CACI INTERNATIONAL INC
Moderator: Ken Asbury
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Operator: Welcome to the CACI International Third Quarter FY15 conference call. Today's call is being recorded. At this time, all lines are in a listen-only mode. Later, we will announce the opportunity for questions, and instructions will be given at that time. A special reminder to our media guests who are listening in, please remember that during the question-and-answer portion of the call, we're only taking questions from the analysts.

At this time, I would like to turn the conference over to Dave Dragics, Senior Vice President of Investor Relations for CACI International. Please go ahead, sir.

INTRODUCTION AND SAFEHARBOR STATEMENT

Dave Dragics: Thanks, Kevin. Good morning, ladies and gentlemen. I'm Dave Dragics, Senior Vice President of Investor Relations of CACI International, and we're very pleased that you're able to participate with us today. And as is our practice, we are providing presentation slides, so let's move to slide number 2.

Turning to our written and oral disclosures and commentary, there will be statements made in this call that do not address historical fact and, as such, constitute forward-looking statements under current law. These statements reflect our views as of today and are subject to important factors that could cause our actual results to differ materially from anticipated results. Factors that could cause our actual results to differ materially from those we anticipate are listed at the bottom of last evening's earnings release and are also described in the Company's Securities and Exchange Commission filings. And our Safe Harbor statement is included on this exhibit and should be incorporated as part of any transcript of this call.

I'd also like to point out that our presentation today will include discussion of non-GAAP financial measures. And these non-GAAP measures should not be considered in isolation or as a substitute for performance measures prepared in accordance with GAAP.

So let's turn to slide number 3. And to open up our discussion this morning, here's Ken Asbury, President and Chief Executive Officer of CACI International. Ken.

CEO OVERVIEW

Ken Asbury: Thank you, Dave, and good morning, everyone. Thank you for joining us to discuss CACI International's third quarter 2015 results. With me this morning are John Mengucci, our Chief Operating Officer and President of U.S. Operations, Tom Mutryn, our Chief Financial Officer, and Greg Bradford, Chief Executive of CACI Limited, who is joining us from the United Kingdom.

Please turn to slide 4. Overall, I'm pleased with our performance. Our year-to-date contract awards are at record levels for the company, despite continuing delays from award decisions and award protests. Nearly 40% of our contract wins this year were for business new to CACI. Our funding orders were strong and our backlog remains above $9 billion. We continue to ramp up the background investigations work that we perform for the Office of Personnel Management, and it is on track with our expectations. In short, we have won and continue to win more new business, but delays in award decisions and from protests mean that we have to wait longer to realize revenue and profit from these wins. The delays have had an impact on our results. And John will discuss the steps we have taken to offset these delays, later in the call. With the visibility we now have, we have refined our guidance for the remainder of FY15.

Slide 5, please. Since the current fiscal year appropriations have been enacted, our customers have had a more stable platform from which to plan, program, and obligate funds. Overall, we are cautiously optimistic about the market environment. We see positive signs from strong award activity, a healthy Q4 exit rate, and full OPM run rate contributing to FY16. However, we must realistically balance that optimism against a continued backdrop of uncertainty inside the federal market. Pricing and run rate pressures on professional services remain. Delays in awards will continue and protests on larger, more solution-centric work will continue to push execution even farther to the right, and we will likely see additional Afghanistan drawdown impacts. Based on our FY15 performance and the ongoing market realities, I fully expect CACI to realize low single-digit organic growth in FY16. We will have more details on that in our June conference call.

Our customer priorities continue to be shaped by escalating global tensions and threats at home and abroad. U.S. forces remain engaged in combat against the Islamic State in Syria and Iraq. As vital national security interests are threatened across the Middle East and Africa, the U.S. is also supporting coalition operations in those parts of the world. The administration has decided to retain a sizable military presence in Afghanistan, opening the door to a potentially longer-term commitment beyond 2016. Russia's behavior has raised tensions in Europe to levels unseen since the Cold War. And in response, the U.S. is engaged in land, sea, air operations to reassure allies and to deter further aggression. These diverse and increasingly sophisticated threats, along with the growing Chinese assertiveness levy new requirements on our customers in the defense and intelligence communities.

Slide 6, please. As part of our drive to support these national priority missions, we acquired in the third quarter LTC Engineering Associates, a great complement to the capabilities we gained through our acquisition of Six3 systems. LTC adds innovative security and communication intelligence specialists, further expanding and enhancing our penetration into high-end C4ISR and cyber markets.

During this quarter, we won four C4ISR contracts where our probability of winning was greatly improved because of the sophisticated and proven solutions in electronic warfare and nontraditional cyber that Six3 brought to CACI. Going forward, we are confident that we will continue to capture market share, winning new business, delivering operational excellence and deploying our capital for long-term growth.

With that, let me turn the call over to Tom, to discuss our financials. Tom.

FINANCIAL OVERVIEW

Tom Mutryn: Thank you, Ken, and good morning, everyone.

Let's get to slide number 7. In the quarter, we generated strong cash flow and we had solid funding awards in new business. The quarter results reflect the OPM program returning to a profit, and we expect to achieve steady-state profitability on this contract in our fourth quarter. Our third quarter also reflects a low amount of award fees due to normal timing.

Revenue is down year over year, driven by a continued decline in lower margin subcontractor labor and other material direct costs. We continue to grow our direct labor base, the primary driver of profitability.

