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HII - Q1 2015 Huntington Ingalls Industries Inc Earnings Call

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## CONFERENCE CALL PARTICIPANTS

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**Robert Spingarn** *Credit Suisse - Analyst*

**Sam Pearlstein** *Wells Fargo Securities - Analyst*

**Pete Skibitski** *Drexel Hamilton - Analyst*

**Jon Raviv** *Citigroup - Analyst*

**Myles Walton** *Deutsche Bank - Analyst*

**George Shapiro** *Shapiro Research - Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Huntington Ingalls Industries Q1 2015 earnings call.

(Operator Instructions)

As reminder, today's conference call is being recorded. I would now like to turn the conference over to Mr. Dwayne Blake, Corporate Vice President, Investor Relations. Please go ahead, sir.

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**Dwayne Blake** - *Huntington Ingalls Industries Inc - Corporate VP of IR*

Thanks, Candace. Good morning, and welcome to the Huntington Ingalls Industries first-quarter 2015 earnings conference call. With us today are Mike Petters, President and Chief Executive Officer; and Barb Niland, Corporate Vice President, Business Management and Chief Financial Officer.

As a reminder, statements made in today's call that are not historical fact are considered forward-looking statements, and are made pursuant to the Safe Harbor provisions of federal securities law. Actual results may differ. Please refer to our SEC filings for a description of some of the factors that may cause actual results to vary materially from anticipated results.

Also in the remarks today, Mike and Barb will refer to certain non-GAAP measures, including certain segment and adjusted financial measures. Reconciliations of these metrics to the comparable GAAP measures are included in the appendix of our earnings presentation that is posted on our website.

We plan to address the posted presentation slides during the call to supplement our comments. Please access our website at HuntingtonIngalls.com, and click on the Investor Relations link to view the presentation, as well as our earnings release. With that, I'll turn the call over to our President and CEO, Mike Petters. Mike?

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Thanks, Dwayne. Good morning, everyone, and thanks for joining us on today's call. This morning we released first-quarter 2015 financial results to reflect steady operating margin performance and improved cash generation. Ingalls in Newport News had another solid quarter, while UniversalPegasus continues to be affected by the prolonged weakness in the oil and gas market.

For the quarter, sales of $1.6 billion were slightly lower than last year. And segment operating margin was 8.2%, down from 8.6% last year. Diluted EPS was $1.79 for the quarter, down from $1.81 last year. Q1 results include $0.13 of negative impact from the Other segment. We were a net cash user in the quarter. However, operating cash flow improved by over $200 million from last year. Additionally, we received $1.6 billion in new contract awards during the quarter, resulting in backlog of approximately $21 billion, of which $14 billion is funded.

Since our Q4 earnings call in February, FY16 defense budget discussions in Washington have been ongoing, with what appears to be a healthy debate about ways to mitigate the adverse implications of sequestration. While no decisions have been made, we are encouraged by the ongoing budget deliberations, and remain hopeful that the defense authorization and appropriations process will proceed in regular order. At the same time, we will continue to closely monitor the process for all of our programs, with a particular focus on LPD-28, CVN-73 RCOH, CVN-79 and CVN-80.

Now I'll provide a few points of interest on our programs. At Ingalls, NSC-5 James completed successful acceptance trials last week and is preparing for delivery to a customer in June. In addition, the contract award of the eighth National Security Cutter at the end of March reinforces the Coast Guard's commitment to leveraging the benefits of serial production on a program that continues to perform extremely well. Ingalls also christened LPD-26 John P. Murtha, and launched DDG-113 John Finn during the quarter, representing achievement of significant milestones in the construction of these vessels.

At Newport News, the test program on CVN-78 Ford is progressing, and delivery remains on track for the first half of 2016. For CVN-79 Kennedy, we still expect a detailed design and construction contract to be awarded in the second quarter of this year. In addition, SSN 785 John Warner is preparing for sea trials, with delivery slated for next month.

Our display of Proteus -- a submersible undersea vehicle built by our recently acquired Undersea Solutions Group, Battelle and Bluefin Robotics -- created long lines and a lot of excitement at the annual Navy League Sea-Air-Space Exposition last month. Proteus is designed to be manually crewed or to function as an autonomous, unmanned underwater vehicle. We see Proteus as a key component in our pursuit of opportunities in the unmanned submersibles market.

Regarding UniversalPegasus, I talked about specific actions we were taking to position this business for long-term success, during our call last quarter. These difficult but necessary actions include a 30% workforce reduction, and a restructuring of UPI's benefit and compensation programs, which are expected to reduce overhead costs by 25% over the next 12 months. Even with these cost reductions, market conditions will continue to impact performance. While none of us can predict when the market will turn, UPI will be positioned to provide our customer base with high-quality products and services to help them complete their projects safely, on schedule, and on budget.

