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Science Applications International Corp. (SAIC)
Q2 2022 Earnings Call
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MANAGEMENT DISCUSSION SECTION

**Operator:** Good day and welcome to SAIC's Second Quarter Fiscal Year 2022 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 second quarter fiscal year 2022 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 Prabu Natarajan, our Chief Financial Officer. Today, we will discuss our results for the second quarter of fiscal year 2022 that ended July 30, 2021.

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. These documents, in addition, to our Form 10-Q to be filed soon should be used 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 defer 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. Thank you all for joining us today. Before I begin our quarterly update, I would like to take a moment to share some great news on the leadership transition of an exceptional individual that many of you know very well. Those of you in the investment community have worked closely with Shane Canestra over the past several years. Shane will be transitioning into a new assignment within the company, leading our corporate social responsibility and public relations function. I'm excited for Shane's continued growth in SAIC. This is a real-time example of our focus and investment in talent development.

Joe DeNardi, who many of you also know, will be joining us to lead our investor relations function, bringing a wealth of experience from his prior role as a sell-side analyst. Joe and Shane will work closely over the next few weeks to ensure smooth and seamless transition with our investment community.

Now on to the business at hand, we are excited to discuss our quarterly results and updated outlook for the rest of fiscal year 2022. SAIC performed very well in the second quarter, delivering strong financial results, while continuing to execute on our strategy for long-term shareholder value creation.

During our second quarter, the team delivered strong revenue, increased organic growth and outstanding profitability. Organic growth for the quarter was approximately 4%, our third consecutive quarter of organic revenue growth. Adjusted EBITDA margin was 10.1%, another all-time high after producing record margins last quarter.

Free cash flow generation continued to be strong and in line with normal second quarter seasonality. We continue to allocate capital for long-term value creation through a balanced mix of accretive M&A, share repurchases and dividends. We are proud of our accomplishment while remaining ever vigilant in driving performance into the future. SAIC is in a strong position as we focus on our tomorrow. We are strategically positioned with a balanced portfolio of business and capabilities.

We've accelerated our investment in technology, talent, and solution developments in critical areas including digital transformation, artificial intelligence, and engineering innovation, while also enabling our customers to procure these solutions and services in newer acquisition and delivery models. For example, last quarter, we discussed our acquisition of Koverse, a key step in creating the artificial intelligence platform for our solutions.

Our efforts with Koverse are off to a great start as we have seen an encouraging number of important new business opportunities. We are excited about the differentiation we can bring to our customers through the combination of our deep mission understanding and Koverse's unique technology platform utilizing artificial intelligence and machine learning on complex, sensitive data.
This quarter we launched another suite of technology solutions in CloudScend, our end-to-end suite of integrated cloud and digital tools. With CloudScend, we are able to systematically modernize customer's legacy systems with proven and repeatable processes and tools, immediately unlocking the value of the cloud.

We're already seeing success in CloudScend in our work with an army customer where SAIC assessed, modernized, and migrated 90 applications to a cloud environment by leveraging CloudScend. By migrating and rebuilding application components in the cloud and for the cloud, we strengthened cybersecurity, improved application performance, and delivered a lower total cost of ownership to our customer.

Combined with our continued investments in areas such as zero trust and digital innovation, we are delivering significant value to our customers. Our solutions-focused investments and tools continue to accelerate, secure, and deliver our customer's mission needs for greater adoption of emerging technology.

We've also made significant strides in the second quarter by expanding our presence in growing markets, specifically federal health. Our acquisition of Halfaker and Associates is off to a good start, performing well and providing immediate access to strategic health sector customers. Early successes are being driven by the strategic intersection of a customer and contract vehicle access brought by Halfaker, combined with market-leading offerings and capabilities leveraged from the entire enterprise. With the full scale and breadth of SAIC now available to Halfaker, we are investing and further accelerating new business opportunities as one fully integrated team in the federal health market.

It is also important to note the accomplishments we have made in our commitment to cultivating and attracting industry-leading talent, one of our strategic priorities. We recently announced the hiring of a Chief Climate Scientist to advance SAIC's leadership, capabilities, and solutions in support of our customers as they address climate-related missions, a critically important priority for this administration.

We remain committed to a culture that promotes the hiring, retention, and development of our largest asset, our exceptional talent. Talent is a critical element of our strategy. And I'm pleased with our ability to differentiate ourselves in a tight labor market, allowing SAIC to deliver the strongest teams to the most pressing customer challenges. Our continued investment in talent is a key differentiator and enabler of profitable growth in the market.

