Jul 07, 2020

Leidos Holdings, Inc. (LDOS)

$88.45 (As of 07/06/20)

Price Target (6-12 Months): **$94.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 04/22/20) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: A | Growth: A | Momentum: A	**3-Hold** VGM:A

Summary

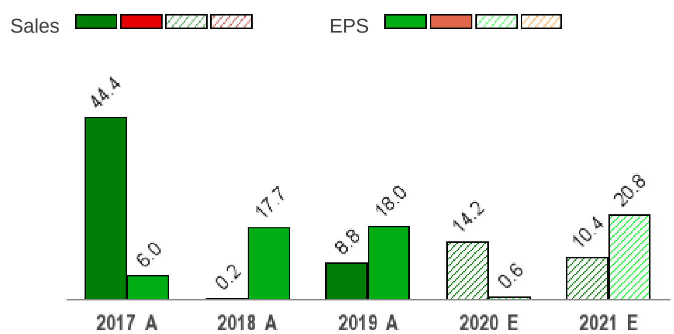
Leidos Holdings has outperformed its industry in the past year. With the current U.S. administration being in favor of increased defense spending, macroeconomic environment in the nation has been boosting the company's growth prospects. Ledios' Dynetics buyout, in the first quarter of 2020, will boost its businesses' strength in fast-growing strategic areas such as hypersonics, space exploration in unmanned systems. However, a comparative analysis of its historical EV/SALES ratio reflects a relatively gloomy picture that might be a cause for investors' concern. The company does not hold a very strong solvency position, as is evident from its sequentially deteriorating financial ratios. Due to COVID-19, new contracts have been delayed and may continue to get delayed along with scheduled deliveries, thereby impacting revenues.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$125.84 - $68.00**
20 Day Average Volume (sh)	**1,131,977**
Market Cap	**$12.6 B**
YTD Price Change	**-9.6%**
Beta	**1.13**
Dividend / Div Yld	**$1.36 / 1.5%**
Industry	**Aerospace - Defense**
Zacks Industry Rank	**Bottom 10% (227 out of 251)**
Last EPS Surprise	**-4.0%**
Last Sales Surprise	**0.2%**
EPS F1 Est- 4 week change	**0.4%**
Expected Report Date	**08/04/2020**
Earnings ESP	**0.9%**
P/E TTM	**16.9**
P/E F1	**17.0**
PEG F1	**2.3**
P/S TTM	**1.1**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	3,434 E	3,481 E	3,623 E	3,749 E	13,986 E
2020	2,889 A	3,042 E	3,282 E	3,446 E	12,672 E
2019	2,577 A	2,728 A	2,835 A	2,954 A	11,094 A

EPS Estimates

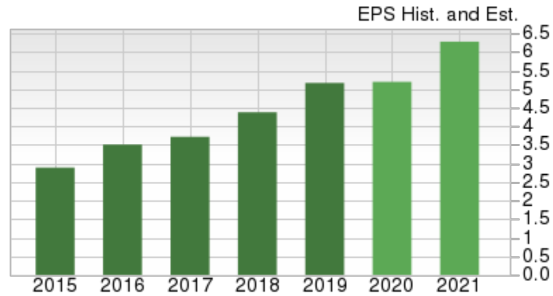
	Q1	Q2	Q3	Q4	Annual*
2021	$1.52 E	$1.58 E	$1.68 E	$1.85 E	$6.28 E
2020	$1.19 A	$1.08 E	$1.34 E	$1.53 E	$5.20 E
2019	$1.13 A	$1.16 A	$1.36 A	$1.51 A	$5.17 A

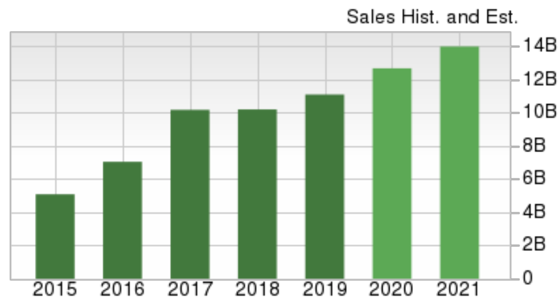
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 07/06/2020. The reports text is as of 07/07/2020.

