Q3 2023 Earnings Call

Company Participants

- Joe DeNardi, Vice President of Investor Relations and Strategic Ventures
- Nazzic Keene, Chief Executive Officer
- Prabu Natarajan, Executive Vice President and Chief Financial Officer

Other Participants

- Bert Subin
- Cai von Rumohr
- David Strauss
- Gavin Parsons
- Matt Akers
- Seth Seifman
- Sheila Kahyaoglu
- Tobey Sommer

Presentation

Operator

Good morning. My name is Rob, and I will be your conference operator today. At this time, I would like to welcome everyone to the SAIC Third Quarter Fiscal Year 2023 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Thank you.

Joe DeNardi {BIO 22467920 <GO>}

Good morning, and thank you for joining SAIC's third quarter fiscal year 2023 earnings call. My name is Joe DeNardi, Vice President of Investor Relations and Strategic Ventures. And joining me today to discuss our business and financial results are Nazzic Keene, our Chief Executive Officer; and Prabu Natarajan, our Chief Financial Officer.

Today, we will discuss our results for the third quarter of fiscal year 2023 that ended October 28, 2022. Earlier this morning, we issued our earnings release which can be found at investors.saic.com, where you will also find supplemental financial presentation slides to be utilized in conjunction with today's call and a copy of management's prepared remarks. These documents, in addition to our Form 10-Q to be filed later today, should be utilized in evaluating our results and outlook along with information provided on today's call.

Please note that we may make forward-looking statements on today's call that are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from statements made on this call. I refer you to our SEC filings for discussion of these risks including the Risk Factor section of our Annual Report on Form 10-K and Quarterly Reports on Form 10-Q.

In addition, the statements represent our views as of today, and subsequent events may cause our views to change. We may elect to update the forward-looking statements at some point in the future, but we specifically disclaim any obligation to do so.

In addition, we will discuss non-GAAP financial measures and other metrics which we believe provide useful information for investors. And both our press release and supplemental financial presentation slides include reconciliations to the most comparable GAAP measures. The non-GAAP measures should be considered in addition to and not a substitute for financial measures in accordance with GAAP.

It is now my pleasure to introduce our CEO, Nazzic Keene.

Nazzic Keene {BIO 18292745 <GO>}

Thank you. Joe, and welcome to those joining us today.

This morning, we reported solid third quarter results, which reflect revenue ahead of plan and strong business development activity, both of which contributed to the improved outlook for fiscal year 2023, and further builds momentum as we enter fiscal year 2024.

Before we review the quarter, however, I would like to continue a practice we began last quarter. I want to recognize a member of the SAIC team, whose accomplishments reflect the values of our organization and contribute directly towards executing our strategy to drive long-term value for shareholders.

In October, SAIC was recognized by Frost & Sullivan, as a JADC2 Company to Watch and is one of only three companies named as being a provider of both Services and Products in support of the JADC2 effort, and the only company in IT services. Katie Sheldon Hammler, our leader in Industry Analyst Relations, continues to ensure that our unique offerings are well understood by the market. She played an important role in our recognition by Frost & Sullivan, a resource relied upon by many of our customers. The recognition highlights the unique role SAIC can play as a trusted integrator and builds upon other successes in recent years in executing on our JADC2 campaign, which is summarized on Slide 6 of the presentation.

Two recent accomplishments serve as solid platforms for further JADC2-related growth. The first being one of two IT solutions providers named to the five-member ABMS Digital Infrastructure Consortium and the second, a key $100 million JADC2-related award won in September. With this momentum, we are very proud of our leadership position in the JADC2 mission area as this is critical to our national security and an integral part of our growth and GTA strategy.

Now, onto review of our third quarter financial results. We reported revenues of $1.9 billion, approximately 1% growth as compared to the prior year. We were able to overcome pressures from contract losses with new business wins and a continued focus on driving on-contract-growth. Our revenue performance year-to-date contributes to our ability to increase guidance for this year, as outlined on Slide 12 of the earnings presentation.

I'm pleased with our program execution year-to-date, which contributed to the solid margin performance in the quarter. We remain on track to meet our full year margin guidance of 8.9% and expect to see modest margin improvement in fiscal year' 24 with further progress in fiscal year '25 and beyond. Our focus remains centered on driving long-term value for our shareholders, which we believe can be best accomplished by positioning the business to deliver sustained organic growth, improving margins, and deploying capital based on the highest ROIC.

Given the importance we place on capital allocation as a strategic priority, I'd like to spend a few minutes reviewing our approach to capital deployment. Our first priority for cash flow is to invest internally to support future growth. Over the past 24 months, we've continued to refine our process to ensure that our internal investment dollars are allocated to markets and strategies that will produce the best long-term return for our shareholders. We see evidence of this priority in our pipeline as represented on Slide 11, which continues to expand with disproportionate growth in our GTA area of focus.

With the excess free cash flow generated, we will then deploy capital in ways that maximize long-term ROIC amongst various options including our share repurchase program, dividend, debt reduction, and M&A. Over the last few years, our capital deployment has skewed more towards M&A with roughly two-thirds of capital going towards acquisitions with the remainder returned through dividends and share repurchases.

