Company Name: Science Applications
Company Ticker: SAIC US
Date: 2023-12-04
Event Description: Q3 2024 Earnings Call

Market Cap: 7052.047924498352
Current PX: 133.22000122070312
YTD Change($): 23.16
YTD Change(%): 21.043

Bloomberg Estimates - EPS
Current Quarter: 1.518
Current Year: 7.484
Bloomberg Estimates - Sales
Current Quarter: 1631.9
Current Year: 7225.8

Q3 2024 Earnings Call

Company Participants

- Joseph DeNardi, Vice President of Investor Relations and Strategic Ventures
- Toni Townes-Whitley, Chief Executive Officer
- Prabu Natarajan, Executive Vice President & Chief Financial Officer

Other Participants

- Jason Gursky, Analyst
- Bert Subin, Analyst
- Cai von Rumohr, Analyst
- Seth Seifman, Analyst
- Sheila Kahyaoglu, Analyst
- Matt Akers, Analyst
- Josh Corn, Analyst
- Tobey Sommer, Analyst

Presentation

Operator

Good morning. My name is Krista and I will be your conference operator today. At this time, I'd like to welcome everyone to the SAIC Fiscal Year 2024 Third Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Thank you.

I would now like to turn the conference over to Joe DeNardi, Vice-President of Investor Relations. Joe, you may begin.

Joseph DeNardi, Vice President of Investor Relations and Strategic Ventures

Good morning and thank you for joining SAIC's Third Quarter Fiscal Year 2024 earnings call. My name is Joe DeNardi, Vice President of Investor Relations and Strategic Ventures, and joining me today to discuss our business and financial results are Toni Townes-Whitley, our Chief Executive Officer; and Prabu Natarajan, our Chief Financial Officer.

Today we will discuss our results for the third quarter of fiscal year 2024 that ended August 4, 2023. Earlier this morning, we issued our earnings release, which can be found at investors.saic.com, where you will also find supplemental financial presentation slides to be utilized in conjunction with today's call and a copy of management's prepared remarks. These documents, in addition to our Form 10-Q to be filed later today, should be utilized in evaluating our results and outlook along with information provided on today's call.

Please note that we may make forward-looking statements on today's call that are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from statements made on this call. I refer you to our SEC filings for a discussion of these risks, including the risk factors section of our annual report on form 10-K. In addition, the statements represent our views as of today and subsequent events may cause our views to change. We may elect to update the forward-looking statements at some point in the future, but we specifically disclaim any obligation to do so.

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

It is now my pleasure to introduce our CEO, Toni Townes-Whitley.

Toni Townes-Whitley, Chief Executive Officer

Thank you, Joe, and good morning to everyone on our call.

I want to start by thanking my colleagues at SAIC for the warm welcome I have received over the past several months and for their level of engagement and enthusiasm towards creating the very best future we can for SAIC. In particular, I want to express my appreciation to Nazzic. The strength of our culture, our commitment to inclusivity, and the focus on our customers' missions are true differentiators for our company and they exist, in large part, because of Nazzic's efforts in recent years. And as I have already discussed with many of you, SAIC's progress during her tenure has set the table for this leadership team to do exceptional things for our employees, customers and shareholders.

I spent much of my time since becoming CEO listening and learning and then forming and testing with certain hypotheses to solidify a growth strategy for the company going forward. While this process will continue, I want to share some early observations related to four strategic pivots our leadership team has focused on; specifically: our solutions portfolio, our go-to-market, our culture, and our brand.

Since my announcement as CEO, I've come to understand the value of SAIC's brand. Over the past five months I've received congratulatory phone calls from senior government, military and business leaders as well as SAIC alumni. Many characterized SAIC as a national asset and informed me of the company's deep legacy of tackling complex, large scale national security challenges. As the threats and opportunities for our country have evolved over the decades and will continue to, we at SAIC must ensure that our customers appreciate the breadth of our capabilities so that we can capitalize on the value of our brand.

On culture, we will operationalize an enterprise-first mindset while driving a stronger sense of entrepreneurial execution. While we are still finalizing how best to implement our plan, I would expect it to include additional changes to the design and execution of our incentive compensation model to further a culture of accountability and align our objectives with shareholder value.

On innovation and solutions, I believe the capital-light business model we have committed to is the right one. However, this increases the importance to SAIC of differentiating itself in the market with the best solutions, solving for where our customers are today and where they will be in the future. We must ensure that our portfolio is mission-relevant, scalable, differentiated and aligned with our strategy to drive sustainable organic growth in our key markets. This view drove the decision to hire Lauren Knausenberger as SAIC's first Chief Innovation Officer where Lauren will be responsible for operating our Innovation Factories, managing our technology roadmap, and ensuring that the investments we make maximize differentiation and long-term value.

