CACI INTERNATIONAL INC
Second Quarter FY18 Conference Call

PRESENTATION

Operator
Ladies and gentlemen, thank you for standing by. Welcome to the CACI International Q2 Fiscal Year 2018 Earnings Conference Call. Today's call is being recorded. At this time, all lines are in 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, zero and someone will help you.

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

INTRODUCTION AND SAFEHARBOR STATEMENT

Dave Dragics
Thanks, Kate, and 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. 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 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. 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 3. And to open up, here's Ken Asbury, President and CEO of CACI International.

CEO OVERVIEW

Ken Asbury
Well, thank you, Dave, and good morning to everyone. Thank you for joining us to discuss our Fiscal 2018 second quarter results. With me this morning 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.

Last night, we released our second quarter results for the Fiscal Year 2018. We also raised net income and earnings per share guidance to account for strong profitability from operations, and benefits from the recent tax reform. This morning I'll provide an update on our results and strategy looking forward. Tom will give details on the financials, and John will cover the operational aspects of the quarter.

Please turn to Slide 4 in our deck. We delivered a solid second quarter, now our fourth consecutive quarter of positive organic revenue growth. Profitability was also healthy with operating margins over 8%, and we booked more than $1 billion of contract awards in what's typically a seasonally light quarter. This gives us the confidence to reiterate our revenue guidance and raise net income and EPS before the benefit of tax law changes. Tax reform also contributed materially to our second quarter net income and has been incorporated into our full-year guidance. Tom will lay out those details for you in just a few moments.

Let's turn to Slide 5 please. As you know, we are currently operating under the fourth continuing resolution for this government fiscal year, and experienced a brief shutdown in January, which will not have a material impact on our financial performance. We remain optimistic that a budget agreement will drive increased defense and intelligence spending, which will be positive for CACI, our industry, and our country.

Before Tom walks us through the mechanics of tax reform, I'd like to spend a minute talking about what a great opportunity this is for CACI and our employees, customers, and shareholders. On an annual basis our operating cash would increase by more than $30 million. Given such an opportunity, we're looking at ways to invest in the long-term development of our people through enhancements to our education and certification programs, career development activities, and other benefits that we think are valued by today's talent pool. We're still working on the details of these options, and I look forward to providing you and our employees an update once we have more specifics. I want to make sure that I reiterate our commitment to our margin expansion goals of 10 to 30 basis points annually despite using this investment. And we will continue to allocate the remaining cash to our stated priorities.

I would be remiss if I didn't mention a recent accolade CACI received from *Fortune* magazine. We were named as a World's Most Admired Company and the fifth worldwide in the IT Services industry. This survey identifies companies that enjoy the strongest reputations with their industries as business leaders who deliver valuable solutions and services with ethics and integrity. We are very proud to have been selected for this prestigious award.

To wrap up my opening, I'm quite pleased with our second quarter results. We continue to deliver with quality and value driving revenue and profit growth. We are winning business and investing in innovation and strategic growth initiatives across several markets with an eye to the long term. All of this gives me confidence in CACI's prospects and our ability to achieve our long-term financial goals while driving increased shareholder value.

Now here's Tom to discuss our financials. Tom?

FINANCIAL OVERVIEW

Tom Mutryn
Thank you, Ken, and good morning, everyone. Let's go to Slide 6.

Our second quarter revenue was $1.09 billion, 2.9% greater than the second quarter last year, with 2.4% organic growth. Operating income in the quarter was up 10% compared to last year. This was driven by additional gross profit from strong program performance.

Indirect costs and selling expenses were essentially flat with last year, and net income for the quarter, excluding the impact of tax reform, was $50.5 million, up more than 19%. GAAP net income for the quarter was $142.8 million. This includes a $94.8 million benefit derived from the revaluation of our net deferred tax liability under the new tax law. In addition, we incurred a one-time tax expense of $9.7 million associated with the cumulative profits generated by our UK subsidiary. Lastly, we realized the $7.1 million benefit in the quarter from the lower blended rate for Fiscal Year 2018.

Slide 7, please. We generated $76 million of operating cash flow for the quarter with days sales outstanding of 61 days, down from 64 days last quarter. Operating cash flow represents over 150% of our net income excluding the benefits derived from the new tax laws. Net debt at the end of December now stands at $1.1 billion, and our net debt to trailing 12-month EBITDA leverage ratio is now 2.9 times.

Slide 8, please. Turning to guidance, we are maintaining our prior annual revenue range of $4.35 billion to $4.5 billion. And, we are raising our net income guidance to reflect continued strong operating performance and the impact of tax reform. Driven primarily by operations, net income excluding tax reform guidance is now $177 million to $183 million up from our prior guidance of $171 million to $179 million. GAAP net income, which includes the impact of tax reform, is now $277 million to $283 million. This includes an estimated $100 million tax reform benefit. Our updated earnings per share guidance reflects the same expectations as net income. We expect our net effective tax rate beyond Fiscal Year 2018 to be in the 24% range. And lastly, we are increasing our full-year operating cash flow guidance to at least $300 million, reflecting strong cash generation and the impact of tax reform.

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

OPERATIONS OVERVIEW

John Mengucci
Thanks, Tom. Let's go to Slide 9 please.

Operations delivered our fourth consecutive quarter of organic revenue growth with strong operating profit and margin. We continue to win business and our forward indicators remain healthy. This is a result of our market-based strategy and reaffirms our guidance in CACI's ability to deliver long-term revenue growth of 1% to 4% above our addressable market and margin expansion of 10 to 30 basis points on average.

