CACI INTERNATIONAL INC
Second Quarter FY20 Conference Call

PRESENTATION

Operator
Good day, ladies and gentlemen and thank you for standing by. Welcome to the CACI International Quarter 2 Fiscal Year '20 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. Should you need assistance during this call, please press star (*), then zero (0) and someone will help you.

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

INTRODUCTION AND SAFEHARBOR STATEMENT

Dan Leckburg
Thank you, Chuck. Good morning everyone. I am Dan Leckburg, Senior Vice President of Investor Relations for CACI International and I thank you for joining us this morning. We are providing presentation slides, so let us move to Slide 2 please.

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. Those factors are listed at the bottom of last night's press release and are described in the company's SEC filings. Our Safe Harbor statement is included on this exhibit and should be incorporated as part of any transcript of this call. I would also like to point out that our presentation will include discussion of non-GAAP financial measures. These should not be considered in isolation or as a substitute for performance measures prepared in accordance with GAAP.

Let us turn to Slide 3 please. To open our discussion this morning, here is John Mengucci, President and Chief Executive Officer of CACI International. John?

CEO OVERVIEW

John Mengucci
Thanks, Dan, and good morning everyone. Thank you for joining us to discuss our Fiscal Year 2020 Second Quarter results. With me this morning are Tom Mutryn, our Chief Financial Officer;

and Greg Bradford, President of CACI Limited, who is joining us from the UK. Let us move to Slide 4 please.
Last night, we released our second quarter results for Fiscal 2020, and I am very pleased with our performance. CACI again delivered strong financial results across the board--significant revenue and profitability growth, accelerating organic growth, and robust cash flow. We also won $2.7 billion of contract awards with approximately 60% of that value representing new business for CACI. These results round out a great first half to our Fiscal 2020. At the beginning of the fiscal year, we guided to accelerate organic revenue growth and margin expansion. Today we are raising revenue and net income guidance to reflect further organic acceleration with ongoing margin expansion.

Slide 5 please. We continue to see healthy demand trends across our addressable market supporting both revenue growth and margin expansion. Let me illustrate this demand with awards from this quarter.

- First, CACI won a 5-year $1.1 billion enterprise and mission technology contract to modernize the customer's business and mission applications portfolio, including extensive cloud migration. This is one of the government's largest Agile Software Development Programs, which we won by leveraging our unique class performance and the award-winning innovative capabilities of our Agile Solution Factory. CACI now delivers on two of the federal government's largest Agile development programs.
- On the mission technology side, CACI won a $475 million sole source contract with an intelligence community customer to enable their critical national security mission. We won this opportunity by offering new unique intelligence in communication technologies leveraging the R&D field innovation of LGS. This contract represents new and recompete work for CACI.

Slide 6 please. These awards are just a few examples of the high-value contracts we are consistently adding to our backlog. These are larger, longer duration, and enduring drivers of organic growth and margin expansion. In fact, today the contracts we are winning have a weighted-average contract duration that is 1.5 years longer than those we won over the past three years. This results in a dependable revenue base and allows us to focus items, such as B&P investment, on additional growth rather than simply maintaining our book of business via recompetes.

Many of these contracts are also more complex technology development efforts that initially ramp slowly but provide the high-quality, long-term growth we are focused on delivering. What we are now seeing is something we have discussed for the past several quarters. As we successfully deliver on these contracts and enter higher-volume phases, we are driving and accelerating organic growth. In fact, we now expect fiscal 2020 organic growth on at least 7%, up materially from just six months ago, when we guided to about 5.5%.

Slide 7 please. Turning to the market environment, we continue to be very encouraged by what we see. The two-year budget agreement signed back in August was followed by the passage of government Fiscal '20 appropriations bills in late December, funding the government at levels about 4% higher than government fiscal '19.

More important to us than the absolute budget levels are the multiyear investment plans of our customers. When we map CACI's capabilities against these priorities, we see tremendous opportunity across our $220 billion addressable markets. Within our enterprise business, customers are modernizing IT infrastructure and business applications. In our mission business, customers are investing heavily in signals intelligence, electronic warfare, cyber, communications, and space. Our alignment to these critical areas enables our ability to take market share and gives us confidence in our future growth.

Slide 8 please. To ensure CACI remains ready to address our customers' emerging needs, we continue to invest for future growth. We are developing differentiated technologies ahead of customer demand through our research and development program. When we win on differentiation, we deliver more value to our customers and our shareholders.

Our business development and operations organizations are developing solutions in pursuit of the right growth opportunities, testing technologies with our customers and win opportunities that will provide long-term sustainable growth. And we are consistently investing our leadership and our people. We are adding strategic leaders like retired general Mike Nagata, who will establish a strategic advisory group of industry and customer experts to ensure CACI remains ahead of market trends. And on the broader people side, we continue to offer highly competitive benefits, including training, certifications, and work-life balance to name just a few. This continues to attract and retain the industry's best talent.

In closing, I am very pleased with our second quarter performance. We remain committed to our successful strategy that has served us so well: win new business, deliver operational excellence, and deploy capital to support future growth. Relentless focus across the organization on this strategy drives growth and margin expansion, which generates increasing levels of cash flow. We then deploy that cash to add strategic capabilities in customers' critical investment areas.