Lauren joins SAIC from the United States Air Force where she served as the Department's CIO. This role combined with prior commercial and private equity experience makes Lauren a true triple-threat and I am thrilled to have her on our team. In my first months as CEO, I have been impressed by the degree to which our innovation factories differentiate SAIC in the market as evidenced by specific customer feedback on competitive procurements in recent years. I am confident that under Lauren's leadership, SAIC can further develop our portfolio of solutions and increase pull-through of these differentiators across our business lines.

On go-to-market, I see opportunities across the lifespan of business development and capture from early-stage shaping, through leveraging of our factory differentiators, to premium proposal submission, and impactful customer program execution. In order to prioritize the quality and pace at which we execute these opportunities, we will be establishing a new enterprise business development function responsible for standardizing and optimizing our go-to-market strategy across our sectors. This function will be centralized and report into our new EVP of Enterprise Operations, Tim Turitto, who previously led the creation of the Microsoft Federal entity and their business development and capture organization.

Tim will be responsible for instituting enterprise guardrails to drive greater rigor in our sales and delivery processes in conjunction with our sector leaders. Given the audience, I will provide my initial perspective on what all of this means for our financial strategy and performance in the coming years. I believe the framework that was provided at our April Investor Day is appropriate and one that I support. However, as Prabu has mentioned previously, our internal aspiration is to do better.

We, as a leadership team, are aligned with the goal to establish a new normal for SAIC's sustainable organic growth rate above the 2% to 4% framework we provided in April while delivering increased earnings and free cash flow. We will share more detail as to how and when we get there at our 2024 Investor Day, but it will be a multi-horizon approach with an initial focus on enterprise-wide mechanisms and processes to drive improved business development and capture execution as well as an increased focus on quantifying, targeting, and prosecuting on-contract growth.

Finally, on my view of M&A. It is my belief that in order to be an effective acquirer and create true long-term shareholder value, a company must have a proven track record of maximizing organic growth from its own portfolio. As we demonstrate success against this goal going forward, our capital deployment philosophy remains open to additional M&A, and with a healthy skepticism towards larger transactions and a focus on shoring up our solutions portfolio with new technology, as well as maximizing long-term returns.

I am incredibly excited to be a part of the SAIC leadership team and I take great pride in the opportunity to lead such a storied company. I now turn the call over to Prabu to discuss our financial results and updated outlook.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Thank you and welcome, Toni, and good morning to everyone on the call. Let me start by saying how excited we all are to have you leading the team. Your vision for SAIC, your experience and strong leadership skills will no doubt contribute to a stronger SAIC for all our stakeholders.

Now, onto a review of our performance and increased guidance. We reported strong fiscal third quarter results with revenue of $1.90 billion, an increase of nearly 11% when excluding FSA and supply chain revenue from the prior year. Revenue growth in the quarter was driven primarily by the ramp up of work on new and existing programs, improved labor productivity, and favorable timing of materials sales. I am very proud of the focus our team has shown in recent quarters to deliver value to our customers and exceed the commitments made to our investors.

Adjusted EBITDA margin in the quarter was 9.4%, an increase of 50 basis points year-over-year driven by strong program performance, the impact of our previously discussed portfolio actions, and cost efficiency initiatives. Adjusted diluted earnings per share of $2.27 represents an increase of 19% year-over-year driven primarily by the strong operating performance in the quarter, a lower tax rate, and a roughly 4% decline in our diluted weighted average share count.

Free cash flow, adjusted for transaction fees and other costs related to the sale of our supply chain business was $148 million in the quarter and $367 million year-to-date as we continue to see good traction on our working capital improvement efforts.

Net bookings of $2.5 billion resulted in a book-to-bill of 1.3x in the quarter and roughly 1.0x on a trailing 12-month basis. I'll now discuss our updated guidance for fiscal year 2024 and increased financial targets for fiscal years 2025 and 2026.

We are increasing our FY '24 revenue guidance at the midpoint by roughly 2% to a range of $7.325 billion to $7.35 billion which represents pro-forma organic growth of approximately 6%. This increase reflects our stronger operating performance in fiscal third quarter and captures pressures related to previously discussed contract transitions and the potential for a short- lived, but disruptive government funding environment.

We are also increasing our FY '25 and FY '26 targets for revenue to reflect favorable recent momentum while factoring in some degree of risk that budgetary disruptions and our year-to-date outperformance in FY '24 may create more challenging year-over-year comparisons in FY '25.

We are maintaining our adjusted EBITDA margin guidance for FY '24 in a range of 9.3% to 9.4%. However, if our stronger than expected financial performance continues through the remainder of the year, we could see higher incentive compensation accruals in our fiscal fourth quarter which may result in full year margins at or slightly below the low end of our guidance range. As I have discussed with many of you, aligning our incentive compensation structure with increasing shareholder value has been an important part of our strategy to drive change. Adjusting for these potential costs, we expect our full year EBITDA margin to be within our guidance range for the year.

Rewarding strong performance with increasing pay is an important part of our philosophy and I believe our results year-to-date reflect this. Rest assured that our Board and executive leadership team is focused on raising the bar going forward so that incentive compensation plays an important role in the evolution of our strategy which Toni discussed. Notwithstanding this potential for Q4 margin pressure, we continue to expect margins in the mid 9% range in FY '25.

