Q2 2023 Earnings Call

Company Participants

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

Other Participants

- Ellen Page
- Gavin Parsons
- Bert Subin
- Cai von Rumohr
- Matt Akers
- Seth Seifman
- Tobey Sommer
- Colin Canfield
- Louie DiPalma

Presentation

Operator

Good morning. My name is Rex, and I will be your conference operator today. At this time, I would like to welcome everyone to the SAIC Fiscal-Year 2023 Q2 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Thank you.

Joe DeNardi, Vice President of Investor Relations and Strategic Ventures

Good morning, and thank you for joining SAIC's second quarter fiscal-year 2023 earnings call. My name is Joe DeNardi, Vice President of Investor Relations and Strategic Ventures, and joining me today to discuss our business and financial results are Nazzic Keene, our Chief Executive Officer; and Prabu Natarajan, our Chief Financial Officer. Today, we will discuss how results for the second quarter of fiscal-year 2023 that ended July 29, 2022. Earlier this morning, we issued our earnings release, which can be found at investors.saic.com, where you will also find supplemental financial presentation slides to be utilized in conjunction with today's call, and a copy of management's prepared remarks. These documents, in addition to our Form 10-Q to be filed later today, should be utilized in evaluating our results and outlook along with information provided on today's call.

Please note that we may make forward-looking statements on today's call that are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from statements made on this call. I refer you to our SEC filings for 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. The non-GAAP measures should be considered in addition to, and not a substitute for, financial measures in accordance with GAAP.

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

**Nazzic Keene, Chief Executive Officer**

Thank you, Joe and good morning to those joining us today. As we look for new and differentiated ways to tell our story and articulate what makes SAIC unique, I want to start a new earnings call practice and highlight a member of the SAIC team whose performance and contributions exemplify our culture to give you a deeper understanding of what we are.

Our purpose-driven culture is part of what underpins our success, and in a month in which we honor our first responders, military members, and so many civil servants who protect us day in and day out, we believe it’s even more important to celebrate our own leaders who serve our government. In prior calls, we have discussed SAIC’s leadership as a top employers for veterans as evidenced by our number five ranking in Forbes most recent list of top employers for veterans.

In addition to this, we were recently notified that the National Veteran Small Business Coalition named SAIC as contractor of the year. Just as impressively, Rita Brooks, the leader of our small business organization, was named the Veteran Small Business Advocate of the Year for 2022. These recognitions reflect Rita’s efforts, that of her team, and SAIC’s commitment as advocates for the veteran small business community, and we are very proud of this acknowledgment. Working effectively with the small business community, and, in particular, those led by veterans, is an important part of our teaming strategy. A heartfelt congratulations to Rita and the small business outreach team at SAIC.

Shifting from some of our recent cultural successes to our financial results, I’m pleased with our performance in the quarter as we delivered revenue, adjusted EBITDA margins, and earnings consistent with or better than our plan. As a result of our performance to date, we are increasing guidance for fiscal-year 2023 revenue and earnings per share, which we detail on Slide 13 of our earnings presentation. We continue to invest strategically for our future and remain confident in our ability to deliver organic revenue growth, expand margins, and increase free cash flow in the coming years.

Following our discussion last quarter around our Growth and Technology Accelerants, or GTAs, and core areas of focus, I want to provide three recent events that illustrate our leadership position as a technology integrator. This role positions us well to best meet evolving customer requirements, particularly in markets with rapidly advancing, commercially available capabilities. The first example falls within our Systems Integration and Delivery or SID capability within GTA. In April, the Joint Capabilities Office held flight tests in Arizona to assess counter UAS solutions across a variety of platforms and operating scenarios. SAIC performed extremely well and delivered a technology-agnostic, scalable, and modular solution capable of detecting, tracking, identifying, and defeating UAS threats in various environments.

Our solution performed as well as it did for two reasons. First, we integrate best-available technologies in the area of directed energy, radars, optics and power management, and second, Valkyrie, which is our internally developed software solution and which allows us to be technology agnostic and deliver a single pane-of-glass, single operator solution, both discriminators in this market. Our success at this event served as a catalyst for an encouraging rate of adoption in recent months with greater potential upside going forward. As you’ll see on Slide 7 of our earnings presentation, our recent progress in counter UAS builds upon our strong legacy in this market.

The second example sits in Secure Cloud within GTA. In fiscal-year ‘22, Secure Cloud accounted for roughly $1 billion in revenue for SAIC at accretive margins. Over the last 12 months, we have won new programs centered on cloud migration and cloud management with a total contract value of roughly $500 million. We have other large pursuits in
our pipeline, which lay the groundwork for sustained, profitable growth within Secure Cloud in the coming years. A common thread we have seen in customer feedback has been the technical quality of our offering, which gives us confidence in the differentiation of our solution known as CloudScend, which we illustrate on Slide 8.

According to Gartner, SAIC is the number one vendor for infrastructure implementation and managed services by revenue in the United States Government. The third example relates to the recent successes we've had winning programs to help several customers implement their JADC2 strategy, which we show on Slide 9. While many of you on the call will appreciate the breadth of this effort across the Department of Defense, we are confident that our role as a technology integrator positions us as a leader in the market. Last quarter, we indicated that we had roughly $1.1 billion in award value under protest. One of those wins, known as AOC Falconer, with an award value of roughly $300 million was resolved in our favor. Through this key program, we will help the air force modernize and advance a premier command and control system using SAIC's expertise in JADC2 critical technologies, including cloud migration and modernization and big data integration. Importantly, we won this competitive pursuit in large part because of our superior technical solution, fueled by CloudScend.

