26-Mar-2020

Science Applications International Corp.

(SAIC)

Q4 2020 Earnings Call

CORPORATE PARTICIPANTS

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

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

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

OTHER PARTICIPANTS

Edward S. Caso, Jr.
Analyst, Wells Fargo Securities LLC

Sheila Kahyaoglu
Analyst, Jefferies LLC

Matthew Sharpe
Analyst, Morgan Stanley & Co. LLC

Cai von Rumohr
Analyst, Cowen and Company, LLC

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Matt Akers
Analyst, Barclays Capital, Inc.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Tobey Sommer
Analyst, SunTrust Robinson Humphrey, Inc.

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

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC

Josh Sullivan
Analyst, The Benchmark Company, LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to SAIC's Fourth Quarter and Full Fiscal Year 2020 Earnings Call.

At this time, I would like to turn the conference call 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. My name is Shane Canestra, SAIC's Vice President of Investor Relations and thank you for joining our fourth quarter and full fiscal year 2020 earnings call. Joining me today to discuss our business and financial results are Nazzic Keene, SAIC's Chief Executive Officer; and Charlie Mathis, our Chief Financial Officer.

This afternoon, we issued our earnings release which can be found at investors.saic.com where you'll also find supplemental financial presentation slides to be utilized in conjunction with today's call. Both of these documents, in addition to our Form 10-K to be filed soon, 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 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.

Good afternoon and thank you for joining us to discuss SAIC's fourth quarter and full fiscal year 2020 results, our outlook for fiscal year 2021, and the execution of our strategy to continue providing value to all of our stakeholders.

SAIC's full year results reflect strong operational and financial performance as we successfully implemented many strategic initiatives to position the company for sustained profitable growth and long-term value creation. Charlie will provide details on the business development and financial results, but I would like to highlight a few areas of our strong performance in fiscal year 2020.

SAIC delivered strong profitability and cash generation that met or exceeded the expectations that were set at the beginning of the year. Compared to fiscal year 2019, SAIC improved adjusted EBITDA margins by 80 basis points and increased our free cash flow by $281 million to $437 million, representing a 180% increase in the fiscal year. Additionally, we are on track to generate over $0.5 billion in free cash flow in fiscal year 2022.

We also had a very successful business development year, with a book-to-bill of 1.2 times, with strong third and fourth quarters of 1.4 times and 1.5 times, respectively. Our work in the space and intelligence community has seen impressive recompete and new business contract wins, accelerated by the Engility acquisition and integration. It's a great example of our team's ability to embrace the exciting expanding opportunities that are available to SAIC as well as our steadfast focus to bring mission-critical technologies and specialized expertise to our customers.

Last year's business development results positioned the company well for growth in fiscal year 2021 while increasing our pipeline of opportunities in our strategic markets. This performance was accomplished while also integrating the Engility acquisition and now further accelerating our strategy through the acquisition of Unisys Federal. It was a busy year on many fronts and I'm very proud of SAIC's continued strong performance.

Turning to the market environment, the past few weeks have been challenging for our global community. The spread of the COVID-19 virus has altered many aspects of our collective and individual lives. I'm confident that as a nation, we will remain resilient and we'll overcome this challenge. Our thoughts and sympathy is with all of those affected either directly or indirectly.

Now, specific to SAIC due to the nature of our business, we have seen minimal impact to our operations to-date and have proactively developed readiness plans should disruptions increase. We already maintain an infrastructure that accommodates remote work for a significant number of employees when needed, frequently allowing employees to support customer programs remotely.

Specific to our business, the government services market is very resilient to challenges. Our federal government customer is largely less economically sensitive, with a significant portion of the work we perform considered mission-critical. This frequently minimizes the impact of these types of disruptions.

We have honed our operational muscles from events like government shutdowns and weather- related disruptions. As the effects of COVID-19 continued to unfold, we are likely to see some impact to our business but we expect the impact to be very manageable. The government services market has long-term contracts, a flexible operating model and cost structure, and customers with stable funding levels.

As our team consistently meets and exceeds our customers' expectations, another key element of our continued success is our ability to execute on our strategy. We continue to focus on three strategic items that we have previously mentioned.

First, with the successful integration of Engility largely completed, we have now pivoted to the successful integration of Unisys Federal.

Second, we look to accelerate sustained profitable growth by focusing investments in key strategic areas, as well as leveraging new market access and capabilities from the Engility and Unisys Federal acquisitions.

And third, every level of the organization is working diligently to win the war for talent. We have made improvements and investments in areas that directly enhance our employees' work lives and provide attractive benefits to attract and retain high demand technology talent.

While the government works on fiscal year 2021 budgets, SAIC's balanced and diversified portfolio provides great stability in the event there are shifts in individual agency funding. The acquisition of Unisys Federal further balances and strengthens our customer base with increased federal civilian customer access. All indications point to the US federal government continuing to allocate budget increases to areas where SAIC is a leader and is strongly positioned for future growth such as space, mission engineering and integration, and IT modernization. As we have mentioned before, these are the focus areas of our long-term strategy.

We are excited to have closed the acquisition of Unisys Federal on March 13. We welcome a talented and mission-driven Unisys Federal employees to SAIC. We are very excited to have you join the company and work with you to leverage a commercial style delivery model across our broad portfolio. SAIC is now a leading government services technology integrator in digital transformation, with increased value creation through four dimensions.