We are increasing FY '24 adjusted EPS guidance to a range of $7.70 to $7.90 driven mainly by improved operating results, lower interest expense, and a lower planned effective tax rate. We are maintaining our free cash flow guidance of $460 million to $480 million and the strength of our earnings growth and the robustness of our cash collections provides us with increased confidence in our path to at least $11 per share in FY '26. Importantly, as we communicated, our plan to increase free cash flow per share by approximately 10% annually for the next three years assumes that the company's cash taxes, excluding section 174 payments, increase from approximately $0 in FY '23 to approximately $100 million in FY '26.

Notwithstanding this planned increase in cash taxes, we continue to expect double digit free cash flow per share growth in the coming years driven by strong earnings growth, continued rigor in managing working capital, and prudent capital deployment focused on our share repurchase program and M&A posture informed by capability-based tuck-ins.

We are encouraged by the strong financial results we have delivered in recent quarters. Our updated FY '26 targets for revenue and adjusted EBITDA are already 2% higher and adjusted EPS 5% higher than the original targets provided at Investor Day eight months ago and position us well to create additional value for our shareholders.

With that, I'll now turn the call back over to Toni.

Toni Townes-Whitley, Chief Executive Officer

Thank you, Prabu. Before we begin Q&A, I want to re-emphasize how excited I am to be leading SAIC, a company whose combination of mission knowledge, domain expertise and legacy of problem-solving is a remarkable national asset. As I mentioned, the table has been set and my focus going forward will be accelerating our growth through strategic pivots in four areas: our solutions portfolio, go-to-market, culture, and brand.

Each pivot has the potential to create significant value for our shareholders, customers, and employees. Collectively, if well executed, these pivots will position SAIC as a market leader in every dimension. Consistent with our focus on a culture of transparency and accountability, I look forward to sharing updates on key milestones as we progress in the coming quarters and years.

Now, let's open the call for Q&A.

Questions And Answers

Operator

(Operator Instructions) Your first question comes from the line of Jason Gursky from Citi. Please go ahead.

Jason Gursky, Analyst

Hi. Good morning, everybody. Let's see your (Multiple Speakers)

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Good morning, Jason.

Toni Townes-Whitley, Chief Executive Officer

Good morning, Jason.

Jason Gursky, Analyst

Thanks. Bigger-picture question to start. So, just kind of curious what you saw coming in here at the outset that, you know, gives you -- give confidence in, you know, a higher gross outlook for the company may be starting with the customers set and the demand signals that you're seeing? And how you think you're going to -- what you're seeing and kind of what pockets you're seeing the demand signals coming in that align well with the solutions that you have and the technology that you have. I just wanted to get a sense of where you initially saw some of the opportunities here that are giving you confidence and leaning forward on the growth.

Toni Townes-Whitley, Chief Executive Officer

Hey, thanks for the question, Jason. Listen, I came in with a hypothesis around four strategic areas, which I mentioned in my prepared comments there. The hypothesis was around our solutions portfolio, our go-to-market strategy, our culture and our brand. And I've been testing whether there have been opportunities to accelerate shift or change in any or all of those areas. And let me give you an example in terms of our solutions portfolio where I've -- what I've learned over the first 60 days here.

I have four questions coming in around whether our portfolio was at enterprise scale, whether it was innovative, differentiated and mission relevant. Whether in our portfolio, we would be able to evolve our solutions to greater profitability and value for our customers. And then finally where those solutions and differentiators systematically deployed across our various sectors.

Here's what I've learned. I've learned that the portfolio is majority at enterprise scale. We have a few gaps to close, that's been very promising. Recent investments have been made in digital engineering, secure data analytics, operational AI, multi-level security, different forms of technology differentiation combined with the way we deliver in an open-systems architecture with various approaches have yielded differentiation and mission relevant integrated solutions.

And what's been most promising is that our customers have cited these solutions in many of our recent bids and recompete efforts. While we understand, I think, the profitability of our solutions within our portfolio, we do have to improve on value-creation processes within once we've gotten into a contract with the customer, do we know how to increase value both on the profitability side for our company as well as for the customer itself. And whether our differentiators are systematically deployed across our enterprise, which we still have some room to grow there. But overall, I've been super pleased to find out the resiliency, the robustness of our portfolio and the fact that our customers are now able to identify our differentiators in our bid activity.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Hey, Jason, Prabu here. If I could maybe add to the question on growth rates. Look at Investor Day, earlier this year, we shared that, you know, the 2% to 4% that we've put out there that our internal aspirations are higher. And I think we are demonstrating rather convincingly this year, especially Q2 and Q3, that structurally that we can grow this business at clips that are consistently above that, let's call it, mid-single-digit growth rate. So to me, I think, our increase confidence is primarily faith in the team that we are actually capable of delivering these growth rates. And we are committing to driving a little bit harder on growth and that's what you're hearing in our prepared remarks.