Indirect costs and selling expenses decreased as a result of our ongoing cost control efforts. Net interest expense was lower as a result of reduced debt levels and no longer incurring non-cash expense on our convertible notes which matured in May of last year, offset by slightly higher effective interest rates.

Our tax rate for the quarter was 35.8%, reflecting a reduction in our tax reserves for uncertain tax positions. We are expecting a full-year tax rate of 37.6%.

Slide 8, please. Our operating cash flow in the quarter was $97 million, and $190 million year to date. DSO decreased 6 days during the quarter to 61 days. We continue to issue invoices timely and work constructively with the various government payment offices. Trailing 12-month free cash flow was $226 million, and our annualized free cash flow yield per share is 10.5% at an $88 share price. With just under $1.1 billion of total debt, our net debt-to-trailing 12-month EBITDA leverage ratio is at 3.5 times.

Slide 9, please. We are narrowing our FY15 guidance range. As Ken pointed out, delays in the award process and protests on a significant amount of new awards are the primary factors. We continue to expect that our fourth quarter will be favorably impacted with stronger award fees, the increased work on a number of existing contracts including OPM, a modest amount of new business, and an extra billing day.

Slide 10, please. We now expect our full-year direct labor to increase in the 3% to 4% range, and our operating margin to be about equal to last years 7.2% level.

With that, I'll turn the call ever to John.

OPERATIONS OVERVIEW

John Mengucci: Thanks, Tom. Let's go to slide 11, please. Operations closed Q3 in a comfortable position to deliver FY15 within guidance. We remain focused on winning new business, flawless execution of our current contracts, and securing contract funding. We won $687 million of awards in Q3, with 40% of those awards for new business.

With that said, let me provide an update on our previously protested awards. We had $300 million protested in Q1, all of which have been adjudicated in our favor. Of the $700 million protested in Q2, approximately $150 million has been adjudicated in our favor, leaving $550 million yet to be resolved. I'm confident CACI will prevail in the majority, if not all, of the remaining protested award decisions.

As Ken mentioned, we partially offset award delays and protests in FY15 to remain within our original guidance. I'm particularly proud of the organization who has successfully first ramped up background investigations for the Office of Personnel Management, grew work under our current book of contracts, and won a higher percentage of our recompetes. These offsets illustrate the value CACI continues to provide to its customers.

Let's go to slide 12, please. We also received $965 million in contract funding orders in the third quarter. This is 22% higher than a year ago and brings our funded backlog to $2.1 billion at the end of March. Our book-to-bill ratio was 1.13 times for the trailing 12 months. Total backlog was $9.7 billion, a 32% increase from a year ago. This provides an estimated 36 months of revenue at the third-quarter run rate, a very comfortable position.

As we move into Q4, our FY15 revenue guidance consists of virtually 100% existing business, with negligible amounts of recompete and new content. In addition, with the $965 million of funding orders received in Q3, we are now effectively 100% funded for the remainder of FY15.

Our opportunity pipeline remains strong. Pending contract awards total $8.3 billion, with 75% of that new business to CACI. In addition, we plan to submit another $14 billion in bids over the next six months, more than half of those bids will be for new business. This pipeline reflects our focus strategy of pursuing larger contracts with higher financial and strategic value.

All in all, I'm pleased with our performance through Q3, putting us in a position to deliver within guidance in a challenging market environment. Awards and funding are strong, and our attention to operational excellence continues to serve us well. I'm confident in our market-driven strategy and CACI's ability to support high-value [in doing] missions for our nation.

With that, I'd like to turn the call back over to Ken.

CEO CLOSING REMARKS

Ken Asbury: Thank you very much, Tom and John. Appreciate your support this morning.

Let's go to slide 13, please. Over the last nine months, we have won record contract awards and successfully completed a value-added acquisition. The solutions that we offer continue to be in high demand across all of our market areas. Through our strategy, we are committed to increasing the support that we can provide to our customers. Overall, I'm confident that we are positioned to finish FY15 strongly, and well situated for the start of FY16.

I would like to take a moment to say how proud I am of the talent, dedication, and good character of CACI's 16,700 employees around the world, and the work that they do in support of our customers' critical missions and our nation's future. Thank you all for your hard work.

With that, I'd like to open the call up to questions.

Operator: Hello, ladies and gentlemen. We also ask that you limit yourself to one question and one follow-up. Our first question comes from Bill Loomis with Stifel.

QUESTION ON WHY MARGINS ARE NOT INCREASING AS DIRECT LABOR INCREASES AS A PERCENT OF DIRECT COSTS

Bill Loomis: Good Morning. Just on direct labor, I mean, we've seen it continuing to grow as a percent of direct costs and as a percent of revenue, or direct labor costs, I should say, and ODCs fall, and it's the highest it's been in 15 years. So why aren't we seeing margin? I know the business is turning and revenues are starting to turn up, so that's been a headwind. But why aren't you, with such a higher level of direct labor versus ODCs in the mix, why aren't margins higher than they were a couple years ago? And if you could talk a little bit, maybe looking a year or two down the road, is there something systematically that's changed, in terms of profitability of the space, that won't allow you to get back to the old margins—because the direct labor, obviously, is much higher than what it has been in recent years.

