KBR, INC.
Form 10-Q
October 24, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2012
OR
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File Number 1-33146

KBR, Inc.

(a Delaware Corporation)
20-4536774
601 Jefferson Street
Suite 3400
Houston, Texas 77002
(Address of Principal Executive Offices)
Telephone Number – Area Code (713) 753-3011

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of October 11, 2012, there were 147,553,868 shares of KBR, Inc. common stock, $0.001 par value per share, outstanding.

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Forward-Looking and Cautionary Statements

This report contains certain statements that are, or may be deemed to be, “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Private Securities Litigation Reform Act of 1995 provides safe harbor provisions for forward looking information. Some of the statements contained in this quarterly report are forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. The words “believe,” “may,” “estimate,” “continue,” “anticipate,” “intend,” “plan,” “expect” and similar expressions are intended t forward-looking statements. Forward-looking statements include information concerning our possible or assumed future financial performance and results of operations.

We have based these statements on our assumptions and analyses in light of our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly affect expected results, and actual future results could differ materially from those described in such statements. While it is not possible to identify all factors, factors that could cause actual future results to differ materially include the risks and uncertainties disclosed in our 2011 Annual Report on Form 10-K contained in Part I under “Risk Factors”.

Many of these factors are beyond our ability to control or predict. Any of these factors, or a combination of these factors, could materially and adversely affect our future financial condition or results of operations and the ultimate accuracy of the forward-looking statements. These forward-looking statements are not guarantees of our future performance, and our actual results and future developments may differ materially and adversely from those projected in the forward-looking statements. We caution against putting undue reliance on forward-looking statements or projecting any future results based on such statements or on present or prior earnings levels. In addition, each forward-looking statement speaks only as of the date of the particular statement, and we undertake no obligation to publicly update or revise any forward-looking statement.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

KBR, Inc.
Condensed Consolidated Statements of Income
(In millions, except for per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenue:				
Services	$1,949	$2,364	$5,942	$7,057
Equity in earnings of unconsolidated affiliates, net	43	23	113	108
Total revenue	1,992	2,387	6,055	7,165
Operating costs and expenses:				
Cost of services	1,767	2,188	5,484	6,553
General and administrative	56	61	163	163
Impairment of long-lived asset	2	—	2	—
Impairment of goodwill	178	—	178	—
Gain on disposition of assets, net	—	—	(2)	(2)
Total operating costs and expenses	2,003	2,249	5,825	6,714
Operating income (loss)	(11)	138	230	451
Interest expense, net	(2)	(3)	(6)	(13)
Foreign currency gains (losses), net	(2)	1	—	4
Other non-operating income (expense)	—	1	(1)	—
Income (loss) before income taxes and noncontrolling interests	(15)	137	223	442
Less: (Provision) benefit for income taxes	(45)	54	(73)	(7)
Net income (loss)	(60)	191	150	435
Less: Net income attributable to noncontrolling interests	(21)	(6)	(36)	(45)
Net income (loss) attributable to KBR	$(81)	$185	$114	$390
Net income (loss) attributable to KBR per share:				
Basic	$(0.55)	$1.23	$0.77	$2.57
Diluted	$(0.55)	$1.22	$0.76	$2.55
Basic weighted average common shares outstanding	147	150	148	151
Diluted weighted average common shares outstanding	147	151	149	152
Cash dividends declared per share	$0.05	$0.05	$0.15	$0.15

See accompanying notes to condensed consolidated financial statements.

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KBR, Inc.
Condensed Consolidated Statements of Comprehensive Income
(In millions)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income (loss)	$(60)	$191	$150	$435
Other comprehensive income (loss), net of tax:				
Net cumulative translation adjustments (“CTA”):				
Cumulative translation adjustments	4	(16)	(11)	(19)
Reclassification adjustment for CTA included in net income	—	—	(2)	(1)
Net cumulative translation adjustment, net of tax	4	(16)	(13)	(20)
Pension liability adjustments, net of tax provision of $1, $1, $5 and $4	5	4	16	12
Unrealized gain (loss) on derivatives:				
Unrealized holding gain (loss) on derivatives	—	(1)	2	(4)
Reclassification adjustments for losses included in net income	—	1	2	2
Net unrealized gain (loss) on derivatives, net of tax benefit of $0, $(1), $1 and $1	—	—	4	(2)
Other comprehensive (loss) income, net of tax	9	(12)	7	(10)
Comprehensive income (loss)	(51)	179	157	425
Less: Comprehensive income attributable to noncontrolling interests	(20)	(7)	(36)	(46)
Comprehensive income (loss) attributable to KBR	$(71)	$172	$121	$379

See accompanying notes to condensed consolidated financial statements.