Jason Gursky, Analyst

Okay, great. And then just a quick follow-up on the balance sheet. I am trying to, love to just get your initial thoughts on the balance sheet itself and, you know, how willing you're going to be to use it to drive growth, you mentioned M&A in some of your prepared remarks. I am just kind of curious what your general philosophy is around the balance sheet and their leverage metrics. Thanks.

Toni Townes-Whitley, Chief Executive Officer

Listen, I have tried to make it very clear that my perspective particularly on M&A is that organizations that can show a track-record of organic growth with their own portfolio tend to do better, better over-time in terms of being able to identify targets and do successful inorganic activity. And so when I look at the history of SAIC and the various acquisitions it's done, we are going to be focused in the short-term on tightening all forms of our internal processes, making sure our portfolio is fully at enterprise scale and capable with whatever investments are needed to get there.

And that would be our priority for the short-term we are open to and we'll always be open to excellent M&A, but a little more skeptical on the large-scale at this point, more towards our portfolio needs, differentiation, focused on our growth vectors and making sure we're fully aware of our integration capacity. So that's where we are for the short-term as we look-forward. Very focused on organic growth over the next 12 to 24 months.

Jason Gursky, Analyst

Great, thanks.

Operator

Your next question comes from the line of Bert Subin from Stifel. Please go ahead.

Bert Subin, Analyst

Hey, good morning --

Toni Townes-Whitley, Chief Executive Officer

Good morning.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Good morning, Bert.

Bert Subin, Analyst

-- Toni and Prabu. So back in April when you hosted your Investor Day, you highlighted expectation for $7.60 [ph] to $7.80 [ph] in earnings next year. You're already pacing ahead of that range this year and raised our expectation for FY '25, it seems partly on better below-the-line items, but also improvement to EBITDA. With your book-to-bill at 0.9x over the last 12 months, what happens from here to keep the earnings trajectory you've been seeing going?

Toni Townes-Whitley, Chief Executive Officer

Well, look, we've been focused significantly on our book-to-bill mostly in the context of our business development capture function. As you heard me announce during the prepared comments, we are centralizing that function to an enterprise BD capability to make sure that we're driving more rigor, a standardized process and we get back to the win rates, if you will -- recompete and new business win rates that we've had historically. And that's one of the first organizational structural changes I've made to drive again more rigor, increase the velocity and volume and quality of our bids and enhance our program execution in that direction.

So that's going to be a specific focus. Look as we look-forward, our expectation is that our growth rate moderates next year based on our view of the market and some elevated headwinds from, as you know, the major recompete losses we've discussed previously. So, we've got a continued ramp on recent contract wins, which is moving us in the right direction, but we'll not fully offset some of the revenue impact of the recompete losses that materialize in H1 of next year. But even with that said, the combination of the ramp of our current work that we've been winning as well as our focus on our business development and capture function with a centralized capability, we feel confident and very bullish about our ability to grow next year.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

And Bert, maybe as a follow-up to that, on the specific EBITDA and EPS questions from Investor Day, look, you know, we're performing really well on topline. I think we are demonstrating that we can convert topline into good-quality EBITDA. And our conversion rate from EBITDA-to-cash is best-in-class I think and therefore we are demonstrating we can convert nearly every dollar of EBITDA into a dollar of cash. When you put those three things together in a single year, you get to sort of compelling operating performance that we have delivered this year.

Now, fast-forward, what does this look like next year, I think we're going to be going back to basics Q1 of next year and say here's what the revenue and EBITDA rhythm looks like for a year or inside of a year within a quarter. And then we have to make sure that we are delivering justice effectively next year as we are delivering this year. So, I don't want to get too far ahead of sort of our current view of FY '25 or FY '26, but trust that Toni and the leadership team here is just singularly focused on making sure we're putting metrics out there and we are outlining a path internally for the team to deliver outsized EBITDA growth and cash from there.

So to me that's where the focus is and we happen to be having I think a phenomenal year this year, but it's really important to make sure that we don't get too far ahead of ourselves for next year. And I want the teams internally to hear that as well. So I think next year is a new year and we're going to have to start all over again. Thank you, Bert.

Bert Subin, Analyst

Yeah, thanks for that, Prabu and Toni. Just a follow-up question to think about '25 maybe more on the contract side, NASA NCAPS is looking to be a pretty competitive bid and the type of contract that would seem to put you on the positive end of your organic growth targets as we head into FY '25 and '26 if you secure it. What are you watching on that contract? And if it were to not pan out, how do you feel about growth potential in a fiscal year where outlays are likely to slow down quite a bit?

Toni Townes-Whitley, Chief Executive Officer

Well, Bert, let me give you a few couple of responses here and then I'll let Prabu add to that. Look, we're performing well on this program and we've got those inputs that we are performing well. The potential for this program is to double. We pull about $100 million a year on this program. It may double with the new procurement up to as much as $200 million per year. We're expecting an award to be announced in roughly six months and we're going to continue that solid program execution through that time.