The actions taken in the second quarter underscores our commitment to investing in mission critical emerging technologies, expanding our customer base, and securing key talents. We will continue to share important technology and mission updates as we make progress in these areas.

Let me now turn to what we're seeing in the market as we enter the last month of government fiscal year 2021. Our customers continue planning for the future and making the war decisions. While it is very likely that the government's fiscal year 2022 will start under a continuing resolution, our country's leaders are working through the budgeting process with indications that appropriations could be in place by the end of the calendar year. While not optimal, it is also not unusual that SAIC knows how to successfully navigate this environment.

We believe that federal budgets are shaping largely in line with the President's request and perhaps a bit more favorable but initially requested for the Department of Defense. While the process is still unfolding, we are encouraged by the recognition from our country's leaders on the importance of continued technological investment. Of course, the pandemic continues to be at the forefront of everyone's thoughts. The emergence of the Delta variant and a surge in cases has resulted in continued caution. SAIC continues to operate well, navigating the environment but also looking forward to an eventual return to a new normal.
Our plan is to continue at a hybrid work environment, recognizing some employees required to be at SAIC or customer sites while others can work partially or fully remote. This approach aligns well with our objective to attract and retain high quality talent by providing flexibility for our workforce. This will continue to open our aperture for talent as we recruit from a wider geographical area.

Prabu will now discuss the details of our second quarter results and financial outlook for the rest of the year.

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

Thank you, Nazzic, and good afternoon, everyone. SAIC delivered another quarter of strong performance across a variety of financial measures. We continue to deliver in the near-term for our shareholders while continuing to make the necessary investments to align to our long-term future.

Let me start with our business development results. Net bookings for the second quarter were approximately $1.6 billion, translating to a quarterly book-to-bill of 0.9 and a trailing 12-month book-to-bill of 1.6. The larger contributions to our quarterly bookings are disclosed in our press release today.

At the end of the second quarter, SAIC's total contract backlog stood at over $24 billion, up 25% from a year ago. At the end of the second quarter, the value of submitted proposals was nearly $20 billion, up from last quarter by $1.7 billion, reflecting a continued healthy pipeline and strong demand for our solutions, just over half of the value of submitted proposals is for new business opportunities.

Let me now turn to financial results for the quarter. Our second quarter revenues of approximately $1.84 billion reflect growth of 4.1% as compared to the second quarter of last fiscal year due to ramp-up on new and existing contracts, net favorable changes in contract estimates, and partially offset by contract completions.

Halfaker and Associates, which closed early in July, contributed a modest amount of revenues for the quarter. Excluding the impact of the acquisition and divested revenues, second quarter revenues grew organically by 3.8%.

Second quarter adjusted EBITDA was $185 million, an $18 million increase from prior year. Adjusted EBITDA margin was 10.1% after adjusting for $14 million of acquisition and integration costs. Second quarter margin performance was very strong across the business and a quarter favorably benefited from solid profitability across the portfolio, net favorable changes in contract estimates and the accelerated amortization on certain off-market liability contracts. The acceleration of amortization of off-market liability contracts and other contract adjustments totaled $17 million for the quarter or about 80 basis points of profitability.

Diluted earnings per share was $1.41 for the quarter, inclusive of the second quarter acquisition and integration costs of $14 million. Excluding these costs, as well as amortization of intangibles and net of a tax rate of approximately 24% in the quarter, our adjusted diluted earnings per share was a $1.97.

Second quarter free cash flow was $85 million, a quarter of solid cash generation and day sales outstanding at the end of the quarter were approximately 60 days. Second quarter generation was modestly below the prior year quarter. However, last year’s generation benefited from about $40 million of payroll tax deferral as supported the CARES Act.
During the second quarter, we deployed $310 million of capital towards the closing of the Koverse and Halfaker acquisitions, share repurchases, dividends and capital expenditures. In addition, we continue to de-lever, making mandatory debt repayments and ending the quarter with a net leverage ratio of just under 3.5 times. We are running modestly ahead of our internal targets on this front due to our favorable performance. We continue to prioritize share repurchases over voluntary debt repayment in the quarter. As announced in our press release today, our board of directors has approved a quarterly cash dividend of $0.37 a share payable on October 29 to shareholders of record on October 15.