Tom Mutryn: Yes, Bill, this is Tom. I'll take a first stab at that one. Yes, your observation is entirely correct. Yes, we have richer mix of direct labor versus ODCs. Our gross margin and, therefore, our operating margin should be higher.

Not all of our direct labor is in the same flavor. Some of our direct labor is on fixed-price contracts, which are generally more profitable. When we did the Six3 acquisition, it has a greater percentage of fixed-price contracts, more profitable contracts.

But we still have direct labor on the normal cost-plus and T&M contracts. In some of the cost-plus contracts, we're seeing pricing pressure as we go after -- get a new work as we protect our recompetes, because we do see some pressures. And so it's somewhat of a related rate issue. While the mix is richer, we're seeing some reduced margin on our direct labor.

Now, going forward, what do we plan to do about that? In some of the work that we're pursuing, which is greater solutions focus, and a higher fixed-price contract, less LPTA, less commodity, less run rate professional services, should help us have a greater margin on our direct labor.

QUESTION ON WHAT IN THE CURRENT BUSINESS MIX WOULD PREVENT HIGHER MARGINS

Bill Loomis: Okay. So other than near-term pressure we've seen with LPTA, if we do get some stabilization and the customers come back realizing that strategy isn't working, is there anything in the business mix today that shouldn't allow you to go back to much higher margins of a couple years ago?

Tom Mutryn: Yes, Bill, you're right, we should be able to increase our margins. We're having a richer mix of business. I mean, that's consistent with what's in our pipeline awards to be submitted. We're focused on that. We're focused on indirect cost control, trying to ensure that we become efficient on an ongoing basis. Those are constructive to margins.

That being said, this year we have higher intangible amortization expense associated with the Six3 acquisition, a non-cash component of it. But if we bid the right work, that will translate into higher gross margin. And as we grow, it's easier to control indirect expenses. They just need to grow less than revenue, and good things will happen. And so that's certainly our aspirations—to generate greater net income, and one of the ways to do it is to focus on profitability.

And I'll make one other point, and, John, you may want to elaborate. We have a portfolio of business today. And how do we ensure that existing portfolio of business continues to perform accordingly? And that gets into our operational excellence program, the profitability of existing programs. How can we better, more closely monitor that base of business? That has been a focus of ours, and will continue to be a focus of ours, and that will certainly contribute.

Bill Loomis: Okay. Thank you.

Operator: Our next question comes from Steven Cahall with Royal Bank of Canada.

QUESTION ON THE FACTORS BEHIND CACI'S FORECASTED FOURTH QUARTER PERFORMANCE AND THE SUSTAINABILITY OF THE OPERATING MARGIN

Steve Cahall: Tom, maybe the first one for you, Tom. If I just look at the implied, kind of midrange guidance for the balance of the year, if I've got my numbers somewhere close, it looks like it's a very, very strong Q4 in terms of earnings—one of the best you've had in quite a few years. And then also, the implied operating margin is very, very strong. So I guess first, can you give us a sense of what the dynamics are they give you that confidence in that very strong Q4? And then is that sort of an operating margin, which I think is close to 9%. Is that a sort of run rate, once OPM gets to steady-state, that we can start to extrapolate going forward? Or do we have some special things in Q4 that may not repeat?

Tom Mutryn: Yes, so good question. Yes, there is a significant increase in our profitability from our third quarter to our fourth quarter.

Four major factors. The first one's relatively easy to explain. It's award fees. We have approximately $10 million more award fees in our fourth quarter than our third quarter. And that is simply due to the whims nature of when we won contracts and when we get award fees. Typically we'll get those on an annual basis or an every six-month basis. They just happen to be lumped in the fourth quarter. So $10 million of award fees, which is pure profit. They fall directly to the bottom line. So that's been very influential in that bridge.

The second one is increase in existing work. One of them is OPM. We expect OPM to reach steady-state in the fourth quarter. That is kind of material. And we have a number of other programs which we won in our first and second quarters, which are in the process of ramping up. Some of those programs are not a step function of ramp-up but they're a slower ramp up. And we expect to see increases in profitability due to those existing programs. Again, OPM plus a handful of other new wins that we had.

The third factor is we have an extra billing day. It's not worth a lot, but it's worth something. And we still have a little bit of new business left in the fourth quarter, and that's a modest amount. But those generally allow us to bridge the gap.

The question is, is the implied margin in the fourth quarter sustainable? And if I exclude those high award fees and more normalize it, you'll get a margin in the mid-sevens, which is more normative. And I think that would be a better benchmark for planning purposes.

QUESTIONS ON THE PROSPECT OF RETURNING TO POSITIVE ORGANIC REVENUE GROWTH AND CLARIFICATION OF FUNDING FOR FY15

Steve Cahall: That's very, very helpful. Thank you. And then, maybe as a follow-on, over to one for you, Ken, on growth. You mentioned the low single-digit organic growth possible in 2016. A, do you feel that that is almost certain at this point and it's just an issue of timing, or is there a chance that that slips into the following fiscal year? And relatedly, I think I heard the comment that now 100% of FY15 is funded. Is that 100% at the midpoint? Is that 100% at the bottom of the guidance range? So maybe just a little bit of clarification on that would be helpful. Thank you.

Ken Asbury: Yes, Steve. Thanks. Look, we are in planning for 2016 now but we thought it would be useful to give people a preview, at least on the revenue side, of where we are. We're going to have more fulsome discussion about that.

