Science Applications (SAIC)

$92.93 (As of 01/09/20)

Price Target (6-12 Months): **$98.00**

Long Term: 6-12 Months	**Zacks Recommendation:**	**Neutral**
	(Since: 09/04/19)	
	Prior Recommendation: Outperform	
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:A
	Value: B	Growth: A	Momentum: B	

Summary

Science Applications is benefiting from the Engility acquisition. Strong performance of the company's contract portfolio is also a tailwind. Further, solid program performance and a positive impact of cost synergies are boosting EBITDA margin. Also, SAIC hopes to provide increased customer access, higher investments in competitive solutions and an improved cash flow going forward. However, acquisition-related dis-synergies were an overhang on the top line. Additionally, the company is facing delays in contracts due to the ongoing protests with the Government Accountability Office. Competition in the emerging growth segment and an intense rivalry with CACI are concerns as well.
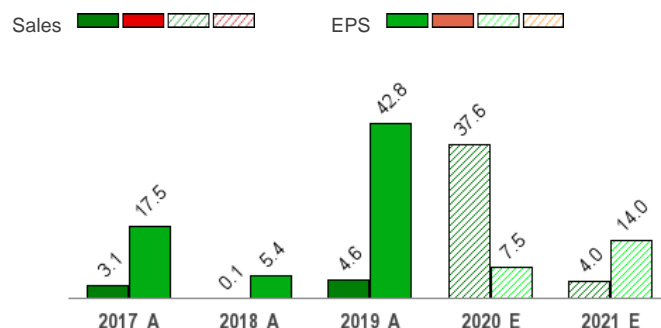
Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$94.31 - $62.56**
20 Day Average Volume (sh)	**321,949**
Market Cap	**$5.4 B**
YTD Price Change	**6.8%**
Beta	**1.29**
Dividend / Div Yld	**$1.48 / 1.6%**
Industry	**Computers - IT Services**
Zacks Industry Rank	**Bottom 21% (201 out of 254)**
Last EPS Surprise	**-3.5%**
Last Sales Surprise	**-0.0%**
EPS F1 Est- 4 week change	**-0.1%**
Expected Report Date	**03/26/2020**
Earnings ESP	**-7.1%**
P/E TTM	**17.6**
P/E F1	**17.2**
PEG F1	**3.1**
P/S TTM	**0.9**

Sales and EPS Growth Rates (Y/Y %)

Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	1,673 E	1,642 E	1,685 E	1,610 E	6,668 E
2020	1,615 A	1,594 A	1,630 A	1,573 E	6,412 E
2019	1,175 A	1,115 A	1,177 A	1,192 A	4,659 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$1.48 E	$1.51 E	$1.65 E	$1.56 E	$6.18 E
2020	$1.36 A	$1.35 A	$1.39 A	$1.31 E	$5.42 E
2019	$1.13 A	$1.13 A	$1.35 A	$1.17 A	$5.04 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 01/09/2020. The reports text is as of 01/10/2020.

Overview

Science Applications International Corporation (SAIC) is one of the leading IT and professional services provider, primarily to the U.S. government. Founded in 1969, the company's headquarter is located at Reston, VA.

Science Applications offers transaction, technical, engineering and enterprise IT services primarily to the U.S. government. Its offerings include technology and equipment platform integration; engineering; logistics; operation and program support services; maintenance of ground and maritime systems; and training and simulation. Apart from this, Science Applications provides end-to-end services like design, development, integration, deployment, management and operations, sustainment, and security of its customers' IT infrastructure.

The company's customers lists primarily includes different government agencies, including the U.S. military, comprising Army, Air Force, Navy, Marines, and Coast Guard; the U.S. Defense Logistics Agency; the National Aeronautics and Space Administration; the U.S. Department of State; and the U.S. Department of Homeland Security. The company serves its customers with more than 15,000 employees.

The company generated $4.57 billion of revenues in fiscal 2019, of which more than 97% came in from the U.S. government. The company segregates its contracts in three different types:

EPS Hist. and Est.

Sales Hist. and Est.

Cost-reimbursement contracts: Under this type of contract, the company gets reimbursement for its direct and indirect allocable costs associated with the contract plus a fee (contract profit).

Time-and-materials (T&M) contracts: These contracts are based on fixed hourly rates for particular categories of direct labor, plus reimbursement for any other direct costs.

Firm-fixed price (FFP) contracts: These contracts provide for a predetermined price for specific solutions.

