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BWX Technologies, Inc. (BWXT)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to BWX Technologies Third Quarter 2023 Earnings Conference Call. At this time, all participants are in 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, Chase Jacobson, the BWXT's Vice President of Investor Relations. Please go ahead.

Chase Jacobson
Vice President-Investor Relations, BWX Technologies, Inc.

Thank you, Cheryl. Good evening, and welcome to today's call. Joining me are Rex Geveden, President and CEO; and Robb LeMasters, Senior Vice President and CFO.

On today's call, we will reference the third quarter 2023 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 the appendix of the earnings presentation that can 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, Chase, and good evening to everyone.

This afternoon we reported solid third quarter results that were slightly ahead of our expectations. The quarter was highlighted by robust 13% organic revenue growth with double-digit revenue growth in both segments. Adjusted EBITDA grew 6% compared to the same quarter last year as higher revenue in Government Operations and solid revenue and margin performance in Commercial Operations were offset by lower margin in our Government Operations segment and some growth in corporate expense.

As we forecasted last quarter, although higher sequentially, Government Operations margins were somewhat compressed by the onboarding of new team members and less favorable product mix, while Commercial Operations margins benefited from operational improvements and Medical profitability. Adjusted earnings per share declined 3% to $0.67, as higher EBITDA was offset by non-operating items.

Overall, and consistent with what we have experienced throughout 2023, the combination of steady advancements in our core franchises and incremental increases from new growth vectors is producing strong, organic top line growth even in these challenging and unpredictable economic times. Coupled with our focus on operational excellence and functional continuous improvement, we expect to produce good financial performance and strong cash flow throughout the remainder of 2023 and 2024.

Based on our year-to-date performance and our expectations for the fourth quarter, we are narrowing our 2023 adjusted earnings per share guidance to $2.90 to $2.95, the midpoint of which is slightly higher than where we started the year. Our guidance assumes approximately 8% year-over-year adjusted EBITDA growth. And as Robb will detail in his remarks, we are pleased to have a similarly positive outlook for 2024, anchored again by solid organic growth at the top and bottom line. Our preliminary view is that we can grow revenue, EBITDA and earnings at a mid-single digit rate in 2024 and continue to drive improved free cash flow.

Last quarter, I provided a detailed update on some of the major secular themes driving our demand outlook, including the impacts of the great power competition and decarbonization of the grid. As we begin to turn the page on 2023, I expect these same themes to remain key drivers of the increased application of nuclear solutions in our key national security, clean energy and nuclear medicine end markets.

Looking through that lens, let's step through the drivers of our segment results, including key wins in each segment. Starting with the Government Operations segment, we had a strong third quarter with 13% organic revenue growth driven by an increase in naval propulsion volume and strong growth in nuclear fuel services and microreactors.

On the demand outlook, our naval propulsion business prospects remain robust, underpinned by the 30-year shipbuilding plan, which supports the government's strategy to bulk up our strategic force capabilities, including a recapitalization of the US Navy nuclear fleet. On top of a consistent procurement of Virginia-class submarines, the current shipbuilding plan calls for 10 years of serial procurement of Columbia-class submarines beginning in 2026, and the potential for the Ford-class aircraft carrier to move to a four-year ordering centers beginning in 2028.

We are also anticipating incremental demand for submarines resulting from the AUKUS trilateral security agreement signed a little more than one year ago. To that end, Australia's recent announcement to invest $3 billion into the US naval manufacturing industrial base is a positive step in helping to increase US submarine production, not only to meet our country's needs, but also to support incremental demand from our key allies, including Australia and the United Kingdom.

However, even as AUKUS efforts mature, our primary focus continues to be fully supporting naval reactors. Just last week, we announced a $300 million award for the manufacturing of naval nuclear fuel through mid-2025. We expect to finalize the other elements of our next multiyear pricing agreement, including reactors and key components of the propulsion package in the coming months.

Within our non-naval propulsion government business, which now comprise about 20% of the segment's total revenue, up from about 15% just two years ago, we're also seeing nice growth in emerging opportunities. Leading this growth, of course, are microreactor programs within the advanced technologies division of the segment.

During the third quarter, we booked the initial portion of our $200 million contract for the DRACO project, the first demonstration of a nuclear thermal rocket engine in space. BWXT will manufacture the reactors' hardware and complex fuel, and assemble the reactor in our Lynchburg facility before delivering the fully-fueled subsystem for spacecraft integration.

Programs like DRACO and Pele are progressing well, and others that we are pursuing show how our investments in talent and infrastructure are driving growth beyond our core and enabling BWXT to offer the US government breakthrough nuclear solutions for applications in all national security domains, including sea, land and space.

Our wins with government customers are also creating opportunities to develop microreactors for novel commercial applications. While some of our nuclear technology peers are taking more significant and open-ended profit risks to enter these nascent markets, BWXT is taking a page out of the navy's history books.

As some of you will know, early naval investments in the 1950s led directly to the first commercial nuclear power reactor in Shippingport, Pennsylvania. We believe this model is still sensible today as we can leverage government program funding and experience to advanced novel, commercial, nuclear concepts while investing modest amounts of capital to further development of nuclear solutions for maritime, remote power or other industrial applications.