First, enhanced capabilities in government priority areas, including IT modernization, cloud migration, managed services, and DevSecOps.

Second, an expanded portfolio of intellectual property and technology-driven offerings, enabling government-tailored, commercial-based solutions.

Third, increased access to current and new customers with a strong pipeline of new business opportunities.

And finally, an acquisition that is highly accretive across key financial metrics. We are very proud of our success in the Engility integration and have tremendous confidence in the successful integration of Unisys Federal.

Just like the Engility acquisition, we have spent considerable effort planning for the integration of Unisys Federal, leveraging our experience and processes to ensure a smooth transition for employees and customers. Compared with the Engility integration, there are not as many milestones to communicate as it is a less complicated integration than Engility, but we will communicate notable activities as they are accomplished. We're off to a very strong start, and we are very excited about the opportunities that are before us.

I'd like to ask Charlie to share our business development and financial results before taking your questions.

Charles Alexander Mathis

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

Thank you, Nazzic, and good afternoon, everyone. SAIC's fourth quarter and full fiscal year 2020 results reflect strong profitability and cash flow generation, while business development activity and the acquisition of Unisys Federal point to organic revenue and profit growth in fiscal 2021. Let me start with our business development results.

Contract award activity in the fourth quarter led to net bookings of $2.4 billion, translating to a book-to-bill of 1.5 times for the quarter and 1.2 times for the full year. At our December call, we communicated our confidence in a strong fourth quarter book-to-bill and how this quarter would be the strongest quarter of the year, and we have delivered on that expectation.

Fourth quarter net bookings was comprised of a wide variety of contract awards and modifications, including $1.1 billion of space and national security awards, including the new business win of U.S. Air Force Common Computing Environment, or Cloud One, contract valued at $727 million. We were also successful at retaining a classified space contract valued at approximately $265 million, demonstrating our leadership in the space domain and our emphasis in this market.

U.S. Army awarded SAIC a new business contract award valued at $98 million for IT support and C4I services in the Pacific region. SAIC was also successful in retaining a multiple award IDIQ contract with the Pension Benefit Guaranty Corporation to provide IT operation support services and have been awarded the first two task orders worth approximately $115 million.

The remaining award activity in the fourth quarter was across many smaller contracts and contract modifications, but did include about $193 million of increased value in SAIC's existing AMCOM portfolio, demonstrating our continued performance and customer satisfaction.

Subsequent to the end of the quarter, SAIC resecured two notable new business contracts that have been in protest resolution. Protests were resolved in our favor on the U.S. Air Force's $655 million EDIS contract and the $950 million FSG-80 contract to support the Defense Logistics Agency.

I'm also very pleased to announce that we were successful in the recompete of our Department of Justice asset forfeiture contract. As a reminder, this is a significant recompete of a contract performed through a joint venture structure, where SAIC consolidates the financials. The contract award is still in a potential protest period. After a prolonged award cycle, we are very excited to begin support to these customers.

At the end of the fourth quarter, SAIC's total contract backlog stood at approximately $15 billion, with funded contract backlog of $3 billion. The estimated value of SAIC submitted proposals awaiting award at the end of the fourth quarter was approximately $14.5 billion, down from the third quarter and representative of a strong fourth quarter of awards.

Our pipeline is strong and robust and as we continue to focus on sustained profitable growth, as Nazzic mentioned, with about half of the value of the submitted proposals relating to new business opportunities. Our refresh strategy is better than ever aligned to service offerings focused on an organic growth strategy.

Let me turn to our financial results, and I will primarily focus on SAIC's fourth quarter performance with references to full-year results in specific areas. Our fourth quarter revenues of approximately $1.5 billion reflect growth of 29% as compared to the fourth quarter of last fiscal year due to revenues associated with the Engility acquisition. Excluding the impact of the Engility acquisition, fourth quarter revenues contracted year-over-year by 1%, driven by the revenue dis-synergies that has affected us all year and will not reoccur in fiscal year 2021.

Full fiscal year 2020 revenue, excluding acquisition revenues, contracted approximately 1%, but included an approximate 2% headwind from the revenue dis-synergy, which again is a headwind we do not have in fiscal year 2021.

Fourth quarter adjusted EBITDA was $134 million, a $39 million increase from the prior year. Adjusted EBITDA margin equated to 8.7% after adjusting for $18 million of acquisition and integration cost, mostly related to the Engility integration. Fourth quarter margin performance was strong as we continue to see exceptional program performance and the continued benefit of the net cost synergies.

For the full fiscal year, adjusted EBITDA margin was 8.4%, 80 basis points above our prior fiscal year and at the top of our guided range for the year. Again, this was due to the same drivers I mentioned: strong program performance and the benefit of cost synergies.

Acquisition and integration costs were $18 million and $48 million for the quarter and fiscal year, respectively. The vast majority of the fourth quarter amount was related to the Engility integration activities, with approximately $2 million related to the Unisys Federal acquisition cost.

Net income for the fourth quarter was $60 million and diluted earnings per share was $1.01 for the quarter, inclusive of the fourth quarter acquisition and integration costs, of $18 million. Excluding acquisition and integration cost, as well as amortization of intangibles, our adjusted diluted earnings per share was $1.58.

One-time favorable tax treatment as a result of a research and development tax credit contributed about $0.16 to diluted EPS. Our full-year effective tax rate was approximately 20%, lower than our previous expectation of 22% to 24% due to the mentioned research and development tax credit.

