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KBR, Inc. (KBR)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, all, and welcome to KBR, Inc.'s Third Quarter 2023 Earnings Conference Call. My name is Lydia, and I'll be your operator today. [Operator Instructions] We kindly ask that you limit yourself to one question and one follow-up only.

It's my pleasure to now hand you over to your host, Jamie DuBray, VP of Investor Relations, to begin. Please go ahead.

Jamie DuBray

Vice President-Investor Relations, KBR, Inc.

Thank you. Good morning and welcome to KBR's third quarter fiscal year 2023 earnings call. Joining me are Stuart Bradie, President and Chief Executive Officer; as well as Mark Sopp, Executive Vice President and Chief Financial Officer. Stuart and Mark will provide highlights from the quarter and then open the call for your questions. Today's earnings presentation is available on the Investors section of our website at kbr.com. This discussion includes forward-looking statements reflecting KBR's views about future events and their potential impact on performance as outlined on slide 2.

These matters involve risks and uncertainties that could cause actual results to differ significantly from these forward-looking statements as discussed in our most recent Form 10-K available on our website. This discussion also includes non-GAAP financial measures that the company believes to be useful metrics for investors. A reconciliation of these non-GAAP measures to the nearest GAAP measure is included at the end of our earnings presentation.

I will now turn the call over to Stuart.

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Thank you, Jamie, and a warm welcome to our Q3 earnings presentation. So let's start on slide 5.

A Zero Harm moment today attempts to give you a high-level view of how KBR is engaged in space sustainability and security. This for us is both from space-looking factor and in the space environment itself.

So starting on the left of the slide, we have highlighted a couple of programs in which data is generated in space to enhance environmental understanding of what is happening on our planet. And this gives real-time analysis on trending of things like deforestation, out-of-the-land developments, et cetera.

In the middle, we have highlighted our proprietary technology, Iron Stallion, that digitally tracks satellites and space debris using proprietary algorithms, advanced AI and machine learning to predict, estimate and validate future events. In addition to the US DoD, two of our allies have acquired and are using Iron Stallion today.

And on the right, we have highlighted two programs focused on going to space, working on next-generation satellites for earth monitoring, with the added objective of resurfacing and recycling existing assets to minimize space junk; and the exciting work being done at NASA Ames, which is in Silicon Valley, a key research center for NASA, where KBR has been engaged for many years, looking at water and ice on the moon to sustain human exploration.

Now, this is KBR playing in the knowledge economy and the space vertical across both civil and military space, developing and deploying differentiated knowhow and technologies. And I have to say, it's pretty cool stuff. Our people really do amazing things that matter every day.

So on to slide 6, and a quick look at our overall business well-being and business health slide. On the people front, we have increased head count by low double digits since this time last year. I think a good indicator of managed and sustained growth in the services and technology business.

From an innovation perspective, we're in the middle of our first global hackathon. Now, this is a competition where volunteers competed in 145 teams across the world, innovating to develop and present solutions in the areas of sustainability, digitalization AI, and branding. The six regional winners will be coming together to compete in the final later this month. The leadership, including myself, have all reviewed the six finalist submissions, and I have to say they were absolutely terrific. And we'll certainly be taking a number of their ideas and solutions forward. So I think, really, truly a value-add process.

So also in a world where there is more working from home, and thus I think a greater risk of creating silos, this has the added benefit of connecting people and fostering collaboration across non-traditional binding so very, very successful.

And lastly, on the people front, we were notified within the last week that we have been once again recognized by Forbes as one of the world's top companies for women in 2023. And this recognition, I think for the third consecutive year, really underscores our commitment to fostering an inclusive and empowering environment for all our employees. And we are proud to be forging forward in gender equality in the workplace.

Now, on to HSSE. Our people continue to really impress with our unparalleled commitment to health, safety, security under the environments they're working in, looking after themselves and those around them. And I think the statistics really speak for themselves, and are really, truly best-in-class. This, obviously, helps with recruitment, and it's very clear example of our values-driven culture. And it's also a key differentiator with clients and with partners around the world.

And as you know, Zero Harm is a broader ESG and sustainability program. And internally, we link our activities to the UN Sustainability (sic) [Sustainable] Development Goals. So we thought we would present what KBR is doing opposite one of these goals each quarter going forward. So we started today with water and sanitation.

So just to give you a flavor, KBR today runs the combat water supply for the UK military. We run both potable and wastewater in a number of sites across the world, from Djibouti to Kosovo. We are heavily engaged across Australia supporting the major water authorities in upgrades, expansions, modernizations of the various city's water and wastewater infrastructure. And we engage with local communities and schools to educate on plastics in the oceans, organize river and beach cleanups, et cetera, through our One Ocean program, and you've seen that before. So just as we did for space sustainability, I think this gives you a different lens into and across KBR.

On to business growth on the bottom left, a really, really strong bookings quarter reflecting continued momentum as we continue to 2024 and beyond. As you would expect, our work under contract to allow us to finish strongly this year is over 95%.