But let's talk -- I'll talk about a couple macro factors that are both on the plus side and then on the negative side. We do have the healthy base of awards. We do have the FY15 protest delays that built sort of a bow wave that, once those get cleared, and John's going to talk more about that a little bit later, that will contribute nicely into the FY16 picture. Plus, having OPM for a full year at the full run rate, I think are really the positives going into the year.

Challenges are going to be, look, we have to face the fact the customers do have lower budgets, generally speaking. We are seeing continuing impacts to our professional services run rates. That's the easiest way for customers to save money as opposed to being on solutions contracts, that's harder. We believe there's still or will continue to be Afghanistan uncertainty. And as Tom spoke about a little bit earlier, there are still recompete and pricing pressures associated -- recompete pricing pressures associated with some of the competitions. This year, we had a relatively low amount of recompetes. We expect to have a more normal amount, in the 20% or so range, next year.

So those are the factors that sort of are going to go against the positives, or at least be some headwinds against the positives. And we will be clearer as we get our plans filled out for our June call.

Now, relative to the 100% funding, John, do you want to add to that?

John Mengucci: Yes. Yes, sure, Steve. Yes, we're 100% fully funded at our current midpoint today, which is based on the revenue guidance narrowing. So, 100% at our current midpoint is what we're funded to.

Operator: Our next question comes from Cai von Rumohr with Cowen and Company.

QUESTION ON WHETHER THERE HAS BEEN A SHIFT IN CACI'S PRICING STRATEGY

Cai von Rumohr: So a follow-up to Bill's question. If we go back a couple of years ago, I know Paul Cofoni was focused on growing the business, and with S3, I think your strategy was to grow profits and not as much emphasis on margin. It looks like here you've had a strategy that's been quite successful in terms of take away business from other folks, but in a tough pricing environment. So essentially, did you consciously go into this bidding higher profit but lower margin, even though the mix is shifting toward direct labor?

Ken Asbury: Yes, Cai. This is Ken. No. I mean, not -- I think what you see represented is a mix and as the business shows up in front of us. And what I mean by that is how the government procurements roll out on any particular period of time. We are favoring solutions-oriented work with higher direct labor content and places where, we believe, customers are going to be looking for best value sort of determinations as opposed to LPTA. So that's fundamentally the strategy.

What happens, though, is in any particular time, you have to depend on what, as we look at the markets and how the government procurement schedules come out, it'll show up as a mix. We want to defend some of our work that turns to LPTA because we want to keep it. That's where we see pricing pressures in other work.

We've been high cost and very nice profitability but that mix is going to take a while for it to show itself. It's only been the last three to four quarters where we've seen a really significant uptick. We've had really nice gross, or increases, in our awards activity through 2014. But in 2015 it started to make truly a large difference as we won larger, more complex jobs where we believe we will get a better return. We're waiting for those to get into our baseline before we actually can have a comment about where we see the ability to increase profitability.

Does that help?

QUESTION ON THE IMPACT OF AWARD FEES ON CACI'S GUIDANCE IN FY15 VERSUS FY14

Cai von Rumohr: Yes, that helps a little bit. Maybe a follow-up. Tom, you'd mentioned that excluding awards, margins would be in the mid-sevens. But basically, correct me if I'm wrong, but aren't award fees normally a recurring phenomenon? For example, approximately where would you guess award fees would be in FY15 with your guidance and where were they in FY14?

Tom Mutryn: Yes. So I think for the full year on the annualized basis, award fees should be normalized because they're occurring throughout the year. So there's fluctuations on a quarterly basis but not many fluctuations on an annualized basis. Hence, your observation, Cai, is correct.

I'll elaborate on Ken's point. Fundamentally, we want to try to enhance shareholder value. And we believe that the drivers of shareholder value are share price. In our case, primarily, it is cash flow, net income, earnings per share. I mean that pays the bills; that is, in our mind the measure which is most highly correlated to stock price performance and expectations thereof. Are we going to grow, are we going to not grow into those particular kind of metrics? And as a result, we're trying to increase profitability. Now, an easier way to do it is to bid projects with higher margins than lower margins. We're using the same amount of B&P, approximately, so let's go after higher-margin business.

But it's not an either/or situation. We have our portfolio of business, more of a dial than a switch, where we're moving directionally to higher solutions business. But we have a base of business which is important to us. It's important to our customers, getting -- it's critical to some of their particular missions. And it's valuable in terms of allowing us to maintain our base of business and grow.

And so we will continue to defend that work. Some of that comes at lower margin levels because of various pricing pressure, price to win, the recompete situation. So we're trying to do both.

QUESTION ON THE MIX OF SOLUTIONS VERSUS OTHER TYPES OF BUSINESS IN CACI'S PORTFOLIO

Cai von Rumohr: Could you give us a rough sense—you contrasted between higher-margin solutions and lower-margin core recompetes. Roughly, approximately what percent are they of your revenues? And where do you see that mix going?

Ken Asbury: Yes, Cai. This is Ken. I think last year we looked at it, and it was about 40/60 solutions versus services. This year, it's looking more like, as everything comes into our plan, 45/55. So it's a slow sort of ramp up on that kind of work, and I think it'll continue to be that way.