Its competitors include companies such as General Dynamics, Northrop Grumman, Raytheon Company, Booz Allen Hamilton, CACI International, Leidos Holdings, ManTech International, Serco Group, Perspecta, Accenture, IBM, Unisys and Agility Logistics.
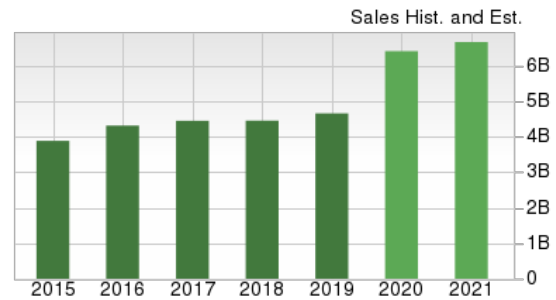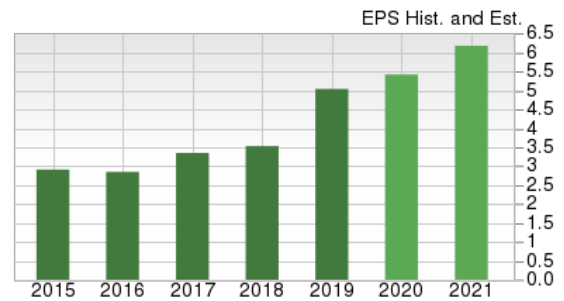
Reasons To Buy:

▲ Science Applications remains focused on the federal government marketplace and capturing more market share. The company intends to drive operational excellence by intensively focusing on its organic and inorganic growth strategy, and strengthening existing customer relationships while building newer ones. Higher spending as proposed in the latest federal government budget is anticipated to accelerate the pace of contract awards which in turn will be beneficial for Science Applications' top-line growth.

▲ A leader in IT outsourcing for the U.S. government agencies, Science Applications has exposure to the rapidly growing DoD and Department of Homeland Security budgets. Its system-integration skills and intelligence expertise consume a significant portion of the funds earmarked for the Department of Homeland Security while creating systems that foster the sharing of critical information among all intelligence agencies. We believe the company is comfortably positioned, given its favored relationship with the DoD. Moreover, cyber-attacks are creating increased awareness, leading to more demand for cyber solutions.

▲ Furthermore, having the government as a big client lends stability to the business and moderates fluctuation in revenues. Although the government generally has a lengthy approval process, the project earns money for a number of years after it is approved. Moreover, government contracts improve the visibility of future revenue streams. The company has been doing very well with a record level of awards, which reflects its disciplined business development actions, consistent operational excellence and high customer satisfaction. The company continues to execute its strategy of winning high-value contracts, delivering excellence to customers and deploying capital for growth. Its robust business model is expected to help it grow further.

▲ Science Applications has been aggressive in the acquisition front to boost competitive position. Notably, the spin-off from Leidos had resulted in a very little intelligence business left with the company, due to which it had been lagging to keep pace with competitors. However, the buyout of Scitor Holdings has now put it as a market leader within the intelligence community, immediately boosting its top line, bringing in approximately $600-million additional revenues annually. The upcoming acquisition of Engility is expected to boost the company's top-line, profitability and cash flow, consequently enhancing long-term shareholder value creation. All this makes us optimistic about the company's growth prospects.

▲ Science Applications' strong operating cash flow has helped it return cash through regular quarterly dividend payment and share repurchases. Share repurchases is a good way of returning cash to investors while boosting the company's bottom-line. Moreover, consistent returns to shareholders reflect balance sheet strength and company's cash flow generating ability. During fiscal 2019, the company paid a total cash dividend of $53 million and repurchased $40 million worth of its common stock. Since the inception of the share repurchase program in 2013, it repurchased $539 million worth of stocks.

> Higher spending as proposed in the latest federal government budget is anticipated to accelerate the pace of contract awards which in turn will be beneficial for Science Applications' top-line growth.

Reasons To Sell:

▼ Though Science Applications has been steadily winning contracts from the federal government, but these low-margin deals have been affecting the company's profitability, which remain a major concern.

▼ Unfavorable contract mix is also hurting the company's profitability. The company continues to witness increase in cost reimbursement type contracts compared with fixed price contract, which is expected to be a drag on margins.

▼ Revenue concentration is a major risk for Science Applications. In fiscal 2019, over 95% of revenues came from sales to the U.S. federal government either as a prime contractor or subcontractor. Due to this massive dependency, changes in the government's IT spending budget is a huge deciding factor for the company's top-line growth. Moreover, these contracts are subject to extensive legal and regulatory hurdles, which are stringent, and subject to change from time to time. The government also investigates operations periodically to ensure that the terms and conditions have been properly adhered to. Deviations from the terms laid out by the government might result in huge penalties or termination.

