CACI INTERNATIONAL INC
Third Quarter FY18 Conference Call

PRESENTATION

Operator
Ladies and gentlemen, thank you for standing by. Welcome to the CACI International Q3 FY18 Earnings 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. If you should need any assistance during this call, please press star, then zero and someone will help you.

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, Chad. 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. As is our practice, we are providing presentation slides, so let's move to slide number 2.

Now, about our written and oral disclosures and commentary. There will be statements 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. Now factors that could cause our actual results to differ materially from those we anticipate are listed at the bottom of last evening's earning release and are described in the company's Securities and Exchange Commission filings. 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. These non-GAAP measures should not be considered in isolation or as a substitute for performance measures prepared in accordance with GAAP. Please turn to slide 3.

And now, here's Ken Asbury, President and CEO of CACI International. Ken?

CEO OVERVIEW

Ken Asbury

Well, thank you, Dave. Good morning, everyone. Thank you for joining us to discuss our Fiscal Year 2018 third quarter results. With me this morning on the call are John Mengucci, our Chief Operating Officer; Tom Mutryn, our Chief Financial Officer; DeEtte Gray, President of US Operations; and Greg Bradford, President of CACI Limited, who is joining us from the UK. Let's turn to slide 4 please.

Last night we released our third quarter earnings for Fiscal Year 2018. We delivered very strong operating results with revenue growth of 3.5%, of which 2.7% was organic. This is now our fifth consecutive quarter of organic topline growth. And our programs continue to generate high levels of profitability, giving us continued confidence in our ability to deliver margin expansion of 10 to 30 basis points annually. In fact, we are on track to exceed that goal this year. Tom will take you through the details of that in just a moment.

We also won $1.4 billion of contract awards, with almost 40% of that as new business to CACI. Operating cash for the quarter was $99 million. All in all, I am very proud of our team that continues to deliver innovation, customer satisfaction, and exceptional financial results. Their performance gave us confidence to raise guidance in March, which we reiterated in our release last night. Please turn to page 5.

I'd like to mention two notable honors that we are particularly proud of this quarter. First, Chief Operating Officer, John Mengucci, was named to the Federal Computer Week 2018 Federal 100, an elite list of government and industry leaders who have positively transformed Federal IT. John was selected for his strategic leadership and insight, which were essential to CACI's record-setting operational and financial performance and our positioning for continued growth. Congratulations, John.

And second, CACI Board of Directors member, General William Scott Wallace, was awarded the US Military Academy's Distinguished Graduate award, conferred upon those graduates whose character, distinguished service, and stature reflect West Point's motto: Duty, Honor, Country. General Wallace embodies that motto in his service to CACI as well. Thank you, Scott, and congratulations on this unique award.

Let me turn to the external environment. The two-year Bipartisan Budget Agreement and passage of the government Fiscal Year 2018 budget is positive for our industry and our customers. And with a relatively short amount of time to spend the additional budget dollars in FY18, we expect to see healthy plus-ups and contract awards in both the June and September quarters.

Based on commentary and direction from Secretary Mattis, the Department of Defense is prioritizing government Fiscal Year '18 spending on readiness in areas such as training and maintenance, while government Fiscal Year '19 investments will be focused on advanced warfighting capabilities. We are currently in the process of analyzing the budget and will provide our long-term addressable market expectations when we issue our guidance for Fiscal 2019 in our call in June. Let's turn to slide 6 please.

During the quarter, we made a bid for CSRA, because the transaction met every element of our M&A strategy. It provided long-term strategic value, filled capability gaps, added new customers, and, at our bid price, we believe it would have created significant value for our shareholders. These are the qualities we look for in any potential acquisition, large or small. And, as with any target we pursue, CSRA fit each of these beautifully.

In closing, I'm encouraged by our prospects, both near- and long-term. The budget environment is improving with customer demand signals that align extremely well with our capabilities and offerings. We have demonstrated our ability to strategically reposition, return to organic growth, and at the same time consistently expand margins. Our financial performance over the past two years has been outstanding, and I look forward to closing Fiscal Year 2018 with excellent results.

With that, I'll turn the call over to Tom to talk about our financials. Tom?

FINANCIAL OVERVIEW

Tom Mutryn
Thank you, Ken. Good morning, everyone. Let's go to slide number 7.

Third quarter revenue was $1.12 billion, 3.5% greater than the same quarter last year with 2.7% organic growth. Operating income in this quarter was up 56%, or $38 million compared to last year. This increase was driven by a combination of continued strong and improving program performance and one-time items. Of the $38 million, strong program profitability on fixed-price contracts and product sales contributed $16 million. This is a sustainable profitability increase, which will carry forward into FY19 and beyond, and is reflective of our strategy to win and perform more solutions and fixed-price work.

One-time items totaled about $22 million and consist of a $10 million higher incentive fee associated with a program by which our customer came to us to ask us to help solve a pressing need, the release of certain reserves, and strength on several programs, which were more one-time in nature. Overall, the strong third quarter operating income demonstrates our ability to meet customer needs and generate higher margins.

Indirect costs and selling expense were up modestly due to fringe on direct labor and incentive compensation expense. Excluding those, indirect expense was actually down, indicative of efficiencies we are realizing.