Although the delay in award of the contract for CVN-79 may impact volume at Newport News on a full-year basis, I remain confident in our ability to maintain 9%-plus operating margin in our shipbuilding business for 2015. We will maintain our relentless focus on program execution, and continue investing capital in our shipbuilding businesses, to improve operational efficiency and position ourselves for future Navy programs. We'll also continue distributing cash to shareholders in the form of dividends and share buybacks, subject to Board approval. And continue evaluating M&A opportunities to provide long-term value creation.

With all that being said, when people talk about Huntington Ingalls, the discussion is typically all about Navy shipbuilding. However, since January of 2014, we have made three acquisitions that leverage our core competencies in nuclear operations, and engineering and program management. I am excited about the future, as our Company is well-positioned to provide innovative solutions for our Navy customer in the traditional shipbuilding, repair and fleet services markets, as well as in the unmanned submersibles market.

We have also expanded our ability to compete for engineering and environmental services opportunities for the Department of Energy, and commercial nuclear markets, and engineering services for the oil and gas market. These strategic actions have formed a strong foundation for the future, as we continue exploring opportunities to create long-term sustainable value for our customers, employees and shareholders. That concludes my remarks, and I will now turn the call over to Barb Niland for some remarks on the financials. Barb?

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Thanks, Mike, and good morning, everyone. Starting with the consolidated results for the quarter on slide 4 of the presentation, revenues of $1.57 billion in the quarter decreased 1.5%, due primarily to lower volumes at Ingalls. Segment operating income decreased 7% in the quarter to $128 million. And segment operating margin was 8.2%.

Total operating income decreased 2% in the quarter to $156 million, and total operating margin was 9.9%. These decreases were primarily due to under-performance at UPI, as a result of continued weakness in the oil and gas market. Excluding UPI, segment operating income in the quarter was $137 million, which was consistent with Q1 2014. And segment operating margin was 9%, a 36-basis points improvement over the same period last year. Excluding UPI, total operating income was $165 million, a $6 million increase over Q1 2014. And total operating margin was 10.8%, which is 81 basis points over the same period last year.

As expected, we were a net user of cash in the quarter. Cash used in operating activities was $3 million, a $211 million improvement over the first quarter of 2014. Capital expenditures in the quarter were $20 million compared to $24 million last year. We successfully closed on the sale of the Gulfport facility and collected approximately $32 million in proceeds. Now that we have sold the facility, we will focus our attention on reaching a final agreement with the customer on treatment of the remaining closure costs, so that we can begin the recovery process.

Additionally, we contributed $2 million of the planned $99 million discretionary contributions to our qualified pension plans. We intend to fund the balance in the second quarter. We also purchased approximately 210,000 shares at a cost of $29 million during the quarter. And paid dividends of $0.40 per share, or $19 million, bringing our quarter-end cash balance to $904 million.

Before I move on to the segment results, let me give you a quick update on the Avondale facility. As you may have already seen from the press release a couple weeks ago, we ended the study with Kinder Morgan, and have mutually agreed not to pursue a joint venture using the facility. We will continue to explore other alternatives for future use of the facility, including a sale. We have also submitted an updated proposal to the Navy, which reflects a revised estimated restructuring cost of $287 million, a $3 million increase over the previous proposal. As a reminder, once a final agreement is reached with the Navy, the restructuring costs will be recovered via our billing rates over a five-year period.

Now moving on to segment results on slide 5. Ingalls revenues of $469 million declined 14% from the same period last year, driven by the deliveries of LHA-6 and NSC-4, and lower volumes on the LPD programs. Operating margin of 9.6% in the quarter increased 173 basis points over the first quarter of 2014, primarily due to risk retirement on LHA-6.

Turning to slide 6, Newport News first-quarter revenues of $1.1 billion increased 1% over the same period last year, due to higher volumes on the VCS program, and on aircraft carrier maintenance. This was partially offset by lower volumes on CVN-72 RCOH, and the construction contract for CVN-78. Operating margin for the quarter was 8.8%, down 21 basis points from the same period last year, due to lower risk retirement on CVN-78, which was partially offset by higher risk retirement on the VCS program.

Now on to the other segment, which consists primarily of UPI. In the first quarter, the segment generated an operating loss of $10 million on revenues of $40 million. Lower volumes due to project delays and work scope reductions, as well as the cost to restructure the business in light of the downturn in the oil and gas market, negatively impacted UPI performance in the quarter.