▼ Science Applications competes primarily in the government IT services arena, which, like other government sectors, consists of many competitors of various sizes. Its main competitors include ManTech International Corporation, CACI, Unisys, Accenture, IBM, all of which are established players in the industry, with their respective strengths. Consequently, the company has to continuously invest in value drivers which act as a hedge against competition. These increase its operating costs and reduce its profitability.

▼ Moreover, seasonality is an influential factor for the top line. The fourth quarter is usually low-revenue quarter due to holidays and employee vacations. This brings down average top-line growth of the full fiscal.

Revenue concentration and increasing competition remain key concerns for SAIC.

Last Earnings Report

SAIC Q3 Earnings Miss Mark, Rise Y/Y

Science Applications reported third-quarter fiscal 2020 earnings of $1.39 per share, missing the Zacks Consensus Estimate by 3.47%. However, the bottom line improved 2.96% year over year.

Moreover, revenues jumped 38% from the year-ago quarter to $1.6 billion but lagged the Zacks Consensus Estimate of $1.63 billion. Revenues realized from the acquisition of Engility drove the top line. Strong performance of the company's contract portfolio is a tailwind.

However, adjusting for the impact of acquired revenues, the metric declined 1.5% due to acquisition related dis-synergies.

Quarter Ending	10/2019
Report Date	**Dec 05, 2019**
Sales Surprise	**-0.04%**
EPS Surprise	**-3.47%**
Quarterly EPS	**1.39**
Annual EPS (TTM)	**5.27**

Quarter in Detail

Net bookings for the quarter were approximately $2.2 billion, reflecting a book-to-bill ratio of approximately 1.4%.

Science Applications' estimated backlog of signed business deals was approximately $14.5 billion of which, $2.9 billion was funded.

Adjusted operating margin contracted 40 basis points (bps) year over year to 5.8% in the reported quarter.

Adjusted EBITDA of $135 million increased 38%. Adjusted EBITDA margin was flat at 8.3%.

Balance Sheet & Cash Flow

Science Applications ended the quarter with cash and cash equivalents of $162 million, down from $179 million reported in the previous quarter.

Operating cash flow was $116 million, up from $95 million in the sequential quarter. Free cash flow was $116 million compared with $90 million in the preceding quarter.

During the quarter, Science Applications deployed $24 million of capital, $21 million to cash dividends and $3 million to debt repayment.

Guidance

For fiscal 2020, the company expects second-half revenues to be consistent with the first-half figure of $3.6 billion.

For the full fiscal, adjusted EBITDA margin is likely to be at the mid-to-upper-end of the 8.2-8.4% range.

Free cash flow is expected to be at least $425 million for fiscal 2020.

SAIC Q3 Earnings Miss Mark, Rise Y/Y

Recent News

On Dec 11, Science Applications International announced that its Board of Directors has authorized and declared a regular quarterly cash dividend of 37 cents per share. The cash dividend is payable on Jan 31, 2020 to stockholders of record on Jan 17, 2020.

On Nov 27, Science Applications was awarded the IDIQ contract worth $81 million by the Environmental Protection Agency. On the same day, it also received a $582-million contract award from the space and intelligence community customers.

On Sep 25, Science Applications won a $20.5-million contract to deliver an advanced, high-technology Armored Reconnaissance Vehicle technology demonstrator for the Office of Naval Research and the U.S. Marine Corps.

On Sep 19, Science Applications gained a task order on the Joint Range Extension Support contract from the Australian Department of Defence.

On Sep 18, Science Applications announced a regular quarterly cash dividend of 37 cents per share payable Oct 25 to its stockholders of record on Oct 11.

On Sep 17, Science Applications clinched an eight-year contract worth $85 million to provide IT services for the city of Anaheim, CA.

Valuation

Shares of SAIC have grown 7.4% in the past six months and 42.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector have risen 1% and 14.3% in the past six months, respectively. Over the past year, while the Zacks sub-industry has gained 24.4%, the sector inched up 33%.

The S&P 500 Index has gained 9.8% in the past six months and 25.2% in the past year.

The stock is currently trading at 15.12X forward 12-month earnings, which compares to 23.04X for the Zacks sub-industry, 22.73X for the Zacks sector and 18.94X for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.99X and as low as 11.77X with a 5-year median of 16.94X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $98 price target reflects 15.87X forward 12-month earnings.

