

SNA Media Availability Transcript
Chris Kastner, President and CEO of HII
8 Jan 2024

(Edited lightly for clarity)

[CEO Chris Kastner welcomes reporters individually and all take seats; Danny Hernandez opens event and invites CEO to give opening statement.]

Let's start with the budget. The important thing for us is our programs. We believe coming out of the NDAA [they] are supported. Probably the most important one, that's kind of on the fence, is LPD 33, which was protected through the NDAA, and we believe that that number should be protected in the budget. Details to follow. I know there's a lot of steps that need to get done before the budget gets complete. But keeping the amphibious line going is very important to Ingalls. So, the company is actually doing pretty great. We've had a very solid 2023.

[Financially]

We've grown at about 5% year-over-year through Q3. Raised guidance on our top line for sales and free cash flow on our Q3 earnings call. So, the way I identified it or represented it on the earnings call, was we're kind of at an inflection point from a growth standpoint. We've historically grown at around 3%, and we're seeing growth in excess of that, both in shipbuilding and in Mission Technologies. So we're at a bit of an inflection point. I'll be able to talk more about that at the year-end call and at our Investor Day in March.

[Programs & People]

- We have 41 ships in production, which is a very healthy amount of ships in production between Newport News and Ingalls.
- [And] we've had over \$5 billion of awards in Mission Technologies this year through Q3. So Mission Technologies has really validated our investment thesis around Alion and putting that division together.
- We've had some really positive success in Unmanned, in the small award. The small unmanned undersea vehicles (SUUV) award upsized to \$350 million. Very important award. That happened.
- Medium Unmanned Undersea Vehicle (MUUV) is in the water and in water testing. You may have seen the press on that. And also, Yellow Moray, our partnership with Woods Hole, the successful launch and recovery out of an attack submarine. So that was very positive.
- Significant progress in hiring. We've met our goals for the year through Q3. Now we need to work on training and retaining. So that's a lot of our focus right now.
- AUKUS, we've been putting our pieces on the table to prepare for AUKUS, putting our partnerships together, with the universities in Australia, Babcock, and Bechtel, putting those relationships together to go after and support the sustainment effort that will take place over in Australia. And then we expect revenue to flow in 2024 for AUKUS. We don't believe it will be financially material in '24, but there could be revenue flowing in '24.

And 2024 is all going to be about execution and growth. We've cleaned up the balance sheet. Paid off the majority of the debt related to Alion. Got our investment-grade credit metrics in place. So, it's all about execution and growth.

17 submarines will go under contract in the next 12 to 18 months under the VCS and Columbia class. And it's a full slate for the year. It's going to be very busy. It's going to be a pretty exciting year for HII. So that's kind of where we're at. That's my opening statement, and I'm open for questions.

[Q&A with Reporters]

Q: Hi, sir. Thank you for doing this. Just on AUKUS, we've heard from Navy that this push for the 2.3 submarines plus one overview? What does that look like for you, I know there's this separate industrial supplemental that sort of is hanging in the balance. What do you need to get there? And what does that look like for you in the next 5 to 10 years?

A: We don't break out growth or revenue growth by programs. And we're going to talk a lot about our long-term forecast for growth from a company perspective, including AUKUS, at our Investor Day. But \$400 million in the 2024 budget for SIB and then the over \$3 billion in the supplemental for SIB are directly related to ensuring that we can make the rate predominantly Virginia-class, but Columbia-class and AUKUS submarines in the future. In a variety of ways, it's employee development, it's supply chain resiliency, it's capacity enhancement, it's additional training and it's attacking all the elements of the manufacturing processes in the submarine industrial base.

Q: You said you're focused on retaining now, can you elaborate there? When you talked about retaining the workforce, are there any new initiatives on that front?

A: So a number of new initiatives, there's not one initiative that solves the problem. The most important thing we can do is understand the people that we're hiring and engage with them directly. An example, is a 'cohorts program' that we have down in Ingalls, where we used to just train people in the training schools and then put them out into the crews. Now we bring the foreman into the training school. We keep the team together and we put the whole team out as a crew, because we were finding that having them already with a cohort of teammates that they build a culture within the training center and they continue that out into the manufacturing environment, makes them more comfortable. So, that's one example.