We believe our success in these three areas provide great proof points of our strategy to leverage our legacy as a technology integrator to deliver higher value solutions, in fast growing markets, while maintaining our capital-light business model.

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

**Prabu Natarajan, Executive Vice President and Chief Financial Officer**

Thank you, Nazzic and good morning everyone. I'm pleased with the financial results we delivered in our fiscal second quarter and the continued progress I see in the areas of business development and the execution of our strategy, despite the impact on organic growth in the quarter from recompete losses. Our performance in the quarter and year-to-date contributed to our improved outlook for the full year. In the quarter, we reported revenue of $1.83 billion, roughly flat with the prior year. Organic revenue declined approximately 1.5% year-over-year, primarily due to one fewer working day in the quarter as we were able to largely overcome year-over-year revenue pressure from recompete losses with improved on-contract growth. I'll discuss our revenue expectations through the remainder of the year shortly.

We reported adjusted EBITDA of $166 million, resulting in a margin rate of 9.1%. The decline in margin year-over-year is largely due to greater onetime gains in the prior-year period, which we have previously discussed. I am encouraged by our margin performance year-to-date, and we have good line of sight to reaching our full year guidance of approximately 8.9%. Adjusted EPS in the quarter was $1.75, slightly ahead of our plan, primarily due to good operational performance and strong execution from our tax team. Free cash flow of $74 million was negatively impacted by roughly $25 million due to temporary payment delays associated with a government agency, which affected much of the defense contracting industry. Subsequent to the end of the quarter, the delayed payments were received, and we remain on track to meet our full year free cash flow guidance.

Bookings were roughly $2.1 billion, representing a book-to-bill in the quarter of 1.1x and 1.0x on a trailing 12-month basis. Our second quarter bookings include the AOC Falconer award. The customer on our previously awarded DCSA One IT program is taking corrective action in response to a protest, and we are awaiting the outcome of that process. Based on results to-date, we are increasing our guidance for revenue and earnings per share for fiscal-year 2023. Our updated revenue guidance provides for a range of $7.50 billion to $7.55 billion, and represents year-over-year growth of roughly 2% at the midpoint. We continue to expect a low-single digit decline in third quarter revenue and low-single digit growth in the fourth quarter. As previously communicated, the primary driver of the anticipated change in growth from third to fourth quarter are five additional working days in the fourth quarter. We expect the extra days to add roughly $110 million to our fiscal fourth quarter. When adjusted for these additional working days, we expect a fourth quarter revenue decline in the low-to-mid single digits.

Despite the revenue pressure expected in the second half of the year, our new business win rate year-to-date is nicely ahead of our plan. In the past six months, we have won new business with a total value of over $1.2 billion, which
provides us visibility into returning to growth in early fiscal-year 2024. We note that the timing of protest resolution and our ability to ramp up will influence whether we see this inflection in the first quarter or second quarter of fiscal-year 2024. Regardless of this uncertainty, we have confidence in our ability to consistently grow the business and return value to shareholders as we have demonstrated over the past 24 months. Consistent with our performance through the first two quarters of this year, we will continue to aggressively pursue incremental new revenue opportunities, with particular emphasis on on-contract growth. As we indicated on our fiscal-year 2022 fourth quarter earnings call, in order for our executive officers to earn target payout on the revenue component of our incentive compensation plan, we have to drive revenue above the high end of our current revenue guidance.

We are maintaining our full-year adjusted margin guidance of approximately 8.9%. We note, however, that the potential timing of certain material sales later in the year could push total revenues to the high end of our revised guidance, while putting modest pressure on margins. We are also increasing FY ’23 adjusted EPS guidance by $0.10 at the low end, which reflects the strong operating performance to-date and a lower expected tax rate, partially offset by increased interest expense. We are reaffirming our full-year free cash flow guidance of $500 million to $530 million for fiscal-year 2023. We expect the roughly $325 million in free cash flow needed to reach the midpoint of our guidance to be slightly weighted to the fourth quarter.

Through the second quarter, we deployed approximately $130 million for the repurchase of 1.5 million shares and are on track for full year repurchases at the high end of our prior expectation of $200 million to $250 million. This, of course, is market conditions permitting and assumes a deferral of Section 174 legislation. As of quarter end, we have approximately 8.5 million shares remaining under our current authorization, which we intend to execute over the next few years. To close, our focus remains on driving profitable growth and we are committed to strong execution and delivering value for shareholders.

I'll now turn the call back over to Nazzic.

**Nazzic Keene, Chief Executive Officer**

Thank you, Prabu. I mentioned earlier in the call the importance of our strong culture. Continuing on that theme, I wanted to close our discussion by highlighting our recently published corporate responsibility report, which reflects our ongoing commitment to ESG and sustainability. A few notable highlights from this year’s report and progress include, in our environmental efforts, for calendar year 2021, our greenhouse emissions reflect a 30% decrease over our 2019 base year. For our social efforts, we received recognition from Forbes for being a Best Employer for Diversity and the Human Rights Campaign for Best Places To Work For LGBTQ+ Equality. From a governance perspective, we are immensely proud to report that 64% of SAIC’S Board of Directors are women or people of color, reflecting our commitment to providing diversity of thought at all levels of the company. I encourage you to visit the Corporate Responsibility page on our website to view the full report.

With that, I will now turn the call over to the operator to begin Q&A.