In that vein, we recently announced early-stage contracts with the Wyoming Energy Authority stemming from our involvement in the Advanced Reactor Development Program (sic) [Advanced Reactor Demonstration Program] (00:07:50) to assess the potential for microreactors at mining sites in the state. We also announced a relationship with Crowley to explore the use of a microreactor on a barge that could be used for backup and emergency power.

Another part of the Government Operations segment that is sometimes overlooked is our special materials business. While most of our investors are aware of the strength of our Nuclear Fuel Services franchise, over the past several years, we have methodically assembled a broader portfolio based on our strengths and technical capabilities in radiochemical processing and special materials handling and accountability.

Given the reduction of Cold War era infrastructure and other capacity constraints within the government laboratory complex, BWXT has worked with its government customers to pilot and scale backup production systems for special nuclear materials. This special materials franchise includes uranium downblending, wherein we have converted highly-enriched stockpile material into lower-enriched material under a current contract since 2018. A TRISO-coated fuel line, which stood up in 2021 and a uranium metal processing line at our nuclear fuel facility that began production last year, the objective of which is to return valuable national security material to the stockpile for later use in naval fuels or other national security applications.

We further expanded this unique line of business in late August by securing an NNSA contract to recycle scrap material from the Y-12 National Security Complex into high assay, low-enriched uranium or HALEU feedstock material. This material is an important stopgap source for much needed HALEU for the DOE's Advanced Reactor Development Program (sic) [Advanced Reactor Demonstration Program] (00:09:40) that requires higher assay nuclear fuels to support prototype development.

We are in regular discussions with the Department of Energy, the National Nuclear Security Administration, and other government agencies about where BWXT can be of assistance in supporting their missions. So more to come on this special materials processing platform as it blossoms into a larger business line within the Government Operations segment.

Looking ahead to 2024, we believe these demand trends will continue to support growth of our Government Operations segment. However, as we laid out at our November 2021 Investor Day, the lull in the ordering cadence for the Ford-class aircraft carrier in 2024 and 2025 creates some headwinds that we expect to overcome the next two years.

Turning to Commercial Operations, revenue in this segment grew 10%, with high single-digit growth in commercial nuclear and another quarter of robust double-digit growth in Medical. Backlog in the segment, which is almost entirely related to our commercial nuclear business lines, was up sequentially for a third consecutive quarter and is up 14% over last year. This highlights the robust demand we are seeing in the market, which will continue for the next several years given demand for nuclear power in Canada and around the world.

As we discussed in more detail last quarter, the Ontario government is seeking to double the scale of the power grid by 2050 to meet projected demand and is fully committed to using nuclear to satisfy a large portion of this demand. This is evidenced by three recent developments, including Ontario Power Generation's commitment to build four BWRX-300 small modular reactors at the Darlington site, life extensions of existing plants at the Pickering site, and the potential for new large scale power reactors at the Bruce Power Nuclear Generating Station, among many others.

We see international momentum as well. We have talked about the potential for new nuclear in Europe and countries like the UK, Poland and Romania as they seek to add clean baseload power and to improve their energy security postures.

Just in September, Canada announced export financing of CAD 3 billion to be used for the construction of two CANDU reactors at the Cernavodă Nuclear Power Station in Romania. Our strong position as a fuel and equipment provider in the CANDU reactor market and our role as a merchant supplier of large critical equipment to the SMR markets positions us well to benefit from such projects in the global market.

At BWXT Medical, revenue growth in our base diagnostic and contract drug manufacturing businesses continues to accelerate, growing approximately 30% in the quarter. We expect this trend to continue as demand for isotopes such as strontium and germanium used in cardiac and cancer imaging studies remain strong, while we experience the rising tide of demand for newer therapeutic isotopes like lutetium and actinium. It is worth noting that our proprietary actinium generators are now being used exclusively by Bayer for late-stage human clinical trials in Europe.

As it relates to our Tc-99 product development, our team is diligently working to respond to the questions and data requests that we received from the FDA this summer. We have conducted several successful test runs of Tc-99 generator production with irradiated material using the target delivery system at the OPG Darlington site, and we continue to work toward commercialization of the product next year.

Overall, our Commercial Operations segment is poised for continued solid growth in 2024, with improving profitability based upon a better mix in commercial nuclear and higher profitability in Medical.

I would also like to take a moment to discuss a few of the initiatives we have in place to sharpen our business execution and improve the day-to-day operational functionality of our company. Last quarter, I discussed that on top of the significant financial capital we invested in the business over the last several years, we've also made significant investments in human capital throughout the organization and to ensure that we have the people, systems and processes to skillfully manage the strong growth we see ahead.

Not only are we focused on capturing growth, but we are intent on honing our business through the use of AI and automation throughout the organization more efficient operational effectiveness practices, including, for example, real-time monitoring and reporting on large machine tool utilization at all our major US plants and enhanced human resources and financial back office platforms to increase the efficiency of administrative functions. We expect these initiatives to maintain our strong competitiveness in the markets we serve and to drive returns on capital by sustaining our industry-leading growth and solid margin performance and robust free cash flow generation.

In conclusion, as we look at our portfolio and our dual focus on growth and execution, I couldn't be more confident in how well our employees are positioning BWXT to serve the nuclear markets around our three key capabilities: manufacturing, processing and services, mainly for power and propulsion applications. The core of BWXT is our significant experience in manufacturing critical nuclear systems and components, handling and processing highly complex materials, and providing services around these capabilities. Because of our extensive experience in the nuclear markets, unmatched facilities in the US, Canada and the UK, and our deep technical expertise, we are uniquely positioned to benefit from the trends driving our markets. We are focused on taking these power and propulsion solutions to meet the demands of our distinguished customers in the national security, clean energy and nuclear medicine markets.