As Mike mentioned, we continue to take aggressive actions at UPI. But the reality is, market conditions will dictate how these actions affect the bottom line for the remainder of the year. And without a favorable turn in the market, we will continue to see pressure in the business. However, we believe the actions we've taken will strengthen the Company for the long-term.

Let me provide you with an update on deferred state taxes. We are now expecting a benefit of approximately $5 million for the year, instead of the $20 million I provided on the Q4 2014 earnings call. As you know, our estimate of deferred state taxes can fluctuate significantly, due to timing of contract income for tax purposes. So each quarter, we will provide you with an update of our best estimate for the year. That concludes my remarks for the quarter, and I'll turn the call back over to Dwayne for Q&A.

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**Dwayne Blake** - *Huntington Ingalls Industries Inc - Corporate VP of IR*

Thanks, Barb. As a reminder to everyone on the call, please limit yourself to one initial question and one follow-up, so we can get as many people through the queue as possible. Candace, I'll turn back over to you to manage the Q&A.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Doug Harned, Sanford Bernstein.

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**Doug Harned** - *Sanford C. Bernstein & Company - Analyst*

I'm interested in Newport News, because the margins were a little less than they've been in recent periods. You attributed this to lower risk retirement on the CVN-78.

But do you see this as a one-quarter event? Or are we entering a period where there may be some more difficulty in bringing risk down on that program?

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Well, thanks, Doug. A couple quarters ago, we talked about Newport News was going to be in a window here where they're a little bit out of balance. Starting with the delivery of the Ford next year, following that will be the delivery of the Lincoln, and the delivery of the Enterprise -- Lincoln from RCOH and Enterprise from inactivation.

We have three carrier deliveries in the next 21 months out of Newport News. And all of that work is cost-type work. And all of that work is the last year of a carrier project.

We don't yet have the contract for CVN-79, and we talked about this before that, there needs to be a balance in the business of new work coming in, along with work that you're retiring. Relative to the risk retirement on these various programs, the Ford has come together really well. Frankly, I still insist that this was the -- in terms of the construction side of it, it was the very best lead ship that I've ever seen, in terms of things coming together and being complete and ready for test.

There's a lot of new technology on that ship. And we're just being very mindful as we walk our way through to delivery in the first half of next year, about risk retirement. Have we really retired the risk? Do we really understand what we've got there?

So I think that certainly the awarding of a contract for CVN-79 will help us, but I think -- and we're not backing away from our view that for this full-year period, Newport News will be at 9% or better. But I think it's going to be a little bit of a lumpy ride, or bumpy ride, between here and there. Really a bumpy ride between here and over the next 21 months.

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

And I've got to say, in Q1 2014, when you had risk retirement on 78, you had the cume correct effect of that, which made it have a bigger impact. And when you don't have a cume correct for risk retirement this quarter, you have lower margins.

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**Doug Harned** - *Sanford C. Bernstein & Company - Analyst*

And then just separately, on CapEx. CapEx was low for the quarter, I think, about 1.6% of revenues. Now, you said that you're headed toward a 3% to 4% type of CapEx level going forward, so should we expect significant increases later this year? What does that CapEx profile look like now?

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

I believe I said on the last call, the total CapEx would be between 4.5% and 5%, so somewhere between 4% and 5% is my expectation for the year. The reason why you're not seeing a bump-up is, one, the 79 contract has been delayed. And some of that capital was contingent on receipt of the contract, based on that contract structure and being able to get the returns generated. So until the time we have that final contract signed, we won't release the capital associated with that.

And then the other thing I believe I told you was, we allocated a little bit of money for some engineering studies at Ingalls. And until those studies show the returns that we need there, and the efficiencies and improvement to capture the future opportunities for Ingalls, we're not going to release that capital. I would say there's pressure. I doubt we'll spend 5%, but it will be in the 4% range, and I'll keep you posted as we get to the second quarter.

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

And I would just add, Doug, that our intent here is to invest in our core business, and we plan to invest in it in a pretty substantial way. We're also going to do that in a very thoughtful way. And as the business moves around, the investment profile will move around to reflect that. I think we're committed to doing that, committed to driving efficiencies and improvements in the business, and driving more affordability into the business, but we need to do that in a really smart way.

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**Doug Harned** - *Sanford C. Bernstein & Company - Analyst*

Okay, thank you very much.

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

You bet.

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**Operator**

Robert Spingarn, Credit Suisse.

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**Robert Spingarn** - *Credit Suisse - Analyst*

I wanted to ask you on -- well, first going back to Newport News and following onto the last question. With the 79 coming in, I understand that, that certainty of getting a contract is a positive and gets work flowing. But given the fixed-price nature of the contract, and the fact that you generally start off booking conservatively, might we not expect that to bring margins down at Newport News for a period of time?

