

Science Applications (SAIC)

\$77.54 (As of 04/09/20)

Price Target (6-12 Months): **\$82.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 09/04/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: B

Growth: B

Momentum: B

Summary

Science Applications' fourth-quarter fiscal 2020 revenues and earnings increased in double-digit ranges. The company is benefiting from the Engility acquisition. Strong performance of its 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. The stock has outperformed the industry over the last year. However, acquisition-related dis-synergies were an overhang on the top line. Competition in the emerging growth segment and an intense rivalry with CACI are concerns as well.

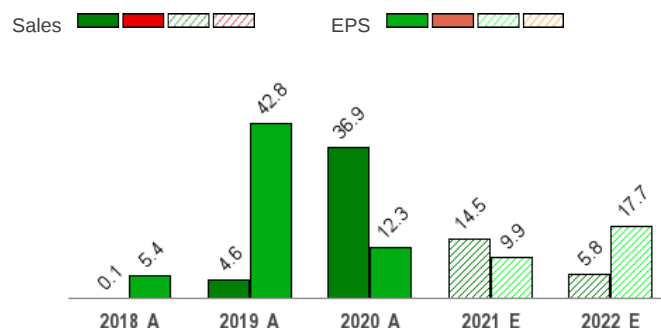
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$96.80 - \$45.45
20 Day Average Volume (sh)	695,069
Market Cap	\$4.5 B
YTD Price Change	-10.0%
Beta	1.12
Dividend / Div Yld	\$1.48 / 1.9%
Industry	Computers - IT Services
Zacks Industry Rank	Bottom 45% (138 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	19.7%
Last Sales Surprise	-2.1%
EPS F1 Est- 4 week change	0.8%
Expected Report Date	06/04/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022					7,729 E
2021	1,762 E	1,839 E	1,888 E	1,817 E	7,304 E
2020	1,615 A	1,594 A	1,630 A	1,540 A	6,379 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$1.74 E	\$1.77 E	\$1.90 E	\$1.86 E	\$7.32 E
2021	\$1.46 E	\$1.54 E	\$1.63 E	\$1.61 E	\$6.22 E
2020	\$1.36 A	\$1.35 A	\$1.39 A	\$1.58 A	\$5.66 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 04/09/2020. The reports text is as of 04/13/2020.

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.

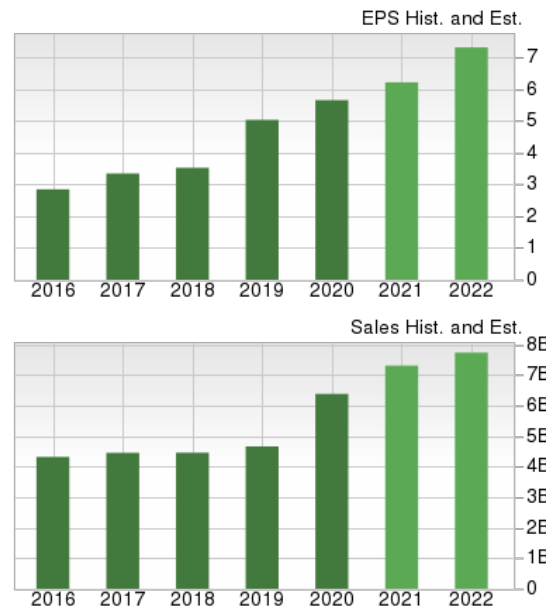
The company generated \$6.38 billion of revenues in fiscal 2020, of which more than 97% came in from the U.S. government. The company segregates its contracts in three different types:

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 recently-completed 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 2020, the company paid a total cash dividend of \$87 million and repurchased \$197 million worth of its common stock. Since the inception of the share-repurchase program in 2013, it has repurchased \$736 million worth of stocks.

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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

Science Applications Q4 Earnings Top, Revenues Miss

Science Applications reported mixed results for fourth-quarter fiscal 2020, wherein its earnings topped the Zacks Consensus Estimate but revenues missed the same. The company reported fiscal fourth-quarter adjusted earnings of \$1.58 per share, surpassing the consensus mark by 19.7% and improving 35% year over year as well.

Moreover, revenues jumped 29% from the year-ago quarter to \$1.54 billion but lagged the Zacks Consensus Estimate of \$1.57 billion. Revenues realized from the acquisition of Engility drove the top line. Solid performance of the company's contract portfolio was a tailwind.