We're increasing the amount of training at Newport News that individuals get before we can implement and put them into the workforce, to make them more proficient and more comfortable. The workforce that we used to have, that came in with some skills, does not really exist anymore. We're having to take people from a very inexperienced level up to an experience level so they can be comfortable and proficient when they get into the shipyard.

Q: Hi, sir, not too long after you became CEO of HII you announced this rebrand, you were kind of America's shipbuilder, and now you want to be seen more as an all-domain defense contractor from the windows of the pentagon. I'm wondering, by the numbers, how is that rebrand going? And when I say that, I mean, where are you in moving the needle in terms of your revenue? I assume most of it is still shipbuilding, but you have mission technologies. There's been some kind of more obscure IT contracts going to HI. From that perspective, how is the rebrand going?

A: Well, the rebrand is really catching up to the business. We are an all-domain provider of defense services and solutions. Mission Technologies is about the same size as Ingalls now. And that rebrand really reflected that. Moving the offices here because we had different customers we had to go see in

the Pentagon made perfect sense for us as well. Recruiting of highly skilled technical talent, it just made sense to have a technical brand so that we could attract that highly technical talent. Because within Mission Technologies, we do everything from AI, software development. We have a significant LVC franchise, which is really software development. So the brand is keeping up with where the business is and how the business is evolving.

Q: Secretary Del Toro has talked about his new maritime statecraft initiative, and when he's described it, there's a lot of facets to it, but he's talked a lot about shipbuilding industry partnerships with Japanese companies, South Korean companies, Indian companies, both on the ship construction and ship repair side. And I just wonder how you're looking at this momentum he's trying to create. Where does that maybe create some partnership opportunities for you or business opportunities? And have you taken any early steps with that yet?

A: No, we have not taken any early steps. I think you have to understand the context. If there is a desire to share best practices and become more efficient, I'm all for that. But investment or ownership of U.S. shipyards or programs, I think you have to be very careful, to protect our technology. So I think it really depends on the context. From time to time, over the last almost every 10 years or so, there will be a go see how the Koreans or Japanese or even the Chinese are doing it. So this could potentially be that. All for learning from the Koreans because they're great shipbuilders. But I think it depends on the context.

Q: Okay. I know there was a South Korean delegation who came to the United States, I believe Ingalls was one of several yards that they visited. I just wonder kind of what the expectation was for that visit, you know anything that you may have gotten out of it? I know it was recent.

A: Yes. I think you may want to ask the Navy about that. It was a Navy-sponsored event. I think it was very successful. We hosted them in the yard. I think it went well, but I think probably the Navy's a better source of that.

Q: But none of this is a preview of any bigger news that you should be referring to?

A: No.

Q: We just heard in the last discussion, heard a little bit more about carriers. I was wondering if we could hear from you, what it would mean for HII if the Navy pushes back that carrier buy. And then, in your talks with the Navy, what have you heard about the likelihood of that actually happening?

A: I think there's a broad understanding that the supply chain is a material risk to achieving the production schedules on future Navy programs. And our job as shipbuilders are to manage risk. And if we can eliminate one of those risks or significantly reduce one of those risks by getting advanced procurement in place well ahead of the shipping order, it only makes sense to do it.

We know the ships are going to be built. They have broad support. So let's eliminate risk. Let's get the major suppliers under contract early enough so they can plan and they can make their production schedules. So I think there's a broad understanding of that. I think the budget is driving discussions around potential delay. One thing we should never delay is the advanced procurement of the major equipment in the supply chain.

Q: Sir. So labor question for you. A few minutes ago, you mentioned more of your new hires are less experienced coming in. Can you talk to what you're doing to get people up to speed as quickly as possible?

A: Yes. So it's additional training, right. We call it meeting them where they are. Don't have an expectation they're going to come in understanding metal shop, and understanding how to read a ruler, and understanding the fundamentals of manufacturing.

Let's meet them where they are, understand where they're at, and we have to do some potentially rudimentary things to get them up to the level where they can intertrain to become a shipbuilder. So we're taking great steps to make sure that we understand the capabilities they have, when they show up, and then the additional training to get them qualified and then supporting them when they get within the workforce. So it's not just, "You're going to work now." It's keep track of them, get feedback from them, what's working, what's not working, and adjust. It's been 24 months of a number of initiatives, adjusting where it makes sense to adjust, in order to position ourselves where we need to be for that new workforce when it shows up.