Turning to free cash flow generation; I'm pleased to report that SAIC generated $437 million of free cash flow, exceeding our previously communicated expectation of $425 million and $281 million above our fiscal year 2019 free cash flow number. We finished the year with cash on hand of $188 million, and we continued to have tremendous confidence in our ability to generate cash. To this point included in our release is the announcement that our board of directors has approved a quarterly dividend of $0.37 a share payable on April 24 to the shareholders of record on April 9. We operate a very capital light business model that contains mostly variable cost, and we receive almost all of our payments from the federal government. Once past the uncertainty of COVID-19, our top priority with excess cash generation will be to make voluntary debt repayments. However for now, we will maintain excess cash on the balance sheet for ongoing operations.

Now turning to our forward outlook for fiscal year 2021. Prior to the COVID-19 virus emerging, we intended to provide formal fiscal year 2021 guidance. Although we have seen minimal impact to-date, we feel it is prudent to postpone issuing fiscal 2021 guidance due to the uncertainty surrounding COVID-19. That being said, we would like to provide the investment community with the framework for how we viewed fiscal 2021 before the COVID-19 issue emerged and some context on the resilience of SAIC's business model in this environment.

As you know, this is a rapidly evolving issue. So these are our thoughts as of today for the consolidated business to include Unisys Federal for the 10.5 months we will own them in fiscal 2021. Prior to the emergence of COVID-19, we believe we would grow revenues organically by 3% to 6%, adjusted EBITDA margins in the high 8% to 9% range, a significant improvement over prior year adjusted EBITDA margins. This excludes approximately $60 million of acquisition and integration costs primarily as a result of Unisys Federal and trailing Engility integration costs.

Free cash flow to be at least $450 million, which includes the tax adjusted impact of transaction related cash outflows. Looking out farther and having cleared the COVID-19 crisis, we expect to achieve $550 million of free cash flow in fiscal year 2022 as I communicated on the call to announce the acquisition of Unisys Federal. Nothing has changed in the basic fundamentals of our company or the demand from our customers to alter that view. We continue to have confidence in that outlook and reaffirm it today.

With this in mind, we expect to meet our targeted net leverage ratio of 3.0 times by the end of fiscal year 2022. Again, I'm providing this framework to demonstrate the fundamentals of our business remained strong. We have a very flexible cost structure and have levers to mitigate impacts of our profitability and cash flow.

While the vast majority of our employees continue to work as normal or remotely, a small number of employees in sensitive work environments are working modified work schedules. And we fully expect to recover cost of disruption. With customers increasingly being flexible to remote work and the mission critical nature of our IT services, it is helpful to lessen the COVID-19 impact. I would like to reiterate a few of the financial benefits of acquiring Unisys Federal and the strength of our capital structure.

The acquisition is immediately accretive to organic growth, immediately accretive to adjusted EBITDA margins, immediately accretive to adjusted earnings per share, immediately accretive to cash generation excluding transaction cost; Unisys Federal, similar to SAIC has a very capital light business model, a flexible cost structure and the ability for approximately 80% of their employees to work remotely. And their primary customer is the US government.

Currently we are able to manage the impacts of the COVID-19 crisis. As of yesterday, our consolidated weekly billings and cash collections have been normal, and our cash on hand remains well above our targeted level of $150 million. In addition, we have full access to our $400 million committed revolving credit facility.

And finally, we amended our accounts receivable purchase facility to allow us to raise another $100 million to the sale of receivables in the event we need to. As noted in our press release today, SAIC is a well-capitalized company that primarily serves the US federal government providing business stability through long-term contracts, a flexible cost structure and a customer whose obligations to pay invoices are backed by the full faith and credit of US government. SAIC has ample liquidity and a strong capital structure to more than adequately service our debt obligations in a context of potential business impacts from the COVID-19 virus.

Nazzic, back to you for concluding remarks.

Nazzic S. Keene

Chief Executive Officer & Director, Science Applications International Corp.

Thanks, Charlie. As we concluded fiscal year 2020, we spent some time reflecting on how SAIC has transformed over the past few years. Through the acquisitions of Scitor, Engility and Unisys Federal as well as significant organic transformational activities, the company is markedly different than it was. Our business portfolio has been strengthened and diversified, our capabilities have advanced and broaden, and we have made significant progress in all key financial metrics. But as we all know, it's about what we'll be doing moving forward. The steps we have taken these past few years have laid a solid foundation for a successful future, and we are very excited for what lies ahead for SAIC.

In closing, I want to express my sincere welcome to all of our new colleagues joining us as part of the Unisys Federal acquisition. We are thrilled to have you as part of team SAIC. And to all my SAIC colleagues, I look forward to the time when we can all walk the halls together again and enjoy the in-person conversation. But until then, I wish you and your families good health. I appreciate all you do each and every day for your company, your colleagues, and your nation.

Operator, we're now ready to take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from Edward Caso with Wells Fargo. Please go ahead.

Edward S. Caso, Jr.
Analyst, Wells Fargo Securities LLC

Q

Hi. Congrats here. Can you talk a little bit more about how the contracting officers are being flexible or not flexible in the current environment as far as setting up remote activity, willingness – you suggested willingness to get refunded for the payback for the blue gold issues and so forth? Anyway give us some color on that front? Thanks.