John Mengucci: Cai, This is John. I might also add something—in that as we're just starting our FY16 plan, our history has been program by program, recompete by recompete, how does this contribute to the upcoming fiscal year? And I think it's safe to assume that on some of our professional services work, Cai, which is lower-margin, as some of that work goes small business or some of our professional services work, which is more commodity based, we will be making different decisions coming into FY16 than we may have made in previous years. We can now do that. We have a strong enough case to maintain our rates so that we can put greater investment into the larger, higher-margin solutions business versus some of this lower-margin work that is going towards small business. So we may make decisions to no longer pursue that type of work.

Again, as Tom mentioned it's not a switch. It's more of a dial. But how do we weed some of that lowest margin work out of our business base in FY16 and beyond?

Cai von Rumohr: Thank you very much.

Operator: Our next question comes from Jon Raviv with Citi.

QUESTION ON WHAT TYPE OF BUSINESS THE OPM CONTRACT WORK IS

Jon Raviv: Just a clarification on OPM. I was wondering, do you characterize that as solutions or professional services or core in that 40/60 split?

John Mengucci: Yes. Jonathan, this is John. We classify that as professional services. We're not actually building something which gets deployed that allows the customer to perform a specific mission. We're actually doing that work on their behalf. So we have that in our professional services side.

QUESTION ON CACI'S PLANS FOR FUTURE CASH DEPLOYMENT

Jon Raviv: Okay. And then for my real question. Noticing on leverage, now that you're almost near target leverage range, which I think is around 2.5 to 3.5, just where do you see the debt pay down trending from here? And more importantly, once you're in that range, how do you see cash deployment decisions coming up? Any change to your strategy? Any sort of milestone to think about in terms of when decisions might get made?

Tom Mutryn: Yes, I'll start this off. We're at 3.5 times leverage. It's a comfortable level of leverage. We've publicly stated that we're 2.5 to 3.5 times range is a reasonable type of range. Over the foreseeable near term, at least, we'll generate our strong cash to de-lever. Last quarter we were 3.7 times. And so we've done a good job of repaying debt—paid down around $300 million of debt since the Six3 acquisition. So we'll continue to focus on that until we find acquisition opportunities, which we will continue to pursue.

Ken Asbury: Yes. Jonathan, this is Ken. Our primary goal for this business is to grow it organically, and I think we're on the cusp of being able to do that again in FY16. But M&A has always been our primary use of our free cash flow. And we use that to acquire new skills and customer capabilities and like. However, that being said, we have had a balanced view over the past four years. Several years ago, we repurchased about 25% of our shares. And management and the board regularly review what we do for capital deployment. As of this time, M&A is still our first priority for free cash.

QUESTION ON WHETHER THERE IS UPSIDE TO CACI'S OPERATING CASH FLOW GUIDANCE FOR FY15

Jon Raviv: Okay, great. Thanks. And then, just a quick follow-up on your cash flow guidance. It implies a pretty weak fiscal fourth quarter. Tom, do you see some potential upside to the $200 [million]?

Tom Mutryn: Yes, I do. We originally added $200 million of operating cash flow guidance—a very strong first quarter. Our second quarter, if you will recall, was actually negative—a material increase in DSO. DSO is returning -- has returned to a 61-day level. If we're able to maintain that level, we should have some positive cash flow and we will exceed the $200 million level.

As I've mentioned in the past, a portion of the cash collection process is in our court—timely invoices, quality of invoices, getting them approved, working constructively with the payment office. Those processes are largely unchanged over the past several years. I think we do a very good job in those arenas. The situation is there is a certain amount of unpredictability of randomness of behavior of people in the government payment office, which has driven higher DSO in our second quarter. We were able to recover in our third quarter.

So there is a possibility DSO may increase in the fourth quarter. So as a result of that we're being a bit cautious in our message to the investor.

Jon Raviv: Thank you.

Operator: Our next question comes from Robert Spingarn with Credit Suisse.

QUESTION ON THE LARGEST ACQUISITION CACI MANAGEMENT WOULD CONSIDER

Robert Spingarn: Ken, just on acquisitions. You just spoke on that. At this point, what would you say the largest type of deal you could consider would be, given all the leverage metrics and so forth that Tom just went through?

Ken Asbury: Robert, I don't know. I mean, it really it will depend on the opportunity. I think we have had internal discussions that said if we got into the 4 -- 4.5 times, that's probably at the limit that we would be comfortable on. So I would ask Tom to do the math, but --

Tom Mutryn: Yes. So when we buy a company, it comes with EBITDA. And so that makes it a little bit easier in terms of getting to a certain debt-to-EBITDA carpet that we're comfortable with.

The other possibility, and if we think long and hard about it is that if it was a very large opportunity, we have another currency called equity, which we could deploy very carefully and judiciously for the right type of acquisition. And certainly, those types of decisions would get careful review by our Board of Directors --

Robert Spingarn: Right.

Tom Mutryn: -- and the management team as well. But that's another option that we have. And given the right set of circumstances, would we seriously consider it? The answer is yes.

QUESTIONS ON WHETHER OPM IMPACTED THE OPERATING MARGIN IN FY15 AND THE STATUS OF THE SIX3 ACQUISITION

Robert Spingarn: That's interesting, Tom, because it sounds like there might be that $1 billion-plus opportunity out there. So I'm taking that as something you might possibly look at.

Wanting to ask just a little bit -- just a couple quick fundamental things. The first was, you mentioned that the lower margin business was driving some of the sales decline in the quarter. I know there's been a lot of discussion around margin. Might have figured margin would rise as a result of that on a year-over-year basis, but it didn't. Was that simply OPM?