And on to the financials, at a high level, 9% growth, all organic. I'll say that again, 9%, all organic at the revenue line, with margins at the group level of 11%. A really terrific performance from our people around the world, delivering for customers, for each other and, ultimately, our shareholders.

Cash was a standout in the quarter with conversions ahead of pace at 125%. But in a world of higher interest rates and volatility, this was a critical focus area for us, as I'm sure is for many, many companies out there, that our people really stepped up once again. And Mark will also cover other positive activities in cash in a moment, which all help to provide deployment optionality.

And as promised and, of course, linked to cash, one subsequent event of note is that we retired the remaining convertible principal of \$250 million in cash on the first of the month as it matured; that's the 1st of November. A clear demonstration of our belief in the value upside of KBR.

Now, on to slide 7. The markets remain buoyant across the energy trilemma, as we've discussed previously. Ongoing geopolitical instability, I think, only adds to this, particularly in the energy security area. And we continue to see high levels of activity across aging assets as owners continually recognize the need to become more efficient, but also in a decarbonized way using a variety of science, engineering technologies, including digital and data-enabled tools.

STS trailing 12-month book-to-bill was 1.3, and we've highlighted three of multiple awards this quarter. Firstly, we announced that we had been awarded the world's first commercial ammonia cracking project with Daesan in Korea. This is effectively taking liquid ammonia and cracking it back into hydrogen so that you can transport and utilize it as a gas in existing facilities, infrastructure and networks.

Now, this is a big deal and a real enabler as it allows countries committed to a hydrogen future to deliver on that commitment; and importantly, for KBR, can have the effect of significantly increasing demand for ammonia production, where, of course, as you know, we have a very high market share.

In the UK, we are deeply engaged with EET Hydrogen in the UK's leading industrial decarbonization project. This project is the largest blue hydrogen project in the UK and is a fantastic example of synergy across all of Sustainable Technology Solutions. It combines our innovative decarbonizing IP with best-in-class engineering services and digitalization.

And finally, in the energy security market, where we believe gas is the transition fuel, we were awarded a reimbursable EPCM, fully aligned to our existing risk profile, services contract for the Pluto LNG Train 1 modifications in Australia for Woodside.

Now, onto Government. So on the Government side, the market in the US continues to be robust as we look beyond with budgets in critical areas and emerging technologies growing with a focus on operationalizing these as quickly as possible, which is a sweet spot for KBR, as we've discussed many times.

Ongoing and recent world events elevate these priorities and the need for greater multi- government collaboration, like AUKUS, which emphasizes the significance and value of our global GS segment as we can play a critical role in addressing these challenges. We believe that our GS International business is a real differentiator, engaged in high-end consulting services in critical areas of defense, energy transition and critical infrastructure.

Book-to-bill this quarter was excellent. GS alone was 1.6x, bringing our trailing 12 months for the whole segment back up to 1.1 times. As you may recall, GS International had a strong bookings last quarter, so the whole segment is well positioned as we move into 2024. We've highlighted a number of awards for the quarter in our Science & Space business. In total, these awards are well over \$2.5 billion and importantly are all multi-year.

These are what's coming through in Q3, and with the IMOC recompute increasing in volume by several hundred million dollars and with OMES and SEAS all being additive as both are takeaways, it's easy to see that on a full run rate basis, 2024 for Science & Space should be a good growth year. Very excited.

Finally, in Defense & Intel, we've had several key awards in the quarter, some real nice wins in the Intel side with customers like the NRO. But unfortunately, we can't say too much more about these. And it was also nice to see awards under the IAC MAC contract vehicle pick up cadence in the quarter. So similar to Science & Space, our Defense & Intel business are in real good shape for growth as we move into 2024.

From a technology perspective, KBR's propriety secured cloud and mission services platform has been prioritized for the Federal Risk Management Program. Our platform called Vaault is one of only six prioritized platforms and is just one example of the investment we are making in the AI space. Investments in this area continue to open new opportunities for KBR, both with government and with commercial customers.

And although not specifically shown on the slides, Readiness & Sustainment, after a flattish to slightly down few months in Europe, has been awarded new multi-year task orders that will also provide opportunity as we head into 2024.

The final point to make on new businesses, while KBR generated 9% of organic growth in Q3, we also finished the quarter to record-high backlog and options since our transformation. I think, really, indicative of great momentum and demand across all of KBR.

And not to forget, on HomeSafe, a TRANSCOM leadership started in early October. The program hasn't quite started yet as readiness is still being evaluated. As you're aware, the number one priority of this effort is to improve the moving experience of service members, civilians and their families. And TRANSCOM and ourselves are fully committed to delivering this via HomeSafe from day one. And thus, we are jointly adopting a careful and calculated approach to ensure this outcome.

I'm sure you'll recall that we assumed no moves this year in our targets with a significant ramp-up during 2024 with modest initial margins, mainly due to the newness of the program. Although it hasn't started yet, we do expect moves to start in Q1 2024 and ramp progressively. But today, it still remains unclear what that ramp will look like. There should be more clarity when we report full-year results and 2024 guidance in late February next year.