GAAP net income for the quarter was $64.5 million, up almost 60% compared to last year. Slide 8, please.

We generated $99 million of operating cash flow in the quarter with day sales outstanding at 62 days. And we continue to pay down debt, with net debt at $1 billion. Our net debt to trailing 12-month EBITDA leverage ratio is 2.5 times. Slide 9 please.

We are reiterating the full-year guidance, which we increased in March. Based on the midpoint of our guidance, we expect fourth quarter net income to be around $39 million. This compares to $64.5 million in the third quarter. The $25 million difference, or about $37 million of pre-tax, is principally due to the $22 million of one-time benefits we recorded in the third quarter and about $10 million of additional fourth quarter expense associated with the startup of our Shared Services Center. Lastly, we are increasing our full-year operating cash flow guidance to at least $310 million, reflecting continued strong cash generation.

With that, here's John to provide operational highlights.

OPERATIONS OVERVIEW

John Mengucci
Thanks, Tom. Let's go to slide 10 please.

Our team delivered another quarter of organic revenue growth and strong operating profit and margins. We won a healthy amount of contract awards, and our forward indicators and pipeline metrics remain very positive. This is a result of our market-based strategy, which is driving CACI's ability to deliver long-term revenue growth of 1% to 4% above our addressable market and the margin expansions Ken already mentioned. This quarter saw continued execution with efficiency, high customer satisfaction, quality, and value.

Organic revenue growth was driven by new business wins and on-contract growth. Operating income and margin growth was primarily the result of efficient performance on fixed price and fixed unit price contracts, product sales, and one-time incentive fees.

In line with our strategy to pursue larger opportunities, we won ten contracts with a value of between approximately $50 million and $150 million during the quarter. Our market strategies are providing the focus to pursue opportunities that drive both organic revenue growth and margin expansion.

In total, we won $1.4 billion during the quarter with about 40% of those for new business to CACI, and our backlog now stands at $11 billion, representing well over two years of revenue on a trailing 12-month basis. Slide 11 please.

Our forward indicators are healthy. Revenue composition now stands at 99% existing business, with a remaining 1% split equally between re-compete and new business So a very comfortable position at this point in our fiscal year.

Our pipeline of opportunities is strong with submitted bids pending awards at $6.3 billion, 82% of those for new business to CACI. We are seeing high levels of submittals in our Business Systems, Enterprise IT, and Intelligence Systems and Services markets. And we expect to submit another $14.1 billion over the next two quarters, with 57% of those for new business across all of our market areas. Slide 12 please.

Let's take a few moments to talk about CACI's Shared Services Center in Oklahoma City, which we announced in March. Opening in July 2018, the center will optimize the delivery of company-wide support services as we evolve to support continued organic and acquired growth. As Tom noted, we plan to invest $10 million in the fourth quarter of Fiscal Year 2018. Additional investments will be completed by the first half of Fiscal 2019. After upfront investments, the center will create savings that we plan to invest in our people and technical capabilities.

On the people front, we've evaluated our total benefits offering using employee feedback and industry benchmarks with a goal of creating an employee experience that makes us a leader in attracting and retaining top talent. For the upcoming fiscal year, we are absorbing increasing healthcare costs such that most employees will see no increase in their premiums. Some will even see reductions. We'll provide enhanced retirement benefits to help our employees achieve their savings goals, and we are looking at new ways to provide the flexibility and work-life balance that attracts today's top talent.

Turning to the capability and solutions side, we are making investments in several critical areas. First, our SkyTracker capability is now a suite of counter-UAS product offerings which includes both mobile and fixed-location versions. We continue to invest in expanding the features and usability of this differentiated product.

We set up an Electronic Warfare Initiatives team, which is developing technologies to address the challenges of today's battle space, which increasingly relies on the use of the electromagnetic spectrum as a warfighting domain, an area where potential adversaries have developed significant capabilities.

We are also advancing machine learning in AI to assist in the production of intelligence. This is speeding up output and increasing quality, allowing our customers to make faster decisions. In the Space Operations and Resiliency market area, we are investing in solutions that enable real-time situational awareness in this key domain.

It's important to note, that we are making these people and capability investments while maintaining our competitive rate structure and expanding margins.

In closing, we are focused on executing our market-based strategy, which is driving success. We will continue to pursue larger bids in our addressable markets where our innovative solutions and services bring significant value to our customer's missions.

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

CEO CLOSING REMARKS

Ken Asbury
Well, thank you, John and Tom. I appreciate your comments this morning. Let's all turn to slide 13 please.

Our fiscal third quarter results continue to affirm our long-term strategy. We delivered another strong quarter of organic revenue growth, profitability, awards, and cash flow. There is momentum across the business that is delivering exceptional outcomes for our customers and gives us continued confidence in our ability to deliver on our long-term commitment to grow revenue organically and expand margins. In addition, the improving budget backdrop should enhance our ability to grow and generate shareholder value.

Before we open the call up for questions, I'd like to say how incredibly proud I am of our employees and the contributions they make to our success. It is their commitment and talent that drove another great quarter and positioned us to continue delivering exceptional financial results.

I am confident we'll be adding more outstanding professionals to our team in Oklahoma City and I look forward to the contributions they will make to our organization. I thank, everybody at CACI for supporting our growth and driving shareholder value.

With that, Chad, let's open the call up for questions.