**Questions And Answers**

**Operator**

(Question And Answer)

**Operator**

(Operator Instructions) Your first question comes from the line of Ellen Page with Jefferies. Your line is open.
Ellen Page

Good morning and thanks for the question. Just looking at the bookings with the 1.1x book-to-bill in the quarter and it looks like 31% year-over-year growth in orders. What are you seeing in terms of the procurement environment? And can you discuss some of the upcoming opportunities in the back half of the year?

Nazzic Keene, Chief Executive Officer

I just want to make sure I understood the question, Ellen, what are we seeing as far as the procurement environment?

Ellen Page

Sorry. So your peers have said that procurement is lower. So what's different about what you're seeing? And do you have any upcoming opportunities to call out in the back half of the year that you're excited about?

Nazzic Keene, Chief Executive Officer

Yes. We have -- certainly, we've heard that narrative as well. I will tell you that we're not seeing anything that I would call systemically different. There are certainly pockets in which some things are getting delayed or getting pushed out. And certainly, we navigate that. But we aren't seeing some of the areas of acute challenge that some of our competitors have mentioned. I will say that as we look to the back half of the year, consistent with normative bookings behavior, we do see more opportunity in the back half of the year as compared to the first half of the year, but that's pretty normal for us, and it does reflect some seasonality as the government gets to the end of their fiscal year and into our third quarter and fourth quarter.

Ellen Page

Great. And just discuss the framework of the return to organic growth next year. Are there any risks to think about as we think about program timing or a potential CR?

Nazzic Keene, Chief Executive Officer

Well, certainly, I think, all of us are expecting a CR. And I think the good news is that we're all accustomed to navigating our way through the CR. As we think about going in from this year to next year, certainly we've mentioned and provided the insight into the some of the recompete losses that create the headwind for us as it relates to being able to return to growth. And as Prabu mentioned in his prepared remarks, we see the opportunity to do that. The first half of next year timing is certainly has to work in our favor as it relates to some of the recompete as well as some of the protests that are outstanding. And so that's how I would think about transitioning from this year to next, but I'm going to let Prabu provide a little more color as well.

Prabu Natarajan, Executive Vice President and Chief Financial Officer

Hi, good morning, Ellen. Thanks for the question. As we noted in our script, we booked in the first half of this year about $1.2 billion in new business. And in fact, after the end of the quarter, we picked up another $300 million of new business for classified work for one of our DoD customers. So we're certainly seeing the momentum on the new business side, which is certainly going to help offset some of the headwinds from the recompete losses. But as Nazzic exactly point out, the timing of that inflection, whether that occurs in FY '24 Q1 or Q2 is a function of how quickly we
clear protests and candidly how quickly we are able to ramp up on these new programs. And of course, that $1.2 billion does not include the DCSA One IT award that's about $1 billion that's sitting out there in protest right now through corrective action. So certainly the momentum is there on the new business side. And as we noted, we're nicely ahead of our own interim plan for the new business side of things. So hopefully, we'll continue to make a dent here. There's six months left in the year. And I think this will be a more meaningful conversation hopefully in December or even in March of next year. Thank you.

Ellen Page
Great. I'll hop back into queue. Thank you.

Operator
Your next question comes from the line of Gavin Parsons with Goldman Sachs. Your line is open.

Gavin Parsons
Hey, good morning.

Nazzic Keene, Chief Executive Officer
Good morning.

Prabu Natarajan, Executive Vice President and Chief Financial Officer
Hi, Gavin.

Gavin Parsons
I think you've beaten your targets on revenue growth for both the first and the second quarter, but haven't changed the third or fourth quarter guides. So can you talk a little bit about what's driven the outperformance in the first half and kind of what factors led you to raise guidance and whether or not those can continue in the second half?

Prabu Natarajan, Executive Vice President and Chief Financial Officer
Yes, appreciate the question, Gavin. And I think you're exactly right. On a year-to-date basis, we've delivered low-to-mid single digit organic growth. The reality is, we do have some recompete losses that will provide some amount of headwind here in the second half of the year. Now at Q1, we said, we see low-single digit contraction in Q2 and Nazzic and I are incredibly proud of the performance from the team to help us effectively offset the headwind from the recompete losses. What certainly implied and as we've expressly stated in the script is we expect some level of modest contraction in Q3 and some level of growth in Q4. And the reality is, we're challenging the teams to continue to push on the on-contract growth message. And if you just think about this step back and think about this contextually in the context of a really slow outlay environment, folks that have the backlog and have the ceilings on their contracts are going to do better in an environment where funding is slow. And so what the teams have done remarkably well in the first half of the year is actually deliver additional on-contract growth for us. And it is a drum here routinely beating inside the company. So I think I certainly appreciate the question.
All I would say is, over the last six to seven quarters, we've demonstrated that we will consistently keep the intensity level up our performance and make sure we are doing better than what's implied in the guidance out there. And the reality is, I think we have an opportunity to do a little bit better than the guidance, but until we're actually going to do better, it's hard to call that a victory. So we're going to continue to press the teams and ensure we deliver good, robust operating performance quarters. Hope that helps.

**Gavin Parsons**

Great. Yes, that's helpful. And then, Prabu, I know it's a little early to get into specifics on fiscal '24 and appreciate the color on return to growth. Is that a comment on full-year '24 as well?

**Prabu Natarajan, Executive Vice President and Chief Financial Officer**

That is correct, Gavin. Short answer is full year expect return to growth in fiscal '24. We have good new business momentum right now. Yes, the recompetes are unfortunate, but we have to deal with them. The team responded magnificently I think to the challenge in Q2 and that's what we've got ahead of us. And I think our view is there's a real opportunity for us to return to organic growth, even accounting for the extra week that we have in fiscal year 2023. And that's really important because we've said that's about $110 million of revenue. So it's about a 1.5% headwind effectively to next year's revenue. And we think we can overcome that and deliver organic growth.