During the quarter, we delivered on our contracts with quality, value, and high customer satisfaction. Positive organic revenue growth was driven mainly by new business we won in Fiscal Year 2017, and margin growth was the result of efficient performance on several fixed-price contracts in addition to high-quality delivery resulting in strong award fees. This margin profile was expected and keeps us on track to deliver the implied margin expansion within our guidance.

We won $1.1 billion of contract awards during the quarter. This is a healthy amount for the December quarter, which is normally light, and keeps us on track to achieve our full-year guidance. About 40% of our contract awards were for new business as we continue to take market share. We received $750 million of funding orders during the quarter, in line with last year. Our total backlog now stands at $10.9 billion, which represents well over two years of revenue on a trailing 12-month basis.

Slide 10, please. Two notable awards during the quarter were a $300 million contract to continue providing business systems support including acquisition, finance, and human resources to a classified customer, and a new $85 million contract to provide state-of-the-art operational, technical, and fielding support to a DoD customer in the sustainment of equipment and systems.

In addition, CACI's Cyber Range test environment, which enables cyber exercises with realistic live fire scenarios, was certified with the important ISO-27001 credential, confirming our adherence to cyber security best practices. This is an important differentiator and allows current and new customers to leverage this offering and test capabilities.

We also invested in an expansion of our Agile Solutions Factory, which has been recognized by the Defense Acquisition University as a DoD best practice. This dynamic facility is providing current customers results and serving as a best-in-class example of success for potential customers as they evaluate the benefits of Agile software development.

Slide 11, please. Looking at the remainder of Fiscal 2018, CACI's forward indicators remain healthy. Our revenue composition now stands at 96% existing business, 2% recompete, and 2% new business. This profile is very comfortable, halfway through our fiscal year.

Our pipeline of opportunities remains strong with submitted bids pending award at $6.9 billion, 77% of those for new business to CACI. We expect to submit another $12.9 billion over the next two quarters, with 65% of those for new business.

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

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

CEO CLOSING REMARKS

Ken Asbury
Well, thank you John. Thank you, Tom. I appreciate your help this morning.

We delivered solid first half results and now a full year of organic revenue growth. Our operating performance is driving profitability upside, which is reflected in the new guidance. And, we're investing in long-term strategic growth initiatives, including the development of our current and potentially future employees. The bottom line is, we believe our strategy is working, and we are well-positioned for continued success.

Before we open the call to questions, I'd like to say how proud I am of the CACI employees. Their talent, innovation, and dedication form the foundation that earned us the recognition I mentioned earlier, *Fortune* World's Most Admired Company. And from the very first day I joined CACI, I've seen how much our customers acknowledge the value our employees provide. It might be that our teams respond rapidly to their urgent requirements or anticipate their needs and provide new capabilities. It might simply be that they can always count on our employees to solve their biggest problems. Across the company, we have people who are thinking big and thinking ahead. They contribute to our company's growth in so many ways and drive our success at delivering shareholder value. I thank them for all that they do.

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

Operator
(Operator instructions for Q&A).

Our first question comes from Jon Raviv of Citi. Please go ahead.

QUESTION ON THE PROGRESS OF CACI'S MULTI-YEAR GROWTH STRATEGY

Jon Raviv
Hi, good morning, guys.

Ken Asbury
Good morning, John.

Jon Raviv
Ken and John, I wonder if you could update us on the multi-year growth strategy that you put in place, especially with John's somewhat redefined role. What sort of things are you pursuing? What sort of new products or capabilities are you introducing? And, where is the money coming from to invest in those efforts?

Ken Asbury
Jon, let me start, and I'll let John give you some of the particulars on it. So, there are a couple of things that we were trying to accomplish in this. One is to make sure that we were prepared to be a much larger company as we return to organic growth, and as we continue to be looking across the horizon from a M&A perspective. So, we had some institutional things we wanted to make sure that we got done, and that's part of John's responsibility.

In addition, there are opportunities that we believe were in the two- to three-, four-year range—maybe some of them actually sooner—that we wanted to not put the burden on our business groups but ask John to take small, if you will, tribes of people and put them in front of those things, and invest a modest amount of money to allow them to go out and build system integration laboratories, or to go prove some concepts about how we might do things differently within some elements of digital signal processing, electronic warfare, machine learning—those kinds of things. And, he's got more specifics here in a moment.

So how is that turning out? I think what we're seeing is a much more disciplined approach to the kinds of things that we're looking at in the future to bid. And, the quality of the kind of pursuits that we're making are being driven a lot by the work that John and his various teams are doing.

So with that, I want to turn that over to him and let him comment.

John Mengucci
Great, thanks, Ken. So as Ken mentioned, really looking at building additional market areas that we can focus this corporation in. Ken mentioned a couple, both electronic warfare, which to us are both Title 10 and Title 50 solutions—some of those being SkyTracker; some of those being other very discrete, offensive and defensive cyber solutions. Also, protection of the homeland. As we have heard with this administration wanting to better protect our borders and the like, many technology solutions, as well as intelligence services solutions that, as Ken mentioned earlier, within our core business areas—they just didn't have the additional bandwidth to be looking at some of those areas.

Jon, you asked how we fund those. Every funding decision and every bid decision is a business decision across this company. We had planned, coming into this year, to look at some of these additional areas. All that investment, whether it's bid and proposal money, indirect selling expenses as well as research and development funding, were all put into this year's plan. So, there is no additional investments we would need to disclose during this year that would in any way, shape, or form impact our commitment to grow margins 10 to 30 basis points.

QUESTION ON CACI'S PROGRESS TOWARDS MARGIN EXPANSION

Jon Raviv
Understood. And then just a follow up on the margin question. I think maybe a year-and-a-half ago you guys talked about margins reaching the low 9% to 10% range over time. I think you talked about some fixed-price programs that could really affect that. Where were we on that journey so to speak?