This combination of organic and acquired growth has successfully compounded cash generation and shareholder value over the long-term. We remain very confident looking forward.

With that, I will turn the call over to Tom.

FINANCIAL OVERVIEW

Tom Mutryn
Thank you, John and good morning, everyone. Please turn to Slide 9.

Our second quarter revenue was $1.4 billion, 18% greater than last year with 8.1% organic growth. Organic growth accelerated from first quarter as our new business awards ramped up and existing programs continued to deliver.

Net income for the Quarter with $79.2 million, up 15.5% from a year ago. This is higher than the expectation from last quarter as we were able to drive higher operating profit in a lower effective tax rate.

Slide 10 please. We continue to generate strong cash flow with $134 million of operating cash flow in the second quarter. Days sales outstanding was 51 days, down from 73 days last year. One major driver of the reduction is lower accounts receivable as a result of the AR purchase facility, or MARPA, which we put in place in January 2019.

In addition, we have continued to drive efficiencies in our billing and collection processes. We ended the second quarter with net debt to trailing 12-month adjusted EBITDA at 3.0 times. This provides ample debt capacity to undertake additional acquisition to add high value strategic capabilities.

Slide #11 please. We are raising our Fiscal Year 2020 guidance to reflect strong operating performance as well as expectations for lower tax rate. We now expect organic growth to be at least 7% in Fiscal Year 20, up from 5.5% when we provided FY 20 initial guidance, driven by our strong contract awards and our program performance. As a reminder for organic growth purposes, Mastodon anniversaries at the end of January and LGS at the end of February.

Our guidance assumes an effective tax rate for approximately 22%, down from our original expectations of 23%. Drivers of this include increased benefits associated with the vesting of equity grants, given strong stock price performance as well as higher tax credits. We continue to expect Fiscal Year 20 adjusted EBITDA margin to be around 10.3%, and we are increasing our operating cash flow guidance to be at least $430 million, excluding any impact of the markup facility.

Slide 12 please. Our forward indicators remain healthy. As John mentioned, we again have strong contract awards in the second quarter coming in at $2.7 billion, more than double the level we achieved last year. On a trailing 12-month basis, this increased our book-to-bill to 2.4 times and drove record backlog of $20 billion, up 61% versus last year. Our pipeline metrics remain healthy and at similar levels we reported last quarter. Submitted bids pending awards are $8 billion with over 70% of that for new business for CACI. And we expect to submit another $13.4 billion worth of bids during the March and June quarters, with over 70% of that for new business for CACI.

Finally, at the midpoint of our revised guidance, we now expect 97% of our revenue will come from existing contract, 2% from recompetes, and 1% from new business.

With that, I will turn the call back over to John.

CEO CLOSING COMMENTS

John Mengucci

Thank you, Tom and let us go to Slide 13. The strength of our performance through the first half of this fiscal year positions us to deliver continued growth, margin expansion, and shareholder value over the long-term. None of this happens without the talent, innovation, and commitment of our employees. I am incredibly proud of the expertise in technology we deliver to our enterprise and mission customers and I thank you all for what you do each and every day to make CACI a great company.

Great companies rely on their culture to define the right way to conduct business and their people to embrace that culture as a success factor. Our culture of good character and innovation is foundational to our success. *Fortune* magazine’s recent listing of CACI as a World's Most Admired Company and as a Top 10 information technology services’ company worldwide recognizes that our culture drives our success.

With that Chuck, let us open the call for questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question-and-answer session. [Operator instructions]

Our first question will come from Gavin Parsons of Goldman Sachs. Please go ahead.

QUESTION ON WHETHER MANAGEMENT WANTS TO SLOW THE PACE OF WINNING AWARDS AND CONCENTRATE ON EXECUTION

Gavin Parsons
Hi. Good morning, gentleman.

John Mengucci
Good morning, Gavin.

Gavin Parsons
So, this is a pretty high-class problem to have but, I mean, you won a ton. At what point do you say we have won enough in the backlog to drive, say, mid- to high-single digit growth for a few years now. We want to slow down on winning, and just make sure we can execute on what we have? Or is that they are not mutually exclusive?

John Mengucci
Yes. Gavin thanks. Yes. I guess, clearly, we don't plan on slowing down. We actually started, as many of you on the call know, with a very specific strategy several years back, and that was to focus on growing both top and bottom line. And we made a quite a substantial commitment that we will never sacrifice margin to get the kind of growth that you are now seeing today. That is really foundational to us, because it is a belief that growing profit and cash flow over time is the best way to generate shareholder value. Some of that was going to be organic. Some of that was going to be through acquisitions.

We have been talking for quite some time now around when to see organic growth show up, and how does it, and at what point does it equal some of your peers and then at what time does it surpass that. If we look at FY20, I am really pleased and confident of the organic growth potential, because we have consistently won larger and longer-term business in the areas where customers are going to spend real dollars. We have been able to maintain rates over the last three years. So, we are not pushing costs of our investments on to our customers, we are just managing a very strong cost basis.