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

A

Absolutely, Ed. Thanks for the questions. This is Nazzic. So we have seen great cooperation and collaboration from our customers and as well as the contracting officers that are part of this – every conversations that we have. And, to-date, they've been very collaborative, very supportive. There's everything from letting folks work from home, work remote, to looking for opportunities to do social distancing inside the facilities that support them today. And so, I've just been very pleased by all the interactions we've had.

In some cases, as you mentioned, the blue gold in some parts of the intelligence community, the effort to go to shift work to give a little more distancing and to be able to serve the mission is something we're navigating real-time as we sit here today. And so, certainly more conversations to be had there. It is – the nature of that contract is a cost plus for the most part; the nature of those contracts are cost plus that provides the protection as well. So at this point, as Charlie mentioned, we've had minimal impact, but again, we know we're early in the cycle. We would expect over time to potentially see a bit more, but the nature of the work that we do and the flexibility that we have seen with our customers is just...

Edward S. Caso, Jr.
Analyst, Wells Fargo Securities LLC

Q

Can you talk a little bit about the military here? Obviously, there are stop travel. They're sort of holding people on bases. Is that impacting your business as well?

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

A

So we – not really. We've actually had very little impact from our DoD portfolio. And so, again, just working hand in hand with the customer looking for the opportunity to do work either at home, remote locations or working with them on opportunities to provide more distancing has all gone exceptionally well, so we've seen very, very small impact from our DoD customers to-date.

Edward S. Caso, Jr.
Analyst, Wells Fargo Securities LLC

Q

Thank you.

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

Sheila Kahyaoglu
Analyst, Jefferies LLC
Q

Hi. Good afternoon, everyone and thank you for the pictures on the slide deck. I get to remember what other people look like now, so appreciate it. Nazzic, I guess, for you book to bill has been above 1 for the last three quarters. What gives you confidence in the organic revenue growth return, and how do you think about the recompete pipeline from here?

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

Great question. Thanks, Sheila. So, certainly the book to bill as you mentioned being above 1 in the last two quarters have been very strong and then – so that gives us some confidence. And then we've been talking about a handful of wins that are new business wins. So we've referenced Cloud One. We've referenced EDIS, FSG-80 just to give you the – some near-term significant wins over the last quarter or so. And so those are new business wins that will go into this year. So, as Charlie mentioned as we did – this is our cycle for putting together our annual plan and in doing so, we do have confidence in our ability to drive organic growth as we go into this year, again, ignoring whatever potential impact COVID-19 could have. But as we look at the business from a core perspective going into the year we had that confidence.

As we think about the recompete pipeline, we've been talking about a couple of significant ones going into this year, one was the FSA recompete, and again, as we noted that is one that has been awarded recognizing we're still in the protest period, so we'll continue to navigate that, but that de-risks certainly some top line as we go into this year.

The other significant one that we have been highlighting and talking to is the – is various recompetes in the broader AMCOM portfolio. And so those – they'll be recompeted over a course of several contracts over the next several months, a year plus. And so that certainly is something we're paying close attention to. Again, we feel confident for our ability to retain our work there based on our history, based on the excellent job that we do with that customer and based on past performance, but again, we take every recompete very seriously, and so we'll continue to navigate that and report out on that. And those two: the broad AMCOM portfolio, not one particular contract as well as the FSA, were the biggest ones that would – that we've been tracking going into this year.

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

Sheila, if I could just add...

Sheila Kahyaoglu
Analyst, Jefferies LLC
Q

Okay. Okay.

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

If I could add just a couple bullet points on the revenue topic as well. Just a reminder, we do not have the revenue dis-synergies that we had last year; that was about a 2% headwind. And with the Unisys Federal acquisition and with our expectation of them growing more than 10%, that will be accretive to our organic growth in FY 2021 as well, although we've owned them only [indiscernible] (00:29:14).

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

A

Thanks, Charlie.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Understood. Thank you. And then, Charlie, maybe just – sorry about the echo, guys. You talked about margin expansion, Charlie. Should we still think about the Unisys business as an 11.5% margin business in fiscal 2021 for you guys and just the pro forma profitability, are there any nuances we should be aware of?

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

A

Yeah. So the framework we gave on the margins was in the high 8% to 9%, pre-COVID-19 crisis. That's from the 8.4% that we just reported. The Unisys Federal will contribute 20 to 30 basis points. Remember, we've only owned them only 10.5 months. And then the SAIC portfolio, given the additional cost synergies from Engility, should contribute another 20 to 30 basis points. So that's really the walk as far as how you get to the higher margins in FY 2021.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Great. Thank you very much.

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

A

Sheila, are you able to hear us okay?

Operator: Your next question comes from the line of Matt Sharpe with Morgan Stanley. Please go ahead.

Matthew Sharpe
Analyst, Morgan Stanley & Co. LLC

Q

Thanks and good afternoon. I just wanted to get a sense of how you guys are thinking about the cadence of business throughout the year just given the recent Cloud One, the FSG-80 and EDIS wins. I know you're not providing formal guidance, but if you can just give us some sense because those recent wins obviously imply a very heavily weighted back-end. But what does the ramp maybe look like?

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

A

Yeah, Matt. This is Nazzic. Can you hear us okay? Let me do a quick check.

Matthew Sharpe
Analyst, Morgan Stanley & Co. LLC

Q

Yes, I can.

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

A

Okay, great. Thank you.

Matthew Sharpe Q
Analyst, Morgan Stanley & Co. LLC

Yes.