John Mengucci
Jon, I mean we've been steadily focused on this 10 to 30 basis points growth year-over-year. I mean this second quarter results is another data point as to where we are along that growth curve. If we look at the bottom line growth, we've done that in three different areas: firm fixed-price programs, fixed unit price programs, and then product sales performance.

If you look at firm fixed price, we've been talking for the last three years or so more solutions-based business and performing that on a firm fixed price effort. This operations team is doing that extremely well.

As we continually have been working on efficiencies for our fixed-unit price programs, where as we improve our delivery processes on those types of contracts, that drives better and better profit. And we're starting to see that during the second quarter. We'll see that continue.

And then product sales. We spent a lot of time talking about SkyTracker but frankly, there's other many, many cyber-based solutions and products to very special groups across this Federal Government—both CONUS- and OCONUS-related—that we have been delivering those to us—I'm sorry we have been delivering those.

Highly specialized solutions in this market drive much higher margins. In the last eight quarters, we've seen a steady state of both requests for mods and also new sales. So, I would tell you, we're well on our path to achieve 10 to 30 basis points, and as our mix of business changes, we will continue to see our bottom line margins grow.

Operator
The next question comes from Rob Spingarn of Credit Suisse. Please go ahead.

QUESTIONS ON WHETHER CACI IS EXPERIENCING INCREASED FUNDING FROM READINESS SPENDING AND WHEN CACI MIGHT SEE AN INFLECTION IN ITS BOOK-TO-BILL RATIO AROUND AWARDS

Rob Spingarn
Good morning. I hope you guys can hear me.

Ken Asbury
We can hear you, Rob.

Rob Spingarn
Okay, good, going through the airport here. I wanted to ask you, Ken, just at a very high level, two things. First of all, we've seen some readiness spending come through for some of the hardware contractors. And I wanted to see if—what your exposure is, some of this has been very strong. And, are you seeing some of that funding, is that an opportunity for upside here in the next couple of quarters? That's question one.

Question two is: with all of these plans that you've made, when should we, in your more traditional businesses, start to expect a more significant inflection in book-to-bill? Thank you.

Ken Asbury
Rob, thank you for the question. Let me start with the second one. The book-to-bill—we're actually quite happy with the book-to-bill because, right now, it reflects a discipline that we are trying to put into the things that we pursue to drive the kind of growth that we want to be in the higher-end solutions and services business. So, it would be easy for us to spend B&P and go chase $500 million of 1% business but that ends up being somewhat dilutive, even though it's driving top line. And we believe that there is a market and we are positioned. And, slowly but surely, we will be able to climb to a higher plateau in terms of the higher-value areas of the business. So, I'm not really worried about book-to-bill in the same way that we might have been three or four years ago, because our strategy is fundamentally very different.

With regard to seeing what we're seeing, we are seeing, from a readiness point of view, the kind of money we're seeing spent on is on intelligence services. It is on training. It is on things that have been supporting the fight against ISIS, some of the Africa work, and the like. So, if that's your context, then that's possible. The training that we're doing is probably not fighter jet or helicopter training. It is training people to avoid or to learn about how to operate in austere environments and do so safely against the threat of IEDs and the like. So, we have seen an increase in that kind of business. We've won a lot of that, but we've seen it grow as well as won a lot of that business over the course of the last two quarters.

Operator
The next question is from Greg Konrad of Jefferies. Please go ahead.

QUESTION ON CACI'S CURRENT PRODUCT BUSINESS, WHAT IT COULD GROW TO, AND ITS POTENTIAL IMPACT ON MARGINS

Greg Konrad
Good morning. In the script you mentioned products. Is there any way to size that business and maybe as you change the bidding strategy how big that business could become and how the impact to margins?

John Mengucci
Greg, this is John. I mean, can we size—it's part of our solutions mix. Products come and go. We've been pushing our customers more from providing dollars to create a solution to self-investing and then turning that into a product. So, I would say that's at its infant stage today. We like to talk about margins within that business because that's much more of a positive impact to the 10 to 30 basis point metric versus the growing top line of 1% to 4%.

So, you would expect us to see high double-digit margins for these product-type sales. As the earlier questioner mentioned, as counter UAS and cyber needs and solutions are needed, both CONUS and OCONUS, we are in the right spot at the right time by a lot of market-based planning to make sure that we had the right type of solutions there.

And, many of our solutions are software-based. So, if you look at the traditional way to solve these solutions, it's a hardware-based, manufacturer-type solution. We have been very focused on disrupting that market by having software-definable solutions, which means you build the hardware once and, as the threat changes, we're able to distribute new software there. Makes it much easier on our customers. Makes it much less additional training, but also drives higher margins for us.

Ken Asbury
Greg, this is Ken. I would also tell you that products is one element of the business. It's relatively small but it's having a meaningful impact on our business now, just at its rate of growth. Going forward—and where I think the market is going to be going more—is "anything as a service." And, I think "anything as a service" becomes, again, a greater fixed price-based business where you control your ability to serve customers. And I think you generate higher profitability as a result of being able to do that. And we are seeing opportunities today in some of the general IT arenas. But I think in the future it could literally be anything. You could be doing border security as a service instead of getting it through traditional government contracting.

So, we think this is a very different market that's going to take some time to develop. But we think this administration is very amenable to those kinds of things versus just buying the entire technology stack themselves, try to manage it themselves, and then hiring contractors on an hourly basis to do it.

Greg Konrad
Thank you.

Operator
The next question comes from Krishna Sinha of Vertical Research Partners. Please go ahead.

QUESTION ON HOW MUCH OF THE MARGIN IMPROVEMENT IN THE SECOND QUARTER WAS DRIVEN BY PRODUCT SALES

Krishna Sinha
Hi, thank you. So just to dovetail off that last question, if you could just focus on this quarter, excluding the award fee lumpiness that I know happens in the second and fourth quarters, how much of the 8.1% margin was driven by product sales as opposed to direct labor contracts?