And we've always said, given the uniqueness and the pedantic nature of the markets and the businesses that we are in, that there were many ways to meet our targets. And interestingly, the overperformance of STS will fill the EBITDA we planned for HomeSafe in 2024. One I'd assume is that if we do get started with moves in 2024, we should be in real good shape from an EBITDA perspective at the group level. As we've said consistently for many quarters, KBR is a company with multiple pathways to earnings growth, and the real focus needs to be on EBITDA for the whole corporation.

So in short, KBR continues to move upmarket, increasingly playing in the knowledge economy, growing EBITDA, delivering strong cash and truly performing, and have secured the right work and exciting well-funded verticals to keep on pace to close out 2023 and keep momentum as we head into 2024 and beyond.

With that, I will now hand over to Mark who will add his own color, of course, and back up the words with the numbers. Mark?

Mark W. Sopp

Executive Vice President & Chief Financial Officer, KBR, Inc.

All right. Thank you, Stuart, and hello, everyone. I'll start on page 9 or slide 9.

So we're certainly pleased with our team's ability to deliver a strong and well-rounded performance in the third quarter. As you see and as Stuart said, revenues were up 9%, all organic, reflecting a balance of ramp-up in recent wins and production of on-contract growth across both segments. Adjusted EBITDA was up the same on constant margins and at the levels we expected. Focus program execution is required to deliver these healthy margins, I've said that before. This continued to be the case across all of our operations in Q3. So a big shout-out to the people who constantly deliver on this front across KBR. Amazing.

Adjusted EPS grew 15% to \$0.75 per share, driven by the EBITDA growth and net favorable below the line items compared to last year. Interest expense was higher year-over-year as expected. The team really pulled together to generate strong cash flow and also debt reduction actions, which kept financing costs in check. While effective tax rates are also trending up a bit, we did have a favorable resolution of an R&D tax credit, which did keep us in line with our tax rate guidance as well. So our Treasury and tax folks really did a superb job mitigating the more challenging interest and tax environment that we have today.

I just mentioned cash flow was strong again in Q3 at about \$90 million with year-to-date adjusted op cash flow of \$380 million, reflecting a conversion ratio of approximately 125%. Quite good.

Consolidated DSOs improved two days, an increase focused by the team across the board. This will continue to be pressed, of course. Free cash flow year-to-date is \$320 million. And I'll remind you, CapEx is running about twice the normative rate this year due to two specific project requirements.

So that's the big picture for the enterprise results. Now, on to slide 10 for segment performance. Starting with STS, we are seeing tremendous growth in profit margins. In addition, while not shown here, STS are generating excellent cash flow as well with year-to-date free cash flow conversion of well over 100%. This entire segment runs a negative working capital. We've said that before. That remains the case. Top line growth was almost 30% and balanced across technology and sustainable services. EBITDA margin was 21% with EBITDA totaling just under \$90 million.

As is evident in Stuart's remarks back on slide 7, we are seeing high demand and increasing adoption of our proprietary solutions and technology service offerings all around the world, and we are improving the sustainability position for our clients. That's what we do.

Over the Government, organic growth was 4% in Q3, which is pretty consistent across the four business units. As Stuart mentioned, strong bookings in Q3 provide opportunity for improved growth prospects moving forward as we head into 2024.

Onto slide 11 and capital matters. With strong year-to-date adjusted cash flow of, again, \$380 million, effective cash repatriation actions and with year-to-date adjusted EBITDA growth of almost 10% at the end of Q3, we actually kept our leverage ratio steady from the start of the year at 2.0 times. That's really saying something after deploying over \$200 million on buybacks, dividends and some modest M&A, \$200 million on the convert and related warrants, \$130 million on the legacy legal settlement, and higher interest costs. So quite an accomplishment, keeping the leverage ratio steady after going through all of that.

Consistent with our messaging at the beginning of the year, our capital priority was and is to resolve the maturity of the convertible notes that mature November 1 and the attendant warrants which expire a little later. As Stuart just said, we did retire the notes yesterday, November 1, which culminated in a cash payment of \$250 million. That was funded with \$200 million of revolver debt and \$50 million of cash on hand accumulated from free cash flow.

As for the warrants, there's an open window to seek early settlement of those in the next two months or so. Doing so will depend on what terms can be negotiated, so we'll see how that goes. But we certainly have the capital capacity to do so.

On to slide 12 for forward guidance. While the numbers through Q3 suggest we are ahead of pace, including the raised EBITDA guide from last quarter, there is seasonality to factor into Q4, including having fewer productive days with the holidays and things like that. With excellent growth, margins, cash flow and EPS production embodied in our current guide, we're sticking to that outlook for the rest of the year.