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Well, I think it will be part of the plan. That's why I say, we are a little bit out of balance. I think the more immediate impact to the yard is that, as work completes on these various other projects, the management of the workforce in the yard and how it flows from one project to another is a little bit out of sequence. And I think that's what the programs are actually seeing down on the deck plate.

In terms of the returns in the business, my expectation is that the business will stay at 9%. But we got to work our way through these three deliveries, and we got to work through the startup on 79. The reality is that we have been building units for 79 for a couple years, and so we got a good start on that. We've got a good start on that program.

**Robert Spingarn** - *Credit Suisse - Analyst*

Mike, are those the modulars, the things you can build with advanced procurement? But then as you put the ship in drydock and start assembling everything together, does that change the dynamic?

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Well, certainly. We're coming through the manufacturing phase of 79, and there's a lot of work on 79 going on in the yard. But it's the turning the yard loose to go execute all those other parts of the program, that have to be executed to make it successful at delivery. That's what this contract -- a detailed design and construction contract -- will do for us. The advanced construction and advanced procurement that we're doing is very specific to material procurement and specific modules that we agree with the Navy that need to be done to keep the ship on schedule.

**Robert Spingarn** - *Credit Suisse - Analyst*

Okay. And then just a higher-level question. I've asked this before, but here we are now getting well into 2015. At what point do you think, if ever, are you going to be comfortable guiding? (laughter)

**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

You hit him too hard, Rob.

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Yes, ouch.

**Robert Spingarn** - *Credit Suisse - Analyst*

Not meant to be too harsh, but we're kind of at that point. The performance has been excellent. You've hit the targets that you've set, even a little bit early. You've been sufficiently cautious where needed. I understand that this UPI and the oil and gas is a curve ball. But even at guiding ex that, is that something you can do?

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

At this point, we don't really have a plan to begin providing guidance. Our view of the business is that, our task is to achieve the full potential of this business. And so that's what we'll continue to do. I like the way that this worked out over the last -- since 2011, where we said -- this is where we think this business is going to be in 2015.

And if we do something to provide a view of where do we think this business is going to be in a few years from now -- we may have that discussion later this year. But I'm not sure that -- we're not a quarter-to-quarter business. And as you can see, that in some of our programs, the way these things play out, in some cases we're not even a year-to-year business. So I'm, at this point, thinking more about -- what does this business look like in the three- to five-year timeframe? As opposed to where are we going to specifically be at the end of this year.

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**Robert Spingarn** - *Credit Suisse - Analyst*

Right. But you are saying -- or maybe Barb said earlier -- at least with UPI, this June quarter could look somewhat similar, the pressure is still there?

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

UPI is correct.

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Yes, there's still market pressure at UPI. But on the other hand, we've taken some pretty dramatic steps there that we think will help that business, certainly over the course of this year. But also positions it well for the inevitable rebound in that market space.

We have a business there that has a great set of customers. They had some big wins in the second half of last year -- projects that they've won that have now been slowed down or delayed. And our challenge is to make sure that we maintain the customer contact with those projects so that when those projects start back up, we're ready to provide the quality work that we needed to go do.

When they will start back up, I'm not exactly sure. We've been looking at this from the standpoint of making sure that we maintain the customer contact and the quality capability that we have to have to support that. And some of that will play out over the next couple of quarters.

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**Robert Spingarn** - *Credit Suisse - Analyst*

That's certainly understandable. Thank you.

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

You bet.

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**Operator**

Sam Pearlstein, Wells Fargo.

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**Sam Pearlstein** - *Wells Fargo Securities - Analyst*

You talked about the restructuring in the Other segment. Can you size how much that restructuring cost might have been?

**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Sure. Which, out of that $10 million loss, $9 million was specifically related to UPI. And if you recall, when we acquired UPI, we set up our Wagman facility -- it was called AEC. And Wagman was really to do some machining and fabrication for the oil and gas market in the Gulf region in support of UPI.

We closed that facility. So of the $10 million, about $1.5 million was for the closure of Wagman. About a little less than $2 million was related to restructuring -- so that was separation costs, things like that. And then if you think about it, $1.5 million was related to purchased intangibles. That's about half of it. And then the other half was really volume-impacting performance.

**Sam Pearlstein** - *Wells Fargo Securities - Analyst*

Okay. And given the downturn, at what point do you re-assess the goodwill position and the intangibles? And is there any sense that where you have that might change?

**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Actually, we re-assess it every quarter, and we re-assess that based on the customer, whether they're cancellations or project delays. We re-assess that based on performance. We re-assess it based on market conditions. We look at all that. And then we assess our ability, when the market comes back, to come out in a positive way. Which is why we're trying to maintain the skill sets we need to, so when the projects that have been delayed get turned on, we will be successful, and those partners will continue with us.

