section of the BWXT website. We will also discuss certain matters that constitute forward-looking statements. These statements involve risks and uncertainties, including those described in the Safe Harbor provision found in the investor materials and the company's SEC filings.

We will frequently discuss non-GAAP financial measures, which are reconciled to GAAP measures in a separate presentation that can also be found on the Investors' section of the BWXT website.

I would now like to turn the call over to Rex.

Rex D. Geveden

President, Chief Executive Officer & Director, BWX Technologies, Inc.

Thank you, Mark, and good evening to everyone. Earlier today, we reported fourth quarter and full year results that were in line with our expectations as we closed out the year on a strong note. 2022 revenue and adjusted

EBITDA each were up 5% and underlying operational profitability was up 9.5% factoring out pension headwinds. Despite macroeconomic pressures this year, earnings per share grew by 2%, and we brought down capital spending by over $100 million.

Labor remains a focus area for the company as we experienced growth in all our major markets. We continue to monitor hiring and retention metrics and are making progress, streamlining our processes and advancing our training programs, particularly on the government side of the business. We remain cautiously optimistic that our efforts will deliver the net employment required to support our growth. Having said that, we believe the challenging labor dynamics will mask some of the potential growth for BWXT this year, but is ultimately a hurdle we will clear. Beyond labor, interest rates have begun to stabilize. While this presents a 2023 headwind to earnings, stable rates and access free cash flow should enable us to overcome interest expense headwinds over the medium term.

In December, the President signed the National Defense Authorization Act for 2023 into law. BWXT's Core businesses remain well-funded and our new growth areas are receiving increased budget support. Columbia Advanced Procurement in aircraft carrier funding saw significant increases. Virginia submarine advanced procurement is steady and in line with our expectations. Budget for Project Pele is increasing and the Army is receiving funding to support fielding. DARPA and NASA received increases to support a nuclear thermal propulsion space demonstration program. The National Nuclear Security Administration received increases for uranium processing projects, including uranium purification and down blending, and the Department of Energy site remediation and operations budgets were well supported. All in all, we see an improving macro backdrop of positive momentum in our government and commercial markets.

Let me go into a little more detail for 2022 highlights and near-term opportunities in both of our reporting segments. Within government operations in 2022, we announced about $1 billion in option orders for the core Navy franchise. We certified and shipped some of the first items for the Columbia program and continued steady production for Virginia class and Ford class components. For 2023 we anticipate wrapping up negotiations for the next multi-year pricing agreement encompassing two years of scope, which will span orders through 2024. We eagerly anticipate the announcement of Decisions for the AUKUS Trilateral Security Agreement, particularly as it pertains to naval nuclear propulsion. We expect to hear additional details next month and remain engaged with our customer and other key stakeholders to support the nation's allies in deploying this unique technology to ensure global security.

We continue to leverage our NRC Category 1 license facilities to grow the business and provide the nation with critical services. In 2022, we were awarded a production contract for high assay, low enriched uranium TRISO fuel to be used for the first fourth generation micro reactor in the United States.

Separately, this year, we completed the first phase of uranium purification and conversion for the NNSA. Both of these programs will grow in 2023 as we undertake production runs for TRISO fuel and expand into the second phase of uranium purification.

As you are all aware, 2022 was a hallmark year for BWXT with micro reactors, as certain programs transitioned from design contracts into prototype production. In June, the Strategic Capabilities Office awarded BWXT the $300 million contract called Project Pele to build and deliver the first advanced mobile nuclear reactor in the United States.

As we look to 2023, we anticipate growth in that program as we experience a full year of revenue and achieve key project milestones. Beyond Pele we see ourselves in a strong position on DRACO, a Space nuclear propulsion demonstration mission. Early this year, NASA and DARPA announced they will be collaborating on this program to demonstrate a nuclear thermal rocket engine in space, enabling capabilities for both space exploration and other potential applications, including national security.

We believe that our history with NASA's nuclear thermal propulsion work, combined with our innovative technology solutions, creates a favorable competitive position for our company. This program would be similar in size to Project Pele and would have similarly aggressive program goals.

Lastly, on the government side, in early 2022, we successfully transitioned the Savannah River Mission completion contract and had a year of excellent safety and contract performance, resulting in higher site scores and income than we originally forecasted. In 2023, we look forward to the award of the Hanford Integrated Tank Disposition Contract which if successful, would likely be the largest single contract in our government services portfolio.