QUESTIONS AND ANSWERS

Operator
Q&A instructions.

The first question will come from Krishna Sinha with Vertical Research Partners. Please go ahead.

QUESTION ON THE CURRENT AWARD ENVIRONMENT AND THE USE OF BRIDGING

Krishna Sinha
Hi. Thanks, guys. Can you talk a little bit about the award environment? I know you've posted a pretty good book-to-bill here. But just generally speaking in the last couple of quarters we've seen the customer go to more bridging contracts rather than re-competes. Is that still something you're seeing? Or are you seeing the pipeline now flow a little bit better or a little bit smoother?

John Mengucci
Krishna, thanks for your question. This is John. As we've always said, award activity continues to be lumpy. But we had our ninth straight quarter of greater than $1 billion worth of awards.

You specifically mentioned bridges. And as I mentioned last quarter, in any given year about 10% to 15% of our current year revenue is re-compete revenue. I think last quarter we had nearly 50% of our programs bridged. Suffice it to say that the bridge has actually increased from last quarter, with about two-thirds, or about $450 million, of our re-compete programs.

Now, as I continue to mention, that activity does not impact revenue or our earnings. So the bridging practice continues, and our bridges continue to be for a period of three-to-six months, but we are seeing some being bridged for an entire year.

As a reminder, the action of bridging clearly impacts our backlog number as well. But, again, in this instance, both backlog and award numbers did not adequately provide, clearly, a lone indicator of our growth across the business, as evidenced by our consecutive quarters of organic growth that we have seen while the government continues to bridge some of our re-compete work.

Ken?

Ken Asbury
Krishna, this is Ken. I think the other thing we should look at is during the beginning of this government fiscal year, we had five or six or seven—I lost track of the number—of CRs we had before we finally had budget authority. I think that once we see that budget, and even the increased amount of money flowing into the departments at the various acquisition offices, I think we'll see some return to normalcy. But I think there's going to be pressure here in the near term on getting that money placed onto current contracts. We may see more bridging activity in the near term, and it will take us a while to get back to a normal flow of acquisition activity, where we're not reliant on bridging as much as we've seen in the last couple of years.

QUESTION ON WHETHER THERE HAS BEEN AN INCREASE IN FIXED PRICE AWARDS TO CACI

Krishna Sinha
Okay. Then, just a question on your pipeline of the backlog that you already have. Have you

seen an uptick in fixed price in the awards that you're winning? You talked about $16 million of improved performance on contracts that you've got already contributed to your strong operating margins this quarter. Obviously, that's going to carry forward. But I'm just looking for a little bit of clarity on what we can expect your margin profile to be heading into the next year and beyond.

Ken Asbury
Well, obviously we'll talk about the margin profile when we get there. I mean our commitment to 10 to 30 basis points of margin improvement on an annual basis remains consistent. We'll have to take a look, once we finish our '19 planning, to see whether there is a change to that. But, right now, that's sort of the mantra.

With regard to fixed price, I think we're flat, year over year, with fixed price. But that's going to ebb and flow. Some of our fixed priced programs are delivered. Some of our cost plus coming up. But I think it's within a percentage point. So, we still have a healthy nice assemblage. I'd like to see that increase to 40%, 50%, 60% over time. But, we have to wait until the market presents that to us. We can't go out and just pick fixed price contracts because of that.

John, do you want to add anything?

John Mengucci
Yes, I think you also asked about performance. We could not be happier with the performance. We've had this long-term strategy of looking at higher margin work as well as more FFP work as well as more solutions work. What I think you are starting to see are the results of that long-term strategy, frankly, and the type of work that we're pursuing that's allowing us to both grab top line as well as bottom line growth.

As Tom's remarks mentioned, we're very pleased with performance on our existing firm fixed price for all brands. It's not just one or two specific ones but the majority of our programs across all of our customer sets.

And I'm also going to make one more mention about something Tom mentioned on the incentive fee. This customer had the ability to take their urgent and compelling need to any of three contractors on this large IDIQ contract. They selected CACI to perform a time-critical and national security level of additional work. The team performed exquisitely where they're able to capture the full amount of that incentive fee. Again, focus on operational excellence is one of our key tenets of the long-term strategy.

Operator
The next question comes from Jon Raviv with Citi. Please go ahead.

QUESTION ON CACI'S M&A STRATEGY FOLLOWING THE CSRA BID

Jon Raviv
Good morning, guys.

Ken Asbury
Good morning, Jon.

Jon Raviv
Can you all give us, and you mentioned it in your prepared remarks, Ken, but give us a little more

insight into the thought process behind pursuing CSRA, some of the lessons learned and where you think you might go to next in this process? Not CSRA, but M&A generally.

Ken Asbury
Fair enough, Jon. Look, our first priority in doing anything is going to be to invest capital to grow CACI organically and then through acquisition. That's been our mantra and our strategy for a very long time. So, as we go to look at that, we think that's a very good way of delivering long-term shareholder value. In this specific case, we were pretty disciplined. I would say very disciplined, in this particular case, about how we want to look at filling.