Now turning to our forward outlook as noted in our press release today and slide 8 of the presentation slides. Based on performance of the second quarter, the addition of Halfaker and Associates to the portfolio and our outlook for the rest of the year, we have updated our guidance to the following. Revenue between $7.3 billion and $7.4 billion, raising the lower end of our previous range by $50 million and adding approximately $100 million of anticipated contribution from Halfaker and Associates. This reflects lower estimated full-year COVID impacts of approximately $125 million, down from $150 million and achieving ramp on new programs, somewhat earlier than previously anticipated.

Given recent COVID trends, we expect to see continued pressure in our supply-chain portfolio over the next few quarters. However, we are challenging our team to focus on growing the portfolio with or without any recovery in this business. Adjusted EBITDA margins between 8.9% and 9% raising the top and bottom end of our previous range reflecting our strong year-to-date performance but continued anticipation of higher indirect costs and increased investments in the second half of the year.

On EBITDA dollars, we continue to expect COVID to have up to $10 million of impact in fiscal 2022, unchanged from our prior estimate. Adjusted diluted earnings per share between $6.50 and $6.70, raising both the top and bottom end of our previous range reflecting increased profitability from Halfaker and our strong first half performance. Free cash flow unchanged at between $430 million and $470 million.

Summing up, we are pleased with our strong performance of Q2 and look forward to solid execution over the remainder of the year. Nazzic, back to you.

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

Before taking your questions, I would like to highlight SAIC's recently published 2021 Corporate Responsibility Report. As you've heard from us in multiple venues, SAIC is very focused on creating a better tomorrow from climate change, strong corporate governance, to diversity, equity and inclusion, we are committed to making a difference for our stakeholders, environment and communities. It is core to who we are and it's reflected in our purpose statement to advance the power of technology and innovation to serve and protect our world.

Operator, we're now ready to take questions.
QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Cai von Rumohr from Cowen. Your line is open.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Yes. Thank you very much. So, first, your guide looks like it’s essentially unchanged if we take out the COVID and we take out Halfaker. And your numbers imply that looks like organic growth decelerates in the second half. Is that correct? And if so why?

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

Hi, Cai. It's Prabu here. Thanks for the question. In terms of the guidance, maybe I'll just jump right to it. We're very pleased with our performance for the six months of the year. I think the second quarter followed a really good first quarter on both top line as well as bottom line. We view our guidance as challenged at this point of the year. We de-risked what I would call risk to the top line in the first six months of the year and that led us to increase the bottom end of the guide range.

In addition on the top end, we do have plans ahead of us in the form of the S3I world that is going around about in the second half of the year and also continue to ensure we get the right talent on the restricted work we have up there. So I'd say on balance, given maybe a little more muted COVID impacts in the second quarter and adding Halfaker to it, we, sort of, up the lower-end by $50 million and then add $100 million of Halfaker to it.

In terms of, sort of, the second part of the question around deceleration in the second half, as you know, the seasonality in this business, we tend to see softer Q4s. If you actually run the math on the number of productive days in the first half versus the second half, we actually have four fewer working days in the second half than the first half. So if you, sort of, take the first half revenue number at $37 million, if you, sort of, annualize that, it's about $74 million for the year and the reality is that extra four days that we don't have in the second half is effectively about $120 million to $130 million. But we do have, sort of, the ramp on S3I occurring so that cost us our top end of the guide range to be approximately $74 million or so.

So that's sort of the math. As you know, growing the business on a consistent basis is really important to us. It is part of our incentive comp metrics. And therefore, we know what the team has in front of it over the next six months. We're obviously pleased with the performance in the first six months of the year, but we've got six months to go get the remainder of what we need to go accomplish here. So we would hope that we could be able to take a positive view of the performance as we go one quarter at a time here.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Right. So, I mean, if I look at the organic growth last year, it was negative. So it's not like you have a very difficult comp and COVID is down year-over-year. So I still am a little bit mystified why give away basically a 1.5-plus trailing 12 book-to-bill, the organic growth in the second half would not at least equal the second quarter. And is there something else happening?
Prabu Natarajan  
*Executive Vice President & Chief Financial Officer, Science Applications International Corp.*

Right. So we get the question, Cai. I think as they walk through in the math, we're always seeking to offer a balance, sort of, transparency in the way we talk about the risk of the business. And we know what we have to go through in the next six months. And I wouldn't quarrel with the math around what the implied run rate might be?