With all that's happening in the world and in KBR, here's a quick update on how we are tracking toward our long-term 2025 targets. For things under our control, we are well ahead of pace on EBITDA and on pace for cash flow. Our EPS, which is more influenced by external factors, \$4.75 EPS by 2025 is looking much harder to achieve, primarily due to the uncertainty that we have on the ramp-up of HomeSafe and with interest rates now expected to stay higher for longer and all the implications of that. For the more controllable factors, we see our end market as strong or stronger than our original baseline, and our ability to capture demand for our offerings is the same.

Government is on pace to meet our targeted EBITDA. And as Stuart said, STS is well ahead of pace. We see this momentum continuing through 2025 and beyond.

So that's it for me for the quarter; pretty short report. I'll turn it back to Stuart to wrap it up.

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Thanks, Mark, and great job. But just to emphasize what Mark said a few moments ago, our EBITDA trajectory is well ahead of pace, including associated cash conversions. However, there are headwinds due to external factors beyond our control, making the 2025 EPS target of \$4.75 more difficult to achieve.

With that, now, let me summarize the key takeaways that are in our control and are going really well. Firstly, we continue to deliver for our customers, our shareholders and other key stakeholders through our people-centric, value-driven culture, consistent delivery, resilient organic growth and, increasingly so, into the knowledge economy with another great quarter.

Continued strong organic growth across all businesses and the group is a key takeaway. Cash management was absolutely terrific across many elements, as Mark said: repatriation of cash, DSO reduction, interest management, et cetera. We have paid the convert principal in cash, as we promised, once again doing what we said we would do. Responsible leverage and strong cash management gives us optionality on capital deployment going forward. That's another key takeaway. Bookings were strong across the group, especially in GS US in the quarter.

Now, with a light re-compete year in 2024, the in-built organic growth, as a consequence of bookings happening in the latter half, will deliver targeted growth into next year. STS continues to win more across the energy trilemma and energy transition, with outstanding delivery growth and margin performance, as you see quarter-on-quarter.

So the key takeaway here is strong bookings underpin continued momentum and organic growth into 2024. HomeSafe moves should ramp up in 2024, but likely at a slower pace than originally was expected, and we'll know more by year-end earnings. However, we do expect STS to overperform, thus mitigating any shortfall EBITDA from HomeSafe in 2024.

Finally, the key takeaway here is that there are multiple pathways to EBITDA success. This is a result of our differentiated, diversified, global and resilient business model operating across multiple verticals within the knowledge economy.

Thank you again for listening, and I will now hand the call back to the operator to open it up for questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] As a gentle reminder, please limit yourself to one question and one follow-up only. Our first question today comes from Tobey Sommer of Truist. Your line is open. Please go ahead.

Jasper Bibb

Analyst, Truist Securities, Inc.

Q

Hey. Good morning. This is Jasper Bibb on for Tobey. I can appreciate that there's still quite a bit of uncertainty on HomeSafe here, but any additional color you could share with us on the ramp would be appreciated. I think with the expectation of the first moves happening in 1Q 2024, is there an underlying expectation there for the share of total volumes that you're going to be taking over at that point? And do you think it's still feasible to hit the full revenue run rate at some point in 2025?

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

I mean, it's still not clear what the ramp is like, and we've tried to be quite distinct about that in our prepared remarks. Is it possible we can still get to full run rate by summer of 2025? Yes, it is. But until we get through the next few months and get to February, as we said, we'll have more clarity then. But yeah, it is difficult to say what's going to happen in 2024. Could you get to full run rate by 2025? The answer is yes. Is that guaranteed? No. And that's just the bare truth of it.

Today, we're not pulling any punches. That's just the facts. And there's so much uncertainty at the moment on timing because of what's happening across the world, as I'm sure you can understand, totally not in our control. But that's just the way it is, and we're trying to be very upfront and transparent in that message.

Jasper Bibb

Analyst, Truist Securities, Inc.

Q

No, that definitely makes sense. And then I think you said it was going to be harder to hit the \$4.75 EPS target because of higher interest rates. Just curious if you could frame the relative headwind from those higher rates versus your initial plan. Like, is there EPS headwind that you could tie to that? That's more specific. Thanks.

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

Yeah. I mean, there's two factors, of course. That \$4.75 has the embedded ramp-up on HomeSafe, which may or may not be achievable, as we've just talked about. And in terms of interest rates, I think the difference that's happened over the last three or four months in particular is the yield curves are now looking and that interest rates are higher for longer. They were coming down the – if we went back a few months, the yield curves, I would say, they were coming down, which means, of course, it's accretive to borrow money and then buy back stock at the moment that mass is on the edge, I would say.

And so obviously, if you're using free cash flow, it's accretive. If you're putting it on your balance sheet, it's a more difficult decision. And I think that's really the message we're trying to give around that and the implications of the higher interest rates.

Mark, any...

Mark W. Sopp

Executive Vice President & Chief Financial Officer, KBR, Inc.

