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Science Applications International Corp.

(SAIC)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to SAIC's Q1 Fiscal Year 2021 Earnings Call. At this time, I would like to turn the conference over to Shane Canestra, SAIC's Vice President of Investor Relations. Please go ahead, sir.

Shane P. Canestra

Vice President-Investor Relations, Science Applications International Corp.

Good afternoon and thank you for joining SAIC's first quarter fiscal year 2021 earnings call. My name is Shane Canestra, Vice President of Investor Relations. And joining me today to discuss our business and financial results are Nazzic Keene, SAIC's Chief Executive Officer and Charlie Mathis, our Chief Financial Officer. Today, we will discuss our results for the quarter ended May 1, 2020.

This afternoon, we issued our earnings release, which can be found at investors.saic.com, where you'll also find supplemental financial presentation slides to be utilized in conjunction with today's call. Both of these documents, in addition to our Form 10-Q to be filed soon, should be utilized in evaluating our results and outlook along with the 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 a discussion of these risks, including the Risk Factors 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.

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

Nazzic S. Keene

Chief Executive Officer & Director, Science Applications International Corp.

Thank you, Shane, and good afternoon. While I am pleased to discuss SAIC's first quarter results and outlook, I want to first take a moment to extend my hope that each of you and your loved ones are healthy and managing through the disruptions in these unprecedented times. Each of us has been affected in some way. And it is my sincere wish that you and your families are well.

I intend to cover several items that I know are of interest to you, including the impact of COVID-19 on the business, an update on our completed acquisition of Unisys Federal and a significant contract with in our AMCOM portfolio. Before discussing these items, let me touch briefly on our first quarter results which included about seven weeks of Unisys Federal performance.

Additionally, as our quarter ended on May 1, the quarter contained roughly the same seven weeks of COVID-19 impact, a larger timeframe than those with the March quarter end. Charlie will provide more detailed information on the quarter and our outlook for the fiscal year. SAIC has started fiscal year 2021 on a very strong note highlighted by revenue growth, consistent profitability, and healthy free cash flow, all while navigating this unprecedented business environment. These results are attributable to the dedication of our approximately 26,000 employees. And I want to thank our entire team for their resolve during this challenging time. I am so proud of the men and women of SAIC.

Despite the modest impact of COVID-19 to first quarter revenues, SAIC achieved organic revenue growth of 3% as compared to the prior-year quarter. Adjusting for the COVID-19 impact, organic revenue growth would have been 5%. Free cash flow was strong and reinforces the resiliency of our market and of SAIC, as well as continued confidence in our liquidity and rapid delevering plan.

As for the impact of COVID-19, SAIC has been operating as an essential business in a very resilient market. We are fortunate the demand for our services is essentially unchanged. I'm extremely proud that we can provide these vital services to our customers and support our country in a time of global crisis. SAIC has experienced only a modest financial impact. I would, however, like to talk about our focused response to the crisis in three areas: employees, customers, and shareholders.

First and foremost, we immediately prioritized our employees' safety and well-being. In mid-March, we responded decisively and advised our employees where possible to work remotely. Our customers also adjusted quickly and have been very accommodating and supportive, allowing for remote work, alternative work schedules, or modified office environments to ensure social distancing. About 75% of our employees are currently working remotely, while others work at work sites following CDC and local guidelines.

We are working very hard to support our employees when they need us most. We are advancing leave to employees who need more time to care for themselves and family members. Many SAIC employees are donating their accrued leave to fellow employees, and we are committed to providing all direct charge employees with paychecks at least through August 1. In addition, SAIC is setting up a charitable foundation to further support employees, their families and our communities that are struggling due to COVID-19 related financial or health setbacks. We've also increased our recruiting pace throughout this period as we continue to attract skilled, talented people who are looking for the opportunity to work and thrive in a stable business environment.

You've often heard me talk about our deep commitment to our employees and SAIC's focus and priority in winning the war for talent. These priorities have never been more true than today and continues to inform the decisions we make, even more so in these trying times. Second, we are focused on ongoing high quality customer performance to ensure continued mission execution through this pandemic.

The level of customer demand for our core services is essentially unchanged, although we are seeing an increased interest in solutions that will help modernize the government and support the remote workforce of the future. We are developing and deploying solutions to meet those needs initially with agencies that are already looking ahead to a post-COVID work environment, and we are here to support their digital transformation. I'm extremely proud of the work our teams have done to help the US government respond to the needs of our nation and our fellow Americans virtually overnight.

As government employees quickly pivoted to work-from-home, SAIC provided virtual infrastructure engineering and help desk services to return agency employees to productivity, and through our Mobile Ops Rapid Deployment Kit, we are deploying IT and communications infrastructure for use by temporary hospitals and medical test facilities, allowing them to become operational within 24 hours. To assist our healthcare heroes in their life saving work, our data science and analytics services help produce high quality predictive models for demand and supply of healthcare materials.

Third, we have ensured the stability of the business and protected shareholder interests. I'm proud that our strategy to align our company to missions critical to our nation's priorities have allowed us to continue operating as an essential service and support our country in this time of crisis. While we successfully navigate a myriad of operational challenges and individual customer needs, we have managed a stable business for our shareholders.