Overview

Founded in 1969, Delaware-based Leidos Holdings, Inc. is a global science and technology leader that serves the defense, intelligence, civil and health markets. Its core capabilities include providing solutions in the fields of cybersecurity; data analytics; enterprise IT modernization; operations and logistics; sensors, collection and phenomenology; software development; and systems engineering. Outside the United State, the company's international customers include foreign governments and their agencies, primarily located in the United Kingdom, the Middle East and Australia.





Leidos Holdings currently operates through three business segments namely — Defense Solutions, Civil and Health.

Defense Solutions: This business segment offers surveillance and reconnaissance, integrated systems solutions and global services for the U.S. Intelligence Community, military commands as well as other government and commercial customers. It provides multi-spectral, airborne, ground and maritime ISR collection as well as processing systems, advanced sensor design, command and control solutions, and training systems. In 2019, this division generated sales of $5,367 million, contributing 48.4% to total business sales.

Civil: This segment provides aviation solutions, security products, enterprise IT services, federal environment and infrastructure solutions as well as logistics. While aviation solutions provide systems integration for Air Navigation Service Providers, including the FAA and airport operators, security products include Vehicle and Cargo Inspection System, explosive detection systems as well as radiation detection systems. The unit realized sales of $3,729 million in 2019, accounting for 33.6% of total business sales.

Health: This unit offers affordable solutions to federal and commercial customers, which are responsible for the health and well-being of people worldwide comprising service members and veterans. Its primary capabilities include providing complex systems integration, managed health services, enterprise IT transformation and life sciences. Sales at this division totaled $1,998 million in 2019, representing 18% of the entire business sales.

Reasons To Buy:

Favorable Budgetary revisions, solid contract inflows and strategic buyouts should keep Leidos' momentum alive

- Increased contract wins for its cost-effective defense solutions from the Pentagon as well as other U.S. allies have been serving as a primary growth driver for Leidos Holdings. In fact, these contract wins bolster the company's bookings and consequently its backlog count. As of Apr 3, 2020, the company's net bookings were worth $5.5 billion compared with $3.3 billion at 2019-end.Leidos Holdings' total backlog was $28.3 billion compared with $24.1 billion in the prior quarter. Such solid backlog trends indicate impressive revenue growth prospects for the company in the quarters ahead.

- With the current U.S. administration being in favor of increased defense spending, macroeconomic environment in the nation has been boosting the company's growth prospects. In this regard, it is imperative to mention that the fiscal 2021 defense budget proposal reflects a 3% improvement in spending levels from fiscal 2020 budget. Such increased spending levels are expected to drive order growth for defense players like Leidos Holdings. This has also made the company's investors optimistic about its growth trajectory. Evidently, the company's shares have gained 8.6% in the past year against its industry's decline of 30.5%.

- While steady contract wins boost organic growth for Leidos Holdings, notable acquisitions also bolster this defense major's operating results. During the first quarter, the company closed the acquisition of Dynetics, an industry-leading applied research and national security solutions company. The integration activities are progressing per plan. Notably, Dynetics delivered approximately 30% top-line growth in the first quarter, demonstrating its businesses' strength in fast-growing strategic areas such as hypersonics, space exploration in unmanned systems.

  In late April, Dynetics won one of the three prime contracts by NASA under the Artemis program to develop a human landing system through the preliminary design phase. This will add to the company's second-quarter bookings.

Reasons To Sell:

Unfavorable valuation and COVID-19 pandemic led impacts pose threat to this stock's growth

- A comparative analysis of Leidos Holdings historical EV/SALES ratio reflects a relatively gloomy picture that might be a cause for investors' concern. Evidently, the stock has a forward 12-month EV/SALES ratio of 1.54 which remained above the industry's EV/SALES ratio of 1.32. This might be concerning for this stock's investors as higher EV/SALES value indicates that the company is more leveraged when compared to its whole industry.