When we do that—when we win larger or longer duration—we actually generate this with what we are calling a B&P efficiency, which means that if I am winning longer duration, larger awards, then as I get a couple of years out, I am spending far less to maintain the book of business and I am plowing more money into continuing to win.

So coming back to your -- when do we slow down and just focus on execution, our actually three-part strategy, the first -- the first two parts: win new business, which the team has done outstanding job. The BD machine has worked extremely well. And then second, deliver. And our team has done an outstanding job on delivering because, as you all know, once we get the awards, we don't gain margin unless we are generating revenue. And so across the board, we are very happy and do not really see any end in sight.

QUESTION ON WHETHER FREE CASH FLOW CONVERSION CAN BE IMPROVED OVER THE NEXT FEW YEARS

Gavin Parsons
That makes a lot of sense.

Tom, on the free cash flow conversion, I think guidance implies about 110%. That is down a good amount from the last few years. And I appreciate you are growing a lot faster, but can you help walk the bridge over the next few years? What does free cash conversion look like and can you improve that even if you continue to grow at similar rate to this year? Thanks.

Tom Mutryn
Yes. Thank you.

One of the things I'll note in the last year or so is we have had higher capital spending than we had previously, and so that obviously impacted the numbers that you articulated. That capital spending is a direct result of the investments that we are making and the wins that we are having.

It would fall in a couple of buckets. As we win work, often times that work is provided at CACI locations. Often times you need new facilities. some of those have SCIF space, which is an expensive facility. Some of the spaces we have customized laboratories and relatively expensive test and assembly equipment, internal capex, internal. So that is driving some of that conversion.

Other than that, it is a relatively straightforward walk-down from net income to operating cash flow. We have a good number of noncash items: depreciation, stock compensation expense, intangible amortization. So we expect the levels that you articulated to be somewhat consistent going forward with that level of capex.

Gavin Parsons
Thank you.

Operator
Our next question will come from Edward Caso of Wells Fargo. Please go ahead.

QUESTION ON THE POTENTIAL IMPACT OF THE ELECTION CYCLE AND CHANGE IN ADMINISTRATION ON AWARD DECISIONS

Edward Caso
Good morning, and congratulations.

Can you toggle back in your history here and give us a sense on the upcoming election cycle—how that may impact award decisions both before and after, and whether it's maintained current administration or changed to the other party? And then, maybe, weave into that your commentary around extended duration and does it help you here settle over the hump? Thank you.

John Mengucci
Yes. Thanks Ed.

So, look we have been in business for 57 years and counting. I would like to say we fared well under various administrations that clearly have differing priorities. We can debate whether this year's field has even more divergent sets, but we will not do that here. Part of why we see growth coming and continuing, regardless whether there is an R or a D leading the nation is, we have got a well-balanced portfolio of business. And if we look at our Enterprise and our Mission customers and the numerous capabilities that we have, Ed, I mean we have got some pretty strong Expertise and Technology offerings.

So, if we talk this discussion around Mission business and our Enterprise business, on the Mission side, I mean we are well aligned to critical defense and national security areas. You've always heard us say the world is a very dangerous place. And the defense budgets have historically been a highly bipartisan part of the federal government budget. We believe that we are well covered there. On the Enterprise side, every time we move social funding and different programs around, both the fed civil and the defense side are always looking to modernize and updating their systems and making more technological infrastructure investments, and that really drives long-term cost savings.

So, I -- we believe that our business is less susceptible than maybe some pure services business because, as you mentioned, to weave in the kind of work that we do, a much larger portion of our portfolio today, maybe going back five years, is more of technology in nature, and it is with high-end mission customers. And those are very immune to Monday afternoon budget cuts.

So at the end of the day, great power competition continues to be a focus. And some of the capabilities that we have to go fight those and also counterterrorism missions, at least in the EW era, has eroded. And our strategy has always been to position this company to where the government is going to spend their budget dollars less. And at the end of the day, the election is the election. It is Congress that actually votes on and allocates and spends the budgets, which are out there. We are looking forward to who gets reelected or who fills that role. And I believe that we are that kind of business that will continue to grow regardless.

QUESTION ON WHAT THE INCREASE IN COST PLUS CONTRACT VOLUME WILL POTENTIALLY HAVE ON MARGINS

Edward Caso
Thanks. The other question is around your -- you had sort of an uptick in cost plus work here is. Can you give us a sense what's in the pipeline? Is this sort of a short-term phenomenon? Or is there more cost plus in your future, and what the implications, therefore, are on margins? Thank you.

John Mengucci
Yes. So, that is one of those things that as a leadership team we are always watching. But when you see minor movements in cost plus versus fixed price and time and material, when we did the LGS acquisition, a large portion of their work is cost plus. So, when we brought that acquisition in, that would have driven the percentage of cost plus work up. The rest of the minor movements there is really on mix.

There are different awards that we are out there winning. If we looked at the pipeline at a macro level, Ed, the more Technology work that we are winning—more of that as our products business begins to spin up—will be firm fixed price. And the Expertise work is sort of split, sort of 50/50. So, we like that mix.