**Nazzic Keene, Chief Executive Officer**

Yes. And Gavin, the one thing I would add and just as a reminder, we have demonstrated over the course of last couple of years that we can deliver organic growth, profitable organic growth. And so I'm very confident in our ability to do that.

**Gavin Parsons**

Okay. Thank you both for the detail.

**Nazzic Keene, Chief Executive Officer**

Thanks, Gavin.

**Prabu Natarajan, Executive Vice President and Chief Financial Officer**

Thanks, Gavin.

**Operator**

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

**Bert Subin**

Hey, good morning.
Nazzic Keene, Chief Executive Officer

Hey, Bert.

Prabu Natarajan, Executive Vice President and Chief Financial Officer

Good morning, Bert.

Bert Subin

So just to follow-up to some of the CR comments, we’re about a month away from that, an impending CR. However, outlays, I think probably as you noted have been pretty sluggish and slow. So is it fair to think that a CR may be less painful for your business because there’ll be this ability to increase outlays even if funds get frozen. And in that context, how are you planning your revenue accordingly? Do you assume that outlays do not improve or do you assume they do improve?

Nazzic Keene, Chief Executive Officer

Bert, this is Nazzic. Let me provide a little color and then certainly Prabu can weigh in as well. We’re pretty accustomed to navigating our way through the CR process. I mean it’s been something that’s been relatively consistent, good, bad or in different for the last several years. So as we go into this CR, we don’t see any, what I would consider, incremental risk to the profile of the business. And we are assuming with the guidance that we’re giving, we are assuming that CR will be how we’ll have to navigate the few months after the government fiscal year.

So certainly, it’s something we pay a lot of attention to. We absolutely understand how new starts have to navigate their way through this. But as we think about our guidance and the position, the numbers that and the guidance that probably is sharing, it is with the assumption that a CR will be in place. And it will be a normal cadence to how we would operate through that. Prabu, anything to add.

Prabu Natarajan, Executive Vice President and Chief Financial Officer

Thank you, Nazzic. Bert, good question. And at the end of the day, CR is not a good thing, but I think we've all learned to navigate it. The reality is in a business with a good amount of visibility into the backlog, net-net, I think it makes it a little bit easier to have line of sight and visibility. If we get guidance that implies a lot of new business to make guidance, there’s probably some risk. On balance I think we feel pretty good about the guidance out there, and we don’t really need a lot of new business to go make our guidance for this year or what's implied into FY ’24. So on balance, I think we feel pretty good.

Bert Subin

Yes. I guess I meant it as a positive because outlays are quite a bit below where the budget is today. So you could go into a CR and still see outlays rise, which is maybe a slightly different story than past years, I guess. Would you agree with that, just as a clarification?

Prabu Natarajan, Executive Vice President and Chief Financial Officer

I would agree with that.
Nazzic Keene, Chief Executive Officer

And I think the other thing that Prabu mentioned - the other thing that Prabu mentioned earlier is just we also are in the position of having contracts with ceiling that we can drive on-contract growth through the process as well.

Bert Subin

Got it. Okay. That makes sense. Just as a follow-up, maybe switching gears a little bit. SAIC has a larger space business, and I think many investors realize. Can you provide some context on your space exposure, and then just highlight how growth across all of those agencies, both in the space side and the intelligence side is impacting you today and maybe some broad comments on your thoughts on direction into fiscal '24.

Nazzic Keene, Chief Executive Officer

Yes. The space business for us represents around 20% of our portfolio. And across, as you mentioned, whether it's DoD, the civilian agencies and the intelligence community. So it is a diversified space business, which we believe gives us some advantage, as we look at the focus on space throughout the federal government. As we're all saying, we do believe this is an area of growth, especially when you link the space related missions to some of our GTA areas. And so we do think this is an area where we can drive organic growth over the course of the next several years in support of the customers' missions.

Prabu Natarajan, Executive Vice President and Chief Financial Officer

And a couple other data points there. One would be, part of what built the space business was the Engility acquisition. And as we demonstrated, I think on the JADC2 chart we have, which is chart number 7 in the earnings package, the tactical data link, as well as base ground C2 came out of that acquisition. And I think this is our attempt to share a little more insight into how the acquisitions are actually helping build up a technology baseline for us, that's allowing us to actually improve one generation to another on the technology side.

And as Nazzic said, there's also some single work that we have inside of our space business. And so that's a core element of the capabilities set that we have for our various C2 customers. So really good business. And if you think about the C2 business in particular, it's one of those that does not require a significant amount of investment and the cash returns are really good, so it's a good economic business to be in and we're making our mark there.

Bert Subin

Thanks very much. Just a really quick follow-up. Prabu, I didn't hear an update to the amount of submitted proposal outstanding. Do you have an update on that number?

Prabu Natarajan, Executive Vice President and Chief Financial Officer

It's over $20 billion.
Bert Subin
Okay. Thank you.

Nazzic Keene, Chief Executive Officer
Thank You.

Operator
Your next question comes from the line of Cai von Rumohr with SAIC. Your line is open.

Cai von Rumohr
You mean, Cowen? So listen, thanks. Good quarter. So protests, I think you said $1 billion, but DCSA I believe is under corrective action. So what is in that $1 billion and when would you expect GAO decision on it?