- Leidos Holdings' cash and cash equivalents were $445 million at the end of first- quarter 2020, compared with $668 million as of Dec 31, 2019. Its long-term debt was $2,944 million as of Mar 31, 2020 and current debt was $1,793 million. Therefore, both its long-term debt and current debt are much higher than its cash reserve. This reflects the fact that the company does not havea very strong solvency position, further evident from the deterioration in financial ratios. Evidently, the company's first-quarter 2020 interest coverage of 6.2 was lower than the prior-quarter figure of 7.5 and the lowest in the last four quarters.

  Additionally, the company's debt-to-capital ratio of 0.59 as of Mar 31, 2020 increased sequentially from 0.49 and was the highest in the last four quarters. Its current ratio of 0.67 at the end of first-quarter 2020declined sequentially from 1.21 and was also the lowest in the past four quarters. Such unfavorable financial ratios indicate that Leidos Holdings may face difficulty in paying off its debt obligations, at least in the near term.

- The COVID-19 pandemic resulted in sales volume decline for Leidos Holdings in the first quarter. New contracts have been delayed and may get further delayed for Leidos Holdings, along with scheduled deliveries, thereby adversely impacting its revenues. Moreover, the company fears that the fiscal 2021 budget cycle might get delayed as the U.S. government focuses on mitigating the impact of COVID-19, which may result in a re-evaluation of U.S. government spending levels and priorities. If that happens and the U.S. administration makes a contractionary change in budget, Leidos Holdings will be hurt.

Last Earnings Report

Leidos Holdings Q1 Earnings Miss, Revenues Rise Y/Y

Quarter Ending	03/2020
Report Date	May 05, 2020
Sales Surprise	0.17%
EPS Surprise	-4.03%
Quarterly EPS	1.19
Annual EPS (TTM)	5.22

Leidos Holdings' first-quarter 2020 adjusted earnings of $1.19 per share missed the Zacks Consensus Estimate of $1.24 by 4%. However, the bottom line grew 5.3% from $1.13 per share registered a year ago.

Moreover, the company's GAAP earnings of 80 cents per share declined from the year-ago quarter's $1.29.

Total Revenues

Leidos Holdings generated total revenues of $2,889 million in the quarter under consideration, which exceeded the Zacks Consensus Estimate of $2,884 million by 0.2%. The top line also improved 12.1% year over year, backed by growth across all segments.

Backlog

At the end of the reported quarter, the company's total backlog was $28.3 billion compared with $24.1 billion at 2019-end. Of this total backlog, $6.2 billion was funded.

Operational Statistics

Total cost of revenues in the quarter increased 12.3% to $2,494 million. Operating income totaled $192 million, in line with the year-ago quarter's figure.

Non-GAAP operating income margin for the quarter was 8.5% compared with 9.3% in the prior-year quarter, primarily attributable to higher indirect expenditures, including the impacts of the coronavirus pandemic.

Interest expenses summed $48 million compared with $38 million in the prior-year quarter.

Segmental Performance

Defense Solutions: Net revenues at this segment improved 14.4% to $1,705 million from the prior-year quarter's $1,491 million. This upside can be primarily attributed to revenues related to the acquisition of Dynetics, program wins and a net increase in program volumes.

However, the segment's operating income declined to $95 million from the year-ago quarter's $104 million, with the operating margin contracting 140 basis points (bps) to 5.6%.

Health: The segment recorded revenues of $530 million in the first quarter, up 14.5% year over year. The improvement was primarily driven by a net increase in program volumes, program wins and the impact of the acquisition of IMX Medical Management Services, Inc. during the third quarter of fiscal 2019.

Operating income surged 62.2% to $73 million, while operating margin expanded 410 bps to 13.8%.

Civil: Revenues at this segment amounted to $654 million, up 5%. This uptick was primarily attributable to program wins and a net increase in program volumes.

While operating income rose 1.7% to $59 million, operating margin contracted 30 bps to 9%.

Financials

Cash and cash equivalents, as of Apr 3, 2020, were $445 million compared with $668 million, as of Jan 3, 2020.

Long-term debt, net of current portion, amounted to $2,444 million, as of Apr 3, 2020, compared with $2,925 million, as of Jan 3, 2020.

Net cash provided by operating activities in the first quarter of 2020 was $372 million compared with $288 million a year ago.