We continue to maintain an ample amount of liquidity, manage our cost profile, reallocate resources where necessary and continue our focus on business development and growth for the long-term future of our company. While navigating through the pandemic, it should not be lost that during the first quarter, SAIC successfully completed the acquisition of Unisys Federal. While less complicated to the integration of Engility, the successful integration of Unisys Federal is an absolute priority for me and the enterprise.

We are leveraging our previous integration experience in success into this integration and we're off to a great start and are on track. One of the first items that we accomplished was to home the intellectual property and technology-driven offerings in our Solutions and Technology Group and begin to leverage these assets in our business development efforts. Key leaders are working in their new roles and are looking to capitalize on the new customer access we now have.

SAIC, through the Unisys Federal portfolio, was recently awarded a $630 million new business contract to provide Technology Application Development and Sustainment or TADS to support the U.S. Air Force Weather Agency. This award is a great early proof point of the value the Unisys Federal acquisition brings to our shareholders. Charlie will soon share our business development results, but I'm thrilled that after we close the first quarter, we were awarded the first task order in the series of our U.S. Army Aviation and Missile Command or AMCOM recompetes.

The task order valued at $2.9 billion over a five-year period of performance resecures about $300 million of annual contract revenue and provides potential new business revenue in the $100 million to $115 million range. This is the largest contract awarded to SAIC since its separation in 2013 and I couldn't be more proud of this exceptional team.

Building off the deep relationship we have with our AMCOM customer, our proposed systems engineering solutions was recognized as the best opportunity for AMCOM to drive future digital transformation. The award of this task order significantly de-risks the AMCOM recompete portfolio and gives us confidence in the successful award of several remaining task orders.

I'd like to ask Charlie to share our quarterly business development and financial results, as well as our outlook.

Charles Alexander Mathis

Executive Vice President & Chief Financial Officer, Science Applications International Corp.

Thank you, Nazzic. SAIC started fiscal year 2021 with strong results, particularly in organic revenue growth, free cash flow and contract awards while effectively navigating a variety of issues associated with the COVID-19 pandemic. We also closed the very strategic and financially accretive Unisys Federal acquisition.

As Nazzic mentioned in her remarks, the first quarter contained about seven weeks, a little over half of the quarter of both COVID-19 and Unisys Federal impact.

Let me begin with our strong business development results. Net bookings for the first quarter were approximately $1.6 billion, translating to a quarterly book-to-bill of 0.9. While our first quarter book-to-bill ratio is in line with first quarters historically, it does not fully represent the success of contract awards in the quarter.

In addition to contract bookings, we were awarded approximately $44.6 billion of single-award IDIQ contracts, our largest quarterly amount ever. These contract awards do not immediately contribute to backlog for a bookings policy, but will add to bookings for the next several years. Of these single-award IDIQs, approximately half were for new business awards. This included the new business wins on the U.S. Air Force EDIS and Defense Logistics Agency FSG-80 contracts. Also, we were awarded a new business contract valued at $368 million (sic) [$378 million] to provide support services across the FAA's workforce of more than 50,000 people.

The single-award IDIQ also included the successful recompetes of our Department of Justice Asset Forfeiture contract worth up to $1.3 billion and our FAA Controller Training contract valued at $653 million. It was a very exciting quarter of new business awards and maintaining large recompetes.

The momentum continued into the second quarter. Subsequent to the end of the quarter and as Nazzic mentioned, SAIC was awarded the first in a series of AMCOM portfolio recompetes. This $2.9 billion task order has been a notable and significant recompete for SAIC, and we are proud to continue this important work for our AMCOM customer.

Through Unisys Federal, we were also awarded another new business contract from the Air Force worth $630 million. Not only were our contract awards strong, but our contracts submittals continue to be robust as well. SAIC's value of submitted proposals at the end of the first quarter was $15.6 billion, up from the end of the fourth quarter. This improvement from a combination of strong quarter of internal submittals and the addition of Unisys Federal outstanding proposals. At the end of the first quarter, SAIC's total contract backlog stood at approximately $16.6 billion, which included the addition of approximately $1.5 billion from Unisys Federal.

Let me now turn to the financial results for the quarter. Our first quarter revenues of approximately $1.8 billion reflect total revenue growth of 9%, which was a balanced mix of acquisitive and organic revenue growth. Organic revenue grew 3% year-over-year. This was mainly due to own contract growth and new business awards.

First quarter revenues were negatively impacted by approximately $33 million from COVID-19, largely due to canceled or delayed activities in our defense and intelligence business, a slowdown in our supply chain business due to reduced operational tempo in our military forces, as well as in our FAA training services. Excluding the COVID-19 headwinds, organic revenues grew by 5%.

First quarter adjusted EBITDA was $137 million, and adjusted EBITDA margins were 7.8% as a percentage of revenues. COVID-19 negatively impacted adjusted EBITDA margins by $8 million or 30 basis points. This was primarily due to uncertain profit recovery in our intelligence community business on ready-state labor cost. We are grateful for the recognition of the CARES Act. They've been keeping our workforce ready and available. Adjusted EBITDA excludes $28 million of net acquisition and integration-related cost in the quarter.