And, of course, contract type is only one dial or knob that we have to be driving margins. So, we will continue to watch that, but there should be nothing inferred that we are winning more cost-plus work, therefore margins are going to go the wrong direction.

Edward Caso
Thank you.

John Mengucci
Yes. Thanks Ed.

Operator
Our next question will come from Seth Seifman of JP Morgan. Please go ahead.

QUESTION THE SOURCE OF STRENGTH IN ORGANIC REVENUE GROWTH

Ben Arnstein
Hi. Good morning. This is actually Ben on for Seth.

John Mengucci
Good morning Ben.

Ben Arnstein
I was hoping you could add a little more color on the upside in organic growth. Is this something that is broad-based across the portfolio? Is this something stemming from either the Mission or the Enterprise or one of the 4 quadrants that you had laid out the Investor Day?

John Mengucci
Yes. Thanks.

If we look at our organic growth, it truly is a function of a multi-year plan that now you're all starting to see the benefits of generating awards that are longer in duration, and that are much larger in dollar value. When we -- I think we are at 2.8% -- when we came out last year, we guided to 5.5[%]. We are at 7[%]. And what you are starting to see is, based on the mix of business, which is the other part of your question, when the mix of business is more towards the Technology side, those are longer term programs that have a longer-term ramp up. So, you'll start to see that growth later—possibly three, six, nine months after awards. And for the more Expertise jobs that we win, where we're delivering talent, those have a much quicker ramp up.

Across the four quadrants, you know, if I were to put in that quadrant speak, Expertise starts up quicker and holds a sustained level of revenue. And on the Technology side, those programs are going to start up slower and then deliver their growth. The combination of that and the multi-year nature of book-to-bills far beyond 1.5 and 2—I think we are at 2.4 now on a trailing 12 months—the mix of that work really is driving future organic growth. And the more we continue to win, back to Gavin's question, we have no intention in sort of slowing this train down. At the end of the day, broad growth across both our Enterprise and our Mission businesses.

Tom Mutryn
I'll add one comment on there is also growth potential, which we are seeing on existing work—large number of base of business. And we have strong program management discipline, whereby we do everything in our power to provide more value on existing programs: fill open positions quicker on labor base types of activities, and look at scope on existing working. So that's another source of organic growth going forward.

QUESTION ON MANAGEMENT'S INTENDED PACE OF M&A ACTIVITY

Ben Arnstein
Got it. Thanks. And I guess – maybe piggybacking a little bit on Gavin's question—but on the M&A front, this is pretty -- the focus of your strategy here. With organic growth being so strong this year, you know you're at three times leverage, we have seen a number of deals in the space at pretty lofty multiples. Is there any—can you comment on, maybe, your willingness to go out and pursue more M&As with elevated deals in the space? Or would you be willing to build little cash and get the leverage, maybe down little better, maybe closer to two times?

John Mengucci
Yes. Thanks. So, I will start, and I will let Tom talk something around leverage levels. Look, M&A is always going to be a key priority for capital deployment, just beyond organic growth. And the way we look at M&A, and how it grows us, is we are a strategy-based company. So, strategy is a place where we come from. We consistently look at any gaps that we have, or any new areas of white space where we have no capability in but we believe that the government is going to spend materially over the next one, three, five, seven, nine years.

So, we did a couple of acquisitions in the March timeframe. We just came up doing three others. Still have dry powder. But where we come from on the M&A side, whether the large transformation ones or smaller ones, the acquisition is going to provide long-term strategic value. It has to fill capability gaps, or it has to come with customer relationships that we absolutely need for long-term growth. And then it needs to create shareholder value.

You mentioned something around multiples. Yes, they are somewhat elevated perhaps. What we are looking at—and we look at awful lot of books that come in here—but we also look to build relationships with companies that aren't looking to be sold today, but over time working with us, enjoy and get delighted in the fact that when they get integrated inside of CACI, the majority of them see additional growth and additional opportunities for their employees.

So, yes, I mean, we are watching some of the multiple numbers. Again, that's sort of a number that comes along after the deal is done. To our shareholders out there, we've been prudent and very focused and disciplined buyers of other properties. And again it has to drive fundamental, long-term growth of this company.

Tom Mutryn
Yes, and I will comment on both the leverage and the elevated multiples that you had referenced. When we look at acquisitions, we base our decisions—once we establish it's strategic and it's the right company—on a present value analysis. And so, the value of an enterprise is future cash

flows discounted back. We spend a lot of time trying to accurately forecast future cash flow. It's no easy task. But companies which are expected to grow materially are going to command higher prices than companies which have an anemic cash flow growth, just mathematically.

So, to a certain extent, you get what you pay for in acquisitions. And often times we would be willing to pay higher multiples, simply because the company does have materially higher growth potential, which we have identified.

In terms of leverage, 3.0 times today, we are comfortable with that. In the absence of acquisitions, we will de-lever but there are no set targets to de-lever. Everything else being equal, given today's debt capital market, we would prefer borrowing money at relatively inexpensive rates and investing in the business for long-term success via acquisitions. So, it is not a constraint for us, and we are going to utilize leverage effectively to allow us to grow shareholder value.