Switching gears to commercial operations, our base nuclear power business grew nicely in 2022. We saw higher volume of service work related to life extension projects for a large portion of the Canadian fleet. Notably, the Government of Ontario announced its support for the continued operation of part of the Pickering plant that was originally slated to shut down in 2024 and 2025. Under the new plan, Units 5 through 8 will continue to operate through most of 2026.

Given the recent successes in other life extension projects, the utility plans to update its feasibility study on the potential refurbishment of those Pickering reactors, which would extend the operational life another 30 years. Both the near-term extension and the potential for longer term refurbishment upcycle improve an already favorable outlook for our CANDU business lines.

Beyond traditional nuclear power, we established a meaningful stake in the small modular reactor market. On the last call, I said that we are under an engineering design contract for GE Hitachi's BWRX-300. With high interest in decarbonizing electrical grids, we anticipate continued growth and interest coming into 2023. Ontario Power Generation intends to field this reactor by the end of the decade. And I have mentioned in the past that the Tennessee Valley Authority began the planning and preliminary licensing for the potential deployment of this same reactor to Clinch River site.

SaskPower also announced that it has selected the BWRX-300 for potential deployment in the mid-2030s and just the other week, Fermi Energia announced that it has also selected this design for SMR deployment in Estonia. BWXT remains positioned to support SMR designers with engineering services and critical nuclear component manufacturing for these projects. In fact, we anticipate receipt of our first SMR production order sometime later this year. There's a broad consensus now that nuclear power will play a significant role in global clean energy production. This, combined with a renewed focus on energy security in the wake of the Russian invasion of Ukraine, is driving intense interest in grid scale nuclear power.

Now turning to the nuclear medicine side of commercial operations, we saw a string of successes in 2022. Our base business grew double digits and our Tc-99M generator FDA application was submitted, accepted and granted a priority review status.

Next week, the FDA will be conducting an implant pre-approval inspection of our Tc-99M generator line, and we look forward to working with the FDA to support this review. While our FDA submission is based on targets irradiated at the Missouri University Research Reactor, which limits activity levels and restricts our product offering to small generators, our ultimate solution is to irradiate targets on a CANDU commercial power reactor, which will enable production of large generators comparable to those in the market today.

Last month we announced the completed installation of our target delivery system on the OPG CANDU reactor through our collaboration with Laurentis Energy Partners. We have now conducted irradiation test runs of our moly targets. And as expected, these tests demonstrate that our process will yield high specific activity material needed to produce these large generators. Pending final FDA approval, we will enter the market with a product that has all the attributes our future customers have grown to expect and this is a very exciting milestone for this foundational product.

Beyond the Tc-99m generators, we made substantial progress in 2022 on other products, most notably in therapeutic isotopes. Building on its heritage for innovation BWXT Medical executed an agreement with TRIUMF for the manufacture of high purity actinium based products and followed up with the announcement of a commercial agreement to supply Bayer with Actinium 225. We also announced a partnership with Fusion Pharmaceuticals to supply this isotope in support of their exciting portfolio of targeted alpha therapies. We expect growth in this business to accelerate, driven by therapeutics and contract drug manufacturing opportunities that add new layers to BWXT Medical.

Overall, 2022 was a year of meaningful strategic milestones for BWXT accompanied by consistent operational outperformance. I am energized by the tailwinds we see across the portfolio coming into 2023 and the future trajectory of this business. This year we see near-term opportunities in every market as we approach or experience inflection points on EBITDA growth return on invested capital and free cash flow. This provides a clear pathway to the strategic and financial targets we articulated at our Investor Day 16 months ago.

Let me turn it over to Robb to discuss 2022 financial results in more detail and to walk through the components of our 2023 guidance.

Robb A. LeMasters

Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

Thanks, Rex, and good evening, everyone. I'll start with some total company financial highlights on slides 5 and 6 of the earnings presentation. Fourth quarter revenue was up 5% on a consolidated basis, with government operations up 8%, which was partially offset by commercial operations being down 6%. Fourth quarter EBITDA was up 6% to $130 million, driven by higher revenue and better margins in government operations despite lower recoverable pension income. Lower corporate expense also contributed to the growth in EBITDA, which was partially offset by lower contribution from commercial operations. The higher effective tax rate and more interest expense resulted in an earnings per share decline of 2% for the fourth quarter to $0.93.