We are an organization that is not consumed by the notion of scale. We are consumed by how do we fill gaps in capabilities and in customer communities in each of 12 of our markets. So, when we took a look at CSRA, we saw a huge opportunity. There was very little overlap between the two businesses. There were things about their business that we thought were incredibly attractive, given the growing market that we see—in particular their business models around managed service and the amount of firm fixed price business, which is very consistent with everything we've said in our strategy.

Then we looked very closely at how did those strategic capabilities complement what we wanted to do going forward? Where did that customer—and, frankly, a very small amount of customer overlap would have expanded us both in depth and our ability to service customers at multiple levels. Let's just describe it, in terms of starting at their enterprise presence down to our broad and mission context, would have allowed a different value proposition in terms of delivering some of our offerings.

Finally, we wanted to make sure it was consistent with our long-term growth. And it was. And financially, it had to be financially compelling. We took it to the point where we, like we do everything, once we make that decision, we are going to go all the way up to the point where it no longer makes sense. And, as a consequence, we were not successful here, because we did not have some of the other things. But that's the way we're going to go after every single acquisition.

QUESTION ON WHAT CAPABILITIES CACI IS LOOKING TO ACQUIRE

Jon Raviv
Do you feel, given what you described as a compelling opportunity to combine your capabilities with the next gen IT platform provider, should we perceive that as being the priority going forward? Not in terms of all investments, but in terms of your M&A strategy? Or are we maybe back to some, kind of, more small tuck-in here and there opportunities?

Ken Asbury
We look at the market now and there's sort of an increase in the number of properties coming into the market. Some of them we like. Some of them fit our strategy—at least at first look. And some of them don't. So, I don't really want to postulate. It's clear, we've sent signals, for a number of years, that we'd be looking to do a transformational kind of transaction if it made sense across the board, particularly as it related to how we could deliver shareholder value.

As we look at the market today, we're going to continue to be a strategic integrator, and we're going to look at—we're down to about 2.5 times net debt to EBITDA. And so we're in a very good position, and we have some dry powder. If the right opportunity presents and meets all of our criteria, then we will execute on it.

But I don't want to give you an answer that suggests we're going to emphasize one area over another. We have 12 markets. Each one of those we have various strengths or gaps. And if we find the right combination of companies, or a company, to fill a number of those gaps, that's where we will pull the trigger and do something.

Operator
The next question comes from Cai von Rumohr with Cowen & Company. Please go ahead.

QUESTION ON THE INVESTMENT IN THE SHARED SERVICES CENTER

Cai von Rumohr
Yes, thanks, and good quarter. So the Oklahoma City Shared Services Center—the $10 million of investment—is that all expense in the fourth quarter? And how does that compare with what you "invested" in the second and third, and expect to invest next year?

Tom Mutryn
Cai, the $10 million I referenced is all in our fourth quarter. In the first and second quarter, in the third quarter this year, we invested probably $3 million in total, spread throughout that time period. So, perhaps, for the full year, around $13 million.

Next year, we're going to do three things. You're going to see some continued investment lingering into our first quarter as well as savings that will kick in. Then on top of that, we're going to use some of those savings, as we mentioned, to make some investments, both in technology and in people. So, all those numbers will be built in our guidance when we present our FY19 guidance to you.

I will mention that the economics of the Shared Service Center are very compelling, with paybacks approximately a year and a half. So, a real strong financial profile.

John Mengucci
Cai, this is John. I'd also add that this is another strategic venture that we are undertaking as part of our long-term cost efficiency plan. And as Tom's mentioned, we are going to free up spend to invest in our employees and our technical capability expansion, at the same time maintaining our bid rates, at the same time driving overall profitability for the organization.

We did begin planning this center about 12 months back. We assessed about 50 cities across the US, and eventually selected Oklahoma City, which was really driven by being able to pull from their outstanding talent pool of experienced professionals, and then several local colleges there so that we could take advantage of the cost economics of the region. So, all in all, a wise investment at this point. And then, reinvesting those cost savings to both our people and our technical capabilities.

QUESTION ON THE COSTS AND POTENTIAL SAVINGS FOR THE SHARED SERVICES CENTER

Cai von Rumohr
Great. Just a quick follow up. So, the $10 million investment, that's all expensed? It's not partially capitalized? And secondly, you mentioned one-year payback. Should we assume, therefore,

you're going to have about $15 million in ongoing cost savings to invest in other things?

Tom Mutryn
So, [an] 18 month payback. The $10 million is expensed. Now, in addition, we're going to do some lease hold improvements, and those lease hold improvements will be amortized over the lease terms. The nature of those one-time expenses includes some employee overlap. We will have people here in the Metropolitan DC area, simultaneously performing work as we have people in Oklahoma City due to a series of stay-pay retention bonuses for people here; some IT costs; some facility costs; and miscellaneous travel, training, and the like. But there will be sizable savings, as you point out. And again, we expect to use those savings the way John depicted.

Operator
The next question will be from Edward Caso with Wells Fargo. Please go ahead.

QUESTION ON WHETHER THE ORGANIC GROWTH OBJECTIVES HAVE CHANGED AS A RESULT OF INCREASED GOVERNMENT SPENDING

Edward Caso
Hi, good morning. I heard earlier the mention of 1% to 4% growth. I believe that's the number you used a year or two years ago. Now with the improved budget environment, should we be expecting you to increase those sort of market targets and, therefore, assuming you're going to continue the same share gains—the targets for the company? I'm sort of surprised you haven't upped the target level.