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

So, yes, as you would expect, having won significant contracts late in the year or early in this year, for the most part, they do frequently take time to ramp up. And so, we would see in general, as you outlined, the ability to drive growth higher at the back half of the year than in the front half of the year just by the nature of the size of the contract, the ramp-up period, and the way those will come on to the overall portfolio. So I think that's a fair representation on how to look at it.

Matthew Sharpe Q
Analyst, Morgan Stanley & Co. LLC

And then, what does the Q1 book-to-bill look like thus far? Are you seeing any slowing of awards from the government? Obviously, you've had a flurry of big wins, post quarter end. But maybe you could just sort of box in the level of activity as well as what you expect in terms of B2B?

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

Great question. So it is early in the quarter, obviously. As we have in years past, Q1 can be a bit softer book-to-bill just from our business cycle. And so, it wouldn't be extraordinary if we had a bit more softness in our first quarter. We haven't seen any significant delays as of yet regarding the COVID situation, but one might expect as we get further in our quarter, we might see some slowdown there.

So it's something we're paying great attention to. We're tracking it on a regular basis. But I think as a result of one historical performance in Q1 as well as this particular nuance, I wouldn't be shocked to see some softness, but it's not something we're overly concerned about as we sit here today because I believe that even if we do, which, again, it's too early to tell, but even if we do, I have confidence it'll pick up over the course of the year assuming again that this crisis gets behind us.

Matthew Sharpe Q
Analyst, Morgan Stanley & Co. LLC

Got it. Thanks. And then, Charlie...

[indiscernible] (00:33:06)

Matthew Sharpe Q
Analyst, Morgan Stanley & Co. LLC

...just real quick on cash. With the DoD moving from 80% to 90% progress payments, how should we think about the impact here in Q1? Are we going to see a surge level, or what's the implication there?

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

There's not a lot of implication on our business that that – it's a couple of contracts, but it's really not a material impact for us.

Matthew Sharpe
Analyst, Morgan Stanley & Co. LLC

Q

Got it. Thanks.

Operator: Your next question comes from Cai von Rumohr with Cowen and Company. Please go ahead.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Yes. Thank you very much. So I've read somewhere that Unisys is a member of Leidos' team on NGEN. Could you give us some color in terms of how big that is and what sort of a ramp you expect?

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

A

Yeah. Thanks, Cai. So, yes, that's true that it was a – they were part of the team kind of pre-SAIC engagement, and obviously that's got to go through now is protest cycle. But they were part of the team, are part of the team. It is a relatively small position. So we wouldn't view it as a material impact. And, certainly, it would get halted and slow due to the slowdown specific to the protest cycle, but that is the fact of the case.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Got it. And then, I was kind of intrigued by the comments you made that debt was $2.9 billion and cash was $155 million, because I assume you paid $1.2 billion for Unisys and those numbers kind of imply free cash flow in the first quarter of like $160 million, a very strong first quarter free cash flow. Am I misreading that?

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

A

Yes, you are misreading that, Cai.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Okay.

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

A

So I'll go through a little bit. $1.2 billion was the purchase price. We raised $600 million from Term Loan Bs and $400 million on senior unsecured notes. We also sold $200 million of our accounts receivable, that's how we financed the transaction.

Cai von Rumohr
Analyst, Cowen and Company, LLC

Q

Okay.

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

Our free cash flow...

Cai von Rumohr
Analyst, Cowen and Company, LLC Q

Got it.

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

...it's really expected to be around $30 million to $40 million per month on average is what we'd expect.

Cai von Rumohr
Analyst, Cowen and Company, LLC Q

To receivables explains it. That's great. And so, does your guide of free cash flow for the year assume that you'll continue to use $200 million for the receivables?

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

Yes. Yes.

Cai von Rumohr
Analyst, Cowen and Company, LLC Q

It does.

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

We anticipate continuing to use $200 million of our accounts receivable. We also amended our agreement so we could sell an additional $100 million, if we needed to. We don't anticipate that we will need to, but it's there with the amended agreement. And that's part of the 8-K filing that you'll see today as well.

Cai von Rumohr
Analyst, Cowen and Company, LLC Q

Terrific. Thank you very much.

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

Thanks, Cai.

Operator: Your next question comes from Seth Seifman with JPMorgan. Please go ahead.

Seth M. Seifman
Analyst, JPMorgan Securities LLC Q

Thanks very much, and good afternoon. Just I apologize if you guys brought this up, but on the Unisys Federal contribution for fiscal 2021, thinking for the 10.5 months something in the range of $600 million.

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

So let me help you with that. As you know, they recorded $725 million ending December calendar year 2019.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Right.

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

We expect them to grow 10%, and we are going to report 10.5 months of that number. So that's how you should calculate the contribution.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Right. Okay. Okay. And then, I guess, when you think about maybe bridging a little bit from the cash flow that you're looking for in fiscal 2021 to fiscal 2022, if we started at $450 million and then we think about the One-time cost associated with Unisys Federal after tax, probably, takes you up to $480 million or something like that, and then we think about bridging from that $480 million to $550 million, can you take us through some of the big chunks there in terms of how you got there?

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

Yes. So be happy to do bridge it. So again, we'll start at the $450 million, the SAIC. For those 10.5 months, Unisys Federal net of the interest expense and cash tax benefits adds about $50 million to that number. So that's your baseline before the One-time tax adjusted impacts of the transaction costs and some other One-time working capital adjustments that gets you back to the $450 million. So the baseline to get to the $550 million in FY 2022 really going to start at $500 million and then, due to the higher growth, the higher margin portfolio of Unisys Federal, the fact we have them for a full year, not 10.5 months, and then the additional tax benefits that they bring, that's how you get to the $550 million in FY 2022.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Got it. Thank you very much.