It's a significant program that we know will -- could be super accretive as we look forward to an award statement for -- positive for SAIC. You mentioned what's the downside? Obviously, the downside is the $100 million annual hold that it would produce if we were not successful. Prabu, any other thoughts?

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Yeah, that was perfect, Toni. The only thing Bert I would add to that is, as Toni said, we're performing really well on the current program. And, you know, I would remind you and everybody else listening that our backlog sitting at right now about $23 billion, $24 billion. And therefore, you know, we'll have our work cut out for us on contract growth to make sure we fill whatever deficit we have, if we have a deficit on NCAPS. But as Toni said, we're probably about six months away from a decision. It sounds like the proposal is in. There's nothing we can do about it right now other than watch the space right now. And -- but our commitment is making sure we're dialed up on contract growth to offset any pressures we may see, but we're, you know, cautiously optimistic.

Bert Subin, Analyst

Great, thank you very much.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Sure.

Operator

Your next question comes from the line of Cai von Rumohr from TD Cowen. Please go ahead.

Cai von Rumohr, Analyst

Yes. Thank you very much. And Toni, Prabu, great numbers.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Good morning, Cai.

Cai von Rumohr, Analyst

So Toni, you know, you talk about major focus on accelerating growth and mentioned sort of some changes in incentive comp to sort of, you know, encourage that. Can you talk a little bit about what sort of changes do you intend on incentive comp? I mean, it may not have all the specifics, but any color you could give would be terrific.

Toni Townes-Whitley, Chief Executive Officer

Well, I can talk about it in terms of -- and thanks for the question, Cai. I could talk about it in terms of both the design and execution of incentive compensation for specific audiences. We're focused particularly, let me give you an example for, within our business development function, which I've mentioned has been a priority, ensuring that we've got the incentive compensation lined up both in the short and long term that incents our capture and business development leaders to bring the very best performance and holds them accountable for their bid volume, the quality of the bids that are in our pipeline, the way that we progress back to the appropriate win rates. Right now we've got incentives in place. We're going to look at future and increased incentives to ensure that they get to participate in the upside for the short and long term. So that would be one audience that we're looking at.

Similarly, for our program managers, on contract growth is a critical part of how we grow this business and making sure they are also incentivized for growing their contracts beyond the initial scope and contract metrics. And so that's another area, that's another audience that I'm looking at for tightening up and increasing sort of our incentive opportunities for that population.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

And Cai, to me, the other part of the philosophy around incentive comp is, you know, for a couple of years now, we've made a set of changes that have effectively created more Skin in the Game for the management team. I think what you're hearing from Toni and the leadership team is that that trend is likely to continue. That means more upside for good performance and just as importantly downside for poor performance. That philosophy is unlikely to change. So, for example, this year's performance graded on next year's curve is unlikely to yield this year's score on incentive comp. That to me is about as simple as it gets on the design of the incentive comp plan.

Obviously, as you know Cai, we're going to have those discussions, Toni will with the comp committee here over the course of the next couple of months. So, we don't want to get ahead of those discussions other than to reiterate that, you know, pay for performance and making sure we have Skin in the Game to make it just uncomfortable enough for people to not stay in the same place. I think those are key design elements and I think we're going to keep reiterating it and maybe even up the ante a little.

Cai von Rumohr, Analyst

Yes, terrific. And then I don't know who this is for, but unlike many other companies in your presentation, you have forecasted Q4 awards looks like it's $2.3 billion, which based on your revenue guide would work out to like 1.3 to 1.4 in terms of book-to-bill. And your fourth quarter historically has been kind of all over the place. And you also have value of contract submissions with sort of a light gray area kind of suggesting contracts that have moved into '25, give us some color on how do we get to such good numbers and also have submissions that move out into next year.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Right. Hey, Cai. I appreciate the question. We have a, you know, chart in our earnings package where we are signaling potentially up to in contract awards somewhere between circa $2 billion and $2.5 billion in Q4. I think, as you exactly correctly pointed out, you know, Q4 book-to-bill trends are hard to predict. It is historically at least the slowest book-to-bill quarter to begin the government's fiscal year in Q4. I think we're actually in the chart demonstrating that there is a shift between blue to gray in Q4 representing awards that could slip out of Q4 into our Q1 FY '25.

So, we're signaling a possibility that while we'd love for awards to be in that circa $2.3 billion range for Q4, there is a good likelihood that some of it, maybe even up to 40% to 50% of that might slip from Q4 up this year into Q1. Now this is contract awards. Separate from that, we have IDIQs that come in and get booked by the drink, if you will, on a quarterly basis. To me, that's not represented on the chart, but I think your skepticism is well founded. I think we're not suggesting book-to-bill is going to be, you know, well over 1.0 in Q4. I think we're simply signaling that, you know, we're seeing some slowness and that trend is likely to continue from Q4 into Q1. So hopefully that was helpful.

Cai von Rumohr, Analyst

Thank you.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Sure.