Net income for the first quarter was $36 million and diluted earnings per share were $0.62. Excluding the $28 million of net acquisition and integration costs, as well as amortization of intangibles, our adjusted diluted earnings per share was $1.38 per share for the first quarter. The $8 million of COVID-19 impact profitability, equated to about $0.11 per share. The effective tax rate for the quarter was approximately 18%, modestly below our full year rate which was expected to be 23% to 25%.

First quarter free cash flow was $158 million, reflecting a quarter of strong collections and great start to fiscal year 2021. The free cash flow generation in this particular quarter reflects the resiliency of the government services market and reinforces our confidence in our rapid delevering profile. During the quarter and included in our free cash flow are one-time acquisition and integration cash expense of $29 million. And finally, the $158 million of free cash flow does not include the $200 million impact from the accounts receivable purchase agreement that we initiated as part of the financing for the Unisys Federal acquisition. A full reconciliation can be found in our press release and supplemental financial presentation slides.

Pro forma days sales outstanding at the end of the quarter after adjusting for the impact of sale of receivables were 60 days. We finished the quarter with cash on hand of $276 million. During the first quarter, we deployed $39 million of capital consisting of $23 million dividends and $16 million of mandatory debt repayment. We did not make any voluntary debt repayments in the first quarter out of an abundance of caution for potential COVID-19 impacts. However, given our strong first quarter cash flow, ample liquidity, and continued confidence in the full year, we recently made $125 million voluntary debt repayment. I should note that as announced in our press release today, our board of directors has approved a quarterly cash dividend of $0.37 a share payable on July 31 to shareholders of record on July 17.

Now, turning to our forward outlook. In our late March call, we provided a framework for how we viewed fiscal 2021 prior to the emergence of the COVID-19 pandemic but did not provide formal guidance given the deep uncertainty at that time. There is still uncertainty related to the course and effects of the pandemic, particularly around the timing of returning to secured facilities, FAA training and the operational tempo of the Department of Defense. Given the strength and stability of SAIC in our market, we wanted to provide the investment community with formal guidance for fiscal year 2021 based on what we know today versus first fiscal year 2021.

And including 10-and-a-half months of Unisys Federal, we believe revenues will be between $7.1 billion and $7.3 billion, implying organic revenue growth between 1% and 4%. This revenue range assumes a full year impact of approximately $150 million from COVID-19, primarily associated with the same factors that affected the first quarter. This estimated COVID-19 revenue impact equates to about 2 points of organic revenue growth. Without the COVID-19 impact, we would be back at the organic revenue growth range of 3% to 6% framework that we provided in March.

With regards to profitability, adjusted diluting earnings per share are expected to be between $5.80 and $6.10. This includes a negative profit impact of approximately $25 million from COVID-19, primarily due to the uncertain profit recovery and our defense and intelligence community business on ready-state labor. This was the same impact we saw in the first quarter.

Turning to free cash flow, despite the revenue and profit impacts from COVID-19, we expect free cash flow to be equal to or greater than $500 million, an increase of $50 million from our previous communications. This includes the favorable timing impact of $70 million from deferred payroll tax payments afforded by the CARES Act and a negative impact of $20 million from COVID-19-related reduced profitability. And of course, this excludes a $200 million impact from the sale of accounts receivable.

One final point and as a reminder, our free cash flow this fiscal year is negatively impacted by approximately $40 million of expected tax adjusted Unisys Federal transaction-related outflows. We are committed to the rapid delevering plan that we had initially communicated in February at the announcement of the Unisys Federal acquisition. With our increased cash flow outlook for the year, we will be able to pay down debt somewhat faster than previously planned.

We are confident in meeting our targeted net leverage ratio of 3.0 times by the end of fiscal year 2022. In conclusion, it was truly a remarkable quarter of financial resilience as evidenced by revenue growth, consistent profitability, strong cash generation and exciting contract awards. During one of the worst crisis our country has faced, we are tremendously fortunate and proud to continue to support our country with critical missions and solutions during these challenging times.

Nazzic, back to you for concluding remarks.

Nazzic S. Keene

Chief Executive Officer & Director, Science Applications International Corp.

Thank you, Charlie. We have always been recognized as a market leader in our industry, but now we can proudly say that we are a leading company across all industries. A few weeks ago, SAIC was named to the prestigious Fortune 500 list for the first time. With an initial ranking of 466, we have been recognized for transforming from a spin-off company six years ago to the much larger and powerful business force we are today. And as we add the Unisys Federal portfolio and accelerate organic revenue growth, I am confident that we will increase our position on the list next year.

With profitable revenue growth as of SAIC's strategic priority, we have made an incredible hire to further drive that momentum over the long term. We are pleased to welcome Dee Dee Helfenstein to the company as Executive Vice President and Chief Strategic Growth Officer. This new position was created to drive the company's organic growth and market leadership by aligning capabilities with customer needs and market opportunities.

Dee Dee will lead SAIC's corporate strategy and growth initiatives reporting directly to me. Our Solutions and Technology Group and our Strategic Development team will be key parts of Dee Dee's organization to strengthen the company's ability to bring innovative, differentiated solutions to our customers and deliver digital transformation to the federal government.