But with COVID still being a dynamic out there in the second half of the year, there's still a fair amount left in the year. And again, as I said, we hope to come back and have another conversation in December here after Q3. But we've got some ways to go here but the trend lines are positive. And I want to acknowledge that because we're really pleased with the performance of the team but we've got some work to do in the remainder of six months.

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

Yeah. Cai, this is Nazzic. And so let's talk a couple of things that Prabu said. So, obviously, we are pleased as you mentioned with the accomplishments for the first half of the year. I believe we've got a good trajectory going and feel confident in our ability to deliver on the business. But as we look and as Prabu mentioned, there is still half a year to go. And so we believe this is a very balanced risk adjusted set of metrics and guidance that provides visibility, derisk the top line as Prabu mentioned, incorporated Halfaker. But again, there is still half a year to go, so that's really how we think about it. And to Prabu's point, we're optimistic. We feel good about the business. But there's always elements of risk that come into play and we want to make sure that we look at it holistically.

Cai von Rumohr  
*Analyst, Cowen and Company, LLC*

Great. Thank you very much.

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

Thanks, Cai.

**Operator:** And your next question comes from Greg Konrad from Jefferies. Your line is open.

Greg Konrad  
*Analyst, Jefferies LLC*

Hi. Good evening. And just wanted to congratulate Shane, he's been a pleasure to work with. But just looking at, kind of, following up on the last question, just looking at guidance and implied EBITDA at the midpoint goes down to 8% and you, kind of, called out higher investments. Can you maybe help bridge where the opportunities are on the profit side given some of the one-timers in H1 and even adjusted for those? I mean, I think you were still above 9% in Q2.

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

Got it. Thanks for the question, Greg. As I mentioned in my prepared remarks, there were some favorable, I call them materially favorable items in the second quarter that impacted profitability in the second quarter. And as you recall, we also had a significant number of adjustments in the first quarter. Now, the back half math would imply a low-to-mid 8% EBITDA margin rate, and we expect couple of things to happen. One, that we will continue to
spend and invest in the business to sustain the growth rates we’re starting to see in the business, one. And two, I think we also have indirect costs that have undergone in the first half of the year relative to the second half, and we are actually expecting some ramp up in the indirect spend in the second half of the year relative to the first half.

So again, I'd probably go back to the notion that if you, sort of, took the large adjustments as I mentioned in the script that drove second quarter profitability from 10.1%, so we offered a bridge of about, let's call it, 80 basis points to get us to, I call it, sort of, 9.91% in the second quarter. So really good performance in the second quarter gets you to about, sort of, a little over 9%. And then if you then had these couple of elements that I just pointed out in the form of additional investments then it, sort of, implies a back half margin rate of, sort of, a low-to-mid 8%.

I'm going to go back and respond in the way I responded to the prior question, which is, look, we know what we have to do to profitably grow the business. But we're going to take this one quarter at a time and make sure we're executing a quarter out what we're planning three years out of this business. So we understand the back half math. We know what the teams need to go to. It is an important part of an incentive metric for us to ensure that we're profitably growing the business. So I'm looking forward to having the conversation again. But those are the specific drivers and, sort of, broadly how we're thinking about EBITDA performance.

And then just a quick follow-up to that. You raised top line and EBITDA. Is there an offset to why the cash is unchanged or any, kind of, changes the fact given some of the acquisitions?

So, yeah, on cash, look, we're proud of our execution year-to-date on top line as well as EBITDA. On cash, some of the EBITDA adjustments we saw in the second quarter are what I would primarily term non-cash. So they were earnings pickups without a corresponding cash element this year. So that's in part why our cash diet hasn't changed.

I think the second more important factor is a lot of cash gets collected in this business in the second half. And therefore, if you think about the seasonality of the cash flow, we know what we have to go do in the back half of the year around cash. And if you think about cash on a year-to-date basis comparing the first half of 2022 versus the first half of 2021 and if you actually adjust it for the payroll deferral that we got in the first half of last year, we're actually about 20% higher on an operating cash basis on an apples-to-apples if you just adjust it for the payroll deferral.