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KBR, Inc.
Condensed Consolidated Balance Sheets
(In millions, except share data)

	September 30, 2012 (Unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and equivalents	$ 846	$ 966
Receivables:		
Accounts receivable, net of allowance for bad debts of $14 and $24	1,287	1,227
Unbilled receivables on uncompleted contracts	763	435
Total receivables	2,050	1,662
Deferred income taxes	256	297
Other current assets	460	517
Total current assets	3,612	3,442
Property, plant, and equipment, net of accumulated depreciation of $352 and $364 (including $73 and $75, net, owned by a variable interest entity – see Note 14)	380	384
Goodwill	779	951
Intangible assets, net	102	113
Equity in and advances to related companies	250	190
Noncurrent deferred income taxes	146	128
Noncurrent unbilled receivables on uncompleted contracts	312	313
Other noncurrent assets	137	152
Total assets	$ 5,718	$ 5,673

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KBR, Inc.
Condensed Consolidated Balance Sheets, continued
(In millions, except share data)

	September 30, 2012 (Unaudited)	December 31, 2011
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 878	$ 761
Due to former parent, net	57	53
Advance billings on uncompleted contracts	492	626
Reserve for estimated losses on uncompleted contracts	19	22
Employee compensation and benefits	202	226
Current non-recourse project-finance debt of a variable interest entity (Note 14)	11	10
Other current liabilities	625	586
Total current liabilities	2,284	2,284
Noncurrent employee compensation and benefits	446	470
Noncurrent non-recourse project-finance debt of a variable interest entity (Note 14)	87	88
Other noncurrent liabilities	160	177
Noncurrent income tax payable	80	141
Noncurrent deferred tax liability	89	71
Total liabilities	3,146	3,231
KBR Shareholders' equity:		
Preferred stock, $0.001 par value, 50,000,000 shares authorized, 0 shares issued and outstanding	—	—
Common stock, $0.001 par value, 300,000,000 shares authorized, 173,067,645 and 172,367,045 shares issued, and 147,549,882 and 148,143,420 shares outstanding	—	—
Paid-in capital in excess of par	2,043	2,005
Accumulated other comprehensive loss	(541)	(548)
Retained earnings	1,699	1,607
Treasury stock, 25,517,763 shares and 24,223,625 shares, at cost	(603)	(569)
Total KBR shareholders' equity	2,598	2,495
Noncontrolling interests	(26)	(53)
Total shareholders' equity	2,572	2,442
Total liabilities and shareholders' equity	$ 5,718	$ 5,673

See accompanying notes to condensed consolidated financial statements.

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KBR, Inc.
Condensed Consolidated Statements of Cash Flows (In millions, Unaudited)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income	$150	$435
Adjustments to reconcile net income to net cash provided by (used in) operations:		
Depreciation and amortization	48	54
Equity in earnings of unconsolidated affiliates	(113)	(108)
Deferred income tax expense (benefit)	61	(136)
Impairment of long-lived asset	2	—
Impairment of goodwill	178	—
Other adjustments	22	8
Changes in operating assets and liabilities:		
Receivables	(83)	124
Unbilled receivables on uncompleted contracts	(303)	(165)
Accounts payable	117	(27)
Advanced billings on uncompleted contracts	(144)	11
Accrued employee compensation and benefits	(49)	(10)
Reserve for loss on uncompleted contracts	(3)	(7)
Collection (repayment) of advances from (to) unconsolidated affiliates, net	(2)	15
Distribution of earnings from unconsolidated affiliates	60	107
Other, net	48	11
Total cash flows provided by (used in) operating activities	(11)	312
Cash flows from investing activities:		
Capital expenditures	(53)	(66)
Acquisition of business, net	(1)	—
(Investment in) / return of capital from equity method joint ventures	4	(11)
Total cash flows used in investing activities	(50)	(77)
Cash flows from financing activities:		
Acquisition of noncontrolling interest	—	(164)
Payments to reacquire common stock	(36)	(96)
Distributions to noncontrolling interests, net	(9)	(57)
Payments of dividends to shareholders	(22)	(23)
Net proceeds from issuance of stock	5	7
Payments on long-term borrowings	(10)	(10)
Excess tax benefits from stock-based compensation	3	3
Return of cash collateral on letters of credit, net	—	16
Other financing activities	1	—
Total cash flows used in financing activities	(68)	(324)
Effect of exchange rate changes on cash	9	(7)
Decrease in cash and equivalents	(120)	(96)
Cash and equivalents at beginning of period	966	786
Cash and equivalents at end of period	$846	$690
Noncash financing activities		
Dividends declared	$8	$8