Tom Mutryn
Krishna, this is Tom, I'll take a first stab at that and John may want to embellish it. Right now, I don't have that level of specificity in front of us. And for us, we don't look at it in that way. What is driving the margin is performance relatively cut broadly across the board. Within each of our market segments, there are some increasingly fixed-price types of work—fixed unit price work, some larger service activities, outcome-based, which are fixed price. And those afford us the opportunity to drive efficiencies, and though these efficiencies flow to our bottom line versus a cost-plus contract, where not necessarily flowing to our bottom line.

So, relatively broad-based products we highlight because it is an exciting part of our business, albeit small but growing. And, it dovetails quite nicely into the other electronic warfare, intelligence work that we're doing. So, hopefully that provides some color.

QUESTION ON DELAYS IN AWARDS BY THE GOVERNMENT AND HOW THAT MAY IMPACT THE FUTURE PACE OF AWARDS

Krishna Sinha
Okay. And then just on the awards, last quarter you mentioned some slippage of the recompetes, and we've heard a lot of chat on disarray on the customer side that could be impacting when programs are awarded. What are you guys seeing with regards to that, and what do you think is the potential future impact on the awards cycle and maybe the increase in lumpiness there?

John Mengucci
Krishna, this is John. True enough—awards, they continue to lumpy. And it's tougher and tougher for us to be consistent and try to hit some more predictable book-to-bill number. And, I'm going to tie a little discussion around backlog as well, because clearly awards drive this lumpiness within our backlog numbers as well.

So, as Tom's mentioned in previous calls, our backlog numbers are always going to be impacted by a certain number of adjustments that we continue to do as our long-term contracts expire. It's also impacted by some of our short-term solutions work, because that work comes in and it's too quick of a turn cycle for us to show any leading indicators.

You asked about bridges. Look, the recent run of bridge recompetes are the largest contributor to reduction in our backlog, yet you see that we've just completed our fourth straight quarter of revenue growth.

So, a little color on the second quarter. I'm not trying to set the stage where we're going to be discussing this level of detail each quarter, but I thought it was instructive. We had 31 planned recompete competitions during the second quarter, of which 16 of those were awarded. We won a vast majority of those as our recompete rates still remain north of 90%. But the takeaway is 15 of those valued at over $450 million were bridged. Most of those bridges are going to be three- to four-year programs that get bridged for a three-month period or a six-month period.

So clearly, when you do that math, that doesn't support some satiable, year-over-year comparables of either book-to-bill or backlog. If you add that to the nearly $500 million of bridges we had in Q1, if they had all been awarded, we'd be talking about a book-to-bill rate of around 1.4 to 1.5. And although that'd be a much nicer number for us to be talking on, it really wouldn't have any more impact on our near-term revenue growth.

So, it sort of gets us all back to awards are lumpy but it is extremely important. As Ken mentioned, we're being much more selective on what we're out there bidding. But with our wins and our program performance, we're very happy we're meeting our 1% to 4% revenue commitments.

Operator
The next question is from Cai von Rumohr of Cowen and Company. Please go ahead.

QUESTION ON HOW MANAGEMENT VIEWS THE RAMPING UP OF NEW BUSINESS WON

Lucy Guo
Lucy is on for Cai, good morning.

Ken Asbury
Good morning, Lucy.

Lucy Guo
So, a follow-up on that question. As you see some slowness in the recompete side of things, how do you see the ramp-up on new contracts that you've won a good share of new business in your quarterly awards? How do you see that play out, going forward, as you continue to pursue organic growth?

Ken Asbury
Well, I think, Lucy, the ramp up—it really depends. I mean, if we're trying to ramp up a contract that we won in the Fort Meade area of Maryland, it's a very competitive labor market. If we're doing it in Tampa, Florida, it is much more readily—there's a—how should I say it—a more readily accessible population of personnel with the proper skills and clearances.

I think, in general, it goes to why we want to invest in the careers of our employees. We want to create CACI as an employer of choice. And in a down labor market, we want to do things that are going to enhance the employee experience here at CACI. And we're looking at a variety of those things.

So, in general, we could always use more people, but it's probably a half a dozen programs that I think that we really—and they're situational because of the high clearance levels and the fact that they're in places where not very many people live and not many people want to go and live there—so it's tough to get them to go and recruit. So, we're dealing with a smaller thing.

In general, with the kind of organic growth that we've been able to see, our hiring is meeting those needs. We would always look to see it higher. And that's why we're trying to make this—that's why we are going to do things that accelerate our ability to hire folks into CACI. And not only hire, but make sure that the employee experience is such that people find that they're not just coming here for one contract, but they can come here for an enhanced career experience.

QUESTION ON THE MIX OF DIRECT COSTS GOING FORWARD AS A FACTOR IN MARGIN EXPANSION

Lucy Guo
Keeping that in mind with new business versus the mix shifting going forward, just a follow-up on the margin question trajectory earlier. How do you see direct labor versus other direct mix change going forward that may or may not help you get to that low 9% target in the long run?

Tom Mutryn
Yes, so Lucy, this is Tom. As you probably noticed we did not include our ODC/DL mix in our press release this quarter. And we do not plan to provide that information going forward. And, the primary reason is it's not a metric that we are using to measure ourselves. We're committed to growing margin, and we believe we're going to grow margin through solution-based, fixed-price work, which we've articulated in this call and several other calls. And the profitability is less of a function of direct labor than more of the type of work we're doing.