So I think we're off to a good start on cash. We have a lot of cash to go collect over the rest of the year and we're going to keep working really hard on cash. As I've always said, it's important to convert net income to cash on a really strong basis. And on a longer-term basis, we really do believe that there's opportunity on converting EBITDA into cash here again in the form of DSO. So we're going to work this structurally over the long term but for the moment, I'd say we're comfortable with where the guide is with some opportunity in the back half as long as we continue to do the essentials to collect the cash to generate good operating cash flow.
Thank you.

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

Thank you.

Operator: And your next question comes from Seth Seifman from JPMorgan. Your line is open.

Seth M. Seifman  
Analyst, JPMorgan Securities LLC

Hi. Thanks very much, and good afternoon.

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

Good afternoon.

Seth M. Seifman  
Analyst, JPMorgan Securities LLC

I was wondering if you could talk about the NASA interest contract and just how that factored into the view on the top line? And also whether to the extent that it did factor in, if that was accretive to the margin rate?

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

Hi. Good afternoon. It's Nazzic. So as you're likely aware, we did file a protest earlier this year and as a result of that protest, NASA has decided to take corrective action which drove the GAO to dismiss the protest. So that's the status where we are today. As it relates to – and of course, we continue to perform the work for our government customer, continue to support their mission and we'll continue to do everything in our power to maintain that ability to do so.

As it relates to our forecast and the guidance, as with any contract, we take a holistic view. We risk adjust those at the top line and the bottom line based on the knowledge that we have today. And so there is an element of that that is factored in as based on the information that we have at this point.

Seth M. Seifman  
Analyst, JPMorgan Securities LLC

Okay. Okay. And then as you look at the fixed business, I guess, if you could talk about how things have played out in the quarter and thus far this year? And then it sounded like there were maybe some challenges in that business still as a result of COVID and yet we saw the expected impact of COVID on top line fall. So maybe, what the puts and takes are in that business and where it's, sort of, headed with your expectations?

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

So, with respect to the supply chain business back in March, we've signaled that business tends to operate in the range of $10 million to $15 million a week. And where we're seeing volumes in that business is, sort of, squarely in the midpoint of that range between $12.5 million and $13 million a week. And I think when we start to see that business recover closer to $15 million, I'd probably look back and say we'll probably seeing the last wading effects
of COVID. But at this point, I'd say we're still sort of in the midpoint of that range. The business is not any better than it was in Q1, certainly not any worse than it was in Q1. It's sort of maintaining the run rate here.

I think we're sort of estimating what the COVID impacts are for the year. And as you can tell from some of the data we've provided, we're running at about $30 million to $35 million of COVID impacts in a given quarter. And that's, sort of, annualizes to about $125 million at the – in the script. So, I'd say that's where we are and obviously, it's a watch item for us. We spend a lot of time watching weekly volume here of that business. But I'd say, it's fairly stable at this time.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Okay, great. Thanks very much.

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

Operator: And your next question comes from Matthew Akers from Wells Fargo. Your line is open.

Matthew Akers
Analyst, Wells Fargo Securities LLC
Hi. Yeah, good afternoon and...

Prabu Natarajan
Executive Vice President & Chief Financial Officer, Science Applications International Corp.
Hey, Matt.

Matthew Akers
Analyst, Wells Fargo Securities LLC
...congrats. Congrats to Shane. Appreciate all your help.

Prabu Natarajan
Executive Vice President & Chief Financial Officer, Science Applications International Corp.
[indiscernible] (00:30:10) Matthew.

Matthew Akers
Analyst, Wells Fargo Securities LLC
Yeah. Wonder if you could touch on the hiring environment. I think head count was kind of flat sequentially based on the number in your release. And is that – okay, do you guys need to grow head count and just, sort of, what are you seeing out there in the labor market?

Nazzic S. Keene
Chief Executive Officer & Director, Science Applications International Corp.
Yeah, thanks. Thanks for the question. Yeah, so we have about 26,500 employees right now, and that includes the acquisition of Halfaker. And you're right, there is certainly some conversation around a tighter labor market for
a couple of reasons. One, obviously, coming out of the pandemic, we're seeing attrition slightly tick up and that's across our industry for certain and probably most industries as well as the opportunity to grow.

Now with that being said, we've performed very well during the height of the pandemic. As we went into the pandemic situation, we had already mobilized the ability to interview, hire, recruit in an offline manner and able to do so remotely and that served us exceptionally well during that time, so we continue to use that.