See accompanying notes to condensed consolidated financial statements.

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Note 1. Description of Business and Basis of Presentation

KBR, Inc., a Delaware corporation, was formed on March 21, 2006. KBR, Inc. and its subsidiaries (collectively, “KBR”) is a global engineering, construction and services company supporting the energy, hydrocarbons, government services, minerals, civil infrastructure, power, industrial and commercial markets. Headquartered in Houston, Texas, we offer a wide range of services through our Hydrocarbons, Infrastructure, Government and Power (“IGP”), Services and Other business segments. See Note 5 for additional financial information about our business segments.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules of the United States Securities and Exchange Commission (“SEC”) for interim financial statements and do not include all annual disclosures required by accounting principles generally accepted in the United States (“U.S. GAAP”). These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC. We believe that the presentation and disclosures herein are adequate to make the information not misleading, and the condensed consolidated financial statements reflect all normal adjustments that management considers necessary for a fair presentation of our condensed consolidated results of operations, financial position and cash flows. Operating results for interim periods are not necessarily indicative of results to be expected for the full fiscal year 2012 or any other future periods.

The preparation of our condensed consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenue and costs during the reporting periods. Actual results could differ materially from those estimates. On an ongoing basis, we review our estimates based on information currently available, and changes in facts and circumstances may cause us to revise these estimates.

Our condensed consolidated financial statements include the accounts of majority-owned, controlled subsidiaries and variable interest entities where we are the primary beneficiary. The equity method is used to account for investments in affiliates in which we have the ability to exert significant influence over the operating and financial policies of the entity. The cost method is used when we do not have the ability to exert significant influence. Intercompany accounts and transactions are eliminated.

Note 2. Income per Share

Basic income per share is based upon the weighted average number of common shares outstanding during the period. Dilutive income per share includes additional common shares that would have been outstanding if potential common shares with a dilutive effect had been issued, using the treasury stock method. A reconciliation of the number of shares used for the basic and diluted income per share calculations is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Millions of shares	2012	2011	2012	2011
Basic weighted average common shares outstanding	147	150	148	151
Stock options and restricted shares	—	1	1	1
Diluted weighted average common shares outstanding	147	151	149	152

For purposes of applying the two-class method in computing earnings per share, there were no earnings allocated to participating securities for the three months ended September 30, 2012 and $0.8 million for the three months ended

September 30, 2011. Net earnings allocable to participating securities was $0.4 million and $1.8 million for the nine months ended September 30, 2012 and 2011, respectively. The diluted earnings per share calculation did not include 2.4 million and 1.3 million anti-dilutive weighted average shares for the three and nine months ended September 30, 2012, respectively. The diluted earnings per share calculation did not include 0.7 million and 0.5 million anti-dilutive weighted average shares for the three and nine months ended September 30, 2011, respectively.

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Note 3. Business Combinations and Other Transactions
Other Transactions

M.W. Kellogg Limited (“MWKL”). On December 31, 2010, we obtained control of the remaining 44.94% interest in our MWKL subsidiary located in the U.K. for £107 million subject to certain post-closing adjustments. The acquisition was recorded as an equity transaction that reduced noncontrolling interests, accumulated other comprehensive income (“AOCI”) and additional paid-in capital by $180 million. We recognized direct transaction costs associated with the acquisition of $1 million as a charge to additional paid in capital. The initial purchase price of $164 million was paid on January 5, 2011. During the third quarter of 2011, we settled various post-closing adjustments that resulted in a decrease to “Paid-in capital in excess of par” of $5 million. We also agreed to pay the former noncontrolling interest 44.94% of future proceeds collected on certain receivables owed to MWKL. Additionally, the former noncontrolling interest agreed to indemnify us for 44.94% of certain MWKL liabilities to be settled and paid in the future. As of September 30, 2012, we have liabilities of $8 million classified on our condensed consolidated balance sheet as “Other noncurrent liabilities” and $1 million classified on our balance sheet as “Other current liabilities” reflecting our estimate of 44.94% of future proceeds from certain receivables owed to MWKL.