As indicated through our results and commentary today, there is a great deal of momentum in our business. I've often said that we at SAIC are driven by mission, united by purpose and inspired by opportunity. This crisis that we're all living with, although incredibly tragic, creates the opportunity for a purpose-driven company to align and come together in support of each other, in partnership with our customers and in service to our nation.

I've never been more proud to be a leader of such an incredible team of men and women that live this every day, the selflessness, passion, commitment and true purpose. Thank you to all my SAIC colleagues. Operator, we are now ready to take questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And you have a question from the line of Sheila Kahyaoglu with Jefferies.

Greg Konrad
Analyst, Jefferies LLC

Q

Hi. Sorry, this is actually Greg on for Sheila. Good evening. I was just hoping you could provide an update on AMCOM – you had some color in your opening commentary – kind of when the next RFPs are, how much upside you see to the total scope of the contract and just timing on some other awards within that contract.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.

A

Yeah, this is Nazzic. So, as we reported we're very thrilled that we won the first one and certainly secures a significant portion of our revenue and derisks the year for us, so very excited to be able to share that news with you. The AMCOM recompete portfolio has multiple contracts that will go up for bid between now and the course of probably the next 12 to 18 months. And so we'll continue to examine and look at those where we believe we're the best suited to win and in a great position to be very, very competitive. At this stage, this win secures most of the revenue or significant part of the revenue for the year and the rest of them then will start to fall into place from an award cycle as we get later in this year and into next.

Greg Konrad
Analyst, Jefferies LLC

Q

Thanks. And then just one follow-up on Unisys. You had the TADS win in the quarter. I mean, how incremental was that to kind of the growth expectations you laid out when you acquired the business, and how do we kind of think about the ramp on that win?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Yeah. So that was actually in the plan. There was a number of new proposals in there. We knew that going in we had a very good chance of winning those when we did the due diligence and it came to fruition. So that's part of the expectation of Unisys Federal providing double-digit revenue growth for the next couple years. So, yes, that was factored in.

Greg Konrad
Analyst, Jefferies LLC

Q

Thank you.

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Thank you.

Operator: Your next question comes from the line of Cai von Rumohr with Cowen & Company.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Yes. Thank you very much. So you explained the cash flow variance this year, but I guess your guide had been for $500 million next year, and now you have a $35 million headwind from the deferred payroll tax. Is $500 million still kind of – you're still thinking about that kind of a number?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Yes. Thanks, Cai. So a good question. First of all, we're very happy to get off to such a strong start with the free cash flow in the very difficult times. And like you said, because of the provision in CARES Act, we're able to defer payments and accelerate the free cash flow this year. That's why we increased from $450 million previous guidance to $500 million. Now, it's really a timing issue because, previously, the $550 million that we talked about with Unisys Federal, we would have to pay that back, so it's really timing related. But between the two years, we were projecting $1 billion of free cash flow, and we're still projecting $1 billion of free cash flow between the two years.

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

Got it. That's terrific. And can you give us some color on the expected margin profile over the year? I guess if you add back the COVID, your margins were flat year-over-year. How much of that was Unisys? And kind of how should we expect the profile of margins over the years?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Yeah. Thanks, Cai. That's a great question there. And let me just add a few additional comments on the margins just to be clear. The margin outlook provided in our guidance, excluding COVID, is in line with the pre-COVID outlook provided in March. Nothing has changed as far the margin outlook previously except that COVID, we're going to have – we're expecting to have a $25 million profit impact. Most of that impact is related to non-recoverable of the [ph] fees (00:27:53) on the ready-state workforce.

So, our margin are – and additionally, I would say, our second half margins have historically been higher than our first half. The future quarters will contain a full quarter of Unisys Federal margin contribution. This quarter, you only had half. And there are some Engility synergies impacts that are strong in the second half that we're still realizing. So, we have good line of sight to the margins. And again, nothing has changed from our pre-COVID outlook except the fact that we have this $25 million impact. Does that help?

Cai von Rumohr
Analyst, Cowen & Co. LLC

Q

That's terrific. One last one, could you give us some color – you mentioned AMCOM and other recompetes or your bookings prospects for the year.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.

A

Yeah. Cai, this is Nazzic. So, it's a great question. Obviously, since retiring the significant recompetes that Charlie mentioned in his opening comments was – put us in a very strong position going into the year. And certainly, we're very pleased to be able to retire the risk of recompetes as it's related to FSA of $1.3 billion, of the AMCOM at $2.9 billion and the FAA at $650 million. So, retiring those going into the year certainly derisks the year.

Those were the three most significant recompetes that had any type of material revenue impact to us for this year. And so we have the normal cycle of recompetes, as you could imagine, but nothing of that size or scale that would have that kind of impact that we feel very good about going into – and retiring that risk at this stage of the year.

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.
A

Yeah. And, Cai, don't overlook the $4.6 billion of single-award IDIQs in the quarter. I mean that was the largest ever that the company has experienced. And then there's a lot of new business wins, FSG-80, $950 million; Unisys Federal, the TADS win, $630 million; FAA [indiscernible] (00:30:00) ISC $358 million (sic) [$378 million]. So it was a very robust quarter of contract award. So I know those don't show up in a book-to-bill but that is a very substantial number. And I can continue to say that, as we said before, the momentum of submittals and proposals, we're extremely busy, and the momentum there continues on the BD efforts.