The table below shows summary valuation data for SAIC

Valuation Multiples - SAIC		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	15.12	23.04	22.73	18.94
	5-Year High	24.99	32.37	22.73	19.34
	5-Year Low	11.77	15.6	16.86	15.17
	5-Year Median	16.94	22.18	19.24	17.44
P/S F12M	Current	0.8	5.14	3.66	3.51
	5-Year High	0.85	10.29	3.66	3.51
	5-Year Low	0.41	4.34	2.3	2.54
	5-Year Median	0.68	7.46	3.01	3
EV/Sales TTM	Current	1.17	5.15	4.3	3.28
	5-Year High	1.39	8.12	4.3	3.3
	5-Year Low	0.61	4.16	2.56	2.16
	5-Year Median	0.9	5.94	3.44	2.8

As of 01/09/2020

Industry Analysis Zacks Industry Rank: Bottom 21% (201 out of 254)

Top Peers

Leidos Holdings, Inc. **(LDOS)**	**Outperform**
Accenture PLC **(ACN)**	Neutral
Booz Allen Hamilton Holding Corporation **(BAH)**	Neutral
CACI International, Inc. **(CACI)**	Neutral
CDW Corporation **(CDW)**	Neutral
International Business Machines Corporation **(IBM)**	Neutral
ManTech International Corporation **(MANT)**	Neutral
Mercury Systems Inc **(MRCY)**	Neutral

Industry Comparison Industry: Computers - It Services

Industry Peers

	SAIC Neutral	X Industry	S&P 500	CACI Neutral	MANT Neutral	MRCY Neutral
VGM Score	A	-	-	C	B	D
Market Cap	5.36 B	3.35 B	23.94 B	6.58 B	3.22 B	4.08 B
# of Analysts	6	5	13	7	3	6
Dividend Yield	1.59%	0.00%	1.78%	0.00%	1.34%	0.00%
Value Score	B	-	-	B	C	F
Cash/Price	0.03	0.06	0.04	0.01	0.01	0.04
EV/EBITDA	26.01	11.99	13.97	17.95	20.02	34.52
PEG Ratio	3.13	1.90	2.03	2.15	3.84	2.95
Price/Book (P/B)	3.86	5.17	3.33	2.71	2.21	3.14
Price/Cash Flow (P/CF)	20.57	15.72	13.73	18.45	23.73	33.90
P/E (F1)	17.23	20.48	18.79	21.50	30.74	35.00
Price/Sales (P/S)	0.89	1.71	2.64	1.27	1.52	5.93
Earnings Yield	5.83%	3.03%	5.32%	4.65%	3.26%	2.86%
Debt/Equity	1.35	0.25	0.72	0.77	0.09	0.04
Cash Flow ($/share)	4.52	1.39	6.94	14.23	3.39	2.17
Growth Score	A	-	-	B	A	A
Hist. EPS Growth (3-5 yrs)	15.97%	16.94%	10.56%	16.70%	12.56%	39.60%
Proj. EPS Growth (F1/F0)	7.57%	9.60%	7.49%	16.77%	7.91%	14.04%
Curr. Cash Flow Growth	33.43%	14.90%	14.83%	29.08%	38.36%	25.32%
Hist. Cash Flow Growth (3-5 yrs)	16.56%	16.56%	9.00%	11.71%	4.12%	39.83%
Current Ratio	1.20	1.32	1.23	1.35	1.28	5.35
Debt/Capital	57.41%	37.45%	42.99%	43.62%	7.85%	3.94%
Net Margin	2.62%	1.78%	11.08%	4.91%	4.42%	8.51%
Return on Equity	22.10%	12.44%	17.16%	10.86%	6.56%	7.59%
Sales/Assets	1.30	0.81	0.55	1.04	1.06	0.52
Proj. Sales Growth (F1/F0)	37.62%	8.61%	4.20%	13.69%	8.09%	20.31%
Momentum Score	B	-	-	D	B	F
Daily Price Chg	4.11%	1.16%	0.53%	1.16%	0.40%	0.80%
1 Week Price Chg	-0.07%	0.35%	-0.30%	2.05%	1.81%	3.39%
4 Week Price Chg	11.01%	4.93%	1.92%	9.61%	2.83%	3.85%
12 Week Price Chg	12.19%	14.52%	6.54%	15.74%	13.66%	0.78%
52 Week Price Chg	43.94%	14.10%	22.58%	76.75%	49.13%	53.16%
20 Day Average Volume	321,949	253,081	1,580,816	146,078	174,872	350,265
(F1) EPS Est 1 week change	0.24%	0.00%	0.00%	-0.12%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.07%	0.00%	0.00%	0.00%	0.29%	0.00%
(F1) EPS Est 12 week change	-0.59%	-0.70%	-0.50%	1.07%	2.15%	1.74%
(Q1) EPS Est Mthly Chg	-0.40%	0.00%	0.00%	-0.36%	-0.84%	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.

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

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.

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.

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