Operator: Your next question comes from Matt Akers with Barclays. Please go ahead.

Matt Akers
Analyst, Barclays Capital, Inc.
Q

Yeah. Hi. Good afternoon, guys. Thanks for the question. I was wondering if you could talk about the hiring environment right now given that a lot of people sort of can't come out, or you're still hiring or is that any kind of a risk as you guys look at returning to growth this year.

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

Yeah. Good question. So we haven't seen any big swings in hiring at this juncture. We still have contracts where we need to add people, and we've talked about some of the ramp-ups. So at this particular moment, certainly our hiring remains on track. It is a competitive labor market. And so we've done several things inside the company to set ourselves apart, and we'll continue to work on that. So at this moment, again, we're only a month or so into this crisis. We haven't seen any big change in our ability to hire.

Matt Akers
Analyst, Barclays Capital, Inc. Q

Okay, great. And then I guess just an update on the Engility synergy relative to the target that you guys laid out, are those all behind us and how much would you say you're able to achieve relative to the initial target?

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

Yeah. So as we communicated and Charlie can add some color. But as we communicated last quarter we have the vast majority of those behind us. We do have some trailing synergies that will come into this year in the form of real estate consolidations that we have planned, that just took time to navigate and do some of the negotiations and a few small IT consolidations that will take place this year, but the vast majority of those cost synergies are behind us.

Matt Akers
Analyst, Barclays Capital, Inc. Q

Okay. Thanks. And then I guess one more just on interest expense. I think you had talked about $135 million I think for the year now that you're thinking of holding on to some cash a little bit longer. What's sort of the updated number we should expect for this year?

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

Yeah. So, we're looking at around $125 million of interest expense for the year. There's also $75 million mandatory debt payments in the year as well. So, yes, we are looking to not make additional voluntary payments; that number I gave you was based on the mandatory payments. So if we start making voluntary payments, that number would come down. But we just think it's prudent to, in this environment, keep he additional cash on the balance sheet as for now.

Matt Akers
Analyst, Barclays Capital, Inc. Q

Okay. Thanks. That's helpful.

Operator: Your next question comes from Jon Raviv with Citi. Please go ahead. Your line is open.

Jon Raviv
Analyst, Citigroup Global Markets, Inc. Q

Yeah. Thank you and good afternoon, everyone. Hey. So, Nazzic, and just maybe a question for the total SAIC leadership team, paradigm shifts don't come along too often in the federal government environment and I don't want to overstate anything that's "still early" but there are a lot of changes going on. You've also identified public health that's something you're interested in historically. I'm not sure you have too much of it sitting here today. So what is your long-term strategy to address what could be a restacking of priorities for the federal government given the huge disruptions being caused by the pandemic today?

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

A

Yeah. Hi, Jon. It's Nazzic. So, great question. I think a couple things that I would just emphasize. One, is that we have a great ability to be agile and pivot when we need to be and the diversified portfolio allows for that flexibility.

Now with that being said, we still fundamentally believe the areas that we have been focused on, that we believe will drive growth will in fact continue to drive growth. So certainly space is one example of that. The IT modernization and the digital transformation strategy that SAIC has been on and now even further accelerated with the recent acquisition I think is one that absolutely can create a marketable difference for our federal customer.

Our federal customers are also looking for the opportunity to work remotely to find different mechanisms to do the work they need to do and IT is a tremendous enabler of that capability. And so that's just one example where it might be a little different than we were thinking 30 days ago or 60 days ago, but it creates great opportunities.

So I do believe that we're on the right track but we will pivot if we need to, our diversified portfolio access to a broad range of customers, and the combination of our IT skills and our engineering skills as well as our DLA portfolio give us a strong position.

As you referenced in the health space, you're absolutely right. We do not have a significant presence in the federal health market but again, the leverage of IT, the modernization that's required in the broad healthcare IT realm is certainly top of mind and the solutions we bring to bear can absolutely work in that domain as well.

So we still believe we're very well-positioned. We'll pivot. It will be agile. We want to do everything in our power to help our nation and help the federal government through this crisis. And our relationship with our customers and the solutions we bring to bear, I am confident will be an accelerant and provide that opportunity.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

It's typically said in this environment – not this environment, in this industry that their relationships are key and it's sometimes easier to acquire relationships in past performance especially with certain clients rather than build it organically. If there is a bigger push into public health, federal health, there's something Unisys enable you to kind of go there organically and say, hey, we have this commercial model, you should utilize this or do you see yourselves perhaps looking to more of a buy versus a make or more of a inorganic opportunity in the public health space going forward?

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

A

Well, so I think certainly, the recent acquisition of Unisys Federal coupled with the work that SAIC was already doing in this broad IT modernization, the migration to the cloud, the digital transformation, being able to do work from different venues is something that's absolutely critical for the broad healthcare market as well. And so I do believe that the solutions we bring to bear there can and will make a difference in the broad healthcare market.