Before I turn the call over to Robb to discuss the third quarter financial results in more detail and to discuss our updated 2023 guidance and preliminary 2024 outlook, I would like to take a moment to express my gratitude to the men and women at BWXT for their hard work and dedication in supporting the many critical missions carried out by the customers we serve. It is widely known that the US has deployed two carrier strike groups to the Middle East to support Israel, led by the USS Ford and the USS Eisenhower aircraft carriers, both of which are powered by BWXT reactors. This is a stark reminder of the importance of the work we do every day at BWXT in supporting the US and our most important allies.

With that, I will turn the call over to Robb.

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 slide 4 of the earnings presentation.

Third quarter revenue was a robust $590 million, up 13% organically on a consolidated basis, with double-digit growth in both Government and Commercial Operations. Adjusted EBITDA was $107 million, up 6% year-over-year, as higher revenue was complemented by improved margins in Commercial Operations but partially offset by lower margins in Government Operations; and higher corporate EBITDA expense, driven by some seasonally stronger healthcare costs. We still see this corporate EBITDA line coming in at the upper end of the $10 million to $50 million range with fourth quarter coming in more like the level we saw in the second quarter this year. Looking into 2024, we expect corporate EBITDA expense to flatten out in the mid-teens range and only grow at inflationary rates thereafter.

I will note that despite seasonally lower revenue and the higher corporate expense, adjusted EBITDA was essentially flat compared to second quarter of 2023, reflecting solid underlying performance in our government business, better margins in commercial power and improved profitability in Medical.

Adjusted earnings per share was $0.67 compared to $0.69 in the prior year quarter. As you can see in the EPS bridge on slide 5, as has been the case throughout the year, the year-over-year decline was due to non-operational items, including lower pension income and higher interest expense. Our adjusted effective tax rate was 22.6% in the quarter, mainly due to the adjustment of provisions around R&D and certain stock compensation expenses that had a disproportionate impact on the quarter. Nonetheless, we still expect a full-year tax rate of approximately 24%, meaning the fourth quarter rate will likely be a tad higher than the full-year rate.

Despite modestly lower net income, free cash flow improved to $43 million compared to $25 million in the third quarter of 2022, driven by improved working capital management and lower capital expenditures. CapEx was roughly $31 million in the quarter and consisted of maintenance CapEx and select growth initiatives, including investments for our Pele and DRACO microreactor programs.

Moving now to the segment results on slide 6. In Government Operations, third quarter revenue was up 13% to $478 million, driven by higher naval nuclear component production and microreactor volume that was partially offset by lower long lead material procurement.

Third quarter adjusted EBITDA in the segment was $99 million, up 10% from last year as higher revenue was offset by less favorable mix and inefficiencies related to new hiring as we continue to expand the size of our workforce to meet growing demand. EBITDA margin in the segment was 20.7% down compared to last year, but up from 19.4% in the second quarter. This sequential increase was driven by better utilization and onboarding processes, as well as the nuclear manufacturing improvements. We are tracking well to having one of the best years of gross hiring in our history, while also stemming the negative attrition trend we had seen in the wake of COVID.

Going forward, we expect that continued solid performance in Government Operations with some lingering effects from onboarding, timing of projects as well as mix will enable us to hold our underlying margins in this segment relatively steady in 2024.

In Commercial Operations, revenue was up 10%, driven by increases in component manufacturing and field service activity in our commercial nuclear business, as well as robust BWXT Medical revenue growth and partially offset by lower fuel handling volume. Year-to-date, reported Commercial Operations revenue is up approximately 7%, despite a 5% currency headwind due to the appreciation of the US dollar versus the Canadian dollar, highlighting the underlying strength of our commercial nuclear and Medical business.

Second quarter (sic) [third quarter] (00:20:56) Commercial Operations adjusted EBITDA was up approximately $2.5 million to $14 million, driven largely by improved profitability in Medical. Similar to the trends we have experienced throughout the year, this was partially offset by the impact of less favorable mix in commercial nuclear that was skewed toward field service refurbishment activity and less outage work compared to last year. We expect this mix to remain relatively constant in 2024.

Turning now to guidance for the remainder of 2023 and a preliminary outlook for 2024 on slide 7. We are narrowing our 2023 adjusted EPS guidance to $2.90 to $2.95, the midpoint of which is in line with our previous guidance and slightly above where we started the year. We are maintaining our operating assumptions for revenue to be up high single digits and more than $2.4 billion, with both Government Operations and Commercial Operations near the higher end of our forecasted high-single digit growth and mid-single digit growth guidance respectively.

Overall, we expect EBITDA margins of approximately 20%, leading to adjusted EBITDA of approximately $475 million, up high single digits compared to 2022, driven almost entirely by organic growth. Our full-year guidance implies fourth quarter consolidated EBITDA margins to be higher than third quarter, driven by a more meaningful improvement in Commercial Operations due to improved Medical profitability and better commercial nuclear mix, as well as slightly improving underlying government performance, plus the potential to recognize a recovery on non-nuclear components.

Turning now to our preliminary outlook for 2024. Overall, we expect to see another year of good operational performance with mid-single digit growth in revenue, adjusted EBITDA and EPS and continued strong free cash flow.