A simple example is a fixed-price piece of work. Assuming that we're meeting the customers' needs, everything else being equal, less direct labor on that particular] contract drives more profitability, not the other way around. Now that's different than the traditional time and material and cost-plus contracts. And so, as we're shifting our mix, we are focusing less on that ODC/DL split than we have in the past. And I'll leave it at that.

Operator
The next question is from Brian Kinstlinger of Maxim Group. Please go ahead.

QUESTION ON THE CURRENT PRICING AND PROTEST ENVIRONMENT

Brian Kinstlinger
Great, thanks so much, just one. I'm curious how you characterize the pricing environment. We haven't heard also much from CACI and its peers regarding protests, which was obviously a hot topic maybe 18 months ago. So, maybe if you could just comment on both of those in terms of the market landscape.

Ken Asbury
Brian, this is Ken. On pricing environment—where we're heading, we're seeing that it's really more of a value-oriented play: what is the engineering that you're putting behind the bids; how do your solutions stack up against other people's solutions and ideas.

So, there's less of a—in the, as Tom was mentioning a moment ago, in the time and materials or the strict staff augmentation world where there is a lot of pressure on individual's benefits and on their labor costs. We don't have the same sort of thing in many of the solutions contracts. You still have to be—your cleverness is not in how you price the labor. It is how you decide you're going to deliver the solution. And that's changing a little bit for us.

I would say, in general, a more value-driven selection world than cost selection world. But that's also a manifestation of we're not bidding as many of those things that are commoditized.

John Mengucci
And Brian, and you had a question around what level of protests and all. We haven't seen anything different. We still have one open protest. This award, believe it or not, was awarded in June of 2017. It's still under—I think it's on its third protest now, the value is $240 million. We previously disclosed that. We're hopeful that one comes to a positive closure here shortly.

Brian Kinstlinger
Great, thanks.

Operator
The next question is from Joseph Vafi of Loop Capital. Please go ahead.

QUESTION ON WHETHER CACI HAS ANY LARGE CONTRACTS THAT COULD CREATE A MARGIN EXPANSION HEADWIND

Joseph Vafi
Hi guys, good morning. I was wondering just as we are talking on margins here and the margin expansion goals, if we think of more fixed price work, more value versus least cost technically acceptable, it seems like potentially that the margin lift that you're talking about could be a little conservative. So, on the flip side, are there any particular large contracts, perhaps JIDO or others, that may be more ODC heavy that may be perhaps headwinds versus some of the tailwinds we've been talking about on margin trajectory.

Ken Asbury
Joe, this is Ken. I think as we talked over the past year now that we've had JIDO, JIDO started as a consolidation of 14 major contracts. We brought that team together to be able to rapidly solution for that customer and while we had a great deal of revenue, our margins were low. But there was an option of probably $900 million of which we do not have the same commitment to the teaming. And we expect to self-serve and self-deliver more of that work. So over time, we will see that develop. But that's going to happen over the course of the five or six years that that contract is going to go.

In a bigger general sense, we are looking at opportunities for, as I said, solutions as a service. There are those out there, particularly in the IT arena, where the government would like to turn over all of its infrastructure work to you and have you deliver it in a next-gen IT kind of way. So those are probably the other near-term ones.

We continue to have a very, very nice and somewhat expanding base in the single to high single-digit, in our world of digital signal processing and cyber and the like, which carries a higher margin profile. But I will tell you it is not—there's not a single large contract out there that we would do.

We're looking at the mix of business that this takes to be able to do it. Ideally, we're going to be targeting one to seven very large but profitable contracts that will be part of the portfolio going forward that have extraordinary—maybe it takes a little bit more risk at the beginning, but it also over time would allow us then to enjoy better-than-industry margins on it, which would be accretive to the whole company.

So, that's sort of the strategy that we're employing. We picked 10 to 30 basis points because from where we were before that seemed to be a really—that was a unifying goal inside the company. If we find that we can do it faster, we will adjust that. But right now, we're, what, five or six quarters into making that commitment, and I'm happy that we were able to deliver on it this quarter.

QUESTION ON WHETHER "ANYTHING AS A SERVICE" OFFERINGS ARE HIGHER MARGIN WORK

Joseph Vafi
Okay, that's helpful. And then just one quick follow-up, I know it's early, if you've been talking a bit, Ken, about some "as a service" in a lot of potential areas. Do you have a feel for, Ken, "as a service" offerings have a higher margin than perhaps your blended gross margin now? Thank you.

Ken Asbury
Joe, I believe it—I believe generally they would or we wouldn't pursue them. Because if we're going to invest in infrastructure, we're going to invest in training of people and that sort of thing. I love the idea that a customer would pay me for outcomes versus people or versus fee, or versus some other measure. I love the idea of fixed-unit price for outcomes. And if there were more opportunities to do that, we're certainly going to gravitate towards those because we know how to manage them, and we know how to extract value from them.

As time goes on, it frankly is probably as a result of this tax law, we'll have more cash. It may put us in a better position from a balance sheet to be able to go and invest in some of these—in some of these things that would then produce a better-than-average profitability. But I think all of this is enabled by a government environment.

Now, once we get through this first cycle of how the budgets are going to play out—and that's a big fight right now—we're going in, most likely, to our fifth CR. I hope that their—hope is not a strategy—but I don't want to say anything more difficult than that. I hope that we get through this next budget. We don't have another issue.

But once that happens, I think we find a customer set out there that are willing to try a lot of new things. Because frankly, the acquisition forces are tired. They're having to deal with so many different ways in terms of conventional procurement, that they'd be looking for alternative ways of conducting certain aspects of the business of the government as long as it wasn't inherently governmental. That I think puts us in a really nice position, and several others in our industry, in a nice position to be able to do that kind of work.

So that's the plan of attack that we have, Joe, and I hope that helps you understand our strategy.