Nazzic Keene, Chief Executive Officer
So the DC, as you mentioned the One IT is going through corrective action. So there is no timeline on that at this point. It is back in the government's hands to run their corrective action as they see fit. So it's very hard to predict, Cai, what that timeline would look like. And so we'll continue to navigate that. The other significant item that was in that in excess of $1 billion was the AOC Falconer that we made reference to that has been reawarded in our favor and we're beginning work on that.

Cai von Rumohr
So the One IT is essentially $800 million, something like that, roughly, is that correct?

Nazzic Keene, Chief Executive Officer
Yes, roughly.

Prabu Natarajan, Executive Vice President and Chief Financial Officer
It's about $900 million, I believe.

Cai von Rumohr
$900 million. Okay. And you don’t -- therefore, you don't have much in the way of other protests outstanding?

Prabu Natarajan, Executive Vice President and Chief Financial Officer
Correct. Nothing significant yet. We're -- some of these new wins that I referenced to are still in a window, so we're not going to comment on it and we're just going to wait for the process to line up.
Joe DeNardi, Vice President of Investor Relations and Strategic Ventures

Yes. Cai, just to clarify, the $1.1 billion was as of last quarter that consisted primarily of DCSA 1 IT and AOC Falconer. We were awarded AOC Falconer and DCSA in corrective action.

Cai von Rumohr

Got it, got it. Got it. And then so your interest expense is up, obviously it looks like you have about what 80% of your borrowings are floating. And that looks like it's essentially offset by the higher interest -- higher -- lower tax rates, excuse me. But how should we think about that when we look forward to next year because I assume interest rates, I mean, would guess -- one would guess will be about the same or higher. Is 23% kind of a normalized tax rate moving forward?

Prabu Natarajan, Executive Vice President and Chief Financial Officer

Thank you, Cai. Multiple pieces there. So let me take the interest component of that. I think -- so the floating, we do have floating debt, but it's actually hedged out so effectively. I think of it as about 70% to 80% hedged on the portfolio side as fixed. So there's only a nominal amount of exposure I'd say on the balance of the debt. We did update our guidance for interest expense. I think you should think of that as sort of a rough baseline of where interest expense is likely to remain for next year. So to me, that's sort of the second component of interest question. Now at the start of the year, we'd assumed about six or seven rates increases for $1.50 effectively in the interest -- increase for the interest rates. Obviously, we're ahead of that right now and that's why we updated our interest expense guidance.

For taxes, we guided the start of the year to about 24%. We're looking to be tracking closer to 23% right now. So at least for this year, the increase in interest is effectively getting offset by lowering of the tax rate. It's a conversation we have internally about where the appropriate tax rate ought to be. I'd say, 23%, 24% for next year is about where the baseline should be. I don't expect it to be higher. I suspect it won't be lower than 23%. So we're probably going to be in that range for next year, again, not providing guidance for tax rate, but just--

Cai von Rumohr

No, no, no, absolutely. So the last question is, if you turn positive organic growth in the first or second quarter, back to Gavin's question, the fourth quarter looks like the toughest compare because you have five fewer working days. So that's like a 7% to 8% hit. So I mean, it's obviously a little early to talk too much about pattern, but you must be assuming a relatively good turn into organic growth in the middle two quarters because the fourth on paper looks like the toughest compare.

Prabu Natarajan, Executive Vice President and Chief Financial Officer

Yes. It's a fair way to think about it, Cai. And again, I think given that we've already won about $1.2 billion in new work that is starting to come through the spigot here, I think our ability to ramp on these programs will have a fairly outsized impact on how quickly we ramp. But I wouldn't disagree with the math. I think it does imply a healthy growth rates in the second half of next year. But again, we've got six months left and I want to make sure we win all the recompetes we have ahead of us and continue to pick up some new business wins here. And obviously, clearing protest successfully via corrective action on DCSA 1, I think will obviously be immensely helpful for next year.

Cai von Rumohr
Thank you.

**Prabu Natarajan, Executive Vice President and Chief Financial Officer**

Sure.

**Operator**

Your next question comes from line of Matt Akers with Wells Fargo. Your line is open.

**Matt Akers**

Hi, good morning. Thanks for the question. I wanted to follow-up on the payment delays. You talked about can you say which customer that was -- that was responsible for most of those? And I know you said you get some of those back after the close of the quarter, but just what are you seeing kind of in the second half, are you expecting that, that kind of returns to normal?

**Prabu Natarajan, Executive Vice President and Chief Financial Officer**

Hi, Matt, Prabu here. I'll offer a little bit of color, no specific customer references other than to say that the delays were related to a single government payment office that was going through some software updates on their end and some process and system changes that caused delays, not just for us, but a large set of our competitors. And we believe that they're largely done with the upgrades on their side. And as of this week, we have effectively collected what was due to us at the end of the second quarter. So that's the environ. Having said that, lots of customers are going through these system upgrades here and given the need to upgrade IT systems and one could never rule out some potential impacts from similar things at other offices, but the reality is on this one, we -- this one is largely behind us.

**Matt Akers**

Okay. Great. Thanks. And then I guess on the Section 174 change, I don't think you've said how big is the impact if that doesn't get rolled back and what's the timing of when that cash impact would be if that doesn't get rolled back?

**Prabu Natarajan, Executive Vice President and Chief Financial Officer**

Yes. No, fair question. And if we think about it, this was a provision that was introduced as part of the 2017 Reform Package. It impacts us in FY ’23, beginning in FY ’23, and it requires capitalizing and amortizing and qualified research expenditures. And as we think about the prognosis for the fix to this particular legislation, which by the way is really bad tax policy to penalize companies that do research and development activity in the United States. So really bad policy. We are hopeful. We see a fair amount of bipartisan support to actually defer the provision. We think that the fix to this, if one were to happen, is more likely towards the end of this calendar year as part of the end of year extend package, typically kind of think of this as the two weeks running up to Christmas. So that's when we see a potential fix to this, we're still of the view that it is more likely than not that this will get done by the end of the calendar year, again, bad policy, lot of bipartisan support to make sure that this gets deferred.