In Government Operations, we expect modest revenue growth as contributions from our non-naval programs, including new microreactor projects such as DRACO and the expanded special materials franchise that Rex walked through earlier, to be partially offset by the adverse impact of the shipbuilding ordering [ph] keys (00:23:21). As we have communicated, the lull in our aircraft carrier-related work in 2024 and 2025 will only be partially offset by growth in Columbia-class submarines.

Government EBITDA margins are likely to be modestly lower compared to 2023, as solid underlying performance will be offset by the impact of revenue mix, particularly as it relates to our cost reimbursable microreactor project and the non-recurring recovery benefit we expect in the fourth quarter of 2023. Excluding this benefit, Government Operations should be relatively flat compared to 2023.

In Commercial Operations, we expect continued strong growth driven by both commercial nuclear and Medical, given favorable market trends and the opportunities that Rex discussed in his remarks. With this growth, we expect improved EBITDA margin from steady performance in commercial nuclear and improving contributions from BWXT Medical.

Lastly, our capital expenditure targets continue to be focused on discipline, maintenance, CapEx, spending, plus layering in incremental CapEx to support growing for microreactors, commercial nuclear and therapeutics. At this point in time, we expect CapEx to remain in line with 2023. Additionally, we remain focused on working capital efficiency throughout the organization and in how we contract with our customers and suppliers. In total, we expect these factors to produce another strong year of free cash flow, with investors seeing free cash flow growing faster than our mid-single digit EBITDA growth.

To sum it up, we have had another solid quarter and are well positioned for continued growth in 2024. Demand trends in our business remain strong. And while we are not immune to global macroeconomic factors, the high priority of our government programs and the underlying secular themes driving our business leave us relatively insulated from changes in government funding patterns and other macro risks.

As Rex discussed, we are committed to capturing growth and are taking the initiative to drive more predictable earnings and free cash flow conversion, which, combined with our unique assets and technical capabilities, will continue to differentiate BWXT from its peers.

And with that, we look forward to taking your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Peter Arment with Baird. Your line is now open.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.

Q

Hey, thanks. Good evening, Rex, Robb, Chase. Hey, Rex, it sounds like you've done a great job on all the hiring and at least from a growth perspective and in dealing with some of the attrition. But is that going to linger into next year, just thinking about the margins at your Government Operations?

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

A

Yeah. Thanks, Peter. Hey, good evening. Yeah. I'd say to add a little color to that discussion on hiring, I think we're doing quite well with talent acquisition. I'd say the other side of the equation that we haven't talked as much about is that we're sort of reducing the leakage rate with the improvement in attrition, which has markedly improved. We're getting back to that range of mid-single digit attrition when you back out retirements and non-voluntary separations. So the combination of those two things is pretty powerful for the business, Peter.

I would say that in a business like ours, which is growing at the rate our business is growing, we're constantly onboarding and hiring and training new people. So there's a bit of a bit of drag related to the growth itself. And so I think we'll see that linger for a period of time.

Want to add to that, Robb?

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

A

Yeah, yeah. Just to give you a couple of numbers and update you on where we stand, third quarter was excellent. I think last quarter, we talked about how we just saw the building momentum month upon month. As we look at the third quarter from a hiring standpoint on the sort of growth side, we're up almost 30% versus the levels that we brought in in Q2. So we are still onboarding quite a bit.

Rex talked a little bit about the attrition. That number has actually gone back to a sort of more normalized level of mid-single digit. So we're really seeing good performance there. So we both want to bring in new employees and we want to retain them longer. And also, just the overall onboarding, I think you saw in our margin performance just sequentially, we still have an issue of sort of utilization, but our efficiency has really been quite strong. On a per hour basis, if you will, really matching what the customers are asking for. So it's taking a little bit of a drag on our utilization, but our efficiency is quite strong. So I'm pretty proud of that from the team.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.
Q

Appreciate those details. And then on your comments on the 2024, I think we've all kind of expected what you kind of just laid out regarding government, the cadence coming down on the Ford, and then ultimately then, eventually Columbia would begin to offset that. Do we start to see that in 2025 where the Columbia becomes more of a bigger part of the mix or how do we think about that? Because we know the schedule really ramps up in the second half of the decade.

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

Yeah. I think it both – I mean, our goal has always been – I think we're actually kind of doing slightly better than what I thought, right? We're kind of filling in a little bit of the overall shipbuilding, both the carrier loan and the Columbia offset. We're having strength around the microreactor franchise in the AT division, as well as some of these special materials businesses. We have a strong win on the new metal front. And so that's providing a little bit of tailwind to fill in both in 2024 and 2025.

So probably too early to look all the way out into 2025, but I'm hoping that we could surprise you guys to the upside, just like we did. I think, in 2024, we're now seeing a little bit of growth. And you asked me a year or two ago, I'm not sure I would have seen that. So glad to fill that in.

I'd also say that the carrier cadence, just in general, is not like it just falls out on day one of 2024. It's actually kind of through the year decelerating, if you will. And so there is a little bit of a half year impact then we'll get a full-year impact in 2025, if you will. So that's something we have to contend with. But leave it to us. We'll figure out 2025 here soon.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.
Q

I appreciate that color, Robb. And then just one last one on the – Rex, just it sounds like you've had a lot of back and forth with the FDA. It still sounds like you're tracking for commercialization in 2024. Any color on you originally planned on a priority review, what that timeline looks like today when you think about just your exchanges that you've had with the FDA?