Now with that being said, we have said before that access to the customers having more domain and mission experience in healthcare would be advantageous to SAIC but we don't believe we need to do that at this minute. We're well-positioned with the recent acquisition and so our priority is to drive organic growth to the assets we have today for the foreseeable future and I think we're positioned to do that.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

Thanks and then just a quick question on the current book of business. You mentioned that AMCOM – seems like you upsized AMCOM in the quarter by a little bit. Can you just give a little more perspective on what that was? And I know it's a big focus the rest of the year and kind of how you're seeing the customer make the decisions there.

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

A

Well, we had a bridge contract on one of our AMCOM contracts. I think it was $130 million roughly, $180 million roughly in that range, just demonstrating the customer relations that we have with that customer. We will know on the AMCOM recompete sometime likely early summer – summertime, I would think.

But we highlighted that one just again to – there is activity going on. We're continuing to get awards, still have great relationships there and we still are very positive about that recompete.

Jon Raviv
Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

Operator: Your next question comes from Tobey Sommer with SunTrust. Please go ahead.

Tobey Sommer
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you. I was wondering if you could compare and contrast your experience in various government shutdowns to the current environment with respect to maybe a few vectors' contract award collection, kind of what you're experiencing in DSO. So it's not just your own ability to work remotely, but also, in many cases, your customers. How is that playing out for you?

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

A

Yeah. So Tobey, this is Nazzic. So in general, when we work through a shutdown, the dynamics are very different actually. The shutdown is because a particular part of the government doesn't have funding and so we have to navigate it in that manner. And so that means in some cases, the government can't work. They can't let contracts they can't pay and so it does really halt business in a different way than what we're seeing with this particular dynamic.

This is not an economic issue. This is not an issue where our customers don't have the money and so there is differences to the way it's being managed, navigated on our side as well as our customers' side. And so today, as Charlie mentioned, we have not seen a slowdown in being able to get paid. We've not seen a slowdown in being able to do the work that we need to do. Again, it's early days, but we've not seen those dynamics as we would compare it to a shutdown.

Tobey Sommer
Analyst, SunTrust Robinson Humphrey, Inc.
Q

And how would you characterize any differences in your kind of broad customer set, DOD versus intelligence versus civil customers? Are there differences worth noting when you look at the business across those dimensions?

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

Yes. So I think one of the easiest ways to look at it is – and the intelligence community is an example. Frequently, not always but frequently, the work has to be done in secure areas and so to the extent that those secure areas provide a challenge, whether they've been infected, as an example, that could happen or you're looking for social distancing, that has a different nuance than being able to do work from home on a type of work that doesn't have that same security requirement.

So that's just one example. There is nuances. There is differences. But, again, we've been very fortunate to-date to be able to navigate those in partnership with our customer, so that we can continue to support the mission, but also ensure that we do everything in our power to protect our employees as well as the customer employees.

Tobey Sommer
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Thanks. Last question for me. Are you currently able to fully hire and onboard a new employee remotely? And if not, is that something you're looking to be able to do in the near future?

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

No. We can certainly do that today. It is something that we have done even before this. We frequently will hire people in areas where we don't have – either don't have an office or we've got a very small office. So it is something that we have done in the past and we'll continue to do in the normal course of business. Obviously, it takes on a different flavor today, but it's something we're very comfortable doing.

Tobey Sommer
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Thank you.

Operator: Your next question comes from Joseph DeNardi with Stifel. Please go ahead.

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

Yay. Thanks and good evening. Charlie, you're looking at about, I guess, $1 billion in free cash flow over the next two years in the context of the $4 billion market cap [indiscernible] (00:51:26), but pretty unusual for a business with your type of durability and visibility. So can you talk about maybe a little bit how you think that is best deployed, how much needs to go to get paydown and what does that leave in terms of dividend? And then what's your preference for M&A and a buybacks? Thank you.

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

A

Thanks, Joe. So our top priority is to pay down our debt. We have a leverage target of 3 times by FY 2022. So that is the top priority. Obviously, preserving the dividend is something that we'll do, first and foremost. There is no risk in the dividend. And the additional cash, we will have to evaluate this next year, and we're in that position of excess capacity and get within our leverage optimal capital structure.

We always look to maximize, I think, for the shareholders, look strategically to add to certain assets and this type of thing. So I think we'll evaluate it. But, again, top priority is to de-lever, de-lever rapidly in FY 2021 excess capacity in FY 2022.

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

Q

And so, Charlie, how much do you need to pay down or what are your mandatory debt repayments? I think you said it was $75 million this year. Do you have that number for next year?

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

A

$70 million to $100 million next year, about $110 million of interest expense. But the mandatory debt, $100 million. We would look to pay down voluntary debt payments this year. I think it's about $250 million. Again, whether we do that three months, six months at the end of the year, all depends on when we get through this crisis. But that's what we're looking to do to get to that leverage ratio.

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

Q

Got it. No, that's helpful. And then, Nazzic, just on the decision to not provide guidance, I mean a lot of companies aren't providing it. So it's not really unique in that sense, but you're also saying that your business isn't being impacted currently. So how much of this is just kind of out of an abundance of caution versus real concern or uncertainty based on what you're hearing from customers that eventually there could be some disruption? Maybe just try and put that into context a little bit. Thank you.

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

A

Yeah. No, it's a fair question. So I think a couple of thoughts. So as Charlie outlined, we did intend to provide some general guidance. That was our goal going into this particular call, and we've been communicating that over the course of the last few months. And so, that was our starting position.