However, adjusting for the impact of acquired revenues, the metric edged down 1.2% due to acquisition-related dis-synergies and completion of a technology contract.

Quarter in Detail

Net bookings for the fiscal fourth quarter were \$2.4 billion, reflecting a book-to-bill ratio of approximately 1.5.

Science Applications' estimated backlog of signed business deals was \$15.3 billion, of which \$2.6 billion was funded.

Adjusted operating margin expanded 20 basis points (bps) year over year to 6.8% in the reported quarter.

Adjusted EBITDA of \$134 million jumped 41%. Adjusted EBITDA margin expanded 70 bps to 8.7%.

Balance Sheet & Cash Flow

Science Applications ended the fiscal fourth quarter with cash and cash equivalents of \$188 million, down from the prior quarter's \$162 million.

Operating cash flow was \$69 million, down from the previous quarter's \$116 million. Free cash flow was \$62 million compared with \$116 million in the fiscal third quarter. During the reported quarter, Science Applications deployed \$7 million of capital, \$22 million to cash dividends and \$16 million to debt repayment.

In fiscal 2020, the company generated operating and free cash flow of \$458 million and \$437 million, respectively. During this period, Science Applications deployed \$21 million of capital, \$87 million to cash dividends and \$274 million to debt repayment.

Guidance

During the earnings conference call, Science Applications noted that it had intended to provide a formal fiscal 2021 outlook. However, citing the uncertainties due to the coronavirus pandemic, the company has decided to postpone issuing a fiscal 2021 guidance.

Nonetheless, for the investment community, the company shared its thought regarding how it had viewed fiscal 2021 before the crisis. Science Applications said it has witnessed minimal impact of coronavirus on its business.

Prior to the COVID-19 crisis, the company was expecting organic revenue growth in the range of 3% to 6% for fiscal 2021. This would include revenues from the recently-completed acquisition of Unisys Federal.

For the fiscal year, adjusted EBITDA margin is likely to be at the mid-to-upper-end of the 8-9% range.

Free cash flow is expected to be at least \$450 million for fiscal 2021.

Quarter Ending 01/2020

Report Date	Mar 26, 2020
Sales Surprise	-2.11%
EPS Surprise	19.70%
Quarterly EPS	1.58
Annual EPS (TTM)	5.68

Recent News

On Mar 12, SAIC announced that it is partnering with The Goodyear Tire & Rubber Company on a pilot project on securing customer data across supply chain with blockchain technology.

On Mar 11, SAIC received a three-year, single-award, follow-on contract worth \$45.2 million to continue supporting the Navy and Marine Corps in tactical warfare training.

On Feb 6, 2020, SAIC entered into a definitive agreement to acquire Unisys Federal, in an all-cash transaction valued at \$1.2 billion.

On Jan 10, 2020, SAIC won an application modernization contract worth \$727 million for the Department of Defense.

On Dec 11, 2019, 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, 2019, 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.

Valuation

Shares of SAIC have lost 10% so far this year and gained 5.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector have lost 17.6% and 9.9% in the year to date period, respectively. Over the past year, while the Zacks sub-industry has lost 17.6%, the sector declined 0.9%.

The S&P 500 Index has lost 13.6% year to date and 4.6% in the past year.

The stock is currently trading at 12.27X forward 12-month earnings, which compares to 20.68X for the Zacks sub-industry, 20.25X for the Zacks sector and 18.11X for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.99X and as low as 8.58X with a 5-year median of 16.86X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$82 price target reflects 12.88X 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	12.27	20.68	20.25	18.11
	5-Year High	24.99	32.37	21.92	19.34
	5-Year Low	8.58	15.46	16.71	15.19
	5-Year Median	16.86	21.85	19.21	17.45
P/S F12M	Current	0.67	4.01	3.18	3.07
	5-Year High	0.86	10.11	3.58	3.44
	5-Year Low	0.41	3.89	2.32	2.54
	5-Year Median	0.69	7.23	3.09	3.01
EV/Sales TTM	Current	0.97	4.01	3.61	2.77
	5-Year High	1.39	8.12	4.44	3.46
	5-Year Low	0.62	3.61	2.57	2.16
	5-Year Median	0.92	5.86	3.55	2.83