Ken Asbury
The target level ups itself, based on what we think the addressable market growth is going to be. That 1% to 4% is above what we think the addressable market is going to grow, and that's consistent. We've said that now for, I think, about 18 months.

As we look and as we finish our planning, we expect to see addressable market growth. The budget's going to go up some 10%. I would say, lower, middle, single-digit addressable market growth is probably a CAGR target. But I want to get that refined.

The other thing I want to make sure that we have an accurate depiction of is how fast is that going to ramp up if things are going on existing contracts versus new contracts and the like. And what impression that's going to be. But we do see the base budget—when we looked at FY17, we said we saw a five year CAGR of 1% to 1.5%. I think we will see that increase to mid- to slightly below mid-single digits as a result of the bipartisan budget compromise. We'll see what happens in '20 and '21, but our preliminary numbers are telling us that. We would then expect to grow 1% to 4% above that, depending on how the contracts show up in any particular period.

QUESTION ON THE INFLUENCE OF PRODUCT SALES ON THE OPERATING MARGIN GOING FORWARD

Edward Caso
My other question is around the influence of your product business. You mentioned SkyTracker a lot. I know there are other products as well. How important is it to your operating income? And should we be expecting sort of greater volatility in your operating margin going forward?

John Mengucci
As we mentioned, on the revenue side of products—probably not at the material level yet but on the operating income side, yes. So, it is true that the awards for products will be just as lumpy, but we are looking with some of the NDAA budget changes in wording as it relates to the protection of DoD asset both CONUS and OCONUS, we'd like to believe that that will drive additional product sales. But again, the level of product sales that we have in the company today is more of a bottom line play versus a larger material top line play.

Operator
The next question comes from Greg Konrad of Jefferies.

QUESTIONS ON THE INCREASE IN COMMERCIAL AND OTHER REVENUE AND WHETHER THERE ARE MORE OPPORTUNITIES OUTSIDE OF THE US GOVERNMENT BUSINESS

Greg Konrad
Good morning. Commercial and other was up quite a bit in the quarter. I guess a two-part question. What is happening there? Anything specific contract-wise? And then are you seeing more opportunities outside of the US government business?

Tom Mutryn
I'll answer the first part and then Ken can talk about the second part.

The increases are primarily due to the strong performance in our UK operation. They had both organic growth—very solid organic growth—and then a couple of smaller acquisitions, which contributed nicely to their operations. So that would be the vast majority of the benefit of that important part of CACI.

The other part of your question was going forward, are there other opportunities in the commercial arena.

Ken Asbury
I would say we're looking at the UK business now. For example, we have done well over the past seven or eight years in doing work for both the Irish and Scottish census. This year, we're taking a look at some components of the UK census. It's a step up for that business, so we'll see.

In addition, I think there's always an acquisition strategy on the part of Greg Bradford to look at companies in either his digital design or in his enterprise IT business to add to what he's doing over there now.

QUESTION REGARDING THE SOURCES OF ON-CONTRACT GROWTH AND ANY DISCERNIBLE TRENDS

Greg Conrad
Thank you. That's helpful. Just a follow up. In your remarks you mentioned on-contract growth. Is that tied to the Fiscal Year '18 budget? And have you seen any discernible trends between DoD versus civil agencies?

John Mengucci
I'd say the mix of our business is always changing. As we support a large number of contracts,

it's true that in DoD we're seeing some very nice growth, driven by recent awards in addition to a material amount of on-contract growth. And that's really driven by the ramp up of revenue in our Space Operations market. Then if you all remember, with the JIDO program win of last year, we mentioned we would continue to see revenue ramping up and growing on that contract through FY18 and FY19.

When we look at the type of customer, be it Fed, Fed-Civil, or DoD, it's true that Fed and Fed/Civil is down slightly, but that's really driven mainly by the natural delivery lifecycle some of our programs experience. So I wouldn't do a direct extrapolation or make any broad market trend commentary as we continue to see healthy opportunities across all of our customer sets.

Ken Asbury
I would add to that that I think if you were to look at the macro about how the budget played out, it is highly likely that DoD really had a list of what their priorities were going to be and felt very confident that they would see budget coming, and knew where they are going to spend it. So, we're likely to see if there's on-contract—I talked about we expect to see plus-ups. We'll see those plus-ups sooner, I think, on DoD—on existing contracts—as a way to get that money committed for FY18.

Conversely, in some of the Federal Civil markets, the expectation may not have been the same. And while there may have been priorities, the way the bipartisan budget compromise came together was a bit of a surprise. If you went back to the earlier discussions about the FY18 budget, there were going to be bill payers amongst the federal civilian agencies in order to fund the defense upgrades. So how that plays out is it could be that we may see a bit of a lag in the uptake of Fed-Civil spending as they adjust to an increase in budget that they may not have been expecting originally.

Operator
Our next question will be from Ben Klieve with Noble Capital Markets. Please go ahead.

QUESTION ON THE USE OF BRIDGES AND EXTENSIONS BY THE GOVERNMENT CUSTOMERS

Ben Klieve
Thank you. A couple of questions. First, as a follow up to your comment, your bridge commentary, I'm curious, do you get the sense that your customers are increasingly preferring using this and doing so out of self-interest rather than doing so purely as a function of the continuing resolution environment?