Operator

Your next question comes from the line of Seth Seifman from JP Morgan. Please go ahead.

Seth Seifman, Analyst

Hi. Thanks very much. Good morning. Wanted to ask a little bit about growth and, you know, you talk about having an aspiration to deliver growth ahead of what's in the forecast here. And so when you think about what keeps you from, you know, raising the forecast now for growth in '25 and '26, how much of that is based on kind of external budget environment type of questions versus more of the internal dynamics that you can see inside the company in terms of what you're going after?

Toni Townes-Whitley, Chief Executive Officer

Yeah, thanks for the question. It's Toni here. Look, I think when you think about fiscal year '25 particularly, not the out years for a moment, but fiscal year '25, we have signaled that we've got headwinds, both market headwinds as well as in our own digging out of some of the revenue impacts of the recompete losses that we've discussed previously. So, I would say it's a balance of external headwinds and the realities of the recompete financial implications. That said, as we look forward, we are making these pivots in these areas that we believe collectively set us up for a much stronger growth profile going forward.

Now, are there still headwinds in fiscal year '26, '27? Of course, there will be, but we're getting, if you will, leaning into the confidence of having demonstrated that we can grow at beyond mid-single digit even this year. We've got confidence around and leaning into even with the recompete challenges we have of next year that we're building a systematic way to grow. And we're focusing on those functions that drive that growth primarily in business development, on contract growth and program execution and ensuring that our portfolio is differentiated and mission relevant. In those areas, we feel like we've got a much more positive outlook in the out years. Again, balanced to market. And I think probably you've got some perspectives on maybe the market challenge.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Good morning, Seth. I appreciate the question.

Seth Seifman, Analyst

Good morning. Thanks.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

You know, the only thing I would add to Toni's comments would be, you know, we are cognizant of the fact that outlays have been very strong. We've all seen the data. And we are assuming for now that outlays will start to moderate in terms of pace, just reflecting the budgetary environment that we are going to find ourselves in, in the, you know, Q4, Q1, Q2 time frame. So that's sort of the baseline assumption. To the extent that the budgetary environment, you know, starts to inflect to less uncertainty, then I think we'll start to develop additional confidence around converting outlays into revenue growth. To me, I think that's a really important takeaway.

I think the second thing we're assuming right now is and we've been signaling this for a few quarters, we do expect the second half of this year, we said the back end of this year, starting early next year into Q1 is going to be more challenging just from a hill legislative perspective. And therefore, we're just waiting to see how that plays out to the extent that, you know, we get to the right place from a funding and a budget perspective, then I suspect you'll start to see us convert outlays into revenues, but we're not going to get ahead of that trend. And, you know, our customers need the certainty and the clarity that comes from a clean legislative environment and we are not living in it right now and hopefully that starts to clarify itself over the course of the next quarter. And we're happy to share additional color on our Q1 or even our year-end earnings call depending on how things progress. Hopefully that was responsive, Seth.

Seth Seifman, Analyst

Yeah, absolutely. No, thanks very much. And maybe a smaller (inaudible) follow up here just on tax. It seems, you know, even to get to the new lower tax rate guidance, it have to be pretty big tax rate in Q4 and, you know, maybe even less concerned about Q4, but just going forward, based on the history here, it would seem that kind of this, you know, '23-ish type tax rate, seems like you guys can maybe do better than that on a consistent basis. You know, how would you think about that going forward?

Prabu Natarajan, Executive Vice President & Chief Financial Officer

I appreciate the question, Seth, and I'm hoping my tax guy is listening to the question. Look, I think we've done remarkably well this year. And just as important as effective tax rate is the way our team is managing our cash tax rate. And look, I think we've got our work cut out in terms of a year over year comp. And as I said, Skin in the Game and incentive comp, that applies to the functions as well. And look, we just have to do this one year at a time and hopefully we're able to do a little bit better than what our initial view perhaps might be implied for either year end or next year. And so we've got our work cut out for us. So, fair observation. We just have to get through the quarter here.

Seth Seifman, Analyst

Very good. Thank you very much.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Thanks, Seth.

Operator

Your next question comes from Sheila Kahyaoglu from Jefferies. Please go ahead.

Sheila Kahyaoglu, Analyst

Good morning, guys, and thank you very much. Toni, I wanted to ask, I know, you know, you were clearly brought in for growth, so I wanted to follow up on two growth-oriented questions, if that's okay. First, I guess you mentioned solutions as a clear focus item, maybe great color at the analyst day. Can you revisit -- so where you're finding the biggest strengths, whether that's from a specific service that you guys are providing or from a customer area?

Toni Townes-Whitley, Chief Executive Officer

Yeah, I would say -- thank you, Sheila, and good to hear from you. When I talked about solutions, particularly I wanted to be aware of our solutions, the ability to scale the existing solutions in our portfolio and whether those solutions were in fact mission relevant and had sufficient innovation. And what I found and I'm particularly pleased to find that the investments that have been made prior to my arrival, particularly in digital engineering, in secure data analytics, in some operational AI, multilevel security and recent investments, even in zero trust architecture, that forms the basis of differentiation in our portfolio that is being called out and acknowledged both in bids that we're making to customers and in on contract growth where customers are engaging with us in these areas.