Notably, we generated $44 million of free cash flow in the fourth quarter, a little shy of our expectations as we had higher tax payments and lighter accounts payable balances due to year, to end of year activities. A solid fourth quarter drove full year 2022 revenue to $2.23 billion, up 5% with equal growth rate contributions from both operating segments.

Full year 2022 EBITDA was also up 5% to $439 million, despite a $17 million pension headwind. On an ex pension basis underlying operational growth was 9.5% and at the high end of our original operating guidance range for the year. These results were driven primarily from government operations growth and lower corporate expenditures.

Despite higher interest rates and other headwinds to non-operational items, earnings per share grew 2% to $3.13 for the year. We finished the year with $245 million of operating cash flow a little lower than we had anticipated. We have laid the groundwork to improve working capital management by tracing procurement to pay processes across our company.

However, in the fourth quarter, we advanced some payments given the rapid installation work we did at year end on our target delivery system in Canada. Another consideration in evaluating total cash flow as it relates to FX hedging activities. In an effort to hedge balance sheet items and offset potential negative impacts to operating cash flow, we arranged foreign exchange contracts that seek to dampen any currency fluctuations. The net impact of those hedged contract settlements flow through the financing section of the cash flow statement and not through OCF. Given that dynamic, we saw a $24 million inflow which allowed us to ultimately deliver total cash flow in line with our expectations.

Additionally, we successfully brought capital expenditures down over $100 million to finish the year with $198 million of CapEx. We have an EPS bridge on Slide 7 detailing all the puts and takes for the year.

I will now move on to 2023 guidance on Slide 8. As we look to provide guidance for 2023, we want to focus you on five key metrics that taken together show a clear picture of a growing and high margin enterprise. So let me walk you through those on the left hand side of this page, and then I will provide some detail, color and assumptions behind those key metrics.

We project 2023 revenue of about $2.4 billion growing mid to high single digits versus 2022 results. Adjusted EBITDA is anticipated to be about $475 million, up high single digits year-over-year and driving EBITDA margins of about 20%. We expect adjusted pre-tax income of around $350 million, resulting in an anticipated EPS range of $2.80 to $3 per share, down year-over-year due to due to significant non-cash and non-operational items that we will discuss later.

Finally on cash flow, we see a clear path to achieving $200 million as we drive more OCF and finish up our two largest CapEx projects. This free cash flow growth represents a significant step up from our 2022 results. So those are the major metrics that accurately depict the solid financial picture BWXT foresees, as we enter 2023.

So I will offer you some color on the assumptions that underpin that guidance. For revenue, we anticipate government operations to be up mid to high-single-digits year-over-year. This is driven by a slightly growing Navy business, as we build out our workforce to meet increasing demand. Most of the revenue growth, however, is anticipated to come from micro reactors and uranium processing. We have clear near-term visibility on micro reactor growth with a full year run rate on Project Pele.

We could see an additional wedge of micro reactor growth this year, if we are successful on NASA and DARPA's in-space reactor demonstration project called DRACO. The other major component of government growth is the transition from uranium conversion and purification Phase 1 to Phase 2, which is an expansion of that capability. In commercial operations, we expect low to mid-single-digit growth. This growth is expected to be driven mostly – modestly by commercial nuclear power, including some SMR revenue and strong nuclear medicine growth in response to robust demand for our current offerings, as well as the introduction of new products to market.

For total company EBITDA, we expect strong growth and modest segment margin expansion, which would be partially offset by a return to more normalized corporate expenses versus last year. In government operations, I would make a few comments on EBITDA growth and margins. First, the lion's share of [ph] geos (17:31) EBITDA growth is anticipated to come from our core Navy business. As Rex mentioned, we are seeing early green shoots of progress from our hiring and training initiatives, and we expect that to drive modest growth. We are also expecting to see a pick up from our uranium processing contract as we enter a second phase of that program. And then the last growth component within this navel segment will be driven by income we expect to get from cost recovery in non-nuclear components. These items taken together are anticipated to make both EBITDA growth and modest margin expansion.

The second geo driver will come from a full year of growth from 2022 wins that are already under contract, including our Savannah River services effort as well as Project Pele. Taken together, these will have a relatively neutral margin mix impact. And then the third geo bucket of growth and margin will be derived from some mix of new awards in our services and micro reactor businesses. We believe we are tracking well to pull through a few key wins later in 2023.

Then for commercial operations, we expect the modest EBITDA growth driven by the strength of BWXT medical being partially offset by the mix of field services work that propelled the nuclear power business in 2022.