Based on the current market conditions and competitive landscape, we expect capital deployment to be focused more towards returning capital to shareholders, while opportunistically leveraging M&A to add capabilities, solutions or technologies where and when we can accelerate our growth strategy. Our April 2021 acquisition of Koverse is a good example of this as the capabilities acquired have produced true differentiation in our solution and served as a key contributor in winning over $300 million in total contract value since we closed the transaction. Our current pipeline includes over $6.5 billion of contract value where we expect Koverse to serve as a key differentiator in our AI solution.

As I said in our earnings release, aligning capital allocation with long-term shareholder value creation is our focus. Our results year-to-date and outlook for the next year reflect our commitment to this strategy.

As I close out my remarks and reflecting upon the season, I would like to take a moment to extend my sincere appreciation to our SAIC family. Your contributions as demonstrated every day with your dedication to our nation and customers' missions, your engagement in the communities in which you live and work and your support to each other is never taken for granted. I thank you all for what you do for SAIC. And to all of you that continue to take an interest in SAIC and participating in our call today, I wish you a very happy and healthy holiday season.

I'll now turn the call over to Prabu to discuss our financial results and increased guidance.

Prabu Natarajan {BIO 17701667 <GO>}

Thank you, Nazzic, and good morning, everyone.

I am once again proud of the financial results we delivered for our shareholders in the third quarter. Our team's focus on on-contract growth and new business wins resulted in 1% organic revenue growth. Our results to date contribute to our increased revenue guidance for FY'23 and to our confidence in being able to deliver organic growth, improve margins, and drive 10% free cash flow growth in FY'24 despite an over $100 million revenue headwind from fewer working days next year. I'll discuss our outlook in more detail shortly.

For the third quarter, we reported sales of $1.91 billion, representing organic growth of 1% with results ahead of our plan largely due to stronger on contract revenue performance which enabled us to overcome a roughly 3-point headwind from recompete losses. Third quarter adjusted EBITDA of $170 million resulted in an adjusted EBITDA margin of 8.9%. Adjusted diluted earnings per share in the quarter of $1.90 represents growth of 3% year-over-year.

We reported free cash flow in the quarter of $122 million and returned approximately $81 million of this to shareholders via share repurchases and dividends. We delivered third quarter awards of $2 billion, 72% of which represented new business, resulting in a book-to-bill of 1.1x in the quarter and on a trailing 12-month basis. On a year-to-date basis, roughly one-third of our total bookings are in our GTA area of focus. Note that, third quarter awards do not include the roughly $900 million DCSA One IT program, which we were previously awarded as this remains with the customer following a competitor's protest.

We are particularly encouraged by our business development success in the quarter and highlight the diversity of awards that contributed to the $2 billion total with the largest award representing roughly $240 million in our classified space business. We believe this reflects our ability to drive strong awards and growth without a reliance on large orders. Our pipeline of submitted proposals remains healthy at over $20 billion on a trailing 12-month basis. Based on expected submissions over the next few quarters, we expect this to increase in FY'24, a good indication of growth we're seeing in our addressable end-markets.

On Slide 13, we provide an initial outlook for fiscal year 2024. We expect to deliver revenue growth of approximately 1.5% at the midpoint despite pressure in the first quarter from contract transitions and an at least $100 million headwind in our fiscal fourth quarter from five fewer working days compared to this year. This should translate into the second and third quarters providing the strongest growth rates for the year.

Adjusting for the working days headwind, we are encouraged by the 3% to 3.5% growth expected from the business and is a trend we believe can be sustained beyond FY '24. We remain confident in our ability to return recompete win rates to historical norms and are encouraged by the financial performance this should contribute when paired with our recent success in new business capture.

We expect to see modest margin improvement to approximately 9% in FY '24 as benefits from mix and other initiatives are partially offset by reinvestment into the business. We continue to see opportunities to further narrow the margin differential between SAIC and peers and expect to show additional progress again in FY'25 and beyond. We are expecting FY '24 free cash flow of approximately $560 million driven by earnings growth, a continued focus on working capital efficiency and a $50 million year-over-year benefit from having made our final payroll tax deferral payment in FY '23.

These tailwinds are expected to be modestly offset by higher cash taxes based on our current planning. As Nazzic indicated, we are focused on ensuring that the free cash flow we generate is deployed effectively. We currently expect to allocate the majority of our deployable cash to our share repurchase program in FY'24, but can adjust this based on changes in the interest rate environ and broader market conditions.

Our view that the repurchase program represents the best ROI for our excess free cash flow is informed by three factors. One, the confidence we have in our ability to deliver earnings and free cash flow in excess of market expectations over the next several years. Two, our belief that stronger financial performance versus our peer group will drive improved relative valuation. And three, recent transactions which indicate still-robust demand from the private markets for businesses with our end-market exposure and cash flow durability.