Ken Asbury
I think one way to look at this, Ben, is the last couple of years we've seen some increases—the increase in funding that comes late in the procurement cycle. And I think what that begins to do to acquisition organizations, who have a finite number of people on their staff, they try to allocate their teams across what they think that budget's going to be at the beginning of the year. And all of a sudden, they get hit with $10 billion more that they have to get placed. I think bridging becomes a very real, necessary alternative because they cannot turn it into new contracts at that point in time.

I do believe that we're going to see that here. It is nothing more than a finite group of talent being able to absorb an increase in budget when they're not necessarily expecting it or the timing's off.

I think that's the principle reason behind it.

John Mengucci
I'd also add, at a tactical level, our program leaders are being very focused on operational excellence, and where we are performing exclusively for our customers. Our customers have a choice as to when they must recompete versus when they would like to. I have to tell you, across this business, our program leads on a lot of our professional services work have outstanding relationships with our customer set. And that is also driving some of this practice. So, again, bridging to us, when we're performing well, is a positive measure.

QUESTION ON WHAT OPPORTUNITIES WOULD HAVE BEEN AVAILABLE HAD CSRA BEEN ACQUIRED

Ben Klieve
Very good. Thank you. And just one more question here regarding the CSRA bid. You mentioned not being consumed by scale, was I think how you phrased it. But I'm curious how you believe the incremental scale that would have been provided by CSRA would have impacted you. I mean, what opportunities do you think would have been available with that potential scale that aren't available today?

Ken Asbury
Well, just in the aggregate, we saw both businesses—certainly our own and they—were beginning to turn to organic growth. We saw that being one part of the strategy. And we also thought, in our planning, that two or three years into the acquisition in addition to what we saw is about $165 million worth of cost synergies, we would have started to see revenue synergies where-–a small amount in terms of our planning. It likely could have been larger than that, because the probability of win and the ability to shape competitions differently from an enterprise all the way to mission point of view, there's not a lot of other companies in the marketplace that are able to do that. That's the way we're viewing that combination from a strategic point of view.

Operator
Our next question comes from Joseph DeNardi with Stifel.

QUESTION ON THE MARGIN PROFILE OF CACI'S FIXED PRICE WORK AND THE SUSTAINABLE MARGIN FOR THAT WORK

Joseph DeNardi
Thanks very much. Just one for me. Tom, you mentioned the margin performance in the quarter boding well for next year. I'm wondering if you could just quantify that in some way. If you could just talk about the margin profile of your fixed price work now, and the sustainable margin rate as you see it. Thank you.

Tom Mutryn
I'll answer that indirectly, or partially answer it. Our commitment is to increase our margin 10 to 30 basis points. And this year, on a year-to-date basis, we are certainly there. On the EBITDA margin, for example, last year at this point in time we were at 8.5%. We're reporting 9.5% today, which includes those $22 million of one-time items. Excluding those we're at 8.8%. So, a 30 basis point improvement for the first nine months.

As we develop our plans going into FY '19, we will update the numbers and we will provide that to you. But certainly a good portion of that margin performance is in underlying long-term, sustainable activity. And we expect that to carry forward, compounded with the fact that, as we bid higher-solution content, that should also bode well for margin in the future.

Operator
The next question comes from Tobey Sommer of SunTrust. Please go ahead.

QUESTION ON CHANGES IN THE DELIVERY OF SERVICES AND THE IMPACT ON MARGIN EXPANSION

Tobey Sommer
Thanks. I was wondering if you could comment on the service delivery changes and other expense-related things, I'm thinking the shared services that you talked about earlier, and describe the importance of those service delivery changes to your long-term margin expansion goals.

Tom Mutryn
I think the question didn't come across really clearly. I think you were talking about changes in service delivery—reference to Shared Service Center—and how that would impact our long-term margin performance. I think there's two parts to that question.

One is we had an indirect infrastructure that we need to support, in that people are actually generating profit and revenue in the business. And we continue to strive for improvement in those in particular areas.

The Shared Service Center is focused on our indirect cost structure. As you can see in our third quarter, indirect costs were down despite the fact that we're growing, despite the fact that there's inflationary pressure. So, we continue to drive efficiencies through that part of the business. And, at the same time, John or Ken can talk about the drive to provide better program performance efficiencies on that side of the business.

Ken Asbury
We didn't do this to drive it to margin. We did this to be able to keep our rates at where we are—which we think is quite competitive—but to invest more back into what it takes to be an employer of choice and what it's going to take to fight for talent in an increasingly tighter labor market here in the United States. Moving to different geographic locations, in this case, allows us to lower the overall cost of doing the identical service or improved service. And we can take that and reinvest it back into employee benefits and all those things that it takes to be a competitive employer in this—or actually better than a competitive employer—in this kind of tight labor market.

I will tell you that you probably ought to be thinking in the long-term that we'll look at direct models for doing this in different geographic locations so we're not—our constraints seem to be around geography and particular kinds of talent. That talent exists in other geographic areas and it's not mined in the same appropriate way that we could be doing in the future.