For other items, we see three headwinds going into 2023, which are not much different from what we have described on the last couple of earnings calls. Those items include first, we will see about a $40 million non-cash pension headwind driven by the increase in discount rate and negative performance of our pension assets in 2022. This will take the other income line below OI down to about $10 million in 2023.

Second, there is an anticipated $15 million headwind in interest expense driven by an expected 300 basis point increase in interest rates year-over-year.

And thirdly, we will encounter about a $10 million headwind to depreciation and amortization as new capital is put to work. We see a consistent tax rate in 2023 compared to what we saw in 2022 and have assumed share repurchases sufficient to offset any dilution. On free cash flow guidance, we anticipate that 2023 operating cash flow will return to more normal levels, which has been trending towards the $300 million mark that we saw in 2021 and on most LTM look backs. So starting with that, approximately $300 million as a base level, we anticipate adding growth in line with the high single digit EBITDA growth from operations and topping that off with some modest benefits from our working capital initiatives, which should yield a solid operating cash flow step up in 2023.

On the CapEx side, we are currently expecting another material step down year-over-year with maintenance CapEx level – maintenance levels of CapEx in most of our businesses, micro reactors capital in the tens of millions of dollars and a small tail of medical CapEx as we finish up that major investment.

Given the macro dynamics we experienced last year, I want to provide some overall assumptions embedded in the 2023 guidance. On the labor front, we anticipate modest progress on hiring and attrition in line with what we have been seeing for the past several months. We're also assuming that interest rates remain fairly stable in line with the forward one month SOFR curve, which is a close proxy to derive interest expense on our variable rate debt. And lastly, we continue to anticipate minimal supply chain disruptions, also in line with what we have experienced through the COVID-19 pandemic and in recent history. Overall, BWXT is growing across the portfolio and is building on strategic successes and superior competitive positioning that enabled another strong year of operational growth and position us to accelerate and achieve our medium term financial targets. And with that, we look forward to taking some of your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the Q&A session. [Operator Instructions] The first question is from the line of Pete Skibitski with Alembic Global. You may proceed.

Peter Skibitski
Analyst, Alembic Global Advisors LLC

Q

Hey good evening Rex and Robb and Mark. Rex maybe you could start with giving us a little more color on the labor outlook. It's a little tough to see from the outside, just for 2022, how short did you end up on net hiring for the year and what's kind of the goal for 2023? And then understanding you hire people, but then what's kind of the in terms of training, how long does that take to really get to, get the guys up and productive?

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Yeah, thank you Pete, and good evening to you. So last year, we were trying to net hire about 500 people and we thought we'd need to get maybe 1,000 people given our historical attrition rates to get that net 500 Pete. But as it happened, attrition was higher than normal, we reported about that – reported on that throughout the year. So what happened was, we did hire 1,000, but we lost about 700, so we netted about 300, against that goal of getting 500. So think of that as 200 short. And most of that was in government operations where we have about 5,000 employees. And so, if you think about that, that's kind of 4% short on that workforce, the head count is, you translate that to marginal revenue on roughly the same ratio. And you think about the income fall through, it's not an insubstantial impact, but that's how it came out. So coming into this year, we've got that 200 deficit and then we're trying to hire another 500 because of how much growth we have on top of the 200. So we need to net 700 this year. So it's a, I think of it as a pretty high hurdle.

That said, as we discussed on the call, we really revamped our hiring processes, went through an intense Kaizen kind of activity to figure out how to take steps out of it and to streamline it. Bob Duffy, who runs administration, has been in charge of all that and we're seeing big results from that. We're daily monitoring it, we've beefed up our recruiting staff and availed ourselves to various other recruiting services. And so we're seeing a turnaround in that area. I'm getting a weekly report on it, the last one I got on Monday, we were up 89 net for the year, and that's a good pace that would get us there.

So that's the kind of challenge that we face. And I do see it improving overall. Now, in terms of any training, there's a bit of a learning curve, particularly on our naval reactor side, where we have to train welders and assemblers and inspection technicians. And so think of that as weeks or months to go through kind of the training component of that. So there's a little bit of drag on revenue and income until those workers are fully qualified. That said, we've got good support from our customer for those training programs and we expect that to and we expect to work our way, sort of chew our way through that.