We also as a result of our own flexibility as well as increased government customer flexibility have the opportunity to hire talent from lots of geographies and so that's opened the aperture for us. And then we continue to focus on investments inside the company to drive ourselves to be an employer of choice and to differentiate ourselves in the market by leveraging whether it's flexibility, obviously cost benefits, the traditional methods. And so all of those things certainly go into play. We believe we can hold our own and have held our own as it relates to hiring and retention of staff. But there certainly is a tighter market. And we're very cognizant of that and reacting, as well as being proactive to ensure that we can set ourselves apart in that labor market.

Matthew Akers  
Analyst, Wells Fargo Securities LLC

Okay. Thanks [indiscernible] (00:32:03).

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

Thank you.

Operator: [Operator Instructions] Your next question comes from Gavin Parsons from Goldman Sachs. Your line is open.

Gavin Parsons  
Analyst, Goldman Sachs & Co. LLC

Hey. Good afternoon.

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

Hi, Gavin.

Gavin Parsons  
Analyst, Goldman Sachs & Co. LLC

And, Shane, congrats on the new role.

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

Thank you very much, Gavin.

Gavin Parsons  
Analyst, Goldman Sachs & Co. LLC

Guys, on the implied deceleration in growth in the back half, just wanted to touch on the elements of the risk that you're talking about. Is that you actually have visibility into headwinds in the back half and the risk is on how fast
you can ramp up offsetting wins or offsetting revenue to grow? Or is the risk that you don't necessarily have visible headwinds? You have visible growth but you're being cautious about unknown headwinds, if that makes sense.

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

Hey, Gavin. Prabu, here. I'll take the question. We have visibility into the growth in the back half of the year. We said at the start of the year that army REITs will ramp starting in the second half. We actually saw some good growth on army REITs in the second quarter. We said that AMCOM S3I portfolio will ramp in the second half. And all indications are we're well on track to ramping up on S3I.

So certainly from defense point of visibility, I think we have good visibility. I think what we don't have and most people don't is the dynamics around COVID and specifically the impacts, if you can see, on a near-term basis within the portfolio that could potentially be higher than what we're contemplating. So I'd say there is a cautious element to the guide. We do see the ramp. But it is also a tight labor market where we have to go get the head count in place for us to start renting on these programs.

So it's probably a combination of those things that causes us at Q2 to be perhaps cautious around the way we're thinking about the back half of the year, given what we experienced which is severe deceleration at Q4 of last year. So, having lived that painful lesson, we want to make sure we're cautious about how we think about the back half of the year. And again, as I said, at the top of the call, we're hoping to have better results on top-line growth at the Q3 call. But that means you have to actually go get some of these things done.

Gavin Parsons  
Analyst, Goldman Sachs & Co. LLC

Okay. That makes sense. That's helpful on this contract specific detail as well. This may be difficult to do, but if you were to just strip out the COVID impact entirely from this year and last year, what's the business growing? And is that, kind of, the right near-term run rate or do you still have the impact of your trailing bookings to accelerate that or how do we think about that going forward?

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

Got it. There are a couple of ways to think about this question. I think, one, you could certainly add the COVID impact at the second quarter of this year to the 3.8% organically and say here's the business growing at 5%. I think there's probably just another fair way to think about this, which is you think about the COVID impacts from Q2 of last year and then, sort of, eliminate that in the comparison, to say, organically, apples-to-apples, what is this business growing at? And I'd say that math would get you to a number that's in the low 2% range on an apples-to-apples basis. But here is where I think there's an important lesson. That percent is before the S3I program starts to ramp. And that's inherently I'd encourage you the way to think about this business as we build momentum into the second half of the year.

Gavin Parsons  
Analyst, Goldman Sachs & Co. LLC

Got it. And then just last question on cash flow. Obviously, again COVID created a lot of lumpiness there too but you're still on track for the original $1 billion for 2021 and 2022. If you were to roll that forward to include 2023, realizing there's still some COVID impact there, I think around the repayment of the deferred payroll taxes. Should we think of the two-year period including 2023 as higher or lower or similar?
Prabu Natarajan  
*Executive Vice President & Chief Financial Officer, Science Applications International Corp.*

So, I've always said that this business is a strong generator of cash. I've also said that there's opportunity in DSO that would allow us to get better if we make some structural changes to the way we did. So we're on our way to getting better on cash. We're certainly not going to guide through FY 2023 cash at this point. But suffice it to say, that it was a really important message for us. In fact, we've given it higher ratings in our long-term incentive comp plan starting this year. So we know what we have to go through on cash. And, look, we are getting solid generation of cash and we're going to keep doing that over the next few years.