Ben Arnstein
Got it. Thank you.

Operator
Our next question will come from Joseph Denardi of Stifel. Please go ahead.

QUESTION ON WHETHER THE ATTEMPTED CSRA ACQUISITION INFLUENCED MANAGEMENT'S APPROACH TO M&A

Joseph DeNardi
Hi. Good morning everybody.

John, I wanted to ask the M&A question a little bit differently if I can. It was about two years ago that you guys put in a bid for CSRA that would have involved a lot of stock, and your stock has almost doubled since then. You have been able to find other transactions over that period that seem to be working for you in a smaller-ish transactions. So I am just wondering if that experience influences the way that you look at larger scale M&A—if it influences the way you think about using your stock. You know, do you want to keep doing smaller type transactions? Or are you agnostic as to size? Thank you.

John Mengucci
Yes, Joe thanks.

I think, we are focused on small niche ones. We are focused on acquisitions. They have capabilities and customer relationships that can fill a single gap. And we are focused on some, what we have been calling transformational ones—that, really, the way I see they were transformational is just an asset which fills multiple gaps with one transaction.

I am probably not going to go down the CSRA path, and we have our own views on that one. We did believe—and we still believe—that that acquisition would have helped both companies. And we believe that we would have recognized the value that we had talked about. But, unfortunately, we can't win them all.

There are a lot of companies out there today. There are folks out there paying very high multiples, as the last question mentioned. But, at the end of the day, we are going to be a disciplined spender of our cash and make certain that we are getting the best value that we absolutely can. So, it's not transformational versus small, it's really does an asset out there have a capability that we can use.

Now at the end of the day, we have now become a company that is investing far more internally to generate our own intellectual properties. So—and the way I look at acquisitions—we have a gap. I would much rather invest, if we see that gap early enough, and I can meet the timeline that our customer needs—that kind of solution. I would much rather spend R&D funds on intellectual property. On those cases where we did not see that coming and we do find gaps, we will go out there.

So, I am sort of indifferent towards small versus large. When we don't have something—we don't have an edict to do a certain dollar value worth of acquisitions each year. So it really is strategically based.

I will tell you that LGS has filled a lot of gaps on the intellectual property and some of the knowledge that they have, if we look at communications and 5G and the like. So, very, very open to all the kind of companies which are out there. And we'll continue to build upon the long history of doing successful M&As. Tom, anything you want to add?

Tom Mutryn
I'll add a follow-on comment. The ultimate kind of decision, should we buy a company or not, is will it drive long-term shareholder value? Will CACI's stock perform better with the acquisition than without the acquisition? And that is how we measure long-term shareholder value at the end of the day. And then, as consistent with my previous comments, focus on future operating cash flows associated with the acquisition. And then, once we establish a strategic fit, it is economics—how do we ultimately consummate the transaction. And, as acquisitions gets larger, we would have to rely not only on debt financing but on using our equity capital as a form of consideration. And we are very cognizant of the higher cost of capital for equity. And that goes into our calculus determining what the appropriate purchase consideration is.

QUESTIONS ON WHAT GAPS FROM THE TIME OF THE CSRA PURSUIT MAY STILL EXIST AND THE ACCEPTABLE HIGH-END OF LEVERAGE

Joseph DeNardi
Yes, and thank you for that perspective. Do the capabilities or the gaps that you had hoped that CSRA would fill, do those still exist? Do you still want to fill those? And, Tom, if you could just remind us what leverage you are comfortable getting to at a high-end with the transaction? Thank you

Tom Mutryn
Well, I'll start that. That's easy. Remember we said in the past getting to 4.5 times leverage is something that we would be comfortable doing, recognizing that we would be able to de-lever relatively quickly, given strong free cash flow performance. So, in your mind, I would think of independent 4.5-ish times maximum leverage, maybe 10 or 20 basis points thereafter. But generally that is where we feel comfortable.

John Mengucci
Yes, Joe, and on your other question, trying to shake CSRA away. At the end of the day, we were looking at doing some things in the Managed Services area. And in the past three years, since that deal has been finished, we have come up with those capabilities. We are out there winning Managed Services jobs. So we have filled that gap.

If you look at where we are on the software development front, we were sort of in that $50 to $100 million award range. Now we're at the five-year, $1.2 billion, doing Agile. We actually own the -- we are actually performing on two of the largest Agile Software programs out there. And did all that without having closed on acquisitions. I'd say that we have "healed nicely," and we are out there seeing growth in the areas that we would like to grow in. So thanks.

Joseph DeNardi
Yes. Thank you very much.

John Mengucci
You bet. Thank you.

Operator
Our next question will come from Scott Forbes of Jefferies. Please go ahead.

QUESTION ON THE FACTORS BEHIND THE MARGIN INCREASE IN THE SECOND HALF OF FY20

Scott Forbes
Hi. Good morning guys. I mean it looks like you guys have a bit of a margin ramp in the second half. And I am just wondering if there is anything to call out there in terms of products, products mix efficiencies, or any one-time items? Thanks.