Robb A. LeMasters
Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

A

Yeah, Pete and how we model that is, we know that you come off a pretty challenging period at the start of the year as people retire and then we slowly ramp up and all of our efforts are kind of building, we're seeing good data and so we're tracking to how we're budgeting, but we're sort of slowly building to that and we have a lot of inefficiency as we ramp up.

So that's all taken into consideration. The inefficiency of how that ramps up.

Peter Skibitski
Analyst, Alembic Global Advisors LLC

Q

Have we had the increased salaries sort of at an inflation plus type of a level? And I assume some of those you could pass through your contracts maybe?

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Yeah. There's some of that going on. But we're trying to keep a lid on that and still attract the right kind of workforce. And I'd say that what we have in store for our merit pool and race pool throughout the year is kind of consistent with what you're seeing across the US economy.

Peter Skibitski
Analyst, Alembic Global Advisors LLC

Q

Okay. Okay. Understood. Okay. Just last one for me, then. Sometimes it's hard to predict for you guys, some of the material purchases, the seasonality aspect of that as it flows through the year. So I don't know, maybe, Rob, if you could give us a sense of how revenue is expected to kind of flow this year with the puts and takes that you guys kind of typically progress through?

Robb A. LeMasters
Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

A

Yeah, sure. Happy to do that, Pete. Thanks. Thanks for the question. Yeah. As we look out over the year it is difficult as you know, it's kind of splotchy quarter to quarter in terms of different activity. But I think we see the year shaping up as you've seen the past couple of years where you start a little bit lower and build over time. The past couple of years we've generally seen about 20% of earnings, if you will, EPS in sort of the first quarter. And then we build over the course of the year generally end up at almost 30% of our – of the full year results kind of hitting in the fourth quarter. So that's the way I see it playing out. It's about 20%. And then you probably would build over the course of the year. It's actually pretty sequential because you kind of bring on the work force, you get some of the awards later, you have outages early on. And so I'd see sort of 20% and building to almost about a dime every quarter thereafter.

And just while we're on it, because we're pretty focused on matching up that earnings to also in operating cash flow we're really trying to look at that just to help you on seasonality there. Likewise, we start out a little slow in the first quarter. That's when we pay our bonuses. That's when you have lower income. And so as we looked back your model prior to [indiscernible] (27:37) since we went public, I guess about seven years, six of the past seven years, we started out with a negative result in the first quarter to the tune of about $20 million outflow in operating cash flow in the first quarter then we built thereafter. So that's kind of the same seasonal trend that we're seeing in earnings that kind of slows down through operating cash flow.

Peter Skibitski
Analyst, Alembic Global Advisors LLC

Q

Okay. Very helpful. Thanks, guys.

Robb A. LeMasters
Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

A

Sure.

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Yeah. Thanks, Pete.

Operator: Thank you. The next question is from the line of Michael Ciarmoli with Truist. You may proceed.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Hey, good evening, guys. Thanks for. Thanks for taking the questions. Maybe, Rex just on you kind of touched on it with your prepared remarks in terms of everything that's happening in the commercial nuclear market. But there certainly is a lot of activity between, you know, legacy plant builds, new SMRs, multiple players in the marketplace, the need for fuel. I think you kind of talked about maybe getting your first order later this year, but can you just give us maybe the lay of the land? I mean, I know we're expecting slower growth in commercial this year, but it certainly seems like the growth opportunities are pretty prevalent there. Is this a segment that you think can see some significant growth acceleration?

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Yeah, I really do. I really do. Michael, it's a pretty interesting time. It's a very interesting time for nuclear power because of what I said in script, which is this convergence of energy security with decarbonization of the grid is really driving a global trend here of very powerful interest in nuclear. In fact, we literally yesterday morning, we did a comprehensive strategic review with our board of directors on commercial nuclear power.

So a lot of interest, a lot of interest here within our board. And I'd say we think of it in kind of three layers. First off, where, we have that incumbency, that very strong base of business that's centered around Canada with the CANDU fleet servicing and products that we have there. So CANDU fuel, as you know, we do field services, particularly around steam generators and fueling and services, servicing of fueling equipment.

We do spent fuel waste containers in that market and so that's been a good market for us historically. But it really sort of got jet fueled by this refurbishment campaigns going on both at Darlington and at the Bruce site. And that's the reason that business has grown so significantly over the last, let's call it, four or five years.

Now, as I mentioned in the script, in looking at refurbishing that Pickering that set of reactors in Pickering which would be, you know, same set of opportunities for us steam generator manufacturing feeders, various other components that we do heat exchangers and the like. So that that refurbishment upcycle you could imagine going all the way out to maybe 2040 or something now instead of 2032, which is what we had modeled. So that's going on.