I've also been super pleased to find out that we have engaged in with innovation, with using, if I say, state of the art innovative approaches which include opportunities around agile capability as well as open system architecture. Why that's important is because that provides us the ability and provides our customers the ability for us to be agnostic to all of the various technology providers and become that critical sticky mission integrator that is plugging and playing from different technologies in the marketplace.

So it's in the context of the quality of our solutions portfolio that I've been super encouraged as well as the customer feedback. And I've had a chance to be with customers in Huntsville, Alabama, with different customers and across our DoD, across our intel community and some civilian customers to hear that those investments are in fact paying off in day-to-day execution with them. So, I'm encouraged for those reasons.

Sheila Kahyaoglu, Analyst

No, that's super helpful. And maybe one on the other side of the argument as well, you know, recompete losses have weighed on growth potentially have -- you know, have weighed historically on the growth near term. So any changes on the (inaudible) strategy there that you're phasing in, in terms of just improving the recompete win rate?

Toni Townes-Whitley, Chief Executive Officer

Well, look, the recompete win rate, that's always the challenge that goes beyond a specific area. That's -- if you think about the pivots I've outlined, you know, when you start talking about recompetes, it's a combination of the solutions that you're delivering and how differentiated they are, how program execution is occurring. So, think about go to market. It's also the culture, how we show up with our customers. And so when I think most about the recompete rate, I start off with some shifts in how we measure the differentiation in our programs that we are offering from day one of the program. That differentiation that creates value for a customer is also what creates, if you will, your best offense for a recompete.

The second is how do we execute in our business development function so that our recompete stand with the same attention, the same rigor and the same standard quality as we have in a new business opportunity. And then third, when we think about, you know, recompete, the idea here is that our lessons learned across our business in unique domains are applied, which is why we go on to an enterprise business development function. So that we don't have unique pockets of knowledge, but we have a standard higher quality of enterprise, understanding of how to best win a recompete. Those are three of the areas that we are moving out on immediately to address the recompete rate.

Sheila Kahyaoglu, Analyst

Great. Thank you.

Toni Townes-Whitley, Chief Executive Officer

Thank you, Sheila.

Operator

Your next question comes from Matt Akers from Wells Fargo. Please go ahead.

Matt Akers, Analyst

Yeah. Hey, good morning, thanks for the question. I want to ask Toni. I appreciate the comments on M&A. I guess on the flip side, are there any areas you're looking at potentially further divestitures or maybe areas you could deemphasize or are you pretty happy with kind of where the portfolio sits at this point?

Toni Townes-Whitley, Chief Executive Officer

I don't have -- thank you for the question, Matt. Good to hear from you. Listen, in terms of our portfolio, I focused on and just recently responded on where I see differentiation in that portfolio. I've indicated that one of the areas I've been looking at is to ensure that we're enterprise scale across. Are there areas that we may need to invest to ensure that that portfolio is enterprise scale? Absolutely. Are there areas that we invest in our organization that will be around our ability to take to market systematically our differentiation? Right now, I have no plans. It's not in line of sight for any significant divestitures at this time. We see the quality of this portfolio across the board and much of our footprint that we have across various agencies where we have unique expertise and advisory capability we think is an asset that we can deploy further going forward. So, at this point, no divestitures to announce.

Matt Akers, Analyst

Okay, thanks. And then, I guess for Prabu, you mentioned kind of material sales timing in introductory remarks. I guess, can you talk about how big that was? And was there any impact to margins, I guess, because margins had been a little bit better without that. Thanks.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Yeah. I appreciate the question, Matt. Look, we do have, you know, some amount of volume every quarter and every year that comes from material sales. And, you know, the team's done a remarkable job on the procurement side, making sure that things get delivered hopefully on time and hopefully even to the left of, you know, when it was scheduled to be delivered and we saw that good performance continue at Q3.

I would say it was not an outsized impact on revenue growth in the quarter. I'd say the material sales were right about in line with, you know, our prior year performance or prior quarter performance maybe a tad bit better than how we'd planned for it, but nothing outsized. And that's why we did not see the dilution from material sales, you know, impacting EBITDA margins in the quarter. So EBITDA margins were healthy and that's because we did not really see any outsized material inflows from Q4 into Q3, for example. Hopefully that was responsive.

Matt Akers, Analyst

Yeah, very helpful. Thank you.

Operator

Your next question comes from the line of David Strauss from Barclays. Please go ahead.