Q: Are there any new, I don't know, thinking like digital tools or other new training techniques that you've seen success with so far?

A: Well, digital for sure. I was walking through our manufacturing facility in Newport News, and when a CEO walks through a manufacturing facility, it's pretty scripted. But fortunately, I just said, "Hey, I want to go talk to that guy." And he was in the middle of the panel line. And he had his pad up. And I was like, "Hey, how's it going?" This was a pretty experienced shipbuilder. He goes, "Well..." I go, "Well, let me see your pad and how are you using that?" And it was digital shipbuilding. It was digital work constructions. And I asked him, "How's it going? How does that work for you?" He goes, it's really intuitive. It's simple to use. I don't have to carry around a bunch of plans. I don't have to go back to the planning organization to understand all the different changes that went through the design. So digital shipbuilding and digital work constructions work, right? We need to make sure that they're employed beyond the aircraft carrier program, which they are being employed on the Columbia class. But that's just the tip of the iceberg. So data, and the use of data, it's a good lead-in to, it's going to be used everywhere, right?

It's going to be how your data is put together and managed, how you can take advantage of it using artificial intelligence and machine learning tools is something that we are starting to evaluate. We have pilots going on within both of our shipyards, and we think it's going to make us much more efficient.

Q: Thank you. Tech reporter here with a lot of follow-ups on what you just said. Real quick, what are the pilots that you just said?

A: I'll give you general pilots within quality assurance documentation and understanding faults within Q&A on types of defects found and organizing that data so that you can be predictive and do additional training such that you can avoid them in the future. That's one example.

Q: Do you anticipate then I have two lines of questions. First is one that with sort of you said data is used everywhere. It's just going to become more and more of an influx. Is the company going to be sort of investing in more assets to maintain the data and stuff that you will be collecting?

A: Yes. So that's interesting. We have a really strong partnership with AWS. So they will be a partner with us in understanding how to use the data, right? And so, we're doing all that evaluation now on what type of investments might be required in order to get that data in the right format so that it can be used. But yes, exactly.

Q: This digital way of working is the way you're going to be working in the future.

A: We have to. It just makes sense.

Q: You're not going back to paper, as you were saying. And then I know the Pentagon is getting set this week potentially to release its new industrial-based strategy. I was just wondering from your perch if there's any inclusions you're specifically going to be looking for or how you're thinking about that.

A: That's interesting. I can't wait to see it. You know, we get pulsed from time to time on questions about the industrial base. I think I'll be interested in how technology plays into it, right, and kind of a high-low mix relative to the industrial-based strategy. So yes, I'm interested like you are. We'll see.

Q: Unmanned systems or uncrewed systems. The Navy's going to need a lot more of them, of different sizes and capabilities. How do you see that playing out for you? And that kind of seems like it might be a natural for adding some more of this digital construction that you're talking about.

A: It is a natural for us, and it's already playing out for us. In the small award. The medium already into testing. Yellow Moray being a successful pilot that we had there on launch recovery from the submarine. The long-range underwater, the surface vehicle that will be competed on over the next couple of years, is something we're very interested in and we should participate in. So unmanned has gone through a period of where they haven't really ordered new systems, right? And now it's matured such that I think they're finally taking the step of moving into production on some significant systems, and the small is our representative of that. The long-range underwater surface vehicle, when that is competed for, that's important.

So I'm thinking about your digital question in that regard. When we're talking about data, integration of data, and an unmanned system being a node, right? Yes, you can use artificial intelligence and machine learning to be more efficient in building. But that's not the true value of an unmanned system. An unmanned system is a node, right, for an ISR environment, right? And as you have data, and you have integrated data, which we're very good at through our big data platform, you can connect those points to create a better operating picture.

So when we think about unmanned, we think about how do we integrate that with other systems to be more effective to create solutions for customers. So that's how we think about it.

Q: You mentioned LPD 33 looks possible likely the budget and the importance of LPDs for the company. In your discussions with Navy and DOD, do you have a better vision on what they want with LPD going forward, given how there's a possibility of changing the design to some degree? So what are you seeing on what that looks like in the longer range now as we're getting into 2024 now?