2020 Guidance

Leidos Holdings revised its outlook for 2020. The company currently expects adjusted earnings in the $5.00-$5.30 range, down from $5.30-$5.65 per share anticipated earlier. The Zacks Consensus Estimates for 2020 earnings, pegged at $5.49 per share, is below the company's projected view.

Leidos Holdings currently expects revenues in the range of $12.5-$12.9 billion this year, down from $12.6-$13.0 billion anticipated earlier. The Zacks Consensus Estimates for 2020 revenues, pegged at $12.69 billion, is below the midpoint of the company-guided range.

The company's cash flow from operating activities is anticipated to be at or above $1 billion.

Recent News

On **Jun 23, 2020**, Leidos announced that it won a a prime contract by Edinburgh Airport Limited (Edinburgh Airport) to upgrade the airport's security tray return systems with antimicrobial tray technology. This is Leidos' first order of the antimicrobial security tray technology introduced to mitigate the spread of bacteria from person-to-surface contact.

Under the contract, Leidos will provide new antimicrobial security trays that prevent reproduction of a broad spectrum of bacteria, including staphylococcus aureus (staph), E. coli, and antibiotic-resistant bacteria like MRSA and VRE, by 99.99%.

On **May 4, 2020**, it was announced that Leidos has entered into a strategic agreement with Paramount Group USA and Vertex Aerospace to pursue a new contract to deliver the Bronco II, a new purpose-built, multi-mission aircraft. The aircraft will support the U.S. Special Operations Command's Armed Overwatch program.This strategic relationship, with Leidos as the prime contractor and Paramount and Vertex as primary teammates, will combine decades of experience integrating, manufacturing, and delivering cutting-edge airborne solutions to the warfighter.

On **May 4, 2020**, Leidos announced that it has completed the acquisition of L3Harris Technologies' Security Detection and Automation businesses, for approximately $1 billion in cash. The acquired businesses provide airport and critical infrastructure screening products, automated tray return systems and other industrial automation products. They will operate within the Leidos Civil Group, led by Jim Moos, Civil Group president. Combined with Leidos' existing cargo and baggage screening product lines, Leidos now goes to market with a global security detection and automation footprint of more than 24,000 systems deployed in more than 120 countries.

On **April 7, 2020**, Leidos was awarded a new task order by the Internal Revenue Service (IRS) to enhance, upgrade, and maintain the agency's e-Services and Integrated Customer Communications Environment (ICCE) platforms. The single award, hybrid firm-fixed price and cost-plus-fixed-fee contract has a six-month base period of performance and four one-year option years with a total value of approximately $69 million, if all options are exercised.

Valuation

Leidos Holdings' shares are down 9.7% in the year-to-date period and up 8.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 24.7% and 30.6% in the year to date period, respectively. Over the past year, the Zacks sub-industry is down 30.5% and the Zacks Aerospace sector witnessed a 31.8% decline.

The S&P 500 index is down 2.7% in the year to date period and up 5.7% in the past year.

The stock is currently trading at 15.4X forward 12-month earnings, which compares to 20.1X for the Zacks sub-industry, 20.3X for the Zacks sector and 22.4X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.4X and as low as 10.7X, with a 5-year median of 15.9X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $94 price target reflects 16.3X earnings value.

The table below shows summary valuation data for LDOS

Valuation Multiples - LDOS

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	15.36	20.06	20.28	22.36
	5-Year High	22.35	22.53	21.57	22.36
	5-Year Low	10.67	14.53	14.29	15.15
	5-Year Median	15.91	17.39	17.11	17.42
P/S F12M	Current	0.94	1.27	1.15	3.48
	5-Year High	1.48	1.59	1.36	3.48
	5-Year Low	0.32	0.92	0.78	2.54
	5-Year Median	0.85	1.23	1.07	3.01
EV/EBITDA TTM	Current	12.78	10.53	8.71	11.51
	5-Year High	24.28	14.57	12.39	12.81
	5-Year Low	3.81	8.19	7.12	8.24
	5-Year Median	11.63	11.7	9.8	10.75

As of 07/06/2020

Industry Analysis Zacks Industry Rank: Bottom 10% (227 out of 251)