And then just as a last question, I wanted to ask about Six3—an an update for that from Ken in terms of what its sales growth and directional margin was in the quarter and whether you expect that asset to outgrow the rest of the business in 2016. Thank you.

Tom Mutryn: Yes. So I'll handle the margin one, and Ken can talk about how well Six3 is doing.

If I look -- absolutely right, everything else being equal, one would expect the greater direct labor content as a percentage of our direct costs to be productive to margin. A few things have offset it this year. One is OPM. In our second quarter, OPM—the way we account for OPM added material, negative impact on the quarter, and less so for the year, but it was still sizable for the year. And we also have these dynamics that we have certain pressure in our base business in our recompetes in terms of pricing. And that has offset some of the higher margins which we would expect. In other words, the margin under direct labor is under some pressure as well. And, Ken, Six3?

Ken Asbury: Yes, Rob. On Six3, the business is rock solid at this point. There are a number of classified things going on there right now that I can't talk about.

What I will say is that as a result of a variety of things going on throughout the world, there is a series of opportunities that have opened up that we will see latter part of 2015, maybe in the next 60 days into the early part of 2016, that are in the sweet spot of what Six3 would be bidding on. And so we have to go through a bidding process. It's not some of the other activities. I will tell you also -- but we have high expectations for being able to do that, because we do have a unique set of skills for what some of those opportunities would be.

I think you asked a question about whether it would outperform. I mean, that's going to be determined in a narrow competitive field. But we really have high expectations. The one thing that I will tell you over the past year that has really, really changed is we've seen the addition in some of our core bids, such as the four C4ISR ones that I talked about so far in third quarter, where the addition of Six3 added some scoring capability in our proposals, and we ended up winning those.

So still have high expectations. I really do want everybody to have a longer-term view of this. We're in a very complex electromagnetic warfare world these days, and Six3 puts us in a nice position to be able to help the United States in combating that problem.

Robert Spingarn: Can I ask how it did in the quarter?

Ken Asbury: I mean, we put them together with the other business. So we're not tracking those separately. I can tell you what they did for the year last year, and they met our near-term goals of being both GAAP and cash accretive at 5% and 13%.

Robert Spingarn: Okay. Thanks, Ken. Thanks, Tom.

Operator: Our next question comes from Brian Kinstlinger with Maxim Group.

QUESTION ON THE STATUS OF PROTESTED AWARDS FROM THE SECOND QUARTER

Brian Kinstlinger: The first question I had—for the two large CACI awards where protests went against CACI, meaning they were either sustained or dismissed—what was the nature of the protests? Was it a technicality or something more serious that could change the competitive landscape of the award? And then, are those procurements, do you have to build a new proposal or are they reevaluating the old proposals?

John Mengucci: Yes, Brian. This is John. There's a lot of questions around both our Q1 and our Q2 protests. So it probably makes sense to sort of take a step up, and then I'll address those two specific jobs.

If we were to look at protests overall, if I look at the timing of our Q1 awards and when they will begin generating revenue, I know there's also some comments out there around the expectation that there would have been revenue starting in the third quarter versus now showing up in the forth. The $300 million, the first quarter awards, CACI prevailed in all of the protests on those awards. Those awards were made at the very end of Q1 versus pre-and early Q1, which was part of our plan. The GAO cycle that we've mentioned in both of the last two earnings calls—it's a 100-day cycle after the protest is filed. And in some cases, that's two or three weeks after the award, once all the debriefs have been completed. So if we looked at the anatomy of a Q1 protest on an award given at the end of the first quarter, we're now looking at mid-January, early February before the GAO decision comes out.

In some cases, the decision was to deny the protest and re-award that work to CACI. In other cases on our first quarter protests, the decision was to sustain the protest and require corrective actions. Those corrective actions, in some cases, took 10 to almost 30 days, putting us to the middle of February and the middle of March. All of those cases where re-awarded to CACI. And then what the customer does is they complete the funded extension with the incumbent to expend all the funds that they had on contract before they transition the work to us, which pretty much puts us at a middle of March, April 1 date.

If we looked at the $550 million of the Q2 awards that are currently still in protest, none of those Q2 contract awards have been officially reversed. We were successful on about $150 million out of the original $700 million. Some are in the corrective action phase that you have all read on. Those'll follow the same process. There will be the formal debriefs, GAO corrective action, re-award, run out of the current contract funding, and then CACI start.

Brian, you talked about the two that were out there. Both of those are what we would call are in the corrective action phase. I don't want to talk too much on it, but it's safe to say they are both large, solutions based work with very high level of direct labor. We have no reason to believe, based on the corrective actions that we've seen, that we won't prevail in the majority, if not all, of the remaining protest decisions that are out there.

QUESTIONS ON THE CONTRACT MIX OF THE NEW AWARDS RECEIVED IN FY15 AND INDUSTRY RECOMPETE LOSS RATES

Brian Kinstlinger: Great. That was very helpful. The second question I have—a lot of people have talked about margins and, obviously, there's a difference in the contract type versus direct labor, or delivery type. So I'm wondering, on the $2 billion of awards that were brand new work for you, how much -- what's the contract mix there? Is it heavily cost plus? And then on the recompetes, what percentage are companies in general losing? Is it 5%? Is a 10% in price? Thank you.