As you can see on Slide 13 of our earnings presentation, the strength of our expected free cash flow in FY'24 should allow us to return significant capital to shareholders. While we maintain the flexibility to adapt this based on interest rate trends and market conditions, our current expectation is to sustain our dividend, use a minimum of $125 million to pay down debt with the remainder going towards our share repurchase program. This scenario will result in net leverage declining to just under 3x by the end of FY'24 and allow us to have returned approximately $1 billion of capital through dividends and share repurchases to shareholders between FY '22 and FY '24.

Beyond FY'24, we have good visibility into continuing to increase free cash flow despite manageable cash tax headwinds expected in FY '25 and FY '26. On Slide 14, we provide an illustrative view of our free cash flow potential over the next few years, which assumes roughly 2.5% revenue growth and 10 basis points of annual margin expansion. To be clear, this is not intended to be guidance, but rather show our ability to offset the roughly $30 million in total cash tax pressure between FY'24 and FY'26 with fairly modest core earnings growth. As shown on Slide 15, our cash tax assets beyond FY'26 remain fairly stable through the mid-2030s.

Before turning the call over to the operator to begin Q&A, I want to echo Nazzic's sentiment and extend my thanks to my colleagues at SAIC for their dedication to our customers and our shareholders. I wish all of you, happy holidays.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) Your first question comes from the line of Gavin Parsons from Goldman Sachs. Your line is open.

Q - Gavin Parsons {BIO 18748617 <GO>}

Hey. Good morning, guys.

A - Nazzic Keene {BIO 18292745 <GO>}

Good morning.

A - Joe DeNardi {BIO 22467920 <GO>}

Good morning, Gavin.

Q - Gavin Parsons {BIO 18748617 <GO>}

Appreciate all the detail in the slides, that's really helpful. I just wanted to ask, the 3% to 3.5% growth rate that you think you can do over the next few years. What does that assume in terms of a budget? What does that assume in terms of book-to-bill? And just what kind of visibility do you have there?

A - Prabu Natarajan {BIO 17701667 <GO>}

Hi, Gavin. Prabu here. Thank you for the question. In terms of, sort of, our view of the growth rates here, the way we think about this is, we delivered about 2.5% organic growth last year, about 5% total growth. We're on pace to deliver somewhere between, let's call it, 2% to 2.5%, organically again this year, and that includes about 3% in headwinds from recompete losses. So, as we sort of project out into next year and beyond, we believe that that is a sustainable rate of growth for a business like this.

In terms of the budget environment sort of more narrowly the question, I would say, we're not assuming some dramatic improvement in the underlying budget condition. We do expect things to remain as tight as they are right now. We do see budget growing in the low single-digit area, again depending on what areas you're referring to specifically, but that's sort of the budget set up that we see. So, we're not assuming suddenly a burgeoning, sort of, scenario on the budget front and that's sort of the baseline assumption that we have right now in the projections out there.

Q - Gavin Parsons {BIO 18748617 <GO>}

Got it. And then maybe just in terms of backlog duration, that's expanded, you've got much more visibility though that has led to bit of disconnect between backlog growth and revenue growth. Are you at a more kind of level backlog duration on the go forward such that backlog growth should translate more directly to revenue growth.

A - Prabu Natarajan {BIO 17701667 <GO>}

Yes. And I think, maybe a couple of caveats there. So, as we think about our pipeline, one of the key elements we look to inside of the pipeline is the period of performance of the work that we're bidding, and that has tended to grow over the last couple of years. Our average period of performance has been roughly between four and five years, depending on kind of the programs and the specific mix you see inside of a particular quarter.

I think our focus as a team is to not get too concerned about the specific period of performance inside of a quarter, but to think about this qualitatively over a period of time to make sure that we are lengthening the period of performance as much as possible. So, I would not necessarily think of a direct correlation between the period of performance and revenue growth translation, but I'd say we're starting to see stronger connection between what's in the backlog and the revenue growth that we're translating specifically through the on-contract growth that the teams have been able to deliver.

Nazzic, would you want to add to that?

A - Nazzic Keene {BIO 18292745 <GO>}

I think the only thing I'll reinforce and I think Prabu captured it well is, as we sit here today and reflect back on the last seven quarters give or take and we look into the future, I think we're -- we believe strong into the strategy that we're executing against this working. It's demonstrating sustained profitable organic growth and we've got certainly proof points coming into this particular quarter. And as we look out into the future by looking at the pipeline, by looking at the balance between GTA and core, and we just continue to execute on the fundamentals of the business, we do feel we're in a good position to be able to continue to deliver on the strategy that we've been operating under the last couple of years.

Q - Gavin Parsons {BIO 18748617 <GO>}

Got it. Thank you both.

A - Prabu Natarajan {BIO 17701667 <GO>}

Sure.

A - Nazzic Keene {BIO 18292745 <GO>}

Thank you.

Operator

Your next question comes from the line of Bert Subin from Stifel. Your line is open.

Q - Bert Subin {BIO 22037891 <GO>}

Hey. Good morning. Maybe to follow-up or maybe more of a --

A - Nazzic Keene {BIO 18292745 <GO>}

Good morning.

A - Prabu Natarajan {BIO 17701667 <GO>}

Good morning, Bert.