Operator: Your next question comes from the line of Jon Raviv with Citigroup.

Jonathan Raviv
Analyst, Citigroup Global Markets, Inc.
Q

Hey. Thanks, everyone, and good afternoon. Glad to hear everyone's well. Just a quick follow-up, Charlie, on the free cash flow comment. So you're still seeing the $1 billion across the two years. I understand the timing nature of the tax holiday, so to speak. Can you just be a little more specific? So we saw $550 million in FY 2022. Is $550 million now going to be $480 million, so losing the $70 million or what's the $550 million going to be in FY 2022? And where does that $20 million of loss COVID play into that? Still seeing $1 billion across the two years are essentially making up that $20 million elsewhere or it's kind of a rounding [indiscernible] (00:31:16)?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.
A

Yeah. So, good question, Jonathan. And let me just do a little walk here to help you through this. So, our previous guidance was the $450 million. You got to add the $70 million from the CARES Act on the deferred payroll tax, right, and then you subtract $20 million from the profit impact of COVID. That's how we get to the $500 million this year, right?

So, next year, FY 2022, $450 million baseline. And we also had the A&I cash impact in FY 2021 that we won't have in 2022. So you have to add that back to get a revised base of around $490 million free cash flow. We don't anticipate having COVID headwinds next year. That's $20 million we're having this year. And next year also increased profit of $20 million to $30 million gets you to around $540 million, of which we have to pay $35 million back deferred payroll tax. Okay. So that's how you get $500 million this year and $500 million next year. And hopefully, you – if we need to go take this offline and go over this again, but that's the kind of the walk and roll-up, if that helps.

Jonathan Raviv
Analyst, Citigroup Global Markets, Inc.
Q

Yeah, it does. Just want to – just really making sure that we're still at that $550-ish million level. And then you've said approaching $550 million in FY 2022, that one's [indiscernible] (00:32:46) so that helps a lot. Thank you.

And then in terms of a lot of the new wins that you've come across here, how do you think about the margin profile of those wins? You're still targeting 8% to 9% ex-COVID for this year. Where do things go thereafter appreciating that Unisys is accretive? But I don't know, some of those things coming in that are starting [indiscernible] (00:33:08) are going to dilutive.

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Yeah. I'm very pleased by the margin profile and going after firm fixed price contracts, more solutions-oriented if you look at some of our disclosures as far as our own direct labor content. So, we have some very favorable trends happening at a macro level that gives us confidence in that increased margin profile. There's always pressures with the number of recompetes that we have, that we have to deal with for sure, but we've made good progress and just because going after more firm-fixed price contracts should help with the margins in the future.

Jonathan Raviv
Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

Operator: Your next question comes from the line of Gavin Parsons with Goldman Sachs

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Thanks. Good evening.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.

A

Hi, Gavin.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC

Q

Hey, I wanted to ask you on organic revenue growth rate, it was 3% in the quarter and your full-year guidance is 1% to 4%. But I think you'd previously spoken about growth accelerating throughout the year kind of as your new work ramps up. Obviously, the COVID headwind looks like it might be more impactful going forward than it was this quarter. But on the upside you've locked in AMCOM and TADS and you've got $4.6 billion of single-award IDIQs. So, I mean, is there any reason organic should decelerate from the current pace and what might actually get you to the low end of that range? Like, was there any pull forward in the quarter? Thanks.

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

No. When you look out to Q2, we got probably more COVID related than we had in Q1, because that really started halfway through the quarter. And a lot of it is driven by operational tempo for supply chain business. There was a stop movement order. There was a lot of training exercise canceled. That had an impact on the revenue top line there. So, most of this, impact, again, is going to be in the first half of the year. We do see modest improvements in the second half of the year related to the COVID impact. That's how we're planning for this. But, again, as we said when we gave the guidance, we don't actually know. There's still uncertainty related to the pandemic, but this is the best that we know at this time.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. So there's nothing abnormal in the 5% underlying ex-COVID growth rate this quarter.

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.
A

No.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC
Q

Okay. Great. And then longer term, obviously a lot of moving pieces and you spoke about the COVID uncertainty. But, I mean, you guys had a prior target of fiscal 2020 to 2022 organic growth of 3%. Is that something that you could still achieve?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.
A

So repeat that again. You're saying for our longer-term view of 3%? Yes?

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. Is that something you can still achieve over fiscal 2020 to 2022?

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.
A

Yes. We still feel confident in our growth profile. That's obviously a key priority of ours as we've shared with you. And as you heard from Charlie and myself we're seeing good momentum in the pipeline development. We continue to see the opportunity to drive growth in the business. Obviously, we are dealing with a headwind that is a bit unpredictable although we have good visibility into at least the actions that are being taken right now with the customers. So, at this stage, we do still feel comfortable and confident with that projection.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC
Q

Got it. Thanks very much.

Operator: Your next question comes from the line of Joseph DeNardi with Stifel.