John Mengucci: Yes, Brian, on the $2 billion of awards, I don't have here at my fingertips how we would split that based on contract type and on what percentage of direct labor. But we can absolutely get that one to you. I mean, it's pretty much the same mix as what our current portfolio has. So we're just going to have to get that information for you, Brian. Sorry about that.

Brian Kinstlinger: But on recompete? Sorry.

John Mengucci: Yes. And on the recompete side—in our FY15 planning process, we assumed some percentage of both top and bottom line reduction on our recompetes. Part of the protested revenue -- I'm sorry, part of the new business revenue we expected to be in FY15, was actually replaced with better performance on our recompetes than we had originally planned. So as we go into FY16, on our LPTA-type professional services work, we will take a top- and a bottom-line reduction. Our FY16 plan and our other cost-plus award fee work and our cost-plus fixed fee work, we traditionally do not. We traditionally are able to hold both top and bottom line.

Brian Kinstlinger: Great. Thanks so much.

Operator: Our next question comes from Tobey Sommer with SunTrust.

QUESTION ON THE OPPORTUNITIES IN THE CYBER SECURITY MARKET AREA

Frank Atkins: This is actually Frank in for Tobey. Real quick, wanted to ask about the cyber security environment. Any changes in terms of opportunity set there, or how are you feeling regarding opportunities? And what are you also seeing in terms of pricing of that type of work going forward?

Ken Asbury: Yes, thanks, Frank. Well, this is part of the market where there's additional money going in. It's not a -- traditionally this has been a market that's been contained inside of information technology budgets. Now it's beginning increasingly to be broken out as specific sets of capabilities.

In our case, it's even more specific than that. While we continue to have a -- we do provide computer network defense inside of high-end data networks. Our real interest, particularly through the acquisition of Six3, is to look at a niche within digital signal processing and how those signals propagate and how to do things with those signals to both protect and to be offensive.

So, for example, when I want to talk about the market for cyber as it pertains to us, I'm more interested in network platforms than I am about networks itself. How do machines communicate with machines? How do we protect them? And if they're somebody else's, how do we exploit them?

So that market is a very large one. It has a very large current base, somewhat addressed by the OEMs, increasingly addressed by specialty companies that have a unique set of skills, talent, and capabilities. And so we see that part of the market growing. As I referred a little bit earlier to one of the other questions, we see a series of much larger opportunities, than traditionally Six3 has pursued, in the next four to five months that are coming out that are directly related to that. As to margins, I expect those margins to remain double-digit, if not mid-, mid-15 or something like that. I think that it commands that kind of margin.

QUESTION ON WHAT CACI'S STRATEGY IS FOR ITS COMMERCIAL BUSINESS

Frank Atkins: Okay. Great. That's very helpful. And also, I saw that the mix of client type, commercial ticked down a little bit this quarter. Can you talk a little bit about what your vision is for commercial and if there's any plans to grow that or particular areas that may be opportunities?

John Mengucci: Yes, Tobey. This is John. If we were to look at year-to-date FY14 versus FY15, I believe we said that federal civilian revenue was up a little more than 20%. But I think the percentage decreased on the commercial was actually a larger percentage, although a small dollar amount. That was really connected to product sales that came in last year that are not in our FY15 plan but are in our FY16 plan. So that would have been driving some of that delta.

I mean, in general, less the DoD piece that's really more of delays in the awards, natural phasing of projects coming to an end, and, of course, the majority of our war-related effort is in our DoD numbers also. So that's where you're seeing a lot of the subcontract labor and our subcontract ODCs coming down. That's what's driving DoD down.

So as we look at FY16, I wouldn't look at where we are FY14 to FY15 as which portion of that market is more important? All three portions—federal civilian, DoD, and commercial—will play a very important role in our FY16 plan.

Tom Mutryn: And the majority of the work in the commercial is associated with our UK subsidiary.

Frank Atkins: Great. Thank you very much.

Operator: Our next question comes from Jairam Nathan with Sidoti.

QUESTION ON FEDERAL CIVILIAN AND DoD REVENUE TRENDS IN FY16

Jairam Nathan: So if I look at your comments and look at FY16 guidance of organic low single digits, it looks like civilian would be up on OPM, and then you probably will see a flat to down DoD. Is that kind of a fair assumption?

Ken Asbury: I think in general, yes. I mean, I think DoD certainly continues to feel the pressure. To what degree, we won't know that until we see the bottoms of estimates by our team later in June. But I think as a premise, DoD's probably down a little bit more than some of the civilian agencies, from a budget point of view.

Tom Mutryn: Yes. So OPM, that's going to be constructive. We had won new work, like at DHS, that's ramping up. That would be helpful for the civilian agencies. And so we've seen some of that. Some of the other large work is kind of DoD-related as well, so it's --

John Mengucci: Yes. In fact, the $550 million worth of protests is probably evenly split between DoD and fed/civ also. So if that helps you model it.

QUESTION ON HOW MUCH OF THE FUNDED BACKLOG IS NEW BUSINESS

Jairam Nathan: Okay. Thanks. And my other question was, have you -- if I kind of look at a total backlog or funded backlog, how much of that is new business?

Ken Asbury: Funded backlog?

Tom Mutryn: How much of that is -- could you repeat the question? You were a little fuzzy.

Jairam Nathan: Yes. Like how much of total, or even funded, backlog is new business, tier one?