Q - Bert Subin {BIO 22037891 <GO>}

Hey. Good morning, Nazzic, Prabu. The follow-up and maybe a near-term question, one thing people have been watching is outlays, and we saw some really good traction in August, September, and that seemed to come off in October, and probably expect some volatility through the CR. Your fiscal quarter ends in October. I'm just curious, if you could comment on or maybe what you saw in the cadence through the quarter in terms of activity from your customers and ability to capture opportunities?

A - Nazzic Keene {BIO 18292745 <GO>}

Yeah. Let me start a little bit and then if Prabu wants to add some color always. But I think, in general, we haven't seen a very significant change in buying behavior over the course of the last year or so, and given the elections, given the CR, given the future, we -- as we sit here today, we don't see anything that is radically different in the future either. So, for us, it's very much been business as usual. There's always some short-term opportunities and some contracts to do some pickups, but that's really a normal practice for us. So, from my perspective, I haven't seen anything that's really fundamentally different over the last few months nor do we see it going into the next few months.

Prabu, anything to add?

A - Prabu Natarajan {BIO 17701667 <GO>}

Thank you, Nazzic. The only other thing I would add, Bert, is that, our book-to-bill is 1.1x -- our trailing 12-month book-to-bill has been 1.1x. I think we are demonstrating that there is a way to a robust healthy book-to-bill metric that does not rely overly on large awards. And I think, in this environment, if you're relying on large awards, I think you're likely to see some delays there, and thankfully, we're not in that boat, and I think that's probably the other source of a healthy book-to-bill trend.

A - Nazzic Keene {BIO 18292745 <GO>}

Yeah. A good point.

Q - Bert Subin {BIO 22037891 <GO>}

Yeah. That's great color. Thank you, both. Maybe just for my follow-up question on the margin side. Appreciate all the color you gave on your initial outlook for next year. Prabu, as we think about the 9% range relative to where the peer group is, probably closer to 10%, do you think there's something that you guys can do to get to narrow that range? And could you maybe just walk us through what you think the largest contributors to margin expansion are going to be when you start to see that perhaps in the next year or so?

A - Prabu Natarajan {BIO 17701667 <GO>}

Yeah. I appreciate the question, Bert, and I think we reflected on this particular topic on our last earnings call, and acknowledge the fact that we do see that difference between us and our peers on margin rate. We've been consistent in the way we thought about margin and communicated that story to say that we do see over time a path for us to continue to bridge the gap between where we are and where our peers are.

Now, having said that, we do see that as a substantial opportunity to create shareholder value over time and we do expect to make progress against this target over time. Incentive comp and our metrics are aligned to improving the margin performance from the underlying business.

Look, it's early days for FY '24. We wanted to get a baseline view for where we see margins for next year. And we are always seeking to balance improving margins against the needs of the business to make sure that we are taking a balanced view of that investment potential against the backdrop of improving margins over time. So, I think that's the balance we're striving to always, I think, bring into the equation.

And the last but not least, I'd say over the last maybe year to two years, inflation has been maybe more of a factor. While it hasn't improved or it hasn't impacted the margin performance of the business, the reality is, it is keeping a little bit of a check on underlying margin improvement because we are seeing escalating costs on the labor side. So, if you sort of combine all of these factors together, we do see the potential for margin to improve, and what you have there is our initial baseline view for FY '24, and recognize that Nazzic and I are committed to improving the underlying margin performance of the business and that's where the focus is going to be for the team.

Q - Bert Subin {BIO 22037891 <GO>}

Yeah. Just to clarify something, I guess I could ask this better because I know I've sort of asked about margins before. Do you think the opportunity is more to get rid of overhead load [ph]? Or is it portfolio mix shaping? Or is it the combination? I'm just curious, if there's one thing that stands out is, this is going to be an easy opportunity for us to get margin expansion?

A - Nazzic Keene {BIO 18292745 <GO>}

Well, I can certainly say that -- I don't know that I would use the word easy, but I will tell you that we're focused on all the above. And so, you're exactly right, there's multiple levers as Prabu outlined. We are continuously looking at our cost structure and ensuring that we are spending our precious dollars in those areas that support our strategy of sustained organic growth. And so that is ongoing and continuous, and we've recognized that absolutely has to be a lever and part of the conversation.

As we think about the portfolio, GTA drives, in general, greater profitability. So, the further we mature our strategy in GTA as -- and balanced against core, we see that as an opportunity as well. And then even in the current -- in the existing business, where there's opportunities to cross-sell solutions and bring some of the higher value work into the current contracts, and on -- drive on contract growth, we look for those opportunities. So, I think it's very fair to say, we look at every lever, and we never sit idle and assume that either our overhead structure is where it needs to be or our pipeline is where it needs to be. We are always looking at the opportunity to drive, again consistent with our strategy, sustained profitable organic growth. But just -- please note that we are looking at all those levers.

Q - Bert Subin {BIO 22037891 <GO>}

Thank you very much.

Operator

Your next question comes from the line of Sheila Kahyaoglu from Jefferies. Your line is open.

Q - Sheila Kahyaoglu {BIO 17240338 <GO>}

Hi. Good morning, guys, and thank you for the time.