And in terms of what the impact to us, we've disclosed, we expect an impact of around $90 million in FY ’23, the reality is, and we've seen disclosures from other companies all the way from $150 million to $1 billion. It's about $90 million we think for us. And the reality is our tax team is working feverishly to ensure that we can do as much as we can to minimize that number. And the reality is, we don't have a lot of guidance, I think, from the IRS, the treasury department.
And so in the absence of real guidance, everybody is estimating, and there are probably a handful of different ways in which you can estimate the number. So it’s about $90 million, we think hopefully a little bit less and the fix we think is the year end extend package in December.

Matt Akers
Okay. Great. That’s helpful. Thank you.

Prabu Natarajan, Executive Vice President and Chief Financial Officer
Sure.

Operator
The next question comes from a line of Seth Seifman with JPMorgan. Your line is open.

Seth Seifman
Yes. Thanks very much, and good morning, everyone. Just wanted to ask about when we think about next year, if you could give us an update on the Vanguard program and the movement to evolve at the state department. How to think about the latest strategy there for that contract and the timing of when you expect awards and the potential impact as we think about 2024?

Nazzic Keene, Chief Executive Officer
Great. Thank you. This is Nazzic. Thanks for the question. On Vanguard, which obviously is a very important program for us. The good news for us is an incumbent is that we have gotten a contract extension for an additional six months. So at this point, and the government’s still going through, working through their acquisition strategy. And so we don’t -- we obviously don’t see any impact to this year’s revenue as we sit here today and even as we go into next year, most likely if any impact would be in the second half of next year. But again, the current strategy as they are evolving to evolve is to do a multi award, several different chunks of the contract, pulling many things together. And so even when that happens, we expect to win our fair share and we believe we’re very well positioned to do that.

I -- the one shot out I’ll give to our team is, certainly a lot of uncertainty, a lot of moving pieces, but our team remains laser focused on supporting this customer, supporting their mission, and we will absolutely do so even as we transition to a new contract vehicle.

Seth Seifman
Thanks. And then just as a follow up, I thought it was interesting, the slide that you guys had on counter UAS. And I wonder, Nazzic, if you could talk a little bit about how you see that market evolving, and SAIC’s role in it. I know it’s something that’s obviously very important. I mean, we see it in the news from Ukraine. But also there’s a lot of different companies participating in it, some more well known, some smaller. I think the Senate appropriators took money away from the army because they said the service lacked a strategy this year. And so it’s not necessarily been clear on the outside the way that that market is evolving. And so maybe if you could talk a little bit about how you see SAIC’s role there and the opportunity.
**Nazzic Keene, Chief Executive Officer**

Absolutely. So as we demonstrated on the slide, this has been an area of focus for us for many years in partnership with our customers. The -- our role as a technology integrator where we can bring the best of commercial or government technology to bear, integrate it in such a fashion that allows really a vendor-agnostic approach. And we believe that is something that differentiates us from hardware providers or others that might have their own solution to bring to bear. So we continue to execute our strategy on being a technology integrator, bringing the best of technology. And then we also see to your question about the market. We see a vast array of opportunities across not just DoD, but if you think about some of the work that has to get done in some of the civil agencies. And certainly this is an area that is still a lot of opportunity for the government to play a governance role and how we're going to actively manage this across the next many years.

So for us, it's a great opportunity. It plays very well to our strengths and we've gotten very good reviews from our customers as we deploy the solution today and look for opportunities to deploy it in the future. Prabu, any thoughts on that?

**Prabu Natarajan, Executive Vice President and Chief Financial Officer**

Yes. And specifically to the question around funding vis-a-vis, the government, we are actually seeing some modest increases to funding for our specific program. We saw some revenue from it in Q2, and we expect to see some revenue as well in the second half of this year. So we're certainly seeing some of it just given the success work demonstrating.

**Seth Seifman**

Great. Thanks very much. Appreciate it.

**Nazzic Keene, Chief Executive Officer**

Absolutely.

**Operator**

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

**Tobey Sommer**

Thanks. I wanted to get your perspective on how we should think about incremental margin as the company is poised to grow organically next year because there are a lot of inputs to get there, whether it's mix, wage pressures, et cetera. How do we think about what that nets out to in terms of incremental margin?

**Nazzic Keene, Chief Executive Officer**

Yes. So let me provide a little bit of kind of the context around where we're focused and then Prabu we can provide some color. We do see the opportunity to drive incremental margin in a couple of different ways. One as we've been discussing our area -- the areas of focus, GTAs, we see those types of programs bringing additional margin just by the nature of the type of the work that we do. So as we continue to focus on the GTA part of our portfolio, we see the opportunity for margin expansion over the next several years. We're also very focused on driving margin expansion in our core business, in our existing portfolio and looking for the opportunity to do exactly that with the base business that
we have today.

And the third dimension is we are always looking for the opportunity to reduce costs, drive efficiencies inside the organization, so that we can, one, increase margin, but also be able to invest in ourselves and invest in our growth. And so those are the three levers that we are laser focused on each and every day, but I'll let Prabu provide some color as well.