And by the way, the global sorry, the CANDU business is a global business. There's CANDU reactors in Romania, a pair of them there, there's one in Argentina at Embalse. There's the reactors in South Korea. So we do have a global footprint there. And there's talk about refurbishing that Romanian reactor in Cernavoda now. So that's our base business and it's pretty interesting. And then you add on that refurbishment opportunity that's, that upcycle with it.

And then the new layers of growth are what you referred to in your question, which are is a lot of interest in small modular reactors. And I'd say we're kind of in the pole position at the top of the supply chain for the small modular reactor that presently has the most traction in the market, the BWRX-300, which is GE's reactor.

Darlington, OPG Darlington has committed to building one of those by the end of the decade, they're probably build a four pack there eventually. SaskPower is interested in that reactor and would install that one in the mid-2030's is what they're talking about in the TVA opportunity I mentioned and the others. And where we are with that one is we're under a design contract to design the reactor vessel. There are other design opportunities for us and we'll almost certainly have the opportunity to manufacture the components that we design and we expect to do that.

But that's not the only one, we sit there in the top of the supply chain as a merchant supplier. And so there are multiple other small modular reactor opportunities that we have, that we haven't disclosed yet that are kind of in that same sort of in that same opportunity space of designing reactor vessels, heat exchangers and the like.

So very interesting opportunities there, and I really like where we are on it. And then sort of, maybe the surprising demand signal that we're seeing here in the last couple of months, Michael, is that suddenly, globally there's an interest in large reactors, because I think people get that you really can't decarbonize the grid by 2050 or whatever your goal is by building 5,000 small modular reactors. You need to mix in some large reactors and so CANDU has got new life for possible large reactor building. And you've heard about AP-1000 and others and obviously we've got a very strong position on CANDU.

And then maybe a little further out there are, what is the future of micro reactors? We're in the position now in the pole position on micro reactors with the Pele contract where we've got a government sponsor for the development of that thing. But we also have a commercial derivative called BANR that has interesting applications in places like the oil sands, where you need high density power, industrial applications, island economies and all those things that get discussed. And so there could be a commercial end point to micro reactors, too. Now, that's a little further out there.

But the opportunities for small modular reactors are now. We are under contract now for the design aspect of it. And as I said in the script, we expect to have a production program pretty shortly on that. So it's a whole new world. A year ago we had one order, not even an order, but an announcement that Darlington was going to build one. And a lot has changed in that last year. Two years ago, there was nothing. So I'd say that commercial nuclear power has unusual lift now, and maybe more so than we all anticipated.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Got it. That's extremely helpful. And then maybe just one more, Robb, just thinking about commercial as well. The operating margins weak in the quarter they've kind of trended lower. As you look at the opportunities in commercial and even looking into next year, how should we think about this, this commercial? Maybe I guess I'm just keeping it to the nuclear side. I guess I would assume once some of the medical starts to hit, that would that would give you a more of a margin lift. But how do we think about this kind of commercial nuclear margin opportunity going forward as well?

Robb A. LeMasters
Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

A

Yeah. I think we see margin lift across the business, particularly in 2022 modest margin lift. We talked about how at both the segment levels, you're going to see that lift and then that's offset by a little bit of pressure as we have a rebound in our corporate expenditures. When you look at the commercial margins, specifically, as you said, you have that mix of higher margin medical drifting higher over time. That's running a little bit faster. And then you have the low lower margin you to refer to as to the MPG legacy business and then you always have mix within that.

As you look out to 2023, nothing to call out that's super important. There is some push out that we had in terms of signing our fuel contract in 2022, and so that will be a contributor in 2023. We see a good – we see mix in the field services business that's comparable to what we've seen in the past couple of years. So I don't think a lot within that segment is going up or going down. And then you have the mix up of the medical sort of on top of that is how I would think about that segment for 2023 versus 2022.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Got it. Helpful. Thanks, guys. I'll jump back in the queue.

Operator: Thank you. The next question is from the line of Scott Deuschle with Credit Suisse. You may proceed.

Scott Deuschle
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey. Good evening, guys. Rex has the FDA come back to you with any supplemental data requests since they started the priority review on tech 99?

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

So, no, we'll know a lot more in the next weeks and months, Scott, as we go through the – as they go through the pre-approval inspection. They'll send us a formal request for data at that time, and we'll see what we have and when we kind of understand where we are with the FDA.