**Sam Pearlstein** - *Wells Fargo Securities - Analyst*

Okay, thank you.

**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

You're welcome.

**Operator**

Pete Skibitski, Drexel Hamilton.

**Pete Skibitski** - *Drexel Hamilton - Analyst*

I was looking for some more color about Ingalls, just on the top line. In so far as you've had a couple quarters in a row now of double-digit declines there on the top line. Is that just timing-related? Or directionally, is that the magnitude of headwinds that you're facing there?

**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

In terms of the volume, we did have a lighter month, and part of that -- or, a lighter quarter. And part of that was, we had a very strong quarter in the fourth quarter related to material receipts and payments last year. And when you compare Q1 this year to Q1 of last year, we also had accelerated last year some accounts payable because we were implementing a new system called MARS at Ingalls. So we were very heavy in the first quarter of 2014 in terms of accounts payable.

Volumes, we're expecting to be the same -- pretty close to last year, at Ingalls. We just had a light quarter, primarily attributable to a very strong quarter -- fourth quarter in 2014. We expect it to be a little higher the rest of the year.

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**Pete Skibitski** - *Drexel Hamilton - Analyst*

Got it, okay. Very helpful. And then, Barbara, on the working capital performance, probably, I think, the best first quarter you've had in, like, five years. I'm just wondering how you think about the rest of the year? Because I know you don't have the LHA-6 retention release this year, like last year.

So I'm just wondering, does this give you the confidence that you can get to 1 times free cash conversion this year? Or because it's such a strong start, are you thinking maybe that you can exceed that this year, like you did last year?

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Wow. I always tell you that it really depends on really the last three days of the year, and collections. I would love to have another performance like last year.

I expect us, from a segment cash, to do pretty well this year. We do have the delivery of one of the NSCs this year, so we'll collect that retention. That's all in our plan.

I would say I saw lower disbursements was the biggest driver in the quarter, first quarter being less seasonably unfavorable than in the past. But I think cash flow -- it all depends on the last three days of the year, is what I'll tell you.

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**Pete Skibitski** - *Drexel Hamilton - Analyst*

Fair enough. Thanks so much, guys.

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

You bet.

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**Operator**

Jason Gursky, Citi.

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**Jon Raviv** - *Citigroup - Analyst*

It's actually Jon Raviv on for Jason. Barb, could you talk about just EPS cadence this year? You mentioned how Ingalls should be ramping up on the top line over the course of year. Can you touch upon any other elements we should be thinking about, how we get from this quarter's results to what I assume should be better results over the course of the year?

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

I think, like Mike has talked about, at Newport News, we'll expect the total year operating margin to be 9% at Newport News. Ingalls -- 9%, and Ingalls volume, we expect to pick up a bit. So I think that will get you to the EPS.

We do have pressure with UPI, that I talked about. We think we've right-sized it. But if there's continued delays of the projects and everything, we could see a little more bleed-out there. But I think we're on the right path.

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**Jon Raviv** - *Citigroup - Analyst*

Okay. Then on cash deployment, you touched upon all the options in your prepared remarks. Could you just go a little more into the kind of obstacles you're seeing, or the gates we have to go through in order to see more repo? Is the goal in repo to keep share down, or drop share count a little bit here?

And on a related note, is M&A -- has the focus changed at all over the last year? Any particular accretion targets, end-market targets, that you're looking at? Just given the fact that the Proteus acquisition has been exciting, whereas UPI has been a little less so.

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Fair enough. First of all, nothing happens in this business unless we're successfully executing in our core business. As we've talked about, we're going to be investing in our core business to make sure that our programs remain affordable. And that we remain effective and efficient at providing those platforms for our primary customer, the Navy.

We have been bringing our shareholders along with us over this last four years, and we will continue to do so. We expect to do this in a very balanced way. Because we do think that there are opportunities for us to provide some of this tremendous capability that is in this business to new customers. And finding the best way to create access to those new customers is very important to us. Because I think that, that's part of our task of achieving the full potential of the business.

But I think we can do all of that. I think we can invest in our core business, I think we can bring our shareholders along, and I think that we can continue to create new value for new customers in those things that we are particularly really good at. So that's our approach to it at this point.

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**Jon Raviv** - *Citigroup - Analyst*

Thanks, Mike.

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**Operator**

Myles Walton, Deutsche Bank.

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**Myles Walton** - *Deutsche Bank - Analyst*

You talked about balanced capital deployment, and the last question was on deals that you've done. I'm curious -- in terms of size of deals, do you have a scope limitation? Would you entertain multi-billion -- couple billion-dollar deals over the next 12 to 24 months? Is that something that is within the scope of possibility?