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

Yeah. I'd say no change in our outlook there at all, Peter. So we expect to be commercial sometime in 2024, and the work that we've done irradiating the material at Darlington was promising. And so no change on the outlook there. It looks good for us.

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

And as we guided for...

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.

Q

Appreciate it. Thanks.

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

A

Peter, as we guided for 2024, I think we've always said that's a very small contribution to the tech business. So we hope to get commercial, but really that would be pretty low scale. So our guidance, if you will, does not expect full-year ramp, full year of that product or anything like that. So we're being conservative there. We'll see how they go.

Peter J. Arment
Analyst, Robert W. Baird & Co., Inc.

Q

Appreciate the details. Nice results. Thanks.

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

A

Thanks, Peter.

Operator: Your next question comes from the line of Michael Ciarmoli with Truist Securities. You may now go ahead.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Hey. Good evening, gentlemen. Nice results. Thanks for taking my question here. Maybe, Robb, just to actually stay exactly on that line or that topic that Peter was on. On the – I guess, the assumptions for next year with Tc-99, so not really in the full-year guidance, but if you are going to commercialize, can we expect maybe a little bit more pronounced impact to EBITDA margins if you do get commercialization and get better overhead absorption there and you start having some actual product sales? Just trying to think about how that might impact the EBITDA margins next year.

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

A

Yeah. I think overall for the commercial division, we do see tailwinds for margin overall for the year. I wouldn't attribute much of that to the tech business because even if we get a small bid, right, that's a ramping product line, if you will. So frankly, we're going to kind of bring that in at a lower margin rate, but we're going to be just testing supplies, getting it out there and probably not working super efficiently on kind of the first couple of batches if we even have that kind of in 2024.

So I wouldn't say that's a huge driver. I think what is the bigger driver is just as a generally larger BWXT Medical revenue. So we've talked about the fact that we just put up another quarter of excellent growth. Last quarter, we said it was a little bit above 20%. Now, we're saying this quarter is 30%. I think as we look at next year, we can continue that underlying trend of that base business. And then the way I'm thinking about it is, okay, so that's the underlying business and now therapeutic kind of get layered on top of that. And maybe a little hint of tech into 2024, that all should actually accelerate the growth rate from that 30% as we look out to next year.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Okay, okay. And then was – I know you recently broke-even at the EBITDA level in Medical. Were you EBITDA positive for the full quarter in...

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

A

We were. And we do model that business out on a quarterly basis. We're not going to be guiding that. But yeah, no, from this point forward, I see that business is making money at the EBITDA level and then some. So we put out that target. We still stand by that $200 million and $75 million of EBITDA. So when we look out a couple of years, the line to get there is still staggered but we'll get there.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Got it. Perfect. And then, Rex, I got on a few minutes late. I may have missed this. Just on AUKUS and what's been going on with the supplemental support for the industrial base. I mean, I know maybe more over the summer, you guys weren't as overly optimistic on that being a big growth driver. But it would seem like if Virginia-class is going to get produced and delivered to Australia in 2032, I mean, it would have to start flowing through your facilities pretty early here. I mean, what's the latest thinking on kind of AUKUS?

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

A

Yeah. And I think, Michael, that's shaping up a little better than maybe we had been speaking about it earlier. It looks to us like based on the $3 billion investment from Australia into the US submarine industrial base, and then obviously there's another $3 billion on the supplemental that came from the White House over to Congress, it looks like the industrial base and the decision-makers are preparing for incremental demand here. And that's certainly the way it's being discussed. And so we're certainly hopeful that it's incremental so that [ph] three to five (00:35:04) would be layered in on top of our normal Virginia production. And the industrial base will need to produce, let's call it, 2.3 submarines a year.

We also, by the way, anticipate having content, although we can't provide any details here, but we do expect to have content on the SSN-AUKUS that would go to both the UK and Australia. So there's a tail on that for us that's – it's certainly well out into the future, but that's all shaping up to be incremental demand and that's good for our business, clearly.

Michael Ciarmoli
Analyst, Truist Securities, Inc.

Q

Got it. Would you have to – would that require any...

Operator: Your next question...

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

A

Michael, you cut out on us. So I think you were asking – I think, Michael, you were asking whether or not it would require incremental CapEx. I guess it depends on the acquisition tempo, for one thing. But I would say that of that $6 billion that I alluded to earlier from both US and Australia appropriation sources, some of that will come into the industrial – I mean, all of that will come into the industrial base. We'd expect to get some of that potentially. And so we'll have to see where the capital needs lay out, but I think it's shaping up nicely for us.

Operator: Your next question comes from the line of Scott Deuschle with Deutsche Bank. Your line is now open.

Scott Deuschle
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, good afternoon.

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

A

Hey Scott.

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

A

Hey Scott.

Scott Deuschle
Analyst, Deutsche Bank Securities, Inc.

Q

Robb, it looks like the EACs got a lot better this quarter, at least relative to the first half. So maybe could you just talk about if there are any non-recurring elements that drove that or if that was just broad-based performance?

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

A

Yeah. No, that was in our Government segment. In general, as – we've been grinding through as we've had the sort of labor inefficiencies relative to probably how we sold. We had inflation headwinds. We had [ph] strengthened (00:37:02) all of that in the past couple of years. And you're exactly right. In the third quarter, we did have better performance and so we saw better EACs. And I think all the efforts that we have and now that we've sort of gotten better at onboarding, I see the prospects for continued positive EACs going forward.