Prabu Natarajan, Executive Vice President and Chief Financial Officer

That was perfect, Nazzic. And Tobey to the question, we previously signaled that GTAs would be about 200, 300 basis points, better margin, higher margin than our core work. And as we continue to expand the pipeline and have new business wins in this area. We do expect some tens of basis points of improvement from that. Two, as Nazzic mentioned, there are efficiency initiatives and things underway that will continue to help us refine the case to ensure that we are bridging the gap. And last comment is, it will be peculiar for us to not note the margin rate difference between us and our peers and we know exactly what we have to do to bridge the gap. And we talk about it internally all the time with our teams, and therefore, suffice it to say that this probably isn't the right venue to talk about what the specific plan is to bridge as much of the difference as we can. But at an appropriate time, we'll certainly give you the pieces that help you appreciate the journey we're on.

Tobey Sommer

Thank you. And then I wanted to get some color on the procurement environment and activity and sort of contextualize it from the beginning of the Russia/Ukraine war and the sort of extraordinary all-hands-on-deck nature that of our giddy and potentially Intel customer, your customers kind of supporting Ukraine and maybe slower throughput as a result, has that normalized? And I kind of want to get a sense for whether you think it if it hasn't, whether it will soon because you keep emphasizing on-contract growth rather than sort of a seasonal surge in contract activity here in the final fiscal quarter of the federal government?

Nazzic Keene, Chief Executive Officer

This is Nazzic. Let me see if I can tackle some of that. And if I don't get it, you broke up a little bit. So I want to make sure I address it, but let me know if I don't and certainly Prabu can provide some color. As I mentioned earlier, we're not seeing big episodic changes in the procurement or the buying behavior. So for us, it's been relatively consistent. Now, certainly there are pockets of the business where we work hand in glove with our customer. And if there is -- that customer is doing something to support the Ukrainian initiatives, and certainly, there are times in which we might pivot a bit to help support that. But we're not saying big impact, positive or negative from the war in Ukraine or the impact of the procurement environment. Did that address your question?

Tobey Sommer

Yes. I guess, it did. And if I can speak the last one in, over time do you have a sense for whether contracts awards are sort of growing in size and scale as customers on average sort of unify and make contract bigger? I just want to kind of compare and contrast what's happening with Vanguard with what might be sort of the industry trend over time?

Nazzic Keene, Chief Executive Officer

I think I got the question. The question is, are we seeing a consolidation of contracts, contracts getting larger, I believe is what you asked Tobey. But the answer is, in general, I would say there are some trends and where we're seeing that
 happen. And it really, if I think back to the last several years, there was a period of time where all the contracts were
getting divided up and issued in smaller increments, more multi awards. We are seeing some areas of the buying
customer do some consolidation, bringing more things together. And so we are seeing some of that. But then you also,
as you mentioned with evolve, we're seeing customers take very large contracts and divide them up. So I'm not sure I
could say that there's a definitive trend. I know in our portfolio, I can tell you that we are seeing some greater contract
consolidation with the way the customers are buying. But I wouldn't say that that's an industry average.

**Tobey Sommer**

Thank you very much.

**Nazzic Keene, Chief Executive Officer**

So did I get your questions? You were breaking up a little bit. So I want to make sure of that. Okay.

**Operator**

Your next question comes from Colin Canfield with Barclays. Your line is open.

**Colin Canfield**

Hey, good morning. So if you could just parse together the pieces on the FY '24 return growth. Prabu you just
mentioned tens of bases points per year of margin expansion. So maybe if you can just kind of bridge those pieces to the
previous comment of double-digit free cash flow growth in 2014 or excuse me FY '24? Thanks.

**Prabu Natarajan, Executive Vice President and Chief Financial Officer**

Yes. So you are breaking up just a tag bit here, but I think if I got the question, we are expecting a return to growth in
FY '24 on the backs of the new business wins we are generating this year. We are seeing, as we've indicated, potential
for margin expansion in SAIC. And that's a multiyear journey where we are going to be specifically on margin for next
year, it's probably best for the December or the March earnings call, but suffice it to say directionally, we want to move
margins up. And then on the cash side, I think I would reaffirm that our view is we could grow free cash flow by 10%
next year.

That's what our commitment is for this year and we think we can do that. And obviously, beyond FY '24 is a
conversation we'll have at a separate time, but I see potential for underlying improvement in cash flow in this company
from a combination of both top-line margin dollar increases translating free cash flow, as well as working capital
improvement in an environment where we're still seeing somewhat sluggish growth. So to me, as we put the pieces
together, I see a potential for a continued expansion in the amount of cash we can generate on a year-over-basis.

**Colin Canfield**

Got it. Got it. And then maybe if you can talk about the level of bid competition that you're seeing between expertise
and technology, not to use the kind of DACI framework, but if we think about kind of the bid environment that you're
looking at, expertise has obviously been challenged for a while and new work mix can typically come with lower
margins. So as we think about maybe the technology side and what you're trying to get into, the significant commercial
players, they're scaled up defense crimes. So maybe if you could just talk about that level of bid competition between
the two focus areas, and then what are some of the drivers that enable you to win profitable growth? Thanks.
Nazzic Keene, Chief Executive Officer

Yes. So as we think about the competitive environment, there's certainly, it's a dynamic environment for certain. As we have indicated, our focus areas of GTA, leverage the expertise in the organization, the domain knowledge, the knowledge of the customer and bringing innovative technology to bear. And in many times that technology can be ours, but it could also be the best of commercial technology. And so that continues to be our prioritization, as we think about the opportunities to grow. As I think about commercial players, if I understood the question to that are entering our market. Certainly, we see some of that, but many of them look to leverage their technology to bring to bear for the federal government as opposed to a holistic end-to-end solution.