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

That's a great question, Myles. I guess at this point, I would say my aperture is -- I try to keep it as wide open as possible. Because I keep coming back to -- we've got to find the full potential of the business. If there was something out there like that, that would allow us to achieve full potential, we would have to give that some consideration.

On the other hand, our approach has been pretty much what you've seen. The acquisition of the Undersea Group was really about a technology and a capability that we thought married up well with a capability that we already have. Similar to what we did with Stoller, we aligned -- we created access to the Department of Energy that, when we had great capability in our business for that marketplace, we didn't have great access. Stoller brings great capability and great access, so we're able to leverage that.

And we saw the same thing with UPI. I probably was the only person on the planet that didn't know that the price of oil was going to drop after we did that acquisition. But having said that, the reason we did, was all of the same reasons that we did the other acquisitions.

I'm excited about what we're doing at UPI, and I'm excited about the access that we've created to that market space for capabilities that we have. So I won't tell you that we're out there trying to find that home run. We're out there trying to create sustainable value and access to customers for great capability that we have.

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**Myles Walton** - *Deutsche Bank - Analyst*

Okay. One clean-up question, Barb. What was the net cume catches in the quarter?

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

$55 million.

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**Myles Walton** - *Deutsche Bank - Analyst*

Okay, all right, thanks much.

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**Operator**

(Operator Instructions)

George Shapiro, Shapiro Research.

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**George Shapiro** - *Shapiro Research - Analyst*

Barb, I had a different take on cash flow, that effectively the difference is due to trade accounts and payables, which to me, is timing. And on the other hand, receivables actually went up by more than last year at $189 million. And that probably included the $30 million that you got from selling Gulfport. So can you just walk me through why the receivables would have gone up so much in the quarter?

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Receivables are up, and they're primarily up at Newport News, and it's really just timing of collections. The disbursements were down at Ingalls, and that was because of the material in the fourth quarter of 2014.

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**George Shapiro** - *Shapiro Research - Analyst*

Okay. And then one for you, Mike. If you look at this top down, everybody was fairly critical of making a diversification attempt when you're in the defense business. And so far, this UPI acquisition, the timing and what's happened, looks like it would validate that concern. So how do you look at it, at this point in time?

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Well, as I said, the way I look at this is that we have great capability in organization. And there are customers out there that need access to this capability. Our job, to achieve our potential, is to try to find great channels for those customers and that capability.

I think the jury is still out on UPI. I'm not one yet to say that, that hasn't worked out. My view of it is, this is a Company that has a great set of customers, that had some big wins in the fall. The market dynamic that is way beyond anybody's control has put most of those -- a lot of those projects on hold.

We have gone through a pretty healthy process of re-sizing that business, which is going to make an even stronger business when the market comes back. History shows that the market does go back and forth in this space.

It is a capability that we actually have -- a lot of our own capability. It's in the engineering services and engineering design capability that we have resident in our shipbuilding business. So there's a lot of infinity there between what we do in our core business and what happens in that space.

We're creating a channel there that I think -- to a marketplace that I think long-term is going to be a pretty robust marketplace. I'm pretty excited about where -- that's a capability that this Company did not have four years ago, and I'm pretty happy to have it at this point.

**George Shapiro** - *Shapiro Research - Analyst*

But I mean, if you had waited four or five months, you probably could have bought it for a lot less.

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Sure. Like I said, I was only guy that didn't know that, George, so that one's on me. (laughter)

**George Shapiro** - *Shapiro Research - Analyst*

Okay. Thanks very much, Mike.

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

You bet.

**Operator**

Pete Skibitski, Drexel Hamilton.

**Pete Skibitski** - *Drexel Hamilton - Analyst*

A couple of follow-ups, guys. First, a couple of housekeeping questions. Barb, can you tell us what your full-year expectation is for D&A, as well as for cash taxes?

**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Okay. For cash taxes, federal and state, around [$250 million]. But I'm going to caveat that, for it's all dependent on timing of ship deliveries, changes in pension, and things like that. And what was your other question?

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**Pete Skibitski** - *Drexel Hamilton - Analyst*

On D&A full-year expectation.

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Let's see. I don't think I provided that in the past. I mean, I would say, don't expect any significant big movement one way or another. How about that?

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**Pete Skibitski** - *Drexel Hamilton - Analyst*

Okay, fair enough. And then, Mike, wondered if you could share with us your thoughts on how the congressional committees so far have touched your programs, in terms of the FY16 budget, positive or negative? And then how far along are we in terms of your ability to get some assuredness on the timing for the GW repo and the 12 LPD-17? Just wondering what the next big milestones are before we can get some visibility of those programs?