A

Yeah. I think it's an opportunity just to clarify that absent real compelling M&A, we intend to use all of our free cash flow for buybacks. We think that's a terrific return over the long term for our shareholders. But as Stuart suggested, these days to lever up and buy back stock is kind of a push from an accretion perspective. That was not our assumption in the original targets when we had lower rates and so forth. And so that part won't deliver the accretion we want to assume. But all other things operationally, as we said in our prepared remarks, were really strong or stronger than planned. A little bit of headwind on tax rates and FX since the derivation of those targets, but not that dramatic relative to the interest rates, which were the biggest move as well with the HomeSafe timing, which is uncertain.

Jasper Bibb

Analyst, Truist Securities, Inc.

Q

Yeah. I appreciate the detail there. Thanks for taking my questions, guys.

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

Thanks, Jasper.

Operator: Our next question today comes from Bert Subin of Stifel. Your line is open.

Bert Subin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Hey, good morning, Stuart and Mark. Thanks for the question.

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

Hi, Bert.

Bert Subin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hey, maybe just to start out. Stuart, you said STS is expected to over-perform next year. How should we think about the trajectory there? I think last call, you mentioned that you expected sort of double-digit organic growth for a while. There could be some lumpiness in that over time. I mean, right now, you're growing 28%. Is there a situation where you just continue to grow at an elevated level in 2024? And then as we think about 2025, I mean, that was supposed to be \$300 million in EBITDA by then. Is there any update you can give us on that as we think about, I guess, the new 2025 target?

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

Yeah. I mean, I don't think we're going to go over our skis on the 2025 target today. But what I would say is that we are well ahead of pace. You're quite right, we had a \$300 million target. We're going to blow through that this year. We raised EBITDA guide last quarter, and we're ahead on pace of that or on pace for that. And I think everyone recognizes particularly that the Q3 results, that's all pointing to STS.

And I think If you look at the relative performance of STS to KBR, I think year-to-date, it's circa 40% and the quarter it's even higher, and so it's contribution in its volume to KBR is becoming clear and clearer and hopefully that reflects on the multiple as well as we go forward in terms of that contribution. But as we look into next year, the double-digit growth that we set ourselves will be coming off a much higher base. And clearly, that outpaces where we originally thought and even a few months ago thought we would be starting from.

So I think that's probably the best way to look at it. We'll get to the – we've got an Investor Day, as you know, in sort of May next year and we'll certainly be realigning those targets by then. We should also have a lot more clarity on HomeSafe by then as well. So I think we can really sort of cover off where we're heading in the next couple of years at that juncture.

Bert Subin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Just to clarify there, Stuart, do you say it's a higher base and so double-digit growth would be a challenge or you expect double-digit growth off of a higher base?

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

Oh, no, no, no. We firmly expect double-digit growth. My point being, it's a much higher starting number that you put in double digits, too.

Bert Subin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Got it. Okay. Thanks. And then just as a follow-up on the HomeSafe side of things, I mean, I think there were some news out there in September that there was, I guess, challenges or I guess concerns on TRANSCOM part of integrating mil move with HomeSafe Connect. And it seems like you guys are pretty ready whenever they essentially say go. That expectation, I think, is still January start and then sort of sequential ramp from there.

Can you just give us some of the moving parts like the things you're watching to get that turned on and revenue started there?

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

Yeah. I mean, you're quite right. I think it's the integration of the systems and ensuring their readiness. And we don't want to falter in any way. And I think TRANSCOM are quite right to be quite considerate about how they ramp up and then it comes back. If we do expect moves in Q1, I don't think it will be January 1, that's for sure. It would be a little bit later in the quarter.

But I think directionally, I'll reiterate again, the relationship, the passion around this on both sides to get it right is absolutely there. I'm not concerned about that at all. But it's all about being absolutely sure that when we start, we can actually ramp up very quickly and not falter until.

So I can't say more than what we said in the prepared remarks, and the truth is because I don't know anymore. And I think that's kind of where we're at. I'm sorry. I can't give more color. There's just a lot uncertainty. I'm trying to be truthful.

Bert Subin

Analyst, Stifel, Nicolaus & Co., Inc.

Appreciate the color. Thank you.

Q

Operator: The next question today comes from that Gautam Khanna of TD Cowen. Please go ahead.

Gautam Khanna

Analyst, TD Cowen

Hi, guys. Two questions. First, on HomeSafe, I'm just curious about your confidence on execution, given some of the logistics partners may have agreed to contract terms prior to the runaway inflation we saw last year and for part of this year. Just what kind of contractual – what's your confidence that stuff doesn't have to get renegotiated? And then I have a follow-up.

Q

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Yeah. I think – Gautam, I think the – we have support from the supply chain to deliver the initial ramp and the commitments around that. Even if we started tomorrow, never mind in a few months, I think the heat has come out of that market somewhat and TRANSCOM are thinking that those rates should naturally come down as the heat comes out of the market [ph] in any effect (00:35:20).

A

So I think in terms of our confidence levels, we feel we've got the right partners, we've got the right people in the supply chain, and we're feeling really good about that. It's not really a question that we are concerned about.