A - Nazzic Keene {BIO 18292745 <GO>}

Hi, Sheila.

A - Prabu Natarajan {BIO 17701667 <GO>}

Hi, Sheila.

Q - Sheila Kahyaoglu {BIO 17240338 <GO>}

Hey. Maybe going back to Gavin's question. I wanted to go over how you guys are thinking about the budget growth over the timeframe, sort of, listed on Slide 6 -- Slide 14. And then how you think about your different verticals growing? You had significant space in intel awards. You could maybe talk about your end markets and what's driving that?

A - Nazzic Keene {BIO 18292745 <GO>}

Yeah, couple comments. On the budgets, obviously, we'll enter with the CR. It's a little early to tell. But I think, in general, we assume low single-digit budget growth at the macro level, and in some areas growing more than others. And then obviously, the federal government is dealing with the same challenges that industry is, and looking at inflation, which creates some headwinds on the budget as well.

So, I think, Sheila, in general, we're not looking for any dramatic change in the budget environment. To the extent that, good things happen, that's good for industry. And to the extent that there's challenges obviously, we'll navigate that. But I think it's just fair to say, stepping back, looking at the macro view, we're not seeing anything that we view is very -- significantly changes our approach to our strategy.

As it relates to our end markets, we do see modest growth opportunities across the portfolio. So obviously, increased focus at the federal level on DoD improves our access in the DoD market. The balance with some of the civilian programs, obviously, helps as well. And then, of course, Intel. And so, I would say, it's relatively balanced across the macro verticals that we operate in, but obviously there's -- as with any given portfolio, there's some pockets of the business that we expect more growth out of than others. And we've made reference to that as we think about the GTA areas as it relates to core. We expect and we position the company to grow across the board, but disproportionately over the next several years, we look for the growth to come out of the GTA part of our portfolio.

Prabu, do you want to add anything?

A - Prabu Natarajan {BIO 17701667 <GO>}

That's perfect, Nazzic.

A - Nazzic Keene {BIO 18292745 <GO>}

Did that answer your questions, Sheila?

Q - Sheila Kahyaoglu {BIO 17240338 <GO>}

Yeah. No, that does.

A - Nazzic Keene {BIO 18292745 <GO>}

Perfect.

Q - Sheila Kahyaoglu {BIO 17240338 <GO>}

And then maybe going to free cash flow, if I could ask about working capital efficiencies, how you think about those? And then I'll stop there because I'm being greedy and I'll get back in the queue.

A - Prabu Natarajan {BIO 17701667 <GO>}

Sure. I appreciate the question, Sheila. So, on free cash flow, look, we outlined that we're going to grow free cash flow by about 10% this year. And we said we are intending to grow free cash flow by another 10% next year. I think for better or for worse, there's been a view out there that we are over-earning our cash tax assets. And Chart 15 is intended to, I think, address the specific question on, are we actually over-earning on our tax assets or not? As you could see, it's just a modest level of decretion, if you will, on the cash tax side. And there's good visibility on the cash tax assets inside of the portfolio.

As we think about specifically working capital. There are a handful of things that we are doing coming into this year and that we are going to continue to focus on. That includes everything from DSO management, to DPO management, to inventory management, to terms and conditions on our prime contracts, to terms and conditions on our contracts with ourselves to make sure that we are getting as much benefit out of the working capital management side of this as we can.

At the end of the day, as you think about the free cash flow potential growth for this company over the next several years, we think working capital tends to be less of a driver to improving free cash flow in the outer years. We do believe based on just demonstrated growth that we've shown over the last couple of years into next year that if the business grew between 2% and 3% a year and we had modest margin improvement of about 10 basis points, there is plenty of potential for us to offset and grow free cash flow -- offset the headwinds from the tax assets and grow free cash flow.

So, as we think about it with a very nominal set of assumptions, we think we can continue to very nicely grow the free cash flow recognizing, of course, as we caveated, this is not intended to be free cash flow guidance for the next three or four years, but it's a directional view for where we think the potential for this company is, in terms of being able to generate the free cash flow and then deploy the cash flow effectively over the next several years.

Q - Sheila Kahyaoglu {BIO 17240338 <GO>}

Great. Thank you so much.

A - Prabu Natarajan {BIO 17701667 <GO>}

Of course.

Operator

Your next question comes from the line of David Strauss from Barclays. Your line is open.

Q - David Strauss {BIO 20485958 <GO>}

Thanks. Good morning.

A - Nazzic Keene {BIO 18292745 <GO>}

Good morning.

A - Prabu Natarajan {BIO 17701667 <GO>}

Good morning, David.

Q - David Strauss {BIO 20485958 <GO>}

So the 3% to 3.5% growth that you're talking about sustaining beyond '24, it sounds like you're implying that you'll grow maybe a little bit above the underlying budget. How do you think you'll grow relative to your peer group? Do you think that will -- do you think you can outgrow your peer group? Does that 3%- to 3.5%-plus translate to above peer group growth?