Josh Corn, Analyst

Hi, good morning. This is actually Josh Corn on for David. Just a quick one. You raised the EPS guidance, but didn't raise free cash flow guidance. So, just wanted to ask about [ph] what, if anything, was the offset? Thanks.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

I appreciate the question, Josh. Look, so the guide for free cash flow is $460 million to $480 million. That's a $20 million spread. And as I think about it, that's less than a single day's DSO. And so as we think about the cadence of, you know, both collections and disbursements, you know, we've got the guide currently pretty finely calibrated at $460 million to $480 million. The reality is, as we've disclosed, our performance through the first three quarters has been really strong on converting EBITDA into cash. And hopefully we're sitting in a place at the end of January where our actual performance is a tad bit better than perhaps what's implied in the guide.

But again, don't want to get too far ahead of the work that remains. And I would like to remind you that, you know, Q4 of last year was a really strong free cash flow quarter for us, but it was also climbing out of a hole that we created for ourselves. Thankfully, we don't have that dynamic this year. And so hopefully we continue to do well on converting EBITDA into cash and hopefully that gives us some options down the road. But where we're sitting right now, I think we've got it pretty finely calibrated and we're sitting at about 4 hours of DSO if I actually did my math right while I was pontificating here on the call.

But we're -- you know, we're tightly calibrated and hopefully again gives us confidence about the out years more than it does about this year. And we've got some potential government funding issues to account for some time mid-January. And so calibrating all of that into the guide right now.

Josh Corn, Analyst

Okay, great. Thanks. And then I just wanted to ask if you would provide the percentage of GTA in the bookings year-to-date? Thanks.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

So I would say we'll get back to you on that specific question, Josh. I don't have that number in front of me here.

Operator

Your next question comes from the line of Tobey Sommer from Truist Securities. Please go ahead.

Tobey Sommer, Analyst

Good morning, thank you. With respect to your comments about contract awards potentially pushing out of the current quarter, is that a prospective view in sort of just caution about here as we -- as you exit the last two months of the quarter, is that something you're already seeing? And along with that, could you comment is it in any particular bucket like civil, defense, intel, space, anything that's noteworthy there?

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Sure. Hey, Tobey. Prabu here. Appreciate the question. I would say it's more generalized than, you know, sort of occurring in specific buckets or specific domains or specific customers. I think we are simply cautious about the start of the fiscal year for the government starting NSCR with some funding discussions yet to happen in the January to April timeframe. So we're just, you know, cautious about what that means in terms of cadence for awards booked and specifically to book-to-bill for a given quarter. So, I'd say pretty generalized observation and, you know, it's keeping one eye out on history while we're looking at kind of our data in front of us here, but nothing too specific to call out.

Tobey Sommer, Analyst

Thanks. And I wanted to ask a question about your potential deepening of the compensation changes. Clearly, you've been at this for a while, done an analysis and have a sort of philosophy. If would these -- if you do make another round of changes and sort of deepen that Skin in the Game, does that bring you sort of on par with other players in your industry? Or do you think that that, you know, stands out and maybe you're modeling something that is from another industry rather than your own in terms of kind of what you're looking at as a nice benchmark?

Toni Townes-Whitley, Chief Executive Officer

I'll let Prabu start and I'll wrap on that when relative to the industry differentiation. Go ahead.

Prabu Natarajan, Executive Vice President & Chief Financial Officer

Tobey, appreciate the question. I'd say, look, I think, you know, we sit back and ask ourselves the question, what is next year's sort of behavior look like? So it's part economics and part behavior. And, you know, just making sure that the focus on Skin in the Game continues, that was a really important message for us. You know, couple of years ago, when we made the change and I dare say we are seeing the benefit of that focus just in the performance we've delivered over the last couple of years.

So to me, that's sort of what the focus is going to be. I think in terms of, you know, how to get calibrated. Look, we included TSR as a metric. You've heard from Toni now that ROIC is just as important a component of the way we think about returns from a long-term perspective. And we actually have a chart in the earnings package that talks to the progression we expect to see in ROIC. So, you'll see a lot of different areas that we're focused on, but really around Skin in the Game and making sure that we are not just rewarding top line expansion. How do we get the balance right between top line growth and making sure that we are delivering more profitable, sustained EBITDA growth because we do know we can convert EBITDA into cash. So to me, I think that's where the effort is right now and I'll defer to Toni on the industry comment.

Toni Townes-Whitley, Chief Executive Officer

No, well, I was just going to say, Prabu, you know, when you think about the guidepost here between we've been able to demonstrate that we can beat our call quarter over quarter over a sustained period of time. We've been able to demonstrate conversion to cash. As we push the organization to accelerated growth, but accelerated growth without the deterioration of any margin that suggests that we got to have greater Skin in the Game for the upside as well as some very clear signals of what accountability looks like. We've gotten there obviously with our performance this year is indicative that that message that was put in place and those measures put in place a couple of years ago are paying off.

But we are now trying to, if you will, move into the next iteration here. So, we need to have a little more Skin in the Game and quite frankly across more senior individuals in the organization. We're going to focus also on business development and on program management and get targeted with those audiences based on driving the value that we need for our shareholders.

Tobey Sommer, Analyst

Thank you.

Operator

And we have no further questions in our queue at this time. And with that, this concludes today's conference call. Thank you for your participation and you may now disconnect.