Gavin Parsons  
*Analyst, Goldman Sachs & Co. LLC*

Got it. Thanks, Prabu. Excellent.

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

I think the one thing I can add there is, is this is an area where Prabu – you could probably hear the passion in his voice when he talks about it, but it's an area that is – as he noted is incredibly important to us from overall metrics and compensation and one which he's put a lot of attention focused. And I know that we'll see the benefits of that.

Gavin Parsons  
*Analyst, Goldman Sachs & Co. LLC*

Thanks.

Operator: And your next question comes from Tobey Sommer from Truist Securities. Your line is open.

Tobey Sommer  
*Analyst, Truist Securities, Inc.*

Thank you. And, Shane, congratulations. You performed in a superior fashion, and I'm sure you'll continue to do next role. I wanted to ask a question about COVID but from a longer-term perspective and maybe stepping back. Are there material changes that you're seeing now that we've been dealing with this from a long-term perspective and it looks like we will be for the foreseeable future? Their customers are, kind of, really studying, making different changes in the way they procure services and the way they allow work to be done, and then internally, from your perspective, your ability to staff projects and fulfill your clients' needs in a more diverse fashion that perhaps isn't as DC-centric?

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

Thanks, Tobey. Absolutely. I think we are seeing a pretty substantial change in a few areas, and let me touch on those. You talked about one of them or you asked about one of them as it relates to our customers’ willingness and ability to either work differently themselves or certainly engage with us in how they work, and we're seeing that across the board.

It has been probably more common in some of the commercial industries to have workforce working in different fashion, whether it's remote, whether it's offshore. But for the federal government, it has been – it's certainly been part of the way they do business but nothing like we're seeing now.
So I do believe that we are seeing a – I’ll say permanent. I don't know what permanent means but a change that will endure past this particular pandemic stage as many of our customers are allowing for geographic flexibility whether it’s an office in a different city, whether it’s remote work and they're doing still both with their own employees as well as with their partners. And so I do believe that that is enduring and we'll be able to continue to operate that way.

There are some positives that come with that. As I mentioned earlier, it does allow more flexibility in our ability to recruit, hire and retain individuals in different parts of the country. It allows in some cases the ability to reduce the cost of labor, being able to hire in some areas where there might be more talent at a lower labor cost. And so we do see a benefit to that. And it also allows many cases in some geographical areas where the labor market tends to be tighter, just the greater access to talent. And so I think that's enduring. We're seeing that is enduring and in many of our customers, I think we'll create this opportunity as a permanent way to do business together.

Now, the other part of that is obviously, and you’ve heard from our competitors talk about the ability to potentially reduce the real estate footprint. And certainly that’s something we’re looking at. And we'll continue to work through that and provide guidance and insight as we make decisions there. But that will also allow for a lower cost structure. Obviously 50% of our portfolio being cost plus. The government benefits from that as well. And then it just gives us different opportunities from an investment standpoint. So we believe that that will be something that is enduring as well as we look forward.

**Tobey Sommer**  
*Analyst, Truist Securities, Inc.*

Thanks. And you went into financial implications, which is going to be my follow-up. On an aggregate basis, not looking at real estate and isolation, are you able to discern at this point whether the net impact of these changes plus with the customer level and within the company are accretive to profitability or dilutive?

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

I’ll take that one. I would say on balance given the predominant cost plus mix in this portfolio right now. The ability to take some cost out and reinvest in parts of the business that need that investment is a really important way to think about this. So on balance, we'll see some cost reduction but we are likely going to want to reinvest that in the business to continue to grow the business. So I’d say – from a margin rate perspective, I’d say it probably will not be a significant driver to profitability over the long term. But you should think about this as financial flexibility for the company to invest in the areas that need additional investment.

**Tobey Sommer**  
*Analyst, Truist Securities, Inc.*

Understood. Thank you very much.

**Operator:** And there are no further questions at this time. I will now turn back the call to Shane Canestra for closing remarks.

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

Thank you very much for your participation in SAIC’s second quarter fiscal year 2022 earnings call. This concludes the call. And we thank you for your continued interest in SAIC.
Operator: And this concludes today's conference call. Thank you for participating. You may now disconnect.