And, certainly, as we look at the impact of this crisis, we are fortunate. We have not seen significant impact to-date. We remain optimistic that we can navigate this. Certainly, the indications are that we can, but there is so much uncertainty. And so, the way that – as Charlie and I thought about it, we just think it's the responsible position to just be very transparent, and that's to give you guys a sense for what it looked like going into the year, but also to recognize that we are just a few weeks into something that can be a few more weeks or a few more months. And so, we just believe this was the right balance of how to communicate what we know today as well as what we don't know today.

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

Q

Thank you.

Operator: Your next question comes from Gavin Parsons with Goldman Sachs. Please go ahead.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good afternoon, everyone.

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

A

Hi, Gavin.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Just thinking about some of these bigger awards that you've won over that are about to hit the backlog, obviously, is a bit of a shorter portfolio duration than some of the peers. And if you've got a four to five-year leverage duration, you're going to have 20% to 25% recompete a year. So, I mean, some of these bigger contracts with longer durations, are you continuing to mix that way over the next few years and what do you think your direction looks like a few years from now?

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

A

Yeah. In general, Gavin, we see it relatively unchanged. If we think about the average duration for us is, give or take, five years; some are three, some are seven. We're seeing some at 10 years. But I would just assume the general average of five years as we look at contracts that we would be bidding on and winning.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And are you seeing the industry consolidate into bigger contracts and are you seeing any benefits of scale in your ability to bid on bigger work?

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

A

Yes. So certainly in some areas of the business, we are seeing that opportunity. And so, being able to compete with the exceptional past performance that we have and to be able to pursue those sizable contracts is something that SAIC has historically done. So we've certainly had to scale in past performance. Adding on the Unisys Federal portfolio certainly gives us greater strength and capacity in the IT modernization digital transformation. So we feel very good about our position as it relates to the broad market.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC

Q

Appreciate that. And then maybe just on book-to-bill [indiscernible] (00:57:30) good momentum throughout the year, right, and then sequential improvement kind of every quarter since acquiring Engility? I know you said you've put a lot of work in ahead of acquiring Engility to make sure it didn't disrupt the bookings process but maybe if you could do a look back and talk about kind of the success you've had accelerating book-to-bill and whether or not Engility was and is more disruptive than you thought and if you think this momentum can continue? Thanks.

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

A

There was a couple places where I couldn't quite get the question and I apologize for that but can you restate for me, please? I'd like to be able to address it.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC

Q

Yeah, thanks. Just a look back on bookings and how that's improved and accelerated throughout the year.

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

A

Okay. So, yes, we did see – to your point, we did see incremental. Each quarter, in general, got better on the bookings side so I think a couple things contribute to that. One is we did a lot of work with the Engility acquisition to strengthen our go-to-market position, the key markets we've talked about, in particular, the intel market and the space market. So as you would expect, that takes time to get through the pulling together of a go-to-market team, the building of the pipeline and then being able to solidify that.

So I think the early work was very positive and we're applying that same approach to the recent acquisition and again, we're only a little less than two weeks in but we've already gotten through. We're working through the pipeline and ensuring that we've got the right focus. We've worked through the organizational dynamics of ensuring we have the right go-to-market team.

So we try to do as much as humanly possible right out of the gate, really focused on business development and go-to-market and pipeline development and adjudication.

So that is something that we learned. We did it well with Engility. We'll do it even better with Unisys Federal as we continue to learn as an organization, but that is a priority of ours right out of the chute when we do an acquisition.

Gavin Parsons
Analyst, Goldman Sachs & Co. LLC

Q

Thanks.

Operator: Your next question comes from Josh Sullivan with The Benchmark Company. Please go ahead.

Josh Sullivan
Analyst, The Benchmark Company, LLC

Q

Good afternoon. In the prepared remarks, you talked a little bit about potential shifts in funding. Can you just expand on that, where that might happen first? Are you seeing those shifts accelerate in any way in any particular vertical at this point?

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

A

No. There's nothing in particular aside from what may or may not happen with regard to the COVID-19 situation. Yeah, the remarks were really around the fact that we have a very diversified portfolio. Certainly, we have the potential of having administration change later this year and sometimes, it does create an opportunity to drive more money one direction or the other. But again, we believe that really is a strength of SAIC because of diversification.

And so it was really just a statement to say that either navigating through this particular crisis, which obviously is going to have some short-term budget flows with regard to some of the stimulus bills or long-term as the priorities of the nation may change.

We believe we're exceptionally well-positioned because of diversification not just in the customer base and what we do and what we deliver in support of our customers' missions.

Josh Sullivan
Analyst, The Benchmark Company, LLC

Q

Got it. Appreciate that. And then just as far as exposure to the Afghanistan theater at this point, as the drawdown accelerates there, is there still a material exposure there or if you could just highlight that?

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

A

No. No, we do not have any material exposure there.

Josh Sullivan
Analyst, The Benchmark Company, LLC

Q

Okay. Thank you.

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

A

Welcome.

Operator: There are no further questions at this time. I'll turn the call back to Shane Canestra for closing remarks.

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

Thank you. As we conclude, I would like to announce that our annual shareholder meeting will take place on June 3. Similar to last year, we will be conducting a virtual shareholder meeting whereby shareholders will participate online. Instructions on how to participate virtually to be included with the proxy voting ballot as well as our investor website.

Thank you very much for your participation in SAIC's fourth quarter and full fiscal year 2020 earnings call. This concludes the call and we thank you for your continued interest in SAIC.

Operator: This concludes today's conference call. You may now disconnect.