As of 04/09/2020

Industry Analysis Zacks Industry Rank: Bottom 45% (138 out of 253)



Top Peers

NCI Building Systems, Inc. (CNR)	Outperform
DRD GOLD Limited (DRD)	Outperform
Electronic Arts Inc. (EA)	Outperform
TPG Pace Holdings Corp. (ACEL)	Neutral
Cabot Microelectronics Corporation (CCMP)	Neutral
Jacobs Engineering Group Inc. (J)	Neutral
Kite Realty Group Trust (KRG)	Neutral
NexGen Energy Ltd. (NXE)	Neutral

Industry Comparison Industry: Computers - It Services				Industry Peers		
	SAIC Neutral	X Industry	S&P 500	ACEL Neutral	J Neutral	NXE Neutral
VGM Score	A	-	-	B	D	F
Market Cap	4.53 B	2.11 B	19.66 B	687.64 M	10.82 B	335.46 M
# of Analysts	7	4	13	1	8	1
Dividend Yield	1.89%	0.00%	2.18%	0.00%	0.93%	0.00%
Value Score	B	-	-	D	C	F
Cash/Price	0.05	0.07	0.06	0.24	0.06	0.12
EV/EBITDA	12.05	9.82	11.72	15.48	19.23	-428.12
PEG Ratio	2.26	1.54	2.04	NA	1.31	NA
Price/Book (P/B)	3.17	3.97	2.66	8.39	1.78	2.39
Price/Cash Flow (P/CF)	9.58	9.92	10.44	18.32	12.62	NA
P/E (F1)	12.43	23.48	17.51	NA	14.77	NA
Price/Sales (P/S)	0.71	0.84	2.12	NA	0.83	NA
Earnings Yield	7.94%	3.64%	5.65%	-0.91%	6.78%	-7.53%
Debt/Equity	1.30	0.23	0.70	3.91	0.23	0.65
Cash Flow (\$/share)	8.18	1.13	7.01	0.48	6.44	-0.03
Growth Score	B	-	-	A	F	F
Hist. EPS Growth (3-5 yrs)	17.06%	17.85%	10.92%	NA	11.23%	NA
Proj. EPS Growth (F1/F0)	9.95%	2.55%	-1.14%	11.11%	9.01%	-40.00%
Curr. Cash Flow Growth	74.09%	15.51%	5.93%	-8.32%	6.22%	-437.73%
Hist. Cash Flow Growth (3-5 yrs)	23.85%	16.83%	8.55%	NA	9.65%	NA
Current Ratio	1.27	1.35	1.24	2.76	1.55	11.17
Debt/Capital	56.47%	33.63%	42.36%	79.65%	18.92%	39.50%
Net Margin	3.54%	2.36%	11.64%	NA	7.54%	NA
Return on Equity	25.09%	10.99%	16.74%	-23.33%	12.29%	-8.23%
Sales/Assets	1.37	0.80	0.54	NA	1.08	NA
Proj. Sales Growth (F1/F0)	14.51%	5.65%	0.45%	296.63%	8.45%	NA
Momentum Score	B	-	-	D	A	A
Daily Price Chg	4.82%	1.97%	2.48%	5.90%	0.46%	-2.60%
1 Week Price Chg	-0.68%	-8.76%	-4.40%	-3.84%	5.46%	42.76%
4 Week Price Chg	23.31%	7.55%	11.26%	2.21%	2.77%	40.98%
12 Week Price Chg	-15.85%	-20.41%	-20.02%	-27.30%	-13.01%	-26.10%
52 Week Price Chg	5.04%	-22.33%	-11.31%	-14.08%	6.45%	-46.79%
20 Day Average Volume	695,069	611,641	3,931,994	220,727	1,431,631	576,131
(F1) EPS Est 1 week change	0.00%	0.00%	-0.12%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.76%	-4.47%	-5.78%	-112.70%	-1.25%	0.00%
(F1) EPS Est 12 week change	0.69%	-7.08%	-7.64%	-112.70%	-1.34%	-16.67%
(Q1) EPS Est Mthly Chg	-0.79%	-0.79%	-10.13%	-140.00%	0.17%	0.00%

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	B
Growth Score	B
Momentum Score	B
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.

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