Operator
The next question is from Jon Ladewig of Stifel. Please go ahead.

QUESTION ON MANAGEMENT'S ASSUMPTION FOR INDIRECT COSTS AND SELLING EXPENSES FOR THE REMAINDER OF FY18

Jon Ladewig
Hi, gentlemen, thank you very much for a great quarter. Really the only question I have for you all is the discussion you had with the midpoint on SG&A. You've previously said that you saw it flat to being slightly below. Do you still see that happening for the rest of the year?

Tom Mutryn
Yes, Jon, this is Tom. Yes, we do. That was our initial guidance and we're committed to that. We were up a bit in the first quarter. We had some growth initiatives in some systems that we were doing; some slightly higher fringe expense. We were flat on a year-over-year basis this quarter, and we expect flat for the full year.

That being said, there's always minor fluctuations in various accounts: bonus true-ups, various reserves, DCAA or other auto reserves, medical or other expenses, periodic investment spend, facility costs, and the like. But given all of that, we're comfortable with that guidance.

QUESTION ON WHETHER CACI IS MAKING INVESTMENTS IN ITS BUSINESS SIMILAR TO ITS PEERS

Jon Ladewig
I asked that because, when we think forward going, a lot of your peers, especially the larger aerospace and defense guys, are sitting out there and reinvesting in their business. Why now are you not seeing that type of similar investment at this point?

Tom Mutryn
So, we've always been investing in our business. And so, on a year-over-year basis, last year we made investments. This year we're making investments. So, we're not seeing a large incremental increase. And what we're trying to do is drive efficiencies throughout our organization and those efficiencies would be earmarked towards investments.

And so, if I save a little bit here by doing something smarter or a new system or processes, we can use those savings to make those investments. So, it's a balancing act. So, I don't think we're under investing by any stretch of the imagination. I think we're making the right level of investments that we talked about.

Operator
Your next question comes from Joseph DeNardi of Stifel. Please go ahead.

QUESTION ON WHETHER CACI WOULD USE THE BENEFITS OF TAX REFORM IN ITS VALUE PROPOSITION AS AN OPPORTUNITY TO CAPTURE MORE BUSINESS

Joseph DeNardi
Thank you for taking my question. Ken, just to talk about tax reform a little bit. You can make the argument that you guys could use the benefits of tax reform to offer the customer a more compelling value proposition and grow the addressable market. Do you see that as an opportunity going forward? Or is value not really the gating agent for the market that you're going after?

Tom Mutryn
But let me start off, Ken and John can elaborate on that. We operate in a competitive market. We're pricing our product to make the value proposition attractive to our government customers. We have what we consider competitive rates. Over time, there may or may not be pricing pressure, but we'll be fine. But right now, we're happy with the way we price our product. So, we do not see the scenario you articulated playing out for us.

Ken Asbury
And, Joe, I think, you could see over—there's probably a place where you want to decide where

you want to be. If we're going to be a business that's only competing on the basis of price, then, yes, we could flow all that down into our rate structure and that would be helpful. Indeed, some of it may end up there anyway that we don't reinvest.

I think more importantly to our customers today, particularly in a labor market that is tightening the way that it is, is to figure out a way to attract more people into the national security or the federal government services business because, frankly, things like Budget Control Act and sequestration drove a whole lot of talent out of this world into more commercial industries.

And hence, that's our view. We can give out bonuses to our permanent employees. I would rather create a career experience that is really rewarding for folks inside of service to the federal government that is very distinct. And I think that's a better investment than just simply flowing it to lower rates.

So, thank you for the question. I hadn't thought about it in those terms, but that was a good question.

Joseph DeNardi
Yes, and Ken, I guess, what I'm trying to ask is, I guess, the negative spin on this is that companies just compete more aggressively. The pie doesn't grow, and the savings just end up getting passed back to the customer. The other argument is that, again, you make that outsourcing argument more compelling for the customer, and now they'll start outsourcing or contracting for services that they previously didn't. And I'm just wondering if you see the tax reform as an opportunity to grow the pie.

Ken Asbury
Well, clearly, it's putting, as I think we—Tom's estimated for us, we'll have $30 million more cash that we'll be producing on an annual basis, notwithstanding the one-time thing that we have this year. There are certain things that we could invest in from an efficiency point of view that we are considering that may drive longer-term efficiencies, but we haven't perfected that yet, so I'm not willing to talk about it.

I think the idea of where we want to go is not to get trapped into we've got to get rates lower, but we've got to get the ability to deliver outcomes higher. And I think those are two ends of the spectrum in this marketplace. We're preferring to be on the upper end of that, meaning we want to get to a place where we can convince the government that it makes a hell of a lot more sense from a cost efficiency, and from their efficiency point of view, that industry could deliver that better than they could do it inside the government.

Tom Mutryn
Let me add to that with two more observations. One is a lot of our contracts are longer term in nature—one, two, three, five years. And so, in the long run, one can have philosophical discussions about what will ultimately happen, but as a practical matter in the short- and mid-run, the majority of our work is locked in in terms of prices.

And then secondly, if the government decides to outsource or not, I think whether our prices and our competitors' prices are 1% to 2% lower, I don't think that's going to swing their decision. I think there is more philosophical underpinnings to those types of decisions. And so, on the margin, slightly lower cost to the government is not going to be material in their decision calculus.

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

QUESTION ON HOW THE COMPOSITION AND MARGIN PROFILE OF THE CURRENT BID PIPELINE MATCHES CACI'S OVERALL STRATEGY

Tobey Sommer
Thank you. Could you comment on the solutions composition and margin profile of awards in the quarter in bids either submitted or about to be submitted so we can get a flavor for how your strategy is influencing those? Thanks.