Tom Mutryn
Yes. We are just guiding to 10.3% on EBITDA margins for the full year. One can do the first half calculation and it implies that the back half is higher than that. Nothing is particular to call out.

Like awards, sometimes margin performance is lumpy between quarters. If you go back over the past several quarters, you will see that we fluctuate. And some of that is timing of product deliveries, which are higher margins. Sometimes there's award or incentive fees, which are unique to a particular quarter, or other singular events which are driving that -- some expense items. So, I would not call out any specific items driving that.

Underlying across the portfolio, we are seeing positive momentum and driving higher margins, both on existing work and the new work that is ramping up that John mentioned. And probably lastly, as we get larger, we're able to take our indirect costs and spread it over a broader base, and that's productive to margins as well.

QUESTION ON THE CURRENT PROTEST ENVIRONMENT

Scott Forbes
Thanks. And then, I mean the protest environment seems to have picked up recently, just are you guys seeing any challenges coming from that or any delay of new opportunities?

John Mengucci
Yes, thanks, Scott.

No challenges. There is always an ambient level of protests going on out there. Today, we actually have two awards that were awarded to us that have been protested. There was one, back from the fourth quarter of last fiscal year, one this quarter, but nothing that gives us pause. I think our track record on sustaining awards to CACI has been quite amazing over the last few years. I would expect these outcomes to be no different.

Scott Forbes
Thanks, guys.

John Mengucci
You bet, thank you.

Operator
Our next question will come from Jon Raviv of Citi. Please go ahead.

QUESTION ON THE CURRENT COMPETITIVE BID ENVIRONMENT

Colin Canfield
Good morning guys. This is Colin Canfield on for Jon Raviv.

Following up on the protest environment, kind of talking just shifting to the bid environment, can you talk a little bit to the competitiveness of bids and how 12-to-18 months' time your competitors scaling up has impacted both the competitive bids and then also kind of the margins that flow through for the more traditional services work?

John Mengucci
Yes. Sure.

You know, we're still looking at 60% to 70% win rates on new business, so I would like the odds of when I'm spending money to take market share. Seven out of ten times, we are successful. So, I like those odds and I will continue to invest when the odds favor me to that level.

As for margins, if we look at our Expertise work versus our Technology work—sort of getting back to our 2 x 2 quadrant—it's true there are far more competitors on the Expertise side, and that does have an impact on the margins, and also the risk factors that go along with delivering talent has a slightly different risk model. We are looking to continue to grow the Expertise element of our business, even though those may be at a slightly lower margin.

If we look at the Technology side, we are looking to accelerate growth within that part of our business. And because, at the end of the day, those higher margins are going to be what we use to drive bottom line growth.

So, margins that we are seeing out there, clearly when we differentiate based on the technology and the way we're going to solve the customers' problem and our customers buy on value, which is the kind of work that we're looking for and we're continually going after larger contract versus smaller ones, which also narrow the bidding—the number of a potential bidders down—and we lay on the table our intellectual property and ways we can deliver faster than everyone else, that drives the best value decision. That also gives us a great reason to ask for higher margins, because we are investing ahead of customer need.

At the end of the day, every time we differentiate on the technology and the people of this business, we find customers wanting more of CACI versus others. And when they want more of us than everybody else, we win longer jobs that come with a higher margin that over time continues to drive bottom line growth.

QUESTION ON THE TRANSITION OF CONTRACT TYPES AND THE IMPACT ON MARGINS

Colin Canfield
Got it. Thanks for the color. And just following up on that—if we think about the timing of that transition, right, and say, for example, if you look at LGS and the fixed price transition that's going on there, can you just talk a little bit about how the timing of that transition happens in fixed price? And then maybe within the context of the aspirational, mid-teens margin.

John Mengucci
Yes. Thanks, Colin. The way we look at it is probably not by contract type but it's more by the kind of work that we've done out there and have been winning. Now, we have augmented all of our award press releases with whether it is Expertise or a Technology program, because we are trying to provide more information; allows you all to sort of model where our top- and our bottom-line growth are out there are going.

On the Technology programs—which I think its closest, Colin,to relating to some of the LGS and Mastodon firm fixed price work—those technology programs take time for facility build out. We've got to put labs in place. We have got additional material purchases. We are also working on finalizing the requirements with our customer. And that is usually a three- to six-month "delay." It's "delay in seeing material revenue from those awards." So, the more Technology work that we win, the better margins there are, but it has a longer protracted ramp-up period.

So, if you look at our backlog growing with the kind of work we won the last six to nine months, what you are seeing now are those Technology programs we won, whether they are LGS or they are core CACI, we won those in the fourth quarter of last year. And those are now starting to generate higher levels of revenue, and then margin growth.

Colin Canfield
Got it. I appreciate the color.

John Mengucci
Thanks, Colin.

Operator
Our next question will come from Matt Akers of Barclays. Please go ahead.

QUESTION ON HOW MUCH MORE DAYS SALES OUTSTANDING CAN IMPROVE

Matt Akers
Hi. Good morning guys. Thanks for the question. I want to ask about working capital. And you guys talked about the strong collection of the quarter. How much more runaway is there to go there? And how should we think about where that could go in the long run?