LNG Joint Venture. On January 5, 2011, we sold our 50% interest in a joint venture to our joint venture partner for $22 million. The joint venture was formed to execute an EPC contract for construction of an LNG plant in Indonesia. We recognized a gain on the sale of our interest of $8 million which is included in “Equity in earnings of unconsolidated affiliates, net” in our condensed consolidated income statement for the nine months ended September 30, 2011.

Note 4. Percentage-of-Completion Contracts

Claims and unapproved change orders

The amounts of claims and unapproved change orders included in determining the profit or loss on contracts and recorded in current and noncurrent unbilled receivables on uncompleted contracts are as follows:

Millions of dollars	September 30, 2012	December 31, 2011
Probable claims	$ 144	$ 31
Probable unapproved change orders	$ 26	$ 6

As of September 30, 2012, the probable claims and unapproved change orders related to several projects. Included in the table above are probable claims associated with the reimbursable portion of an EPC contract to construct an LNG facility for which we have recognized additional contract revenue totaling $106 million. The contract claims on this project represent incremental subcontractor costs incurred and we believe we have legal entitlement to recover these costs from the customer under the terms of the EPC contract. Contracts with probable claims that will likely not be settled within one year totaled $18 million at September 30, 2012 and $19 million at December 31, 2011, and are reflected as a noncurrent asset in “Noncurrent unbilled receivables on uncompleted contracts” in our condensed consolidated balance sheets. Other probable claims and unapproved change orders that we believe will be settled within one year, have been recorded as a current asset in “Unbilled receivables on uncompleted contracts” in our condensed consolidated balance sheets. See Note 8 for a discussion of U.S. government contract claims, which are not included in the table above.

For our unconsolidated subsidiaries, our share of claims and unapproved change orders was $4 million and $41 million, respectively, for the nine months ended September 30, 2012.

Liquidated damages

Many of our engineering and construction contracts have milestone due dates that must be met or we may be subject to penalties for liquidated damages if claims are asserted and we were responsible for the delays. These generally relate to specified activities that must be met within a project by a set contractual date or achievement of a specified level of output or throughput of a plant we construct. Each contract defines the conditions under which a customer may make a claim for liquidated damages. However, in some instances, liquidated damages are not asserted by the customer, but the potential to do so is used in negotiating claims and closing out the contract. Based upon our evaluation of our performance and other legal analysis, we have not accrued for possible liquidated damages related to several projects totaling $3 million at September 30, 2012 and $11 million at

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December 31, 2011, that we could incur based upon completing the projects as currently forecasted.

Note 5. Business Segment Information

We provide a wide range of services, but the management of our business is heavily focused on major projects within each of our reportable segments. At any given time, a relatively few number of projects and joint ventures represent a substantial part of our operations. Our equity in earnings and losses of unconsolidated affiliates that are accounted for using the equity method of accounting is included in revenue of the applicable segment.

Reportable segment performance is evaluated by our chief operating decision maker using operating segment income which is defined as operating segment revenue less the cost of services and segment overhead directly attributable to the operating segment. Intersegment revenues are eliminated from operating segment revenues. Reportable segment income excludes certain cost of services and general and administrative expenses directly attributable to the operating segment that is managed and reported at the corporate level, and corporate general and administrative expenses. Labor cost absorption in the following table represents income or expense generated by our central service labor and resource groups for amounts charged to the operating segments.

The table below presents information on our reportable business segments.

	Three Months Ended September 30,		Nine Months Ended September 30,	
Millions of dollars	2012	2011	2012	2011
Revenue:				
Hydrocarbons	$1,119	$1,122	$3,357	$3,269
Infrastructure, Government and Power	433	876	1,442	2,621
Services	419	370	1,192	1,212
Other	21	19	64	63
Total revenue	$1,992	$2,387	$6,055	$7,165
Operating segment income (loss):				
Hydrocarbons	191	89	427	309
Infrastructure, Government and Power (a)	(149)	78	(82)	211