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Sure. As I said, I'm a big fan of the regular order process that our government uses to establish priorities and put resources against that. Last year, as you know, the government put $1 billion up for LPD-28, which has really turned into something that's been helpful to the Navy and certainly to us, in terms of defining our future.

Along those lines, that then prompted the Navy to make a decision that the follow-on amphibious class, the LXR, would essentially be a version of the LPD. And we think that's a key decision, because that drives the program schedule in a positive way. That program needs to come in to keep the hot production line that we have at Ingalls working.

All of that has come together in a way that -- so far, the only committee that has come out in 2016 has been the House Armed Services Committee, and we're a long ways from law at this point. But the Defense Authorization Act from the House Armed Service Committee has been very, very strongly supportive of shipbuilding across the board and across the country, particularly to our programs. Trying to make sure that we take full advantage of last year's decisions around amphibs is part of the language that they put in place.

But also in regard to the RCOHs, let's not go through the -- is it in or is out -- for the rest of the RCOHs. Let's get all of those RCOHs authorized and moved ahead, and keep them on schedule. Because we're going to have a -- because of the discussion around CVN-73 -- part of the imbalance at Newport News over the next couple years is that when the 72 leaves, the 73 won't be coming in at that point. There's going to be a bit of a gap. So that's part of the imbalance at Newport News that's been created in this political environment.

And this discussion about how can you -- we're not having a discussion about how many carriers we need. We're actually having a discussion about how can we most efficiently buy them. Are there economic order quantities that we could make sense, where we'd buy more than one ship set of material at a time?

I'm old enough to remember that we bought two carriers at a time twice back in the 1980s, for construction that finished in the 1990s. Those were very efficient programs, and very efficient ways to build those platforms that the nation needs.

So what I see in this regular order process, and why am a big fan of it is, you actually have a chance to vet all those issues and get them out, and allow decision-makers to establish what their priorities are, and then put resources against it. There's been very strong support for shipbuilding, and there's been really good support for our programs. And for that -- I'm very, very happy about that.

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**Pete Skibitski** - *Drexel Hamilton - Analyst*

It sounds like you're a lot more comfortable on the LPD outlook. Is sequestration still a risk for you guys? Do you feel -- or this OCO-driven workaround, does that obviate that risk at least maybe for a couple of years or something? How do you think about that?

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Well, obviously, I think sequestration is a wet blanket for everybody. And I still -- as I've said before, it's absolutely no way to run the best country on the planet.

We've got to get rid of the mechanism, and we've got to think about what our priorities are, and what the resources are that go against that. I don't exactly know how we're going to find our way through that, but I do believe that we will find our way through it.

There will be a path of some sort that's going to go forward. And in that environment, whatever that path is, whether it's an OCO path or a Ryan Murray 2 kind of thing, or whatever it is, whatever that path is. What I see is that shipbuilding programs are being very well supported in that environment.

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**Pete Skibitski** - *Drexel Hamilton - Analyst*

Okay, thank you very much.

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**Operator**

George Shapiro, Shapiro Research.

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**George Shapiro** - *Shapiro Research - Analyst*

Barb or Mike, I wanted to asked -- General Dynamics had like 19% growth in their Marine business. And some of the stuff they do isn't comparable. But they did highlight that the primary reason for the growth was the Virginia class. So if you just go through what may be the accounting differences, in terms of your booking of revenues on the Virginia class, just so I can get a better understanding of why there'd be such a disparity?

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**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

We're seeing -- we said we had like 1% growth at Newport News, and it was primarily driven by VCS. Because we had lower sales on CVN-78 and on the RCOH.

So it's really, our mix is different. And they have ORP in block four -- the two subs per year, in block four driving it. We have a small amount of ORP and the two subs per year. We're seeing growth in VCS, but we're seeing lower volume on 78 as we get to delivery, and lower volume on 72.

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**George Shapiro** - *Shapiro Research - Analyst*

Okay, thanks very much.

**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

You're welcome.

**Operator**

Jason Gursky, Citi.

**Jon Raviv** - *Citigroup - Analyst*

It's Jon again. Just on Avondale, I was wondering how the end of the JV study has perhaps re-accelerated the Navy negotiation? And to what extent has the menu of options for Avondale contracted? Is it only full sale or foreclosure at this point? And then finally, is there any sort of timing that you're thinking about there?

**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Okay. So, look, we have an obligation to look at every opportunity we can. So once the Kinder Morgan -- we couldn't find a way to re-purpose that facility with them, it opened the doors for others.