Scott Deuschle
Analyst, Deutsche Bank Securities, Inc.

Q

Okay, great. And then, Robb, you talked a bit about in the prepared remarks there, but maybe you can just level set us on where you're at in the missile tube recovery negotiations and how much you expect to recover and the confidence interval you have in getting that here in the fourth quarter.

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

A

Yeah. I think the communications are quite good. We're obviously negotiating with our customer and they have to interact with the Navy. I think those discussions are quite good. I think we made a good case. And so we have not actually gotten to a number yet, which is why we're trying to guide with all that in mind for the fourth quarter. I think we've talked about in the past that we had a pretty chunky negative item last year. So we're hoping to recover that and then some. So that's the way we're thinking. We're not really at liberty yet because we haven't actually settled on a true number at this point. But the communication is great. And yeah, we're looking forward to getting that behind us in the fourth quarter.

Scott Deuschle
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. And then last question, just an accounting question. The depreciation for the technetium-99 product line, does that kick in on a straight line basis once you get the FDA approval? And if you're slow to ramp up sales, then you take the depreciation hit. Is there a risk to EBIT margins at Commercial Operations? Obviously, EBITDA won't be affected. Just trying to think about the EBIT margin impact and what it means for EPS, if that treatment gets...

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

A

Yeah, it's a good question. I mean, in general, really, it's more on when you put assets into commercial use, if you will. So it's not necessarily, oh, there's the FDA. So that's the first trigger you should be thinking about.

The second is it's not all in one dose. So there's different assets that get deployed, whether it be the target delivery system versus the assets that are at the facility. So it's not all at once, but pretty close. So there is some layering in.

But you're right, as we go to market, we want to be able to really service the market in a quick manner. But that's a little bit what I alluded to with one of the questions earlier. It's not like we're going to have a full run rate of revenue. That's not going to be an immediately super profitable product. It's going to take us a quarter or two to kind of build into the profitability. And when I mean profitable, I mean EBIT, which includes that depreciation sort of overhang, that's going to be a high fixed cost to work through. So we've always contemplated that. You recall the pace that we had in the materials at Investor Day. That contemplated that sort of headwind to D&A that we had to sort of grind through from the revenue to ultimately get it to be as profitable as we hope it to be.

Scott Deuschle
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thank you.

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

A

Sure.

Operator: Your next question comes from the line of Ron Epstein with Bank of America. Ron, your line is now open.

Ronald J. Epstein
Analyst, BofA Securities, Inc.

Q

Hey, yeah. Good afternoon, folks.

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

A

Hey, Ron.

Ronald J. Epstein
Analyst, BofA Securities, Inc.

Q

Just a couple of quick ones. From the last quarter of the year, the way things are lining up, it seems like it would be the best quarter ever for the company. What gives you confidence about that? And is there any one single thing that's driving that? Like what can we as outsiders keep an eye on to just get a sense that that's going to play out?

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

A

Yeah. Hey, Ron. It would not be a record quarter at the midpoint of the guidance. We delivered quarters like that before. I think last year, it was $0.95. So two years ago, it was $0.95. Last year, it was $0.93. So it's in the range of what we delivered in the fourth quarter. We threw out the TSG contracts that comes through. Obviously, in a growing business like ours, particularly at these rates, the fourth quarter tends to be the strongest quarter in the year. So we've got reasonable confidence we can deliver that and we've got a track record of having done so.

Ronald J. Epstein
Analyst, BofA Securities, Inc.

Q

Got it. Got it. And then just maybe a bigger picture question on just submarine demand writ large. Are you getting any signals from the Navy of Virginia-class rates moving at all? I mean, there's been – supposedly, there's been investments in the industrial base. And the Navy keeps talking about we want three Virginia-class and everybody's struggling to get out two, right? It's like 1.7, 1.6. Are you seeing any movement upward there? I mean, how should we think about Virginia-class down the road? I mean, will they ever get to three? Is that just sort of a dreamy number? I mean, how should we think about it?

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

A

Well, I think the right way to think about it is that the steady-state production rate should settle out at two. And I think that it's fair to say the constraint there is the shipyards and certainly not our production capacity. We're kind of producing to the shipbuilding schedule at present rates. And so the shipyards have to get to that rate. And if you layer AUKUS in on top of that, people are talking about sort of 2.3 Virginias a year coming out of the shipyards. I don't think there's a production rate of 3 that's anticipated, but blend in those Australian ships and get to 2.3. And I think clearly the investment from the Congress and from the Australians is intended to support that. And so it's my expectation that the industrial base will respond appropriately.

Ronald J. Epstein
Analyst, BofA Securities, Inc.

Q

Got it. And what's your sense, Rex, on – I mean, in terms of labor and infrastructure, what the shipyards are going to actually need to get there? I mean, is that something that can happen in a couple of years? I mean, how hard is that to actually do to get there?

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

A

Yeah. I certainly won't speak on behalf of the shipyards there. Just I can speak to our own experience on that, which is labor has been hard to come by and we've really had to double down to try to get it. That said, I believe in capital markets, free markets that the supply chain tends to organize around the demand signal. So I'm hopeful that it'll self-correct here over the next few years.