Tom Mutryn
Yes, so we have been doing a very good job in focusing on timely cash collections driving lower DSO. There's opportunities for continuous improvement: getting the invoices out the door quicker; working closely with the government paying agents to make sure bills are paid promptly, on time; making sure invoicing is done accurately. We have several programs, which have fairly complicated invoicing requirements, which take time for us to ensure that the invoices are 100% accurate. And if it is not, oftentimes they get rejected.

Going up stream, we are working with various contracting organizations to rethink some of those invoicing requirements. Is it really necessary for the government to have that level of detail in backup to support invoices? In often cases, in our belief, the answer is no. And we are having those dialogues to try to change the nature of those requirements in payment terms to facilitate some quicker payment processes. So, there are some opportunities to continue to drive lower DSO.

QUESTION ON THE PERFORMANCE OF THE LGS AND MASTODON ACQUISITIONS

Matt Akers
Got it. Thanks. And then, I guess, could you maybe comment just on how LGS and Mastodon are doing? You talked about, I think at the start of the year, kind of a ramp up as we go through the year on those two new acquisitions. So, just kind of an update on how that is going.

John Mengucci
Yes. Thanks, Matt.

Look, overall, extremely pleased with their performance. And as a proof point, last quarter I was talking about the beginnings of having some customer meetings where they would bring some of our core CACI technology, and we have folks from both Mastodon and LGS in those meetings. And now we are one quarter, or quarter later, and we've been getting great response and support by those customers on a couple of facts: one, of the fact that we continue to invest ahead of needs, and then also being very easy to work with. So, they can consolidate requirements that they may have done with three or four other vendors. So to sit with us and say you can take technology from LGS, and this device from Mastodon, and some of your core technology, we see a much better future for us in how we want to address some of our Mission needs. So, the reason why we bought both of those to continue to provide us a great library of technology on that front is doing well.

Financially, they are both doing well and in line with our long-term expectations, with an understanding that some of the product nature of their deliveries can result in quarter to quarter of lumpiness in speed and deliveries or in margin, as Tom mentioned earlier. But again, we are running the business on an annual basis. And over that period, we expect any lumpiness will smooth itself out.

And on the awards front, the one award that I mentioned during my prepared remarks that was rather a large LGS award that is going to support our intelligence customers.

So, whether it's what we are delivering and the customers take-up rate on what they see from CACI moving forward, given the fact that we have LGS and Mastodon, I would check that as a positive.

Financially, over the long-term, I would check that box as being very successful in their ability to come into this company, be fully integrated, and, under their leadership team, win a $475 million sole source job is sort of a nice punctuation point to how well those two assets are out there doing.

Matt Akers
Great. Thank you.

John Mengucci
You bet. Thanks.

Operator
Our next question will come from Josh Sullivan of Benchmark Company, please go ahead.

QUESTION ON HEADCOUNT GROWTH IN SMALLER AREAS WHERE CACI OPERATES

Josh Sullivan
Hi, good morning.

John Mengucci
Good morning, Josh.

Josh Sullivan
In the light of the acquisitions you just talked about there, can you also talk about the strategy to push out into some smaller tech hubs regionally? Any metrics on headcount growth in these areas? It looks like Mastodon -- I think there are some reports that might be quadrupling headcount. Any metrics that you can give us on that front?

John Mengucci
Yes, sure. So, we have mentioned a lot around something we started, probably five or six years back now, which was trying to leverage more of a dispersed workforce to get some of our technology programs and software development done. It's going extremely well. Actually, our Mastodon folks up in Rochester have doubled the number of employees. I'd like to hear that they had quadrupled—maybe you have information, Josh, and what you are sharing.

Yeah, but I am very excited because it is this model that, when we look at the background clearance processing, we look at the competition for talent in Northern Virginia area, the more technology programs we win, the less important it is that we do work outside of our customers' front gates.

So, we can move that work to many, many locations in the Rochester area, in the Sarasota area, Denver, Colorado Springs, Tampa, Florham Park. Some really great talent there.

And, you know, folks love the technology that we are delivering. They like the mission. And when we can check those two boxes, the fact that they can report to work where they want to live and raise a family works out really well for us.

We have got the infrastructure in place. And as we do more and more acquisitions, they have beachhead—and also university relationships help us as well. So the more disperse our technology workforce is, the better relationships that we are able to obtain that allows us to hire even quicker.

QUESTION ON WHETHER THE LONGER TERM CONTRACTS CACI IS WINNING IS SPECIFIC TO CACI OR A SECTOR TREND

Josh Sullivan
Got it, and I appreciate that. And just on the longer-term duration that you have seen with the contracts—do you think that is unique to CACI? Or is that a broader reality of the defense contracting in general on the IT side?

John Mengucci
Yes, I probably can't speak for everyone else within our sector, but what I can tell you is, it's the same thing I talk to my team about weekly: we're in a $220 billion addressable market. We want to drive top and bottom line growth, and we want to be driving shareholder value. So the real thing that we changed in this company was just the discipline and the focus that it takes to go shape the right deals that make sense for our customer set and for our shareholders.