John Mengucci
Yes, Tobey. We are going to shy away from talking about specific margins on specific small slices, but I'll give you a little more color on the bids that we submitted and the bids that are awaiting award. We find about 40% total of our awaiting awards in the Enterprise IT and Intelligence Services areas, and another like 10% to 15% in our Business Systems area. Those three areas are a very nice mix of professional services, managed services, and solutions. If we look at our expected submissions, pretty much in those same areas. Our Enterprise IT, our Intel Services, and our Intel Systems markets are driving that. And those areas for our expected submissions is going to be a little bit heavier in our solutions based.

If we're looking at margins in each of these different areas, I mean relatively speaking, margins in our professional services businesses—always under pricing pressure, because it's tough to differentiate by delivering a single labor hour in the managed services. And in the solutions area, the contract mix is more towards fixed price versus cost reimbursable, so that gives us a much better opportunity to be driving margin growth.

QUESTION ON WHETHER TAX REFORM HAS AFFECTED THE M&A ENVIRONMENT

Tobey Sommer
Thanks. I had a question about M&A as a follow-up. There was a private equity sponsored business acquired yesterday by a commercial firm. I was wondering if you looked at that and, more broadly, now that we have tax reform behind us, do you see buyers and sellers in mergers and acquisitions closer and able to come to deals more readily than perhaps in the waning months of last year when a deal was forthcoming, but we didn't know the outcome?

Ken Asbury
Well, I think the short answer is that we're very active. We're always looking for great opportunities. As you know, we've acquired 67 plus companies over the past 25 years, and we plan to be a strategic consolidator through M&A.

We've talked to you all a number of times about how maintaining M&A as a priority for both capital deployment and using it as a tool for growth. We look at a wide range of deals. And I'm not going to comment on any specific thing that we have looked at but, suffice it to say, that we're very active, and we'll act as a strategic integrator at some point in time in the future.

Operator
The next question is from Josh Sullivan of Seaport Global. Please go ahead.

QUESTIONS ON THE CURRENT CONTINUING RESOLUTION TIMELINE AND WHAT THEMES MAY BE EMERGING IN THE FY19 PROPOSED BUDGET

Josh Sullivan
Good morning. Can you just go over your view of the continuing resolution timeline right now and maybe with next year's fiscal budget coming up, are there any early trend or themes you're expecting at this point?

Ken Asbury
Josh, I probably can't tell you my real views on the continuing resolution on an open mike. What I will tell you is I think when we saw a change in administration, we saw a change in attitude towards national security, defense, homeland security and the like, which were all favorable trends towards companies like CACI and others that were in our space. What we haven't really seen—with the exception of an additional $18 billion or so last year which came late and was really hard for the acquisition people to place—we haven't seen much of a change.

So, that being said, we see a market that is responding to the call for improvement in readiness, and that's where a lot of money has gone. That typically comes down through the O&M budget. In our case, we're not as involved with aircraft or vehicles or that sort of thing, so we wouldn't see it. But, we have seen it in terms of intelligence, intelligence support—a lot of different kind of training elements for people that are going overseas in a variety of job assignments. So, that's sort of where we've seen the benefit of where we are.

Looking at where the budget is planned to go and what the president is asking for, I think it's significantly favorable. But we're going to have to go through a few more steps to get Congress to get to a point where we will know specifically what that happens.

And as far as what it portends for next year, we've heard what Secretary Mattis has had to say about how he wants to—. Just using DoD as an analog for this at the moment—he wanted to spend FY 2018 really focused on readiness in repairing some of those activities, and 2019 of getting back to really investing in next generation technologies and capabilities and getting out of "we don't want any near peers in the budget from 2019 going forward. We want to accelerate our distance from them in many respects."

That being said, some of that's going to come in the form of new hardware and new capability. But I think a ton of it's going to come in terms of making the things we have today more interconnected in secure ways, more responsive, have more capacity for dealing with speed and numbers. And finally, I think we're going to see a lot of money invested in human-to-machine and machine-only responsive capabilities in many of our defensive and offensive systems.

I think five years ago, we decided that we were going to take a chance and invest in a company like Six3, which was all about digital signal processing and that. What we're seeing now is the manifestation of having that vision, because the world—that world that we're entering right now is all predicated on the capabilities that are in that business. And, I would tell you the same—that there were some elements of the NSS acquisition that did the same.

Josh Sullivan
Thank you.

Operator
The next question is from Brian Ruttenbur of Drexel Hamilton. Please go ahead.

QUESTION ON HOW A CHANGING INTEREST RATE ENVIRONMENT WILL AFFECT CACI'S USE OF DEBT AND M&A STRATEGY

Brian Ruttenbur
Thank you very much, great quarter. I'm sure I'm near the end of the queue. Interest rates. I don't think anybody has talked to you guys about that. I know that you're talking about your plans for M&A continue. But, how does the interest rate environment impact you and how have you hedged yourself? What are your plans? Are you okay levering up even further with M&A, given that we're probably going to have rate increases this year and that impacts you guys to the negative? And then finally, did you take that into account when you're talking about guidance?

Tom Mutryn
Yes, thank you. When we put our annual plan together, we assumed that there would be a steady increase in LIBOR, which was based on the consensus views of the world. So, we have already factored those increases in our guidance. Right now, we have around $1.1 billion worth of debt. We have swaps in place for approximately $800 million. And so, in the next one or two years, we're pretty insulated from increases in interest rates.

Our average interest rate in the quarter was 3.3%, so 3.3% on a little over $1 billion of debt is very attractive. So, I don't see any risks associated with that. As some of the swaps roll off, we'll naturally de-lever and if we need to borrow additional money to fund acquisitions, we'll look at the fixed/ floating mix at that time.