Top Peers

Company (Ticker)	Rec	Rank
Air Industries Group **(AIRI)**	Neutral	4
Bae Systems PLC **(BAESY)**	Neutral	3
CurtissWright Corporation **(CW)**	Neutral	4
Heico Corporation **(HEI)**	Neutral	3
L3Harris Technologies Inc **(LHX)**	Neutral	4
Lockheed Martin Corporation **(LMT)**	Neutral	2
Teledyne Technologies Incorporated **(TDY)**	Neutral	3
Transdigm Group Incorporated **(TDG)**	Underperform	3

Industry Comparison Industry: Aerospace - Defense

Industry Peers

	LDOS	X Industry	S&P 500	AIRI	CW	LHX
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	4	4	4
VGM Score	A	-	-	B	D	A
Market Cap	12.56 B	9.50 B	22.04 B	43.12 M	3.70 B	37.56 B
# of Analysts	9	6	14	1	4	7
Dividend Yield	1.54%	0.83%	1.89%	0.00%	0.77%	1.95%
Value Score	A	-	-	C	C	C
Cash/Price	0.03	0.11	0.07	0.04	0.04	0.02
EV/EBITDA	12.11	11.02	12.81	12.52	8.66	99.15
PEG Ratio	2.28	2.33	2.94	NA	NA	NA
Price/Book (P/B)	3.74	3.25	3.01	3.27	2.26	1.71
Price/Cash Flow (P/CF)	12.58	9.97	11.87	30.40	9.14	18.11
P/E (F1)	17.08	15.24	21.54	NA	13.82	15.39
Price/Sales (P/S)	1.10	1.10	2.35	0.80	1.47	2.38
Earnings Yield	5.88%	3.97%	4.39%	-2.13%	7.24%	6.50%
Debt/Equity	0.88	0.93	0.76	1.58	0.63	0.32
Cash Flow ($/share)	7.03	2.73	6.94	0.05	9.72	9.61
Growth Score	A	-	-	A	F	A
Hist. EPS Growth (3-5 yrs)	14.53%	14.53%	10.90%	NA	19.12%	14.53%
Proj. EPS Growth (F1/F0)	0.58%	1.87%	-9.51%	25.00%	-11.55%	36.38%
Curr. Cash Flow Growth	6.19%	11.64%	5.51%	-136.97%	7.60%	23.01%
Hist. Cash Flow Growth (3-5 yrs)	6.45%	7.38%	8.55%	-22.72%	7.51%	7.97%
Current Ratio	0.67	1.26	1.30	2.14	2.04	1.41
Debt/Capital	46.71%	49.52%	44.46%	61.18%	38.53%	24.18%
Net Margin	5.20%	5.89%	10.62%	-1.39%	12.10%	8.30%
Return on Equity	22.56%	14.41%	15.75%	-4.93%	18.48%	13.20%
Sales/Assets	1.17	0.83	0.55	1.04	0.70	0.54
Proj. Sales Growth (F1/F0)	14.23%	0.00%	-2.57%	-11.23%	-5.01%	95.52%
Momentum Score	A	-	-	C	C	B
Daily Price Chg	-5.54%	1.62%	1.12%	2.17%	1.07%	1.16%
1 Week Price Chg	4.30%	3.37%	3.66%	13.11%	4.21%	1.41%
4 Week Price Chg	-16.98%	-14.19%	-7.12%	14.63%	-23.36%	-17.01%
12 Week Price Chg	-3.94%	9.02%	11.84%	21.55%	-8.78%	-7.60%
52 Week Price Chg	8.65%	-21.23%	-6.03%	38.24%	-29.64%	-5.78%
20 Day Average Volume	1,131,977	735,282	2,400,079	102,354	353,665	2,020,808
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.41%	0.00%	0.00%	0.00%	-0.19%	0.00%
(F1) EPS Est 12 week change	-7.54%	-8.62%	-8.26%	-160.00%	-10.48%	-2.15%
(Q1) EPS Est Mthly Chg	0.60%	0.00%	0.00%	0.00%	0.30%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	A
Momentum Score	A
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.