And so in many times we partner with those commercial technology providers as they look to enter the federal market or look to expand in the federal market. And so where they can bring the best of technology, we can bring the domain expertise, the understanding how to navigate the federal government procurement environment, and that creates a unique opportunity for us to drive growth as well. So that's how I would characterize the competitive landscape, the infusion of commercial technologies and our role as a systems and technology integrator into the market. Did that address your question?

Colin Canfield

Sure, sure. Yes. And then I guess the last one for me is as we think about kind of the appetite for private equity within the government services space, how do you think about selling pieces of your portfolio? The logistics business as we talked about, I think last call, is it really coming back? And there are pieces of your business that could probably sit well within a scaled up cost out player. So maybe if you can talk about your appetite for portfolio shaping and what you view as kind of core versus non-core?

Prabu Natarajan, Executive Vice President and Chief Financial Officer

Hi, Prabu here. Fair question. I mean, as we've said fairly consistency now, we're always actively looking at our portfolio, whether that's increasing the technology components inside the portfolio with acquisitions, small tuck-ins or parts of the portfolio that may be better as core for somebody else. That is an act of conversation we have. We certainly recognize the level of interest in the industry in broad government services, as well as sort of components of the portfolio we have. So that is always part of the equation, and that's typically all we will tend to say about these things. And other than to say, I want to reassure people that are listening that, that is an active part of the strategy conversation internally.

Colin Canfield

Got it. Thanks as always.

Prabu Natarajan, Executive Vice President and Chief Financial Officer

Thank you.

Operator

Your next question comes from the line of Louie DiPalma with William Blair. Your line is open.
Louie DiPalma

Good morning, Nazzic, Prabu and Joe.

Nazzic Keene, Chief Executive Officer

Good morning.

Prabu Natarajan, Executive Vice President and Chief Financial Officer

Good morning, Louie.

Louie DiPalma

You have experienced particular success with Air Force programs using your CloudScend solution. You referenced five different contracts in your slide presentation. Is there the potential to cross sell CloudScend to your several army customers?

Nazzic Keene, Chief Executive Officer

Yes. Great question and the answer is absolutely. We see the ability to leverage CloudScend across our entire customer base. And so certainly good references here to the Air Force, but as the broad federal space, whether it's DoD, Intel, civilian agencies, look to modernize their systems, look to drive their systems to the cloud in a secure and low risk manner. We believe that we've got a differentiated offering at CloudScend to do exactly that. So we are very focused on leveraging this technology, leveraging the broad solution to all of our customers across the federal space.

Louie DiPalma

Thanks, Nazzic. And on that point, where does your Air Force Cloud One program fit into the Department of Defense's broader plan for the JEDI 2.0 like joint warfare cloud capability that has been repeatedly delayed and have those delayed benefited you or just in general how does it fit into the mix?

Nazzic Keene, Chief Executive Officer

Great question. And obviously, still a lot of uncertainty on what's going to be the long-term play there. I can tell you that the clouds -- the CloudScend and the program in support of the Air Force has allowed that part of the government to accelerate and to continue their drive and their journey to the cloud and not have to be dependent or wait for a broader acquisition strategy. And so I think it's been great positioning. It's allowed them to do what they need to do. And at this point, it's a great mechanism for the Air Force to drive their strategy, while the government decides on what they're going to do in the long term.

Louie DiPalma

Great. And Prabu is the margin profile for these CloudScend and broader cloud migration solutions higher than the company average? Should we think of it as more consistent with that GTA bucket that you reference?
Prabu Natarajan, Executive Vice President and Chief Financial Officer

That's exactly right.

Louie DiPalma

Sounds great. That's it for me. Thanks everybody.

Nazzic Keene, Chief Executive Officer

Thanks, Louie.

Operator

Your next question comes from Seth Seifman with JPMorgan. Your line is open.

Seth Seifman

Thanks for the follow up. There'll just be a quick one. It was I think partially asked just a few moments ago, but about the logistics business and just how that recovery is proceeding. And how it factors into your expectations for the rest of the year and fiscal '24? It seems like maybe that's going to be a contributor to outsized fourth quarter growth and lower margins.

Prabu Natarajan, Executive Vice President and Chief Financial Officer

Yes. So I'll give you the latest on that. We think about that business on a weekly run rate basis. And I shared this back in March of 2021. And we said, we tend to see weekly revenue volumes in that $10 million to $15 million range. At the height of COVID, bonds were at the lower end of that range, and pre-COVID, it used to be at the high end of that range about $15 million, roughly a week. The reality is, it's sort of stubbornly right in that second half of that $10 million to $15 million range right now.

Now, with the potential conflict overseas, we could see some upside to that particular element of that business, but at this point, I'd say we're stubbornly sort of in that middle part of that $10 million to $15 million range. Do we see that business growing modestly next year? We absolutely do. We do have some newer programs inside the portfolio that are going to generate some growth for us. There are a couple of big bets inside of the pipeline in that particular business that could actually allow us to see outsized growth in over the next couple of years or so. So there's some revenue potential here. But at this point, our hope is we start to modestly improve from a baseline of FY '23 into FY '24.

Seth Seifman

Perfect. Thanks very much.

Operator

: There are no further questions at this time. Mr.DeNardi, I turn the call back over to you.
Joe DeNardi, Vice President of Investor Relations and Strategic Ventures

Great. Thank you, Rex. And thank you to everyone for joining us today. We look forward to speaking with you our next quarter.

Operator

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

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