Joseph William DeNardi
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Yeah. Thanks. Good evening. Nazzic, can you just talk a little bit about kind of the nature or the impact on the business. It sounds like it's primarily folks not being able to get where they need to be. But is there anything on the award activity side that's kind of factored into the guidance? And then, in terms of the areas of the business that are being impacted, are you having conversations with customers in terms of like a timeline to get back to normal, or is that still to come? Just trying to understand when you think the business kind of gets back to where you thought it would be.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp. A

Now, great question. So, I think on the first part of your question, most of the impact that we see is in areas that are – so, as an example, the intelligence community and all of us in this market that served the intel community are dealing the same challenge. And that is for the most part, there's always exceptions. Many of the individuals that serve that community work in skiffs.

And so, ensuring that we can protect the health and well-being of our employees collectively, customer, employees, as well as ours, be able to respect the social distancing creates an opportunity or a challenge to make sure that we work in a method that allows us to protect that. So, think about shiftwork, think about spreading out a bit. And so, that's been one area of impact. Fortunately, the customers and those of us serving these customers have been working very, very closely together to make sure that we can continue to support the mission. They're incredibly critical while protecting the well-being of our employees.

And so, that's an example of where impact exists. And then as Charlie mentioned, there's just some tempo type thing. So, one example is in the FAA. We do training for air traffic controllers. There is not a lot of activity right now as it relates to commercial flying, and so that scenario where we've seen a slowdown, but – and so that's another [indiscernible] (00:39:31) impact.

So we've certainly those types of impacts. For the most part though, the work that we do is continues and it just continues. In some cases, we do work hand in glove with a customer. We're on customer site. We're on our site, because that's where the work has to get done, but we're doing so in a fashion that allows us to protect our employees and provide them a work environment that allows them to protect themselves.

But in some cases, in many, many cases where about 75% of our workforce now is working remotely, working from home. And so, the work that we can do we can effectively be able to support our customers' missions in that regard as well. So, on the work side, those are some of the impacts.

As it relates to the timing of getting back, I've had extensive conversations with several customers and we're all navigating this in a very real-time method as we sit here today. So, in some cases, we're looking at the option to do work in a combination of our location and the customer location again to be able to spread out a bit more. So we're coming to table with some creative ideas on how to leverage our facilities and service for the customers.

In some cases, we're able to deploy technology that allows the customer to do the work in a different fashion as well. And so, I wouldn't say there is a date certain in which I could certainly predict that we'll get back to normal. I can tell you that that we are all in the industry side as well as the customer side, looking at the opportunity to continue to do the work that we do today as well as to be able to close the gap on some of the areas where there's been challenges. But I think it will continue to be days and weeks and possibly months, in some cases, as we continue to navigate that. Does that answer your question?

Joseph William DeNardi
Analyst, Stifel, Nicolaus & Co., Inc. Q

Okay. That's very helpful. It does. It does. And then, I'm wondering just on the Engility side, can you just talk about the revenue synergies, the extent to which you've recognized or realized any at this point as you guys look at it internally? What have you won that you couldn't have won independently? Or is that opportunity still in front of you, do you think?

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.

A

Yeah. So a couple of comments. One, we fully integrated the Engility business with the SAIC business upon closing that acquisition. And so, as we're now in year two of that, we don't really look at the business from what was Engility or could have been or what was SAIC. We look at it collectively. An example I can give you is EDIS is a great example of one where, coming together – obviously, we were able to secure that win and deliver at this juncture.

The other thing I'll tell you is, we look at it probably in broader conversation, so space is an example where the two of us together are so much stronger in serving the space missions and that continues to be a very, very robust part of our pipeline and part of our strategy.

And so I know that that probably didn't get to exactly what you're looking for, but I can tell you that the revenue synergies we see as a result of that acquisition are in the portfolio development in some critical areas like the intelligence communities, like the space missions that we are seeing growth.

Operator: You have a question from the line of Edward Caso with Wells Fargo.

Edward S. Caso
Analyst, Wells Fargo Securities LLC

Q

Hi. Good evening. Thanks. Just looking for some clarification here on the COVID-19 impact in the guidance. The support in the CARES Act goes through September 30. So, are you assuming that the arrangement will go to then and by that point, all the adjusted work plans will go away? Is that what the assumption is in the guide?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

That is basically the assumption. However, we do believe some of this will be carried till the end of the year of which should – potentially, the CARES Act could be extended or not, but our assumption is most of this risk is in the first half of the year or till the time that the CARES Act ends and – but we still have – we believe we still have some COVID impact till the end of the year that's not covered.

Edward S. Caso
Analyst, Wells Fargo Securities LLC

Q

And I guess the second question is the client – historically, the client generally has been reluctant to do things out of greater D.C., do things off client sites. Now that we're sort of into the business – back to business sort of as usual and clients are starting to say, what are the lessons learned, do you sense any break in that unwillingness to consider alternative models?

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.

A

That's a great question, and I've actually had that specific conversation with several customers over the course of the last 12 weeks or so. And I think you're exactly right. I think there is an appreciation and a willingness to look at different ways to deliver work. We have many customers that would never have contemplated being able to do the types of work that they do in a remote fashion. And, fortunately, working hand in glove with them helping create some of the technology-based solutions and demonstrating that we can, in fact, be as successful in a different delivery model than what they're accustomed to has – if there's a silver lining, maybe that's one of them, of this challenging way in which we're working.