A: So I think there's broad agreement that there's 31 amphibs required, right? So that makes LPD 33 and beyond at a very similar design within the LPD class. What happens beyond that, I'm not sure. I'm not

sure the next design. I'm not sure the next amphib beyond LPD, what that design will be. I'm sure that we'll participate in it because we're really the only builders of amphibious ships for the Navy.

Q: Thanks for doing this. You said earlier that the budget is driving discussions about potential delay on future carriers. What kind of delay do you think could be in the offering in the coming years? I know there's been some discussions coming in. The future of the carriers.

A: I'm not going to speculate on potential delays in the aircraft carriers. I think the right thing to do is what was said earlier, which is two, three, and four, right, and get the suppliers under contract so they can plan and execute. So that's not a risk that I have to deal with when I manufacture them. It's the right way to build the ships. So I'm not going to say that. I'm hoping they can come through that, and there's not a delay.

Q: How are you situated right now as far as working on those future carriers and getting the long lead items and things like that?

A: They are not under order yet. So we could follow that process once they start to get the long lead money available. We can put those under contract and execute those fairly quickly. But I wouldn't speculate on potential delays of the aircraft carrier.

Q: And there's a two-carrier buy that obviously saved money, would you expect they did it again?

A: Absolutely.

Q: To increase those savings, or do you have an estimate of what those savings are?

A: I don't have a current estimate for them, but they'd at least be consistent or greater than what we had previously, just because of inflation.

Q: To hit retention rates real quick. What are the retention rates for Newport News and Ingalls right now? And is there a delta and what's the retention rate for Mission Systems?

A: We don't publish our retention rates, we do quote how we hire and how much we hire by quarter, and so we're comfortable where we are now. For competitive reasons, we don't like to talk exactly about how we're doing from a retention standpoint. So we don't do that. I will say that Mission Technologies is doing very well from a retention standpoint. So that's not very far, but as far as I will go.

Q: That's all right. The other question I had for you, there's building of aircraft carriers and then there's scrapping aircraft carriers. Are you guys going for the decommissioning or the scrapping of the Nimitz class?

A: We will compete for that, yes. The initial activity relative to the defueling has to come to us, right? So we do that on all of the Nimitz class, when they're scheduled to come in, we do that. Then the breakup of them subsequent, which will be the competition for the Enterprise, we will compete for that when it shows up.

Q: Does that involve a bunch of nuclear stuff as well?

A: Low-level nuclear curve management, yes. All the high-level stuff has already been dealt with.

Q: And then the Columbia class, you have not really talked to that too much. Where do you see your role or how the program is sort of settling out?

A: Well, it's progressing. We just delivered the stern of the first vehicle of the electric boat. So that's positive. It is a pressurized schedule. I always refer programmatic, talk a little programmatic to them. But we're delivering modules. Arrived over the weekend. We'll give you a specific day.

Q: I wanted to follow up with two quick ones, have you been briefed on the results of the amphib study, or are you still waiting for the budget to come out just like the rest of us?

A: I'm waiting.

Q: And then you mentioned being hopeful that 33, is protected in the NDAA, and hopeful it will be in the budget. But you know there's this big cloud over it, are there any activities that you would be taking on 34 if you knew it was coming, and that you can't be taking now? Or I just wonder how you look at you know what would come after 34?

A: We're always interested in working with the Navy on the best way to buy ships, and sell ships. So strategies around bundling amphibians are always being evaluated and cost studies being worked on with the Navy to reduce the cost of ships. So, are there studies around bundling 33, 34, and say LHA 11. Those sort of activities always happen because it just makes sense if we can bundle those orders. But there's no formal ask of that.

Q: But I mean, even it is in a bundle, would you be buying steel for the next ship, or would you be buying engines for the next ship right now, even if you had a better sense it was coming, or is too early for that?

A: No, it doesn't make sense. If there was schedule pressure and we needed to get that order in place to protect the schedule, we would do that. And if we were confident it was going to show up.

Q: Can I follow up on the amphibians...So as far as I know we're waiting for the latest budget, but you know for the record right now, they've halted the line, and it's the second budget cycle in a row, that they did that. Can you speak to how, as a company, you can continue building the line that the Navy keeps saying it is ending?