Ronald J. Epstein
Analyst, BofA Securities, Inc. Q

Yeah. Got it. All right. Thank you very much.

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

Sure.

Operator: Your next question comes from the line of Pete Skibitski from – I'm sorry, I apologize, Alembic Global. Your line is open, Pete.

Pete Skibitski
Analyst, Alembic Global Advisors LLC Q

Hey, good evening, guys. Nice quarter.

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

Hey, Pete.

Pete Skibitski
Analyst, Alembic Global Advisors LLC Q

I just want to follow-up on Scott's question on commercial EBIT margins in 2024. Are you expecting them up? My recollection is that you were expecting – when Tc-99 does get FDA approval, I think you quantified it to be $20 million of incremental D&A. Are you still assuming that in those EBIT margins being up in 2024 or are you just offsetting it? Or could you just clarify?

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

No. As I mentioned, the D&A effectively comes when you're commercial. So it's going to match the sales, if you will. And so we've talked about how that is a very small sliver. The way I would think about it, that would model year 2024 without sales, without earnings, and without D&A tied to that specific product in 2024. If we get lucky and pull it forward, I think it'll be relatively neutral to EBIT, if you will. I don't think it's going to screw up your model if we get a sliver of that in 2024. That's the way I would think about it.

Pete Skibitski
Analyst, Alembic Global Advisors LLC Q

Okay, okay. So the incremental D&A will be more of a 2025 event.

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

That's right. And it will come with a full – hopefully, a full year of revenue, right? So then you're able to, like, absorb all that fixed cost. But you're right in terms of the magnitude of the D&A. That was the number we gave out. So [indiscernible] (00:44:50) model in a full year, which comes with all the goodness around a fully built-out product line. Hopefully, maybe not full in 2025, right? We've always promised that in the 2025-plus time zone, but we'll see how it goes.

Pete Skibitski
Analyst, Alembic Global Advisors LLC

Q

Got it. Okay. And then maybe just one for Rex. Rex, on the Canadian financing for Romania, usually, that's the long pole in the tent, right, once the financing is kind of set. Do you guys have any sense of timing for when you might sign a contract for that project? Is it still later in the decade or is that kind of being pulled forward?

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

A

Yeah. I don't have a lot of clarity on that one, Pete. I would say certainly later decade.

Pete Skibitski
Analyst, Alembic Global Advisors LLC

Q

Okay, okay. Got it. All right. Thanks, guys.

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

A

Yeah. Thanks.

Operator: Your next question comes from the line of Bob Labick with CJS Securities. Bob, your line is open.

Robert James Labick
Analyst, CJS Securities, Inc.

Q

Thanks. Good afternoon. I wanted to ask – sorry if I missed this, but can you give us an update on the timeline and expectations for the Hanford Tank program? I read somewhere recently that bids have been resubmitted and things like that. How are you treating that in your 2024 outlook as well?

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

A

Yeah. Hey, Bob, I'll give some details on that. I think you certainly know that we've been through court actions on that. And the court – the appellate court basically sent the matter back to DOE for corrective actions. The DOE did conduct its corrective action. And as the original proposal is to resubmit, we have resubmitted that proposal. In the meantime, the competitors have issued a protest that's gone through the GAO. So there's a lot of legal churn here, and that's all I'll say about that. From a standpoint of how it might impact us financially, I don't think we're expecting any transition on that contract until about at least about the middle of next year.

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

A

Yeah. And how we're looking at 2024 in terms of that guide is the same way we thought about 2023, right? There's a bucket of good things that can happen and bad things and those sort of chunky wins. And we probability-weight those, we time-adjust all those. And frankly, we try to be conservative on all those factors.

So in 2023, as you know, DRACO pushed a little later for us, obviously hampered sell-out, and we're still obviously going to hit the guidance or that's our plan. So we try to put all that into the blender and guide accordingly. And so I think we've learned our lesson on the TSG front that these things just take longer. So we contemplated that mid-single digits. We factored that in. That's when we're going to ramp and how that margin is going to work.

Robert James Labick
Analyst, CJS Securities, Inc.

Q

Got it. Okay, great. That makes a lot of sense. And then obviously, you discussed moly and the FDA approval process for Tc-99. You touched on actinium sales, and non-moly sales up and Medical up 30% – 25%, 30%. Can you maybe just go a little one level deeper and talk about the key drivers there and the opportunity set from the Bayer actinium and all that kind of stuff, please?

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

A

Yeah. Sure, Bob. We've got growth showing up across the board in our Medical portfolio. As you know, we have diagnostic products and also therapeutic products. And so there's very strong demand for germanium. We're seeing real growth there. Strontium is growing. TheraSphere continues to grow at an impressive compounded rate. Actinium-225 is showing up in our numbers a little bit because we're supporting clinical trials with our own medical device, our own generator, which produces a non-carrier-added actinium. And it's the only such generator on the market. And then we're anticipating feathering in some lutetium-177 sales for next year. And there are underlying things to iodine and other products that we have.

And so, yeah, the core business is quite strong. I think it's a bit of an underappreciated asset in BWXT, and we see increasing demand in virtually every product line that we have.

Robert James Labick
Analyst, CJS Securities, Inc.

Q

Okay. That sounds super. Thanks.

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

A

You're welcome.

Operator: Your next question comes from the line of David Strauss with Barclays. David, your line is open.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good evening.

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

A

Hey, David.