So, I do believe that as we go forward, it's an opportunity for us to look at different bases around the US, being able to bring in talent from across the country and in some cases, being able to reduce the costs or improve profitability as it relates to different talent mixes. So, I think that's a great question and it's something that we are talking about and I do believe could have kind of a sustained rhythm going forward.

Edward S. Caso
Analyst, Wells Fargo Securities LLC Q

Great. Thank you.

Operator: Your next question comes from the line of Matt Akers with Barclays.

Matt Akers
Analyst, Barclays Capital, Inc. Q

Hi. Thanks and good evening. I wonder if you could comment a little bit about your thoughts on kind of the longer-term demand environment post-COVID. Are there certain areas of the budget that you think you can target that maybe sort of higher priorities after things have sort of cleared up? Or I guess, how do you think about positioning that portfolio [ph] the best go-forward (00:46:39)?

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp. A

Yeah. Great question. So, we're very fortunate to have a diversified portfolio across the customers we serve, as well as what we do. And I think that that continues to serve us well and will continue to serve us well in the months and years to come.

As I think about the potential of where we could see increased interest as we lean forward, certainly, there has been an appreciation that the digital transformation, the IT modernization, the leverage of cloud technologies and all of that that enables organizations to work in a different environment has certainly become more important collectively across the federal landscape.

And so, I think that scenario of opportunity, we're very, very well positioned to continue to serve the customers in that regard and bring solutions to bear that allow them to meet some of those objectives. So that would be one example where we could see increased interest, increased funding to be able to solve some of the challenges that exist in a more traditional IT back office. And so that would certainly be an example.

Cyber, the way that cyber feeds in, being able to manage the cybersecurity infrastructure in a distributed model certainly is an area that's getting a lot of attention and focus as well.

Matt Akers
Analyst, Barclays Capital, Inc. Q

Got it. Thanks. And then, I guess, if you could update us on, I guess, thoughts on working capital. You had talked in the past about maybe trying to approve DSOs and how much room is sort of still left to run there?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Yeah. Good question, Matt. So, we're very pleased with the DSOs of 60 days that we had in the quarter, and that was also reflected in the fact that people are working from home collecting and billing and going through that cycle. So, actually very pleased with that. So, we're looking to maintain that kind of level of DSOs for the remainder of the year, and our team has done a great job of adjusting to this environment. So, that's – I would say that's our target looking forward.

Matt Akers
Analyst, Barclays Capital, Inc.

Q

Got it. Okay. Thanks, guys.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.

A

Thank you.

Operator: Your next question comes from the line of Tobey Sommer with SunTrust.

Tobey Sommer
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you. I wanted to ask question about the single-award IDIQs, the 50% that's new business, what's sort of the arc and the cadence of that new business ramping in coming quarters, what do you think at this stage?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Well, I think some of the single-award IDIQs have started. FSG-80, for example, Air Force EDIS, and those are ramping up now a little bit slower than we had initially hoped for, particularly with the supply chain FSG-80 just because of the operational tempo. But I would say that we're on track as before except for the COVID related on these ramps. And I know there's a lot of focus on our team to transition quickly to get these ramped up. And just very pleased that we're in this position that we are to have – having won these and now it's transitioning and booking revenue. So, good question.

Tobey Sommer
Analyst, SunTrust Robinson Humphrey, Inc.

Q

And then my follow-up is, based on your cash flow outlook, when will your leverage be at a level that you can reassess your capital deployment priorities? And then specifically, could you kind of speak to the company's exposure in the public health arena and whether that would be an area of focus.

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

I'll take the first one on this one. So, we did make the $125 million voluntary debt payment last week. Based on our outlook, we believe we can make another $200 million of voluntary debt payments if we so choose to, and we'll evaluate that as we go through the year. So that would be a total of $325 million of voluntary debt combined with the $75 million of mandatory.

So, it's about $75 million more of debt repayments than we had initially planned and that would take our leverage down to – quite a bit of an improvement given the fact that, when we closed Unisys Federal, we were at 4.4 times, and this would be really cutting a lot of that off in that 3.6-3.7 type of range by the end of the year. And then we feel very confident of getting to the 3.0 times net debt-to-EBITDA by the end of fiscal 2022. So, I would say that we're focused on continuing to repay debt this year and we'll re-evaluate next year as far as capital deployment and any changes there.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.
A

Yeah. This is Nazzic. So, I'll touch briefly on the public sector health market, certainly, it's getting a lot of attention as we sit here today. Over the course of the last couple years, as I've talked about the priorities, if and when we were to look external, that was one of the areas that I gave as an example. We do not have a significant portfolio serving that part of our market and it has been and continues to be something of interest.

Now, the good news is that we do have solutions that we can take to that market today. And so, if you think about public sector health and their need to modernize our systems, their need to go through digital transformation, those solutions that we have can serve that market and do serve that market and will continue to do so. But as it relates to the deep domain expertise, that would be something as we look forward in the months and years to come as an opportunity to not just organically, but potentially inorganically look to be able to complement that.

Tobey Sommer
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Thank you.

Operator: And your next question comes from the line of Louie DiPalma with William Blair.

Louie DiPalma
Analyst, William Blair & Co. LLC
Q

Nazzic, Charles, and Shane, good afternoon.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.
A

Hello.

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.
A

Hi, Louie.