Gautam Khanna

Analyst, TD Cowen

Okay. And then just a quick follow-up. On the 2025 \$4.75 target, knowing what you know today, what is the variance, earnings per share variance to that from interest expense, a higher share count, et cetera? I mean, take HomeSafe out of it, which I think was about \$0.50, right, to the target when you guys updated for the HomeSafe win. Where do you stand, is it \$4.25? Is it – yeah, what can you see?

Q

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

I mean, it's so tricky because we don't know the ramp on HomeSafe. And as Mark was alluding to, in terms of free cash flow, we'll use to do buybacks. It was a big piece of that in the initial calculation. And so I think the challenge for us, Gautam, if you went back, is that when we set our targets initially, I think it was \$4, not for \$4.25, and then \$4.75 is HomeSafe. There was a base set of assumptions that surrounded that around interest rates and accretion/dilution math around buybacks and things like that and average share prices, I think.

A

But ultimately, everyone forgets about those assumptions and everyone just goes and remembers the EPS target. And so I think the things that we can control are totally a better way to think about how we should be measured, and I think that really is EBITDA. And as it's come with these external factors and the volatility in the world today, we can't control interest rates and FX movements and things like that. But our EBITDA generation is within our control, as is our growth and wins. And I think that's how we will be, I guess, projecting our future, if you like. That doesn't mean EPS, and particularly, short-term EPS will not be certainly part of the executive compensation. But that longer-term EPS with such volatility in movements is something we're probably going to move away from and think more about EBITDA.

Gautam Khanna

Analyst, TD Cowen

Q

And do you have an updated EBITDA target for 2025, recognizing HomeSafe is – ex-HomeSafe?

Mark W. Sopp

Executive Vice President & Chief Financial Officer, KBR, Inc.

A

I think Stuart was very clear in his remarks that we're ahead of pace by a lot in STS and on pace for Government, ex-HomeSafe. And we still believe HomeSafe is there. It's a matter of time. So putting a precise date in 2025 in HomeSafe's contribution is a little hard, but we still are optimistic it will deliver the originally intended EBITDA over time once we get through the first moves and everyone is comfortable that the quality that was intended can be delivered.

So the great news is that relative to the original targets, the most important driver, which is EBITDA, is ahead of pace. We haven't quantified that yet. You can maybe do your own calculation on STS's run rate and where they're heading trajectory-wise, which we think will continue. But I think it's best to wait for the 2024 guide and the Investor Day to be more precise on that exact level for 2025.

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

I mean, and certainly, as we move into 2024, we're very confident of our EBITDA targets and moving them into the pathway that we explained with STS side performing. And opposite, any shortfall in HomeSafe will certainly be made up by STS. So we're not worried about that pathway at all, Gautam.

Gautam Khanna

Analyst, TD Cowen

Q

Thank you.

Operator: Our next question today comes from Michael Dudas of Vertical Research Partners. Please go ahead. Your line is open.

Michael S. Dudas

Analyst, Vertical Research Partners LLC

Q

Good morning, Jamie, Mark, Stuart.

Jamie DuBray

Vice President-Investor Relations, KBR, Inc.

A

Good morning, Mike.

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

Hey, Mike.

Michael S. Dudas

Analyst, Vertical Research Partners LLC

Q

Hello. Can you hear me?

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

We can.

A

Michael S. Dudas

Analyst, Vertical Research Partners LLC

Yeah. Great, yeah. Thanks. Good morning, everybody. So just wanted to maybe move towards STS. There's a lot of news, last couple of weeks, of the funding in US for hydrogen hubs. So certainly, the hydrogen market continues to get a lot of visibility in news flow. Maybe you can explain a little bit about how KBR and its clients are thinking about that and how that could drive some more opportunities on top of what you've already described in the ammonia and hydrogen business for the next several years.

Q

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Yeah. I mean, of the \$7 billion, I think half of it or so will be spent in construction enabling. I think six to eight hydrogen hubs, I think, targeted, I think, for 2030, Mike, to be online. And I think – however, we've got customer sets all around the world, some of which have more funding and are now moving far faster with greater urgency. And we talked a little bit about hydrogen cracking and the things we're doing in that area. And as you well know, we're well-positioned in hydrogen opposite ammonia as well.

A

So I think the US stimulus is a good part of the story. But I guess, probably the near term, it's only part of the story, and I think there's great growth outside of the US as well as in it. And so, I think it's a terrific opportunity for KBR. How we play in that and the way we're thinking about it is evolving, so we recently announced, of course. But we're really busy elsewhere in the world, which, of course, gives us amazing credentials and capability to bring back into the US.

Michael S. Dudas

Analyst, Vertical Research Partners LLC

Terrific. Thank you, Stuart. Appreciate it.

Q

Operator: The next question today comes from Jerry Revich of Goldman Sachs. Please go ahead.

Adam Bubes

Analyst, Goldman Sachs & Co. LLC

Hi. This is Adam on for Jerry today. Thanks for taking my question. Wondering if you could help us understand the growth outlook by platform for 2024 in Government Solutions, how you're thinking about that, excluding HomeSafe. And particularly interested in how you're thinking about the international piece, given some of things going on in the world? Thanks.