A: Well, so we've been doing that since LPD '26. So, amphibians have historically been on the dividing line from a priority standpoint for the Navy. When you think about Navy priorities, it is historically been before Columbia class. Aircraft carriers, submarines, destroyers, or surface combatants, then amphibians is like the dividing line, from a budget standpoint. And that's just where it's fallen over the last few ships that have been procured. So we've been in the position of supporting it every year. And now it's really broadly supported by the Navy, by the Marines, by the Congress, and by law, with 31 amphibians. So while we understand the process and the realities of supporting, every year, it's something we've been able to do, and we'll continue to do that.

Q: Let's go back to AUKUS real quick. Do you have any updates on the work you're already doing in Australia? I think back in December, you mentioned that you already started working with subcontractors in Australia. Do you have any update on how many and what you're doing there?

A: We don't. We had an initial sign up of a number of them. I think it was 100 that were signed up, which is positive. We could potentially go back there at the beginning of this year, to meet with some of those suppliers. There's been no formal relationship put in place with that.

Q: MOUs?

A: Well, it's essentially signed up as a potential supplier for Newport News, right? And then you start going through the vetting process.

Q: Just a quick sort of chance for you to comment on last year's block buy award of DDGs - and one of the issues analysts are talking about is capacity and shipyard capacity and industrial capacity. One of the problems is that it's been sort of a one-for-one reward situation for a long time with your chief competitor, which is General Dynamic, Bath, in terms of DDGs. And this broke the mold, out of 10 ships, you get seven. That would seem just like a comment about it. It seems to me that that's finally an actual tacit recognition by the Navy and the government that you have this capacity down there at Ingalls that doesn't exist anywhere. You have a yard, it's a high-capacity yard. You've got a lot of capacity. And now this is recognizing that sort of breaking away from the political attributes of the usual distribution of those contracts. You must feel good about that?

A: You gave my answer already. We go through cycles in shipbuilding. Ingalls is in a very high-performing execution, where they made sound investments in their shipyard and their leadership, so that they're producing very high-quality, predictable products. I think it's been recognized.

That being said, I know the shipbuilders up in Maine, and they're great shipbuilders. And they'll come back. And I think they're going to build a great ships. But Ingalls has proven themselves over the last 10 years that they can be relied upon. And we made significant investment in the East Bank, which I know you know where the shipyard started in the piers and the facilities over there is that we can handle more work at Ingalls. And I know you've seen the press on DDG 1000.

So Ingalls is poised for additional work, and they're paying attention to the potential additional work.

Q: Submarines?

A: You have to evaluate everything. Module build potentially, piece part, potentially. It's another thing to actually put a submarine in a non-nuclear yard. That's a little bit too far to go.

Q: Ingalls used to be historically, submarines.

A: It's a long time ago. They definitely did. That was before my time, but probably 30 years. It was a long time ago.

Q: I just wanted to make sure I understood what you said about scrapping carriers. You said the initial work for the defueling automatically goes to you because of what you do.

A: Yes.

Q: And then you said you will be competing for the subsequent work where it's just low levels of radioactive activity. You're going to be competing for Enterprise and then any of the contracts for the Nimitz class?

A: Yes.

Q: And the Navy mentioned in their EIS, they were evaluating different sites where that could take place. Do you guys have a plan on where that would take place, if you have that contract?

A: Yes. So I can't disclose that, because we have teammates that we have in bidding for that work. There's only a couple of places that can happen, but that'll be part of our bid.

Q: Submarines. Do you guys do anything with Blue Forge Alliance that you can talk to?

A: Well, it's interesting. They got a great NASCAR. They brought it to our facility, actually. It was pretty awesome. Thanks a lot. No, that's a Navy relationship. If they can bring attention to shipbuilding, I'm all for it. If I get one employee out of it, I'm all for it.

Q: So it's promotional and awareness?

A: Awareness. It's just promotional and awareness to get people interested in shipbuilding. And so that's fine. It's a Navy initiative, and we support them on that.

Q: It's not in distributing tooling or getting facilities up to speed or anything like that?

A: No.

Q: Closing comments Sir?

A: Thanks for coming. I appreciate you being here and have fun at SNA.

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