A - Prabu Natarajan {BIO 17701667 <GO>}

Yeah. So, let me take that one. So, a very big picture, as we think about sort of what nominal view for next year looks like. We said at the midpoint, it's about 1.5%. If you adjusted for the five fewer working days next year in the fourth quarter, but four days overall, we think that translates to a growth rate of about 3% to 3.5%.

I think there are probably two key dependencies here. One, continuing to recover and restore our recompete win rates back to where they were, that's a key assumption. I think we are demonstrating good progress internally on the recompetes. So, I think, Nazzic and I are both encouraged by the trend -- early trend that we are seeing in that regard.

Two, we are winning higher percentage of our new business pursuits this year. I think it's important for us to continue that trend. I think the basics are working really effectively.

As for the budget question and the peer question. Look, I think, we think about this as a relative gain. We see the projections out there that we get from some of our peers as well as the models that are out there. I think we are targeting growth rates that are sort of in that circa 3% to 3.5%. And I think with the right mix of investments tied to a healthy pipeline and good execution, there's no reason that this business could not generate that 3% to 4% -- 3% to 3.5% underlying organic growth. It doesn't mean it is going to be linear. Let me be doubly clear on it. You will always have a recompete that will cause a bottleneck along the way, and you'll have a new business win that creates extra growth. But for me, as I step back and sort of step aside from the noise of the recompete wins and losses and new business wins and losses, there is an underlying growth rate that we're targeting for this business and we are encouraged by the progress we've made, but we recognize this is one quarter at a time, and we have to keep up the level of intensity on our execution.

Q - David Strauss {BIO 20485958 <GO>}

Great. Thanks for the color. And then, you mentioned the -- better win rate on recompetes. Can you just talk about the kind of level set us where we are in terms of recompete, how much the pipeline going forward is up for recompete? What your recent recompete win rates have trend -- how they trended? Thanks.

A - Prabu Natarajan {BIO 17701667 <GO>}

Our recompetes, they always tend to be lumpy depending on what's in the mix. I would say, in general, we've said 10% to 20% of the portfolio comes up for recompete in a given year and we see next year is no different from that. Obviously, the timing of Vanguard and PBMRO is going to have some level of outsized impact on those percentages, but that's nominally what we're seeing in this business.

Operator

And your next question comes from the line of Matt Akers from Wells Fargo. Your line is open.

Q - Matt Akers {BIO 22271349 <GO>}

Yeah. Hey. Good morning, guys. Thanks for the question.

A - Nazzic Keene {BIO 18292745 <GO>}

Good morning.

A - Prabu Natarajan {BIO 17701667 <GO>}

Hi, Matt.

Q - Matt Akers {BIO 22271349 <GO>}

I wanted to ask about some of your comments on M&A. In the prepared remarks, it sounds like it's going to be less of a focus. Can you just talk about what you're seeing in the market there now? I mean, are assets kind of more expensive? Are there are more bidders? And to the extent that you still do maybe smaller deals, are there specific areas that you think are sort of focus areas you'd look at?

A - Nazzic Keene {BIO 18292745 <GO>}

Yeah. Let me tackle couple of those and then Prabu can add some color.

I think, in general, the M&A market continues to be active, so there's certainly assets that come to market. We certainly look at some, we don't look at some. Interest rates, obviously, have the potential of creating some volatility in the M&A market, but we haven't seen it to date. So, I would say, the market for the most part is pretty much what we've seen in the last couple of years.

But that being said, as I think about SAIC's interest, it would be along the lines of the GTA areas of focus that we've highlighted. So, as I mentioned in my prepared remarks, if an asset were to come to bear that accelerates our ability to drive profitable organic growth in those areas of our portfolio where we have decided -- we believe it is in our best interest to grow, those would be of interest to us. Obviously, anything we do, we go through in a very intense process to make sure that it's not just good for the company and the employees, but also for our shareholders. But those are the types of assets that we would be interested in and we'd be very, very selective as we looked at M&A right now.

Q - Matt Akers {BIO 22271349 <GO>}

Okay, great. Thanks. And then, I guess, I want to ask about counter UAS. I know you -- there was a demo the other day, but if you could talk about maybe how big, kind of, that potential market is and any kind of big opportunity as you see coming up in that market?

A - Nazzic Keene {BIO 18292745 <GO>}

Yeah. We're very excited about the market. It is -- as we highlighted in our last call, I believe it was, it is an area that we have been providing services in over the last several years. But as we sit here today, we've developed, what I believe is, a very compelling solution. We have the opportunity to show many of you over the course of last week and actually, I was down there month or two ago and got a chance to see it as well, and it's really exciting stuff.

With that being said, this particular solution set is relatively new. We are working very close with the DoD, obviously, to position ourselves. We're very proud of the fact that we are one of the three solutions as recognized by the Army in providing holistic solutions and end solutions. But at this point, I would say, it's too early to tell what we -- where we think that market is. We're doing a lot of work to assess that. It is a relatively small revenue set for us today, and -- but we do see it as an opportunity to grow. It is consistent with our strategy, especially in the systems integration phase. And clearly, it is an area in which not just the U.S. government, but in support of other governments as well, we believe there's a great market access. So more to come on it and happy to share more as we learn more, but that's how we sit here today, but very excited by it. Very proud of what the team has been able to accomplish there.