Q

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Yeah. So I think our guide, ex-HomeSafe, is somewhere between 5% and 8% in terms of growth, and I think we're well aligned on that, as I saw in the prepared remarks covered off. I think Science & Space is in a terrific place with this recent wins, particularly the takeaways and the additional scope and contract values we've taken on aboard as we move into 2024 for good growth. We've got a lot going on in the intelligence community, as you

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would rightly expect at this time. And we've secured quite a bit across our D&I portfolio, and there's more to come, I think, in Q4.

So, again, we're feeling really strongly about organic growth there. And R&S is the one where we've seen a little bit of softness, I think, in the last couple of months. But as I said, again, I think with the recent task order, all multi-year, we're expecting that to sort of, well, pack up as we move into next year.

The international piece is interesting...

Adam Bubes

Analyst, Goldman Sachs & Co. LLC

Great. Thanks.

Q

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Okay. But I think the international piece is probably growing faster than most. I think we're looking at sort of double-digit growth there as a consequence of what's happening in the world and the stronger collaboration. And I think that the markets there have settled down. There's been a new government in Australia a few months ago, and that's all settled down. We've come through that. And we can see there actually where they're spending, and we're lined up nicely opposite those factors.

So I think, all up, we're feeling pretty good about our overall GS growth range, and that's the sort of breakdown across that portfolio, if that helps.

Adam Bubes

Analyst, Goldman Sachs & Co. LLC

Very helpful. And then, in STS, can you talk about any major new contracts that you might be targeting and expected timing of any award decisions there?

Q

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Yeah. I mean, there's a lot happening in STS across the world. It's a multifaceted portfolio. We do a lot for many different customer sets across that energy trilemma, as we explained. I would say that the largest use, I think, in the market really is probably coming out of Saudi. I mean, they are expected to be the largest economy – or the largest growing economy or the fastest growing economy for the next couple of years. As you're probably aware, they're putting a lot of capital to work as they diversify their economy.

There's a lot going on from a decarbonization thematic, where they're stopping burning crude for power, replacing that with gas, and we're heavily engaged in that. And then, without crude, they're trying to extend the value chain by turning it into petrochemicals. And so, there's a substantial new program with four, five major crackers associated with it and just a huge integrated portfolio of investment, running up hundreds of billions of dollars.

And it's time for bid now in terms of pre-FEED and FEED and project management. And if that comes through, I think if we can win our fair share of that, and we've got a good relationship in Saudi and we really like working with Aramco, we really understand how they operate, and we've got a long history of doing well mutually. And so, if we can win our fair share there, that's very exciting and quite sizable and multi-year. And I think that's probably the

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largest, we think, that there'll be noise about that coming through in Q4. That's probably the largest one out there, and I think, if that comes through.

I think also nice coming through in this quarter was more reimbursable LNG work, which I know a number of people felt that Plaquemines could not be more than just Plaquemines. And I think we've proven that that's not the case and that there are mature customers out there that like to work in the risk model that we can tolerate and can take our sort of high-end capability to help them succeed as we look to use, I guess, gas as a transition fuel and also around energy security.

So I think that's all good. But a lot is happening across the world in terms of ammonia, in terms of more ammonia cracking opportunities. You probably saw that Mura, the plastics recycling partner or the investment we have in Mura, they've opened the doors, if you like, for business and there was a big delegation there in fact just last week. And I was with the CEO at the tail end of last week and very positive of ramping up production as we move into Q1 next year. So, again, I think that's all exciting. So more will come once that's happening, I'm sure, in the plastics recycling area.

So sorry, a long answer to your question, but there's so much excitement around STS. There's a lot happening across the portfolio, and that goes from obviously the olefins opportunities in Saudi, to the global ammonia opportunities, to hydrogen cracking in Korea, to what's happening across the world in Australia on energy security, et cetera. So it's a very global business, and not to mention what's happening in the US with all the additional funding around the decarbonization thematic and [indiscernible] (00:47:41).

So I think all good in that arena. Sorry, it's a long answer, but we're quite excited about STS.

Adam Bubes

Analyst, Goldman Sachs & Co. LLC

Q

No. Terrific. Thanks so much.

Operator: Our next question today comes from Mariana Pérez Mora of Bank of America. Your line is open. Please go ahead.

Samantha Stiroh

Analyst, BofA Securities, Inc.

Q

Hi. Good morning. This is Samantha Stiroh on for Mariana. I was just wondering about – you talked a little bit about at the beginning, the head count ramp. What you're seeing with that and then particularly as you see the strong growth in STS, do you have the head count in place already to kind of keep up with that?

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

A

Yeah. I mean, we're hiring just slightly ahead of the curve, Sam, there. I think our team is doing extremely well, and we've got a large presence in India that allows us a little bit of relief valve there. And we've got a terrific lady who leads that business and is highly respected in the marketplace that we're able to attract real talent and diversified talent, which is terrific.