But the plan right now is closure. We will look at sale as part of that. As far as timing goes, we resubmitted our proposal, based on the Kinder Morgan decision, to the government. And we will work with them to negotiate that going forward.

**Jon Raviv** - *Citigroup - Analyst*

Is there any events around negotiating that and getting Avondale closed that could precipitate some sort of cash deployment decision? Is that something the Board is focused on and wants to see, getting your view before --?

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

I would say that we're proceeding at a pace that we need to for -- as we ship from this phase we've had with Kinder Morgan -- we've had a lot of attention on that, and a lot of energy in that. We are now moving into another phase, and we will work our way through that at an appropriate pace. I'm not sure there's any sort of to triggering event there of any kind.

**Jon Raviv** - *Citigroup - Analyst*

Okay, thank you.

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

You bet.

**Operator**

Robert Spingarn, Credit Suisse.

**Robert Spingarn** - *Credit Suisse - Analyst*

I just wanted to come back to the carriers again, and to the mix. Mike, as you shift from 78 to 79, assuming you get the contract on 79 when you're hoping for it, how do we -- if we just look at the next few years, what's the point at which 79 is driving more revenue than 78?

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Well, certain by next spring when 78 is gone.

**Robert Spingarn** - *Credit Suisse - Analyst*

Well, yes, but we know these things have trailing revenues and so on. So a little hard for us to see from the outside just exactly how that mix -- when that shift change occurs.

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

We don't typically break it all out by programs, much less by ship type. But this is a program that we've already been working on for a couple years. So it's already been part of our base.

And as Barb pointed out, you go into this last year on the Ford, the volume on the Ford, as we go through the test program -- and for all the excitement that's in the test program, what actually happens is the volume comes down. Because as you complete certain pieces of the ship, you don't need as many people on it. They have to move somewhere, and they'll be moving to 79.

So you can think of a ship construction -- you can think of it as a bell curve that goes over -- now I'm talking just the construction piece of this. There's a bell curve that goes over the eight-year period, and we're in the last year of it.

So the Ford is going down that tail. The Kennedy -- we're a couple years into this. And I would have -- in the perfectly balanced world, this contract for the Kennedy would have been done a couple years ago.

**Robert Spingarn** - *Credit Suisse - Analyst*

So does the EBIT follow the same curve, given the fact that you retire risk for the end on the Ford, and then on the new one, you're going to book conservatively in the beginning?

**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

It does not follow that same curve, because risk retirement is usually in the second half of the program.

**Robert Spingarn** - *Credit Suisse - Analyst*

Right, that's what I'm getting at here. So there's a point -- there's a different EBIT curve. So what I'm trying to understand is, over the next couple years, the profitability of new-build carrier, how does that trend?

**Barb Niland** - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

I think you have to look at it as total Newport News, as we'll stick to the 9%. But I will tell you, in terms of the volume that you're talking about, in 2015, you have the volume of 78, plus you have the volume of 79 construction planning. And if you remember, that was like $3.3 billion of award for that contract.

So we've been doing a lot of work on that. When 78 leaves, you will only have 79. And I don't think this is going to happen in 2016, but unless they start CP on 80, you are going to have a little bit of volume mix. And VCS going full-fledged into two subs a year will pick up a little bit of that.

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**Robert Spingarn** - *Credit Suisse - Analyst*

Okay, so that's (multiple speakers)

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

I'll go back to what we've been saying for four years. Newport News is a healthy shipyard. A healthy shipyard should be able to operate in the 9% to 10% range. Notwithstanding all the different mixes and blends and moving parts that happen in there, we fully expect that our core shipbuilding business, for over any horizon, will be operating in that range.

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**Robert Spingarn** - *Credit Suisse - Analyst*

Okay, all right, thank you.

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**Operator**

Thank you. And I'm showing no further questions at this time. I'd like to turn the conference back over to Mr. Mike Petters for any closing remarks.

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**Mike Petters** - *Huntington Ingalls Industries Inc. - President & CEO*

Well, thanks for joining us today, and thanks for your interest in our Company. To summarize where we are today, I'm very pleased with where we are as a Company. As we've talked about, we're continuing to invest in our core business, as that is the engine that drives success of this Company in total.

We will continue to bring our shareholders along. We've been doing that, we will continue to do that, and we expect to do that in the future. And we will continue to look for ways to create long-term sustainable value, new value, for the customers that we have and the customers that can take advantage of our capabilities.

So I'm very excited about the Company that we are building here today. Our capabilities and our channels that we have today put us in a much stronger position than we were four years ago when we first spun out and became a public Company.

We really appreciate your interest in what we're doing, and we look forward to seeing you. Thank you all very much.

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**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Have a great day, everyone.