Q - Matt Akers {BIO 22271349 <GO>}

Great. Thank you.

Operator

Your next question comes from the line of Cai von Rumohr from Cowen. Your line is open.

Q - Cai von Rumohr {BIO 1504358 <GO>}

Yes. Thank you so much and nice results again.

A - Nazzic Keene {BIO 18292745 <GO>}

Thanks, Cai.

A - Prabu Natarajan {BIO 17701667 <GO>}

Good morning, Cai.

Q - Cai von Rumohr {BIO 1504358 <GO>}

So maybe you could -- yes. Could you maybe give us some more color on some of the outstanding bids like the One IT protest? Where are we with Evolve? How many pieces?

When do the bids come up and the PVRO?

A - Nazzic Keene {BIO 18292745 <GO>}

Yeah. So, the One IT is back with the customer going through their process. So, it is -- it's come out of the protest -- the formal protest window and it is back with the customer. So, I really don't know much more than that. They'll decide the timeline and they'll work through their award process.

As it relates to Evolve or Vanguard, that will -- we believe we'll continue to develop their procurement strategy as we go into next year. I believe it's relatively low risk for us in the first part of the year, certainly, as they continue to advance their procurement opportunities, and the way they're going to adjudicate and how they're going to award, we'll get more clarity as we get into next year, but some of that is certainly going through the change cycle right now.

And I'll let Prabu add any more color.

A - Prabu Natarajan {BIO 17701667 <GO>}

Cai, the only other comment on DCSA One IT is, we do expect some clarification perhaps before the end of our fiscal year. And then we'll take it from there. AOC Falconer, which was under protest a quarter or two ago, that's fully underway now and we're on contract and the team is executing to what they need to do there. So, we've got some good momentum on the new business front. But, I'd say, DCSA One IT has probably got the biggest impact potentially on FY '24.

Q - Cai von Rumohr {BIO 1504358 <GO>}

Great. Thank you very much. And then, you made the comment that you see the stronger growth in the second half of the year. And am I correct that the kind of the five-day fallout is basically in the fourth quarter, which would suggest that that's going to be a tougher compare. So maybe walk us through the quarterly pattern and some of those factors.

A - Prabu Natarajan {BIO 17701667 <GO>}

Yeah. Got it. Appreciate the question, Cai. So, for next year, as we sit here today, recognizing with all of the health warnings that that calendar brings on us, Q2 and Q3 of next year is where we see the greatest level of growth potential for this company. Q1, we're likely to still see some headwinds from the NASA NICS program fully rolling off. It turns out, if you will, at the end of Q1.

And Q4, of course, is sort of where we see the headwinds, potentially from having five fewer working days relative to Q4 of this year. As we sort of estimated at the start of this year, we said Q1 would grow, Q2 and Q3 may be small levels of contraction, and Q4 will be growth. What this team has done, and Nazzic and I are just incredibly proud of the work the team has done this year, is for us to go out there and make sure that we can do a little bit better every quarter, and then keep up that level of intensity.

So, as we sit here that's our estimate for next year. But recognize, we've got three months left to the end of this year, and of course, we've got a whole bunch of work to do next year. So, we'll continue to focus on making sure we are delivering ahead of internal plans, but that's truly risks and opportunities driven and making sure we're doing as much as we can to ensure that we are delivering a smooth year for us and our shareholders.

Q - Cai von Rumohr {BIO 1504358 <GO>}

Terrific. Good answer. Thanks so much.

A - Nazzic Keene {BIO 18292745 <GO>}

Sure, Cai.

Operator

Your next question comes from the line of Tobey Sommer from Truist Securities. Your line is open.

Q - Tobey Sommer {BIO 6296228 <GO>}

Thanks. I was wondering if you could give us some color and describe your -- where your space business ranks in your possible growth vectors. I think, Nazzic you said, moderate to modest kind of growth opportunities across the portfolio. But how would you characterize space relative to the overall business?

A - Nazzic Keene {BIO 18292745 <GO>}

Space, as we've mentioned before, is certainly part of our growth strategy. And if we think about the intersection of our space business with the areas -- the GTA areas that we focus on, it's a great combination and a great opportunity for us to expand in both dimensions. So certainly, in the systems integration delivery space, that area that GTA, we see the opportunity to drive that in space. Obviously, as more applications whether their mission -- especially mission go to the cloud, we see the opportunities there as well. So, I would just reiterate that space is an important domain for us. It is part of our growth strategy and it is very complementary and directly interlocks with our GTAs.

Q - Tobey Sommer {BIO 6296228 <GO>}

My follow-up. How do you juxtapose and sort of reconcile your strategy, which is focused on the sort of existing contract portfolio, and extracting as much as you can out of that and revitalizing organic growth with what seems to be a pretty steady externally- and internally-driven growth strategy among some of your industry competitors? And at the end of a multi-year period of focused in on sort of just more organic growth and less external, is there any risk that the portfolio kind of won't be positioned as you want it in three, four, five years?