QUESTION ON WHAT INTEREST RATE TO USE FOR MODELING ESTIMATES

Brian Ruttenbur
Okay, and what kind of rate would we be looking at as you're doing your modeling, going up to 4.5%? I was just trying to get a ballpark what you think or what you have modeled in, in your estimates from 3.3% to maybe the mix goes up to 4%, 4.5%, 5%.

Tom Mutryn
Well, for the rest of the year, I don't think it will be appreciably more than 3.3%. As I said, most of the 80% is fixed, and so it's not going to change materially. Going forward, '19, and '20, '21, again not to—I'll turn it back to you, what do you think LIBOR is going to do during that time period? I don't think we have enough foresight to estimate that.

But that being said, today we have a very favorable borrowing environment. We have the ability to borrow fixed rate at a high-yield bond, somewhere around 5.5%. And so, if we chose to, we could lock-in some very long-term, eight-year rates at those particular rates.

So, the bottom line, increases in interest expense, I don't think, is going to have a material impact on our ability to fund acquisitions or execute our M&A strategy.

Operator
The next question is from Edward Caso of Wells Fargo. Please go ahead.

QUESTION ON THE IMPACT OF THE SECURITY CLEARANCE BACKLOG ON HIRING AND STAFFING OF CONTRACTS

Edward Caso
Hi, good morning. I wanted to ask about the security clearances: your ability to get and retain people with them; your ability to execute on contracts. In other words, if you left money on the table because you couldn't get people. Have you lost any contracts, or have you picked up other people's contracts because they couldn't staff them? Thanks.

Ken Asbury
Thanks, this is Ken. I think the security clearance environment makes it difficult in general. There's an awful lot of work going on throughout the industry and throughout the administration to try to bring some help to the circumstance, not to take shortcuts in terms of how we grant security clearances, but how to find ways to speed it up.

In terms of your specific questions, I think we could probably find a dozen contracts where we're under—that we are continually under in terms of the full allotment of billable positions that we have. And, some of those are made difficult by the way the customer wants to conduct their work. They may have three people that they want—three people serving the same mission—or three contractors serving the same mission. They want to pick the best athlete. So, you give them a variety of things. They all have to be cleared, and that just becomes a very difficult environment. And, those are the more difficult of the contracts.

We have not lost any contracts, to my knowledge, on the basis of clearances. And, I'm looking around the table here to see if we won any. I don't think that's a—I mean, it could be a competitive basis, but we have not won or lost anything on the basis of that.

QUESTION ON WHETHER THERE HAS BEEN ANY CHANGE IN THE USE OF SMALL BUSINESS SET-ASIDES IN CONTRACTING

Edward Caso
My other question is on the small business set asides. Has that headwind eased at all? Are you seeing contracts still being broken into pieces where a piece is going to small business? Is there any change on that front? Thanks.

John Mengucci
Ed, this is John, not materially. I mean if anything, some of these things ebb and flow. So, I think that if you look at JIDO—JIDO is a perfect example of these new contract consolidations where we're looking to bring much more work together. If I look at the small business work, we haven't seen anything materially change there, Ed.

We would expect to maybe see a little bit less of that as we move more towards managed services and solutions. We still have a small business mix in our professional services business. But point-to-point, Ed, and I don't see any material changes there.

Operator
The next question is a follow-up from Jon Raviv of Citi. Please go ahead.

QUESTION ON ANY CHANGE TO CACI'S CAPITAL EXPENDITURE PLANS AS A RESULT OF TAX REFORM

Jon Raviv
Thanks for fitting me in for the follow-up. Just first one on CAPEX this year and CAPEX going forward, any changes as you encounter this growth environment in a post-tax reform world?

Tom Mutryn
Yes, CAPEX this year around $35 million to $38 million, somewhere in those particular ranges. Most of our CAPEX historically has been for IT equipment and infrastructures. The last couple of years, it was higher than normal due to some facility consolidation. We exited some facilities. We prepped the new facility to accommodate a workforce moving from one unit facility to another. We did some work. John mentioned the Agile Factory, that took some money to invest in that.

Right now, we would think that going forward, CAPEX in $30 million to $35 million for the next few years seems reasonable. The one caveat is, as we win more new business that may drive additional in facilities, but generally that gives you a sense of where we are.

Jon Raviv
Thank you very much.

Operator
The next question is a follow-up from Joseph DeNardi of Stifel. Please go ahead.

QUESTION ON THE IMPACT OF BRIDGING AND EXTENDING OF CONTRACTS ON THE AMOUNT OF WORK TO BE RECOMPETED

Joseph DeNardi
Yes, thank you very much. I guess for John or Tom, you talked a little bit about the extension and bridging activity you're seeing. And, I'm just wondering if the rule of thumb is maybe 20% of the business falls away or is recompeted every year. Is that still the right way to think about it? Or is this the bridging and extension activity actually making that more like 10%?

John Mengucci
Yes. Joe, I truly wish I have that golden answer for you. But historically, we've been in that 15% recompete measure. We've got about 2% of that left. If the first and second quarter continue, we'll probably be resetting our metrics in that 10% range.

And, I'm just doing that up the top of my head, Joe. I mean if you look at, we had about $900 million of recompetes in the first half of the year, we probably have about $1.6 billion for the entire year. And if this pace of bridging happens, we would see the percentage of our recompete in the future be far less, if this behavior continues for the next couple of quarters.

Joseph DeNardi
Okay, appreciate it, thank you.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over

to Ken Asbury for closing remarks.

CEO CLOSING REMARKS

Ken Asbury
Well, thank you, Kate, 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 will be available for calls later this afternoon or into tomorrow.

So, I would like to thank you for your interest in CACI. This concludes our call. Thank you and have a very good day.

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.