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

A

Hey, David.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Hey. So, Robb, Q4 free cash flow and working capital reversal to get to around $200 million, if you could just walk through how you get there. And then for 2024, I don't know how I should interpret the comment of improved working capital. Does that mean it's less of a drag or does that mean it's a positive contributor to cash flow? Because I know you're saying free cash flow growth above mid-single digit EBITDA growth, but I would have thought with kind of flattish CapEx that we could see some pretty significant free cash flow growth next year. Thanks.

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

A

Sure. Yeah. Thanks for the question, David. Yeah. So the way that we're thinking, we always have a very significant Q4. If you just look back to past couple of years as a percentage of our free cash flow, it's always meaningful. And this year, in Q4, if you just think about where we stand for the year, we're at about $40 million of year-to-date free cash flow. Therefore, in order to hit obviously the $200 million bogey, we've got to have $150 million plus. And the way that we're thinking about it is we're going to have a big fourth quarter in terms of profit just in general, so you start with that. And if you just think about how the cash flow statement works, right, you have net income, you have D&A, you have stock comp and JV income, that gets you almost $125 million. If you just look at what we've already guided, that's sort of your starting point for operating cash flow drivers and then you need to work higher.

We always have a pretty big retainage that generally is around $25 million. We have accounts receivable, we have [indiscernible] (00:51:09) release. All of that gets you comfortably over $200 million of operating cash flow for the fourth quarter, and then you obviously back off CapEx. So we have a very clear path. We know the items that are coming in. And so that's how we're thinking about fourth quarter.

You're right. First of all, it's pretty early to know where we stand for 2024 for free cash flow. And there's always things that swash between fourth quarter of 2023 and first quarter of 2024. So it's hard to give a growth rate when you don't know what your base is. For 2023, we were using $200 million, obviously, just in general. But whether it's $195 million or $205 million matters a little bit.

We do see exactly what you said, which is a positive growth of working capital next year for 2024. So we're going to have the rate of the EBITDA that'll kick in, that will help free cash flow to grow in line with that. And then we have the steam generator contract that we've talked about in the end. That should free up some working capital and should be a positive.

So we see all the trends pointing in the right direction. Well, I'm sure you've looked in the quarter, if you look at the balance sheet, you'll see that for the third quarter, we had our cash conversion cycle go down for the first time in a couple of quarters, meaning less days. So we're starting to see real positive. That number came down by two days. And I think next year you're going to see some real positive development there in 2024.

David Strauss
Analyst, Barclays Capital, Inc.

Q

Okay. So just – sorry, just maybe I'm not getting it here. Just in terms of working capital as we see it on the cash flow statement in 2024, you think that's a positive contributor to cash or not?

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

That's right. I do see – the working capital items should be a positive to operating cash flow.

David Strauss
Analyst, Barclays Capital, Inc.
Q

Okay. All right. Thanks for the clarification.

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

Sure.

Operator: Your final question comes from the line of Tate Sullivan with Maxim Group. Tate, your line is open.

Tate Sullivan
Analyst, Maxim Group LLC
Q

Hi, thank you. Rex, it sounds like you're quite positive on the fuel downblending and what you call the government specialty materials opportunities. Is that a matter of more volume in the various businesses there? And can you comment on if higher uranium prices have any derivative, positive or negative impact, to you at all, please? Thank you.

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

Yeah. Sure, Tate. Thanks for the question. Yeah. I mean, first off, we're completely uninfluenced by uranium prices because the uranium that we process on behalf of the US government, it comes from stockpile and is government-furnished equipment. In fact, it's government-owned material all the way through. So you can think of our business as having a tolling arrangement on government material.

But the reason I'm bullish on it, Tate, is because for one thing, we're uniquely suited to do it. And I mean that in a specific sense. We've got a Category 1 in our [indiscernible] (00:54:14) license and we can handle stockpile material, and no other commercial entity can do that. So we're uniquely qualified to do it and we're bullish because, A, it's good business. It has a long tail on it. Our competitive position is appropriate there, but then I think there might be more to come. The NNSA, National Nuclear Security Administration, has published a request for information about enrichment for national security purposes. There will come a point when we've got to replenish the stockpile based on demand from naval nuclear propulsion and other things. And that's a special need that will require the kind of licenses and credentials and experiential qualifications that we possess.

And so enrichment is a possible thing out there in the future. Certainly, there's some low-level activity in our business right now around isotope production for national security. And if you want to think more broadly around that strategic thesis, think about whether or not we could expand into non-nuclear special materials that involve electrochemistry or chemicals or specialty metals. And so I think there's a whole world of special case materials out there that require unique processing, that require unique materials handling and accountability capabilities that we uniquely possess. And so it's a really interesting line of business that we hope to expand in the future.

Tate Sullivan
Analyst, Maxim Group LLC
Q

Great. Thank you, Rex.

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

A

You're welcome.

Operator: I would now like to turn the call back over to Chase Jacobson, Vice President of Investor Relations.

Chase Jacobson
Vice President-Investor Relations, BWX Technologies, Inc.

Thank you, everybody, for joining us today. We appreciate your time and your questions and your interest in BWXT. We look forward to seeing and speaking with many you at upcoming investor events. And if you have any further questions, you can reach out to us at investors@bwxt.com. Thank you.

Operator: Ladies and gentlemen, that concludes today's call. Thank you all for joining. You may now disconnect.