So I think so far, so good. And there will become, I'm sure, constraints and certain elements like that in the world's gone past and things like in the process side and things like that. But so far, we're keeping on pace and no real issues. We've got a very strong recruitment team. But I think ultimately, where we sit in the marketplace around

sustainable solutions is a big draw for talent. Particularly, the younger talent, they really value being part of a company that's actually trying to address climate change issues and decarbonization thematic, as well as what we do in government around security and sustaining the way of life and things like that.

So our overall reputation helps where we are in the markets and the things we do to help. But we really look after our people once they're here. And recruitment is only one aspect. I think retention is another aspect and something we're doing very well in that area. So I think so far, so good.

Samantha Stiroh

Analyst, BofA Securities, Inc.

Okay. Great. I'll keep it to one. Thank you.

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Thanks.

Operator: Our final question today comes from Sahil Manocha of Citibank. Please go ahead.

Sahil Manocha

Analyst, Citigroup Global Markets, Inc.

Hi, good morning. This is Sahil Manocha on for Andy Kaplowitz. So another government shutdown deadline is approaching in November. Could you provide some color on how a short-term, medium-term shutdown could impact the Government Solutions business?

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Yeah. Thanks, Sahil. I mean, I'm sure lots of companies that do what we do are getting that question. For us, this is nothing new. I mean, it seems to happen every year, whether there's a [ph] CR (00:50:43) or a short shutdown. And I think we've pulled in year after year. We're very resilient. We understand what we're doing. Remember that our STS business and our Government International business is completely immune to that, so we've got some in-built immunity. We've got a lot of funding on, what I would call, tip-of-the-spear critical operational missions, whether that's in Europe or the space station or whatever, it doesn't matter where, the intelligence, what we do across our whole defense portfolio.

So we're not concerned about that. I think ultimately it's – we've been engaged in it so many times. And I'm sure the answer is the same for many of our peers in the government realm. So, I mean, it's one of those things that would be great to be avoided. But if it does happen, I don't think it's going to impact KBR too much.

Sahil Manocha

Analyst, Citigroup Global Markets, Inc.

That's helpful. And then I know you've provided some color in the opening remarks, but could you just provide an update on your plans to settle the remaining warrants, which mature in the first half of 2024? Has a decision been made on whether they'll be settled in cash or shares?

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Yeah, I think, I think it depends how we go. I mean, we're not allowed to, under the rules of engagement, to start that dialogue with the warrant holders until we're into open window, which we will be in tomorrow so we can stop that negotiation. And as Mark said, if we can cut a reasonable deal around premiums and things, we have options to settle in an accelerated fashion.

I think the interesting fact pattern around that is that if we do decide, depending on how negotiations go to settle early, it will be quite a reduction in share count for the year, the way these things are calculated that will push up our EPS for 2023, I'll bet just because of share count. So there's some good fact patterns there to be taken into consideration as well.

So, Mark, any more color on that?

Mark W. Sopp

Executive Vice President & Chief Financial Officer, KBR, Inc.

A

Yeah. I'll just add because I know this has been a pretty complex story. But the last remaining piece after yesterday are the warrants. And at today's open, the value of those warrants is roughly \$200 million, give or take. And that does vary with the stock price, roughly \$10 of value per \$1 of movement. And so that gives you some sensitivity that will go into our thinking. And so we'll evaluate what the market bears. There are counterparties to those instruments, and that is a negotiation and we'll undertake that and we'll see where it goes and will advise accordingly.

Sahil Manocha

Analyst, Citigroup Global Markets, Inc.

Q

Very helpful. Thank you very much.

Mark W. Sopp

Executive Vice President & Chief Financial Officer, KBR, Inc.

A

Thank you.

Operator: We have no further questions in the queue. So I'll turn the call back to Stuart Bradie for any final remarks.

Stuart J.B. Bradie

President, Chief Executive Officer & Director, KBR, Inc.

Thank you. Thanks again. Thanks for taking the time to listen this morning, and thank you for your questions. I think you can ascertain where we've got control over our destiny. We're feeling really good about the company, the bookings, the performance, the margins. We look ahead into 2024 with bookings based on Q3, and obviously, some very strong prospects we discussed in Q4. Feeling really good about continued momentum.

Obviously, we've been very clear and very truthful about – and not trying to pull any punches about uncertainty on HomeSafe, on ramp. We're feeling very good about the program in general. So please take that as we've said it, but we don't know what they're actually going to look like. We will start in 2024 and it will ramp up overtime. But until we get clarity, it's difficult to give you any more than that. There is a path to get to full ramp by 2025. But again, that path is unclear and uncertain. So, again, apologies as we can't give more than this update at this time.

That's probably a good place to leave it. And I'm sure we'll be talking to you one on one and others as we progress. But thank you for your interest in KBR, and we look forward to a strong finish to 2023 and upwards and onwards to 2024. Thank you.

Operator: This concludes today's call. Thank you for joining. You may now disconnect your line.

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