Tom Mutryn: Well, by definition, our backlog—our funded and our total backlog—is based on awards that we have. And so none of that is new business, if that answers the question.

Jairam Nathan: Isn't there some—like you won some awards six months back, and that's probably in your backlog. I'm trying to understand how much of that backlog is new.

John Mengucci: Yes. So the majority of our new business—when we win an award, all of that value goes into unfunded backlog. And, as we get funding orders in, that's where we move it—from unfunded to funded. So I don't have the exact percentage, but I would say the majority—a material amount of our new business awards that we've experienced this year—would be in our unfunded backlog area.

Jairam Nathan: Okay. That's great. Thank you. That's all I have.

Operator: Our next question comes from Mark Jordan from Noble Financial.

QUESTION ON THE REVENUE CONTRIBUTION OF THE OPM CONTRACT AND WHETHER IT HAS SEASONAL FLUCTUATIONS

Mark Jordan: Question relative to OPM. Is there any way you can size that for us in the fourth quarter? Would you achieve a sort of steady-state run rate? And, moving forward into 2016, will there be any seasonality to that business? And is there any growth opportunity over the longer term from that steady-state in the fourth quarter?

John Mengucci: Yes, Mark. This is John. I'll try to provide some additional color for you.

As for a definitive number, I'm going to shy away from that. There are other folks doing this similar work. But it's safe to say we're fully staffed today. We returned OPM to a profitable level as we closed out Q3. And that trend will continue to move forward. Is their seasonality in it? No. Actually, there's tremendous backlog in trying to get the government background clearance processes done. So it's not seasonality.

What's actually more of a factor, Mark, is once the investigation has been completed, there is quite a rigorous quality check. And we've been working on how can we get more through-put, more quality work delivered to our client? So once we became fully staffed—and we're beyond all of our investigator training windows—then the focus has been on how do we generate better quality sooner? So we are seeing some indications, as we go into the fourth quarter, that that quality number is coming up slightly. It's moving north versus south. So will that bring the run rate up in FY16? Yes. Does that enhance both top- and bottom-line measures on the program? Yes, also.

So I know I sort of gave you more qualitative directional things versus hard numbers, but we really want to shy away from discrete numbers.

QUESTION ON HOW MANY THIRD QUARTER AWARDS HAVE BEEN PROTESTED

Mark Jordan: Okay. As a follow-up, you mentioned the level of protested awards in the first and second quarter that had been -- you've been working through the process of settling. Do you have a number in terms of protests that were incurred in the third quarter?

John Mengucci: Yes. Actually, Mark, we have had no work that was awarded to us in the third quarter that has been protested. And since about 40% of our roughly $700 million of work was there for new business, none of that $280 million or $300 million has been protested as of this moment.

Mark Jordan: Thank you very much.

Operator: Our next question comes from Cai von Rumohr with Cowen and Company.

QUESTION ON WHETHER DIRECT LABOR WILL GROW FASTER THAN OVERALL REVENUE IN FY16

Cai von Rumohr: Just a quick follow-up. So your guide for FY15 of direct labor up 3% to 4% basically implies that it's going to grow low singles in the fourth quarter and ODCs are down again. If, in fact, you do grow the revenues low singles in FY16, should we assume that direct labor continues to grow faster than overall revenues next year?

Tom Mutryn: Cai, we're in the stages of rolling out the plan, and I really do not have that level of detail yet. Everything else being equal, we like growing direct labor, that's more profitable. With that being said, some of the work that we win, by definition, has some ODC contract, either subcontractor labor, small business work. Some of the solutions require software purchases, software licenses to put in some solutions. So, more to come on that as we talk about FY16 in June.

Cai von Rumohr: Okay. Thank you.

Operator: Our next question comes from Jon Raviv with Citi.

QUESTION ON THE CONTRIBUTION OF LTC ENGINEERING ASSOCIATES IN FY15 AND FY16

Jon Raviv: Thanks for the follow-up. Just a really quick one. LTC—does that contribute anything meaningful here in the fourth quarter, or more importantly next year?

Tom Mutryn: LTC had a run rate of around $16 million worth of revenue. Given that, it does not contribute anything materially in terms of earnings. It's slightly accretive, but given the size of it, it's just pennies per share. That being said, it is a very good acquisition, provides augmented capabilities to us.

Ken Asbury: Yes, Jon. This is Ken. What it does is it strengthens our bench strength in digital signal processing and communications intelligence and that sort of thing. And it is an absolute complement to the talent and skills that we bought with Six3. So we're quite pleased with it, and we think that gives the -- there's another piece of the market that it allows us to look at a little more deeply. And so it was a great acquisition. We're very happy with it.

Jon Raviv: Thank you.

Operator: I'm not showing any further questions at this time. I'd like to turn the conference back over to our host.

CEO CLOSING COMMENTS

Ken Asbury: Okay. Well, thanks, Kevin, and thanks for your help today on the call.

We would like to thank everybody who dialed in or logged on to the webcast for their participation as well. We know that many of you will have follow up questions. And Tom Mutryn, Dave Dragics, and Jeff Christensen are available for calls later this morning and today. So this concludes our call. Thank you for your interest in CACI International, and have a very good day. Thank you.

Operator: Ladies and gentlemen, this does conclude today's presentation. You may now disconnect and have a wonderful day.

END

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