A - Prabu Natarajan {BIO 17701667 <GO>}

Hi, there. Prabu here. Maybe I'll take this part of the question. Part of what's in our space business is our restricted space work that is also a fair amount of SETA [ph] work that we do for the government. We think about growth inside of the space business in these two buckets kind of the SETA work and the non-SETA work.

The non-SETA work has the potential to grow at higher growth rates than the SETA work, not surprisingly. And therefore, the way we think about it is, how do we sort of bring sort of legacy capabilities onto the development side, innovate that allows us to gather market share on the non-SETA side, and that's sort of how we think about the space market.

Having said that, the SETA work is really good work and it's the legacy of this company, and it gives us a fair amount of ability to allow us to continue to invest in the business and grow the business. But I'd say, overall, we think about the non-SETA business as sort of the area where there is real growth. And as we've disclosed over the course of the last year or so, we've won some restricted work on the development side of our space business, not SETA, that has allowed us to continue to grow our market share. It is a solution-based offering that we are hopeful we can take to other parts of the market where we are not impacted by our SETA positioning. So that's how we think about the positioning inside of the portfolio. Now we're at ranks relative to the peers and all the folks that have 100% development work, that's, I think, poof's going to be in the pudding and we'll see that over the course of the next several years.

Q - Tobey Sommer {BIO 6296228 <GO>}

Thank you very much.

A - Prabu Natarajan {BIO 17701667 <GO>}

Sure.

Operator

And your next question comes from the line of Seth Seifman from JP Morgan. Your line is open.

Q - Seth Seifman {BIO 16417112 <GO>}

Hey. Thanks very much, and good morning.

A - Prabu Natarajan {BIO 17701667 <GO>}

Good morning.

A - Nazzic Keene {BIO 18292745 <GO>}

Good morning.

Q - Seth Seifman {BIO 16417112 <GO>}

Just wanted to ask one quick one, just to kind of level set about the growth expectation, and I think, when you talk about the underlying market growing in kind of like this low single-digit pace. We look at the overall budget that grew a little bit faster than that in '22. It will see what comes out of the Congress this month, but there's a decent chance it's going to grow faster than that in '23. So, I guess the sort of low single-digit view, is that based on the fact that a lot of that budget growth is headed toward the weapons accounts, whereas your view of your particular end markets and those of your closest peers is more in that low single-digit range within this kind of robust overall budget growth environment?

A - Prabu Natarajan {BIO 17701667 <GO>}

Yeah. Seth, Prabu here. That's a fair way to think about it. I'd say the other dynamic that we're working our way through is, there's sort of nominal growth rates in the budgets and sort of real increases in the budget ex-inflation, and so we tend to think about the world in sort of a qualitative way as well as a quantitative way.

In real terms, we think of budget growth as being in that low single-digit growth rate. Nominally, it's a little bit higher as you just mentioned, and the reality is, we're also seeing some element of, I'd say, bias would probably be a harsh way to describe it, but certainly, directionally a view that it's tending to go towards the hardware side more than the services side or the system side, recognizing that there's an incredible amount of demand for these underlying services on the services side, but that's sort of our view of where the budgets are trending at least as we sit here right now.

Q - Seth Seifman {BIO 16417112 <GO>}

Right. Okay, great. Thanks.

A - Nazzic Keene {BIO 18292745 <GO>}

Seth, the one thing I'll add is, we touched on this earlier. Certainly, the government is dealing with some of the impacts of inflation as well, so we're continuing to watch that.

And I know that Prabu reminded all of us early in the call, but we've tried to provide some early guidance into next year, but we look forward to the opportunity in March to further develop that. And certainly, there are some things that can change the guidance up or down as always, as Prabu pointed out, but there's some very, very great opportunities. We have great pipeline that supports our ability to grow, and we've demonstrated the last couple of years to be able to grow in the low-single digits. So, we certainly wanted to put forth an early view of what we think next year looks like, but we'll provide more color and more dimension on that as we get to the March time frame.

Q - Seth Seifman {BIO 16417112 <GO>}

Great. Thanks very much. And then, maybe as a really quick follow-up. Prabu, I think you mentioned in the press release, year-on-year there were some headwinds from EACs. Maybe was that because they were exceptionally high in the year ago period or is there anything about -- any particular contract performance in this period to be aware of?

A - Prabu Natarajan {BIO 17701667 <GO>}

Yeah. Fair question. I think we had about negative 6 in EAC adjustments for the quarter, most of it was related to a single program where the period of performance has ended. So, I'd say, not a recurring thing, but it's in the process of cleaning out these things that you -- we had the adjustment, but that was it.

Q - Seth Seifman {BIO 16417112 <GO>}

Thanks. Okay. Thanks very much for taking my questions.

A - Prabu Natarajan {BIO 17701667 <GO>}

Sure. Thank you.

A - Nazzic Keene {BIO 18292745 <GO>}

Thank you.

Operator

And there are no further questions at this time. Mr.Joe DeNardi, I will turn the call back over to you for some closing remarks.

A - Joe DeNardi {BIO 22467920 <GO>}

Great. Thank you, Rob. Thank you to everyone for joining us on the call today. If you have any further questions, please feel free to reach out, and have a great day.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.