Louie DiPalma
Analyst, William Blair & Co. LLC
Q

Nazzic, you referenced your Engility space assets. Last week, SpaceX completed an exciting mission as part of NASA's Commercial Crew Program. You're obviously one of the largest providers for NASA and the Space Force. What are your thoughts about the future budget plans for the Space Force, NASA and the moon mission? Do you think that there's bipartisan support there?

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.

A

I certainly can't begin to predict what could happen with whether it's a new administration or even the existing administration down the road. I can tell you that we're very fortunate to serve that customer and to serve these critical missions. And our team takes great pride in it. We bring a tremendous amount of great engineering and related IT work to support the mission. So, at this juncture, they're getting good support. At this juncture, they're getting – being afforded the budget to help serve their missions and we're very, very happy to be part of that.

Louie DiPalma
Analyst, William Blair & Co. LLC

Q

Thanks. And, Charles, can you quantify the amount of integration and restructuring costs for the Unisys acquisition that remain for the rest of the year?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Well, it's pretty small. I can't – let's see. Less than $10 million.

A

[indiscernible] (55:08)

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.

A

Yeah. Unisys Federal.

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Yeah, it's Unisys Federal, right? Unisys?

Louie DiPalma
Analyst, William Blair & Co. LLC

Q

Yes. Yes.

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.

A

Let me get back to you on that one, because I'm not exactly sure. I don't want to give you the wrong number here. We have some acquisition integration related to – still to Engility, a very small part of that. And then we have Unisys Federal, of which, a large part of that was taken acquisition integration in the first quarter. So, we would like to follow up with you and get back to you more specifically on that. So...

Shane P. Canestra
Vice President-Investor Relations, Science Applications International Corp.

A

But, Louie, this is Shane. I think in total for the year between the two efforts, it still remains $60 million for the full year and we'll get this breakout.

Louie DiPalma
Analyst, William Blair & Co. LLC
Q

Great. Thanks, Shane. Thanks, everybody.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.
A

Thank you.

Operator: You have another question from the line of Jon Raviv with Citigroup.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.
A

Hi, Jon.

Jonathan Raviv
Analyst, Citigroup Global Markets, Inc.
Q

Thanks so much for – hey. Thanks so much for taking the follow-up here. [ph] I'm just – got to ask you one earlier (00:56:17), Nazzic. Nazzic, any sort of perspective on creating that role for Dee Dee and bringing her on? I mean, it's a pretty notable hire, someone with a long career at a competitor, involved in a group, driving a lot of change in that other company. What are your plans for SAIC? I know you previously talked about some pivots that you guys are looking to make. So, what are you looking for out of this particular change?

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.
A

Great question. So, as we've looked at the priorities of the company, the strategy of the company, I've really reinforced – one of my top three priorities is to pivot us to profitable organic growth. Then in working with the leadership team, we decided that having somebody who – we all wake up every day focused on it, but who really look across the enterprise, across the Customer Groups, across the Solutions & Technology Group to really help us strengthen our position and strengthen our resolve and focus on growth would be a terrific position and money well spent. And so, as I think about it, it really is to continue to strengthen the leadership team and bring on somebody like Dee Dee, and we're thrilled that she joined us to really help us strengthen our commitment, strengthen our resolve, bring us some best practices as we continue our journey on driving growth.

Operator: You have another question from the line of...

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.
A

Does that answer your question?

Operator: Sorry. You have another question from the line of Cai von Rumohr with Cowen & Company.

Cai von Rumohr
Analyst, Cowen & Co. LLC
Q

Thanks so much. So, you had $33 million of D&A in the first quarter, flat year-over-year even though you had seven weeks of Unisys. How come it wasn't higher, and where should we model D&A for the full year?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.
A

Yeah. So, Cai, let me give you just some general guidance on this. So, depreciation and amortization for the full year is about $175 million. $135 million is amortization intangibles, $35 million depreciation.

Cai von Rumohr
Analyst, Cowen & Co. LLC
Q

Okay. And how come it wasn't higher in the first quarter given that you had Unisys for half of the quarter?

Charles Alexander Mathis
Executive Vice President & Chief Financial Officer, Science Applications International Corp.
A

Yeah. I'm not sure why that is. I would have to get back to you on that, Cai. Let me give you a couple of other just kind of guidance assumptions here why we have the – the tax rate we're assuming for the full year is 23% to 25%. We're also assuming interest expense of $31 million to $32 million per quarter. And we're assuming in the guidance share count an average of 58.7 million year-end diluted shares. And I will get back to you as far as the depreciation and amortization on Q1.

Operator: Your final question comes from the line of Gavin Parsons with Goldman Sachs.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC
Q

Hey, guys. Thanks for the follow-up. Do you expect AMCOM and TADS to be protested? And is there any risk to your guidance if those go into an extended protest cycle like you experienced last year? Thanks.

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.
A

Yeah. The good news is – and I'm happy to report they're both out of their protest cycle.

Operator: And there are currently no other questions. I would now like to turn the call back to Shane with any closing remarks.

Shane P. Canestra
Vice President-Investor Relations, Science Applications International Corp.

Thank you very much for your participation in SAIC's first quarter fiscal year 2021 earnings call. This concludes the call and we thank you for your continued interest in SAIC.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.