One example that I will give you is we just consolidated a number of programs here in the D.C. area into an Agile software factory out in the Virginia area. It is fully staffed and probably at capacity already. And we're thinking about how we replicate that model in other geographic places where we can source talent and integrate that well. We already have satellite offices of that that work very closely together on solving on the same program. But they just happen to be in different geographic areas. And it's driving our efficiency up—our effectiveness in terms of delivering software from a time point of view. And I see that being something that we want to continue to do since so much of our business is software in the future.

QUESTION ON CAPITAL EXPENDITURES AND GROWING CACI'S SOLUTIONS BUSINESS

Tobey Sommer
Thank you very much. Could you describe the implications from a capex perspective over time of your emphasis on growing the solutions business and how you expect to manage that from a capex perspective?

Tom Mutryn
There's a couple pieces here. One is some of the foundational aspects of the solution business is to invest in technology so we can offer that technology or capability to our customers. That's generally IR&D—independently funded research and development. That typically is not capital related but expense in the period.

Going forward there may be some bids where CACI would invest in hardware and software, laptops, other types of equipment and indirectly provide those to our customers on a service delivery managed service model. As we look at those larger bids or win those larger bids, we will update you accordingly with some larger capital spending needs.

John Mengucci
It's also worth mentioning that when we talk about solutions, we're looking at solutions that utilize commercial hardware products. But the real secret sauce to both our space-based and our EW solutions are that they are software-definable solutions. So, if you're a customer, what you want is the lowest cost hardware. And then as your mission changes, or in the RF spectrum, as the signals you're concerned about changes, those are, as Tom mentioned, those are IR&D investments of ours that are within our allowable cost structure that then we're able to deliver directly to the government in a packaged solution. So, both in the EW area and the space area, that's what our customers are out there looking for.

In the machine learning area this is all about algorithms. How can I process more information, both signal information and inventory data, and have machines learn what some of that work is so they can go through much more collected intel on a faster timeline. So, again, more about IR&D, less about capex and facilities, which folks who build land mobile radios are very hardware intensive, very capital intensive. We're looking for a very Agile software-based solutions, and that's what the DoD and the intel customer sets are really craving for today.

Operator
The next question will be a follow-up from Jon Raviv with Citi. Please go ahead.

QUESTION ON WHAT LEVEL TO BASELINE CACI'S OPERATING MARGIN FROM WHICH TO MEASURE EXPANSION

Jon Raviv
Hi, guys. Thanks for taking the follow-up. Just a question on the—try to hit again on the underlying margin power of the business and maybe I'll ask it this way. When you talk about the 10 to 30 basis points expansion, should we be excluding the one-time items, the $22 million in

the support of $10 million next quarter from the base or just that's one all-in number that we'll grow off of? Kind of a similar dynamic with last year we had some facility expenses in the second half. So, just curious if you can get us to a sense of what we're growing off of, what that base is?

Tom Mutryn
Thank you, Jon. Again, we'll provide guidance for FY '19 in the not too distant future.

Our business, like any business, has its series of one-time good guys and one-time bad guys, my kind of technical accounting terms. $22 million of goodness, which we articulated, but in our fourth quarter, we'll have $10 million of expense associated with this. So over time, some of those balance each other out.

And as we go forward into FY '19, we would like to have 10 to 30 basis points improvement. And I would say, under the underlying ambient levels of EBITDA. Besides lumpiness in awards, there is lumpiness in profitability. So let's try to get a smooth average of what EBITDA is and then use that as a base. So, I'm not being very precise and I didn't answer your question exactly, but that's conceptually how we view that commitment.

QUESTION ON THE POSSIBILITY OF CACI GETTING TO A LOW, DOUBLE-DIGIT MARGIN

Jon Raviv
That's understandable. And then just a couple of years ago at the Investor Day, I think you guys talked about going to the low 9, or 9 to low 10 EBITDA margin over time. And, Ken, you talked about low double-digit margin. And again, don't need FY19 guidance, but is that still the right way to think about this business? And under what time frame? Or has it changed because of the growth dynamics?

Ken Asbury
Yes, Jon, great question. You know, it's still aspirational and I would tell you it's probably not an FY19 number that I'd be counting on. But it is going to happen as time goes on. This really has to do with how we select the things that we want to pursue. And while there will be lower margin business that is important to do, because it's part of our commitment to a particular customer sets or markets, it is also likely that we're going to kind of favor those pieces of the business where we can find contracts that are enduring; that are really appreciative of the value that we deliver; and frankly, generate higher returns. We're starting to see a little bit of that now. But I will tell you that it is incremental small steps, and it is something that's going to be a patient margin growth. But the potential for this business is low double digits over maybe the next five years.

Operator
Next question will come from Joseph Vafi with Loop Capital. Please go ahead.

QUESTIONS ON THE PROGRESS OF THE JIDO AWARD AND THE POTENTIAL IMPACT OF ODCs ON MARGIN EXPANSION

Joseph Vafi
Hi guys, good morning. Great results. I was wondering if we could get an update on JIDO if that is—because it's such a large piece of business—if that's at all headwind to tailwind on the margin side at all for this year into next year? And also, how do you look at ups and downs of ODCs relative to committing that 30 points of margin expansion next year? Do you have a good line of sight to ODC levels or is that something that still needs to be managed? Thanks.