Scott Deuschle
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. And then Rex, Rolls Royce is going through its strategic review. I think they have some overlap with you all in a couple of areas. So curious to get your thoughts there if you're going to say anything, kind of whether you see anything in their portfolio that might be of strategic value to be BWXT?

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Yeah, I won't say much about that other than say – other than to say we actually enjoy quite a nice strategic relationship with Rolls. We operate obviously in different geographies and we have very little competitive overlap. And so we do have some collaboration areas in novel nuclear that we've worked on.

Obviously, naval nuclear propulsion is certainly an interesting overlap of capabilities serving our own sort of domestic needs. So there's certainly a lot there that's interesting to us. And we keep an open dialogue with them.

Scott Deuschle
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. And then, Robb, maybe just what's your latest thinking on when you look to take out this variable rate debt and the timing for when you do that, obviously, it's creating a bit of an overhang in terms of estimates, given the stickiness of inflation and the short term rates continuing to creep up. So curious for your thoughts there. Thanks.

Robb A. LeMasters
Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

A

Yeah, I mean, the fixed rates that we're seeing, all companies are seeing right is kind of blown out. I mean, we issued our bonds in the low fours. Right. Where our debt is trading, I think it's around seven. So we think that as rates come down, that would provide an opportunity. We're in no rush to turn that out. We have $500 million in liquidity just in general. And so we're actually in a great position. As you know, we just did a transaction in September that gave us some extra flexibility, which you can see in the 10-K. So I feel like we've got plenty of dry powder. We're looking at, you know, largely looking at just tuck-in acquisitions. So we don't need to do anything to set ourselves up for anything gigantic. So we'll just kind of wait until the market settles in. That's kind of our posture now as it relates to the balance sheet.

Scott Deuschle
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Got it. Thanks, guys.

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Thanks, Scott.

Operator: Thank you. The next question is from the line of Bob Labick with CJS Securities. You may proceed.

Peter Lukas
Director Institutional Sales, CJS Securities, Inc

Q

Yes. Hi. Good afternoon. It's Pete Lukas for Bob. You guys have covered a lot and answered most of his questions here. I just wondered if I can get a little more detail on the target delivery system at Darlington and what's happening now? Are you running weekly batches? How's that going? And I think you kind of covered where you stand with the FDA there.

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Yeah Pete we installed and fully validated that system on the Darlington reactor Unit 2. That was a certainly a comprehensive campaign to assemble that thing and then test it. We have run target material through it at different soak times, we've done moly targets, I believe, at one and two in three week different soak times and retrieved those targets and have begun to test those targets, as we said. So what we've done is proven that the system works, that we can move material in and out of there. And I think certainly the OPG has confidence in that system now. But the important output of all that was the activity level of those targets that we took out of the system, which do support, as I said in the script, that full spectrum of generators that we would deliver to the market ultimately.

Robb A. LeMasters
Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

A

I would note too that now that's up and running were testing. Yeah, I would note that now that we have that up and running, we're testing that as it relates to tech. There's also a lot of potential to use that system for other isotopes, be it lutetium or otherwise. And so now that we've got that up and we can start working with it, we're starting to explore how we use that for all those [ph] margins (40:39). And there's some real potential to scale that equipment. And what we can do goes far beyond tech.

Peter Lukas
Director Institutional Sales, CJS Securities, Inc

Q

Extremely helpful. Thanks. I'll jump back in the queue.

Operator: Thank you. The next question is from the line of Ron Epstein with Bank of America. You may proceed.

<[Q]>

Hi. How are you, this is [indiscernible] (41:11) for Ron Epstein. Quick question, could you just detail the free cash flow bridge from 2022 to 2023, sorry if you went over it already I got kicked on the call.

Robb A. LeMasters
Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

A

No, that's fine. So what we talked about is doing about $200 million of free cash flow in 2023, which is up, very, very significant from around $50 million this year. What that will be driven by is operating cash flow being up at a $300 million plus level. What that's going to be driven by is a rebound from the levels that we saw this year, some working capital, some growth in just the underlying business. So that should drive a $300 million plus sort of number on the operating cash flow side. And then the offset, obviously, to get down to the $200 million level would then be CapEx. We've talked about trying to return to a maintenance capital level, which we've commonly talked about at about $100 million.

And then last year, we described how we had a significant win in the project Pele, and that would generally be about $20 million to $30 million incremental. We only spent a small slice of that in 2022, so you can expect a decent bit of that. We continue to have growth in our nuclear medicine business where we're doing one or two growth projects. So I would say the $100 million plus, if you will, to ultimately get to an operating cash flow minus that of around $200 million.

Q

All right. That's helpful. I'll jump back in the queue for now. Thanks.

Operator: Thank you. There are no questions in queue. [Operator Instructions] The next question is a follow up from Pete Skibitski with Alembic Global. You may proceed.

Peter Skibitski
Analyst, Alembic Global Advisors LLC

Q

Yeah. Guys, I figured maybe we could talk a little bit more about AUKUS just because, Rex, it seems like most of the congressional shipbuilding guys are pretty nervous with regard to kind of the lack of incremental capacity at the submarine yards. Right. I think that's fair right now. So are you seeing in your talks, potential that Australia could be kind of satisfied with what they need in other ways as opposed to our actual yards building more subs to maybe using your reactors in different ways or any other paths, I guess that could benefit BWXT?

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Yeah. So there's a lot of speculation in the trade press about this one right now, Pete. And maybe I won't say much. And we do expect some details here in the middle of March and then we're hopeful about it. But that's about all I could really say at this juncture.

Peter Skibitski
Analyst, Alembic Global Advisors LLC

Q

Okay. That's fair. I'll sneak in one last one then. I was a little confused. You've got the Actinium agreement with Bayer that you had, and now it looks like the same drug with Fusion. So those are two separate revenue opportunities with the same drug. Is it am I understanding that right?

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Yeah. Think about it this way, Pete. So there's the radio isotope, frequently called the active pharmaceutical ingredient, which is sort of the payload. And then there's the drug they're developed generally by large pharma, which are the, are the missile, let's call it. Let's call it instead of the warhead. And those drugs are biochemicals that that have affinity for proteins that are produced by particular types of cancers. And so the combination of those things, the drug plus the radioisotope or the active pharmaceutical ingredient is what you inject a patient with. And so, in this particular case, Bayer has their own drugs, the biochemicals they've been developing for certain indications and certain conditions and we would supply the radioisotope to Bayer for those clinical trials.

Fusion has a different set of drugs they've been developing for different indications in different conditions and different approaches. And we would supply, again, the radioisotope or active pharmaceutical ingredient to them. So it's just the isotope. There are and so we can supply that isotope to a whole number of different drug developing companies. There are also, the businesses that we're layering on, as I said in the script are around that the therapeutic isotopes, but we also have an opportunity to do the contract manufacturing like we do with Boston Scientific for TheraSphere where we would take that drug and our radioisotope and combine it at our plant and then take care of the logistics and distribution to the radio pharmacies. So it's kind of early days on actinium, but there could be multiple customers for our for our particular radioisotope.

Peter Skibitski
Analyst, Alembic Global Advisors LLC

Q

Okay, okay, great. Look forward to hearing more in the future.

Rex D. Geveden
President, Chief Executive Officer & Director, BWX Technologies, Inc.

A

Yeah. Thanks, Pete.

Operator: Thank you. [Operator Instructions] There are no additional questions waiting in queue. I would like to hand the call back over to Rex Geveden for concluding remarks.

Rex D. Geveden

President, Chief Executive Officer & Director, BWX Technologies, Inc.

Thanks, Joel. I wanted to say as we close here that I'm proud of the entire BWXT team of 7,000 employees and the accomplishments that we realized together in 2022. We do have a healthy and growing business and we have positioned ourselves for new, meaningful opportunities. And even in the face of public health, economic and geopolitical distractions, our employees remain steadfast in our mission to provide safe and effective nuclear solutions. And I do commend them for helping us run and grow this remarkable business. So I just want to say to them, thank you for your continued focus and dedication. Robb, would you have anything to add?

Robb A. LeMasters

Chief Financial Officer & Senior Vice President, BWX Technologies, Inc.

Yeah. Thanks, Rex. I echo that sentiment. We have a remarkably resilient team and it showed up in the financial results this year. I'm energized and continue to be amazed by the way the employees here are tackling evolving challenges and thinking to take this company to higher heights. So with that, we thank everyone for joining us this evening. As always, if you have any further questions, you can reach us by phone at 980-365-4300 or email us through investors@bwxt.com. Thank you.

Operator: That concludes today's conference call. Thank you for your participation. Please enjoy the rest of your day.