John Mengucci
This is John, so I'll take the JIDO question first. Yes, we're very happy where that program has ramped up. I believe for the first two-to-three quarters after award, we went through that contract consolidation phase, where the customer is bringing in work from other primes and then putting that under our umbrella contracts. We're very, very pleased with what the team has done. They are now in the mode of generating additional work to address this important customer's new requirements. That is the CACI self-performed work and we've also seen growth with some of the prime work coming in as the customer's looking at solutions that CACI is uniquely qualified to deliver within that space.

As it pertains to margin growth, I think Ken and Tom have covered that one extensively. But at the end of the day, 10 or 30 basis points EBITDA margin growth is very much supported by the level of firm fixed price work, and, again, by the way we're executing on our current work. It ties right in with our long-term strategy. I think we're a little bit north of 9% margins in EBITDA now and doing that math, 10 to 30 basis points growth, year-over-year, gets us to an achievable double-digit EBITDA growth.

I'll also remind folks that we're doing this at the same time that we're trying to grow top line. Ken's initial vision was, "Bid less, win more." Bid larger jobs and make certain that we're providing value to both our customers and our shareholders as well. So, as we're looking at margins that we're out there bidding, we're being very, very careful about making certain that as some of this work is still in the LPTA mode, that is work that is not as attractive to us as it may have been.

You mentioned ODCs. Yes, there absolutely was a time when we measured DL versus ODCs. Then we moved more towards solutions work, where commercial hardware that we need is an ODC and takes us less labor. As Ken mentioned in these Agile solution facilities, DL and ODC and the levels and the mixes of those are less and less of an indicator on how we're working on bottom line growth

Operator
[Operator Instructions].

The next question comes from Brian Ruttenbur with Drexel Hamilton.

QUESTION ON WHAT CACI'S CURRENT M&A TARGET CAPABILITIES ARE

Brian Ruttenbur
Yes. Thank you very much. I want to hit on one point that was brought up earlier, but on the M&A side, because you definitely have the dry powder and the gun is cocked, if you will. What are you hearing in terms of assets? I hear about a lot of assets out there that would add scale to you maybe in SETA, maybe in space, a variety of things, but nothing in cyber. I want to know what direction you're thinking. Is it going to be a scale acquisition? Is it going to be something that you're trying to carve out maybe on the smaller side? Because there doesn't seem to be anything large out there in the super high-growth areas? So, I just wanted to hear what you had to say and what kind of multiples you're willing to pay?

Ken Asbury
Yes, Brian, this is Ken. Look, there's always going to be M&A opportunities, and we're continually scanning and being very active.

When we went to the market-based strategies and we started looking at what skill sets, what customers, what solutions we needed to have, we became far more proactive in terms of seeking out these things. So what you're hearing about is not the totality of the universe that we're talking to these days.

There are conversations that we are having with companies that are not contemplated trying to sell as a way of shaping—and I'll go back to the conversation that we had when we bought L-3 NSS. Tom and John made a trip to go visit Mike Strianese and his team two years ahead of them coming out with that to say, "We see the strategy of this. That's something that we would be interested in. Please give us a call. Please let us have a chance to look."

We're going to remain a strategic integrator. So, expect us to do something. We don't have a list of priorities related to big or small. I can tell you this—we're not going to buy scale for scale's sake. We will not buy revenue. We're going to exercise inside of our market strategy how to fill gaps, how to get into new customers, and how to find the enduring parts of the market that we are not in there yet.

If I was to prioritize things that we're doing, it is in the digital signal processing area. It is in Agile software. We have a lot of cyber assets today. We're manufacturing our own cyber assets at the same time. So, finding a cyber business—you know, many cyber businesses today used to be an enterprise IT business about three years ago, so we're conscious of that.

In terms of what we're paying in multiples, the markets rewarding that pretty high. I'm going to ask Tom to talk about that a bit.

Tom Mutryn
Yes, so, Brian, the way we look at the economics is, we are a firm believer in present value discounted cash flow. So, we will look at the future expected cash flow discounted at appropriate rates. And, as a result, we come up with a maximum amount we are willing to pay. Then, if we want to, we can take that maximum amount, divide by EBITDA to get a multiple. But that's simply an outcome of our thought process. If the future cash flows are growing at faster rates than lower rates, then it's going to be worth more, and on an EBITDA multiple basis is going to be higher. So that is an outcome of our thought process versus an input in our thought process.

Again, you get a company that's going to grow probably 20% a year for the next five years, it's going to trade at a very high valuation. And I divide it by today's EBITDA, it's going to show relatively high multiples versus a company that's going to have lackluster growth.

That is conceptually how we look at our valuations.

Brian Ruttenbur
Thank you very much.

CONCLUSION

Operator
Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the

conference back over to Ken Asbury for any closing remarks.

Ken Asbury
Well, thank you, Chad and thanks for your help today on the call.

We would like to thank everybody who logged onto the webcast for their participation as well. We know that many of you will have follow-up questions and Tom Mutryn, Dave Dragics, and Dan Leckburg are available for calls throughout the day.

I thank you for your interest in CACI. This concludes our call. Have a very nice day.

Operator
And thank you, sir. The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines.

END

The information contained in this transcript, by its nature, reflects facts known to the company and its management at the time of the earnings release and conference call. All information contained in this transcript, including references to other press releases or public filings, should be read in the context of the latest available information in the company's releases or filings.