So, you know, there's always been larger dollar value jobs. I tend to enjoy those more than re-winning work I won last year and next year, because every time I am spending investment dollars to re-win what I already have, that's just taking up capital. I'd much rather plow that money into new technologies and new offerings to go gather new market share.

So, I don't want to say that it's a trend in the sector, it's been a trend for us, and the fact that we are focused on longer duration, larger jobs. And everybody's patience, I mean we're actually starting to see how that actually pays off.

And back to Gavin's first question, this is a train we are not going to get off of. This model works. $5.5 billion company, $220 billion addressable market. There's plenty of things we know how to do well. And we can be very selective as to how we want to go after new business pursuits.

Tom Mutryn
Yes, and I would say, and I do not have the broad statistics across kind of the industry, but I'm pretty confident saying the longer duration is a function of the size of the awards and the differentiated capabilities within those awards. And those are two of the tenants of our business development that we put in place multiple years ago and we are seeing the fruits of that.

Josh Sullivan
Great, I appreciate that. Thank you.

Tom Mutryn
Thanks, Josh.

Operator
Our next question will come from Toby Summer of SunTrust Robinson in Humphrey, please go ahead.

QUESTION ON HOW AGENCIES WRAPPING CYBER INTELLIGENCE CAPABILITIES INTO A SINGLE CONTRACT AWARD WILL IMPACT CACI

Jasper Bibb
Hi, good morning. This is Jasper Bibb on for Toby. So, from our view, it seems that agency customers have increasingly worked to wrap cyber intelligence capabilities into a single contract award. So I was hoping you could comment on that dynamic and how that might impact CACI.

John Mengucci
Yes, sure. So, I mean there are multiple customers that are out there. And we actually assist customers in taking multiple contractual vehicles and co-adapting those into one. One, it takes less contracting power from our customer and frees them up to work on other items, and also gives our customer someone who is going to ensure that what they are looking to have delivered, gets delivered. So, if you look at our Intelligence Community customers, they are combining various contracts. We support that move. We also support helping those customers move work from an Expertise type contractual arrangement to more of a Technology one, and from a cost-plus, buying talent, to a fixed-price, delivering outcomes. We have become a very good company at delivering technology that gives the customer the outcome that they are looking for. So, we have seen that. DHS is doing somewhat of that work as well, Josh. They're out there combining contracts.

One of the largest awards that we have over the last five years was our FS/DE contract with DTRA, where the customers combined 11 or 13 different contracts. What that does for us, is allows us to have a one-on-one relationship with that customer to help them drive productivity levels higher than they would have gotten with 11 different contractors out there. And also drives, as Tom mentioned earlier, some great on-contract growth that, as our customer sees gaps within what they are out there buying, that allows us to bring more folks onboard and drive our organic growth.

QUESTION ON THE PERFORMANCE OF THE TWO MOST RECENT ACQUISITIONS

Jasper Bibb
Thanks. And then, I think we touched on LGS and Mastodon. But can you provide an update on smaller acquisitions from the last quarter?

Tom Mutryn
Yes. So we did, you know, a few—Next Century, Linndustries and Deep3. They are all performing well. Next Century was the largest one. The other two were relatively small, but important capabilities. And everything is on track for those three acquisitions to deliver what we said that we are going to deliver for in the Fiscal Year '20.

Jasper Bibb
I appreciate the details.

Operator
Our next question will come from Cai Von-Rumohr of Cowen & Company. Please go ahead.

QUESTION ON THE AGILE CONTRACT AWARD DURING THE SECOND QUARTER

Dan Flick
Hi, good morning, guys. This is Dan Flick on for Cai.

John Mengucci
Hi, Dan.

Dan Flick
So, just a few points on Agile task order from this quarter. Is it fair to assume that the ramp on that looks like you described tech should look earlier in the call? Was the full $1.1 billion included in backlog of this quarter? And should we continue to expect Agile contracts of this scale moving forward? It sounds like this was one of the larger ones that we have seen. Thanks.

John Mengucci
Yes, sure. So, yes, it is in our backlog at the $1.1 billion level. The ramp for this is very similar to both our Expertise and our Mission Technology programs. It's probably a three- to six-month ramp, which means we will see some revenue assisting us in the third quarter, little more in the fourth. But we will see clearly a more material ramp as we get into the first two quarters of next year, and then from that point and beyond. It consists of about a $225 million ceiling contract, each and every year.

I think the other part of the question is the nature of Agile software contracts and the size. Boy, I hope so. We're actually shaping customers. We have quite an extensive investment we made about four years back in Ashburn, Virginia. It is our Agile Solutions Factory, where if you picture delivering a hardware product, it is picturing a factory line. We have the same type of building layout and functional laydown for us to develop software while customers can see it. They can feel it. They can touch it. They can witness the much better metrics that are being done out there. And like any production line, once you refine it and you are delivering 99 and two 9's error free software, that drives a lot of attention.

So, what you are seeing is customers taking multiple software development applications and work that they need, and they are consolidating those and buying those from one specific contractor. And we are enthused and very pleased and very happy that we are performing on two of the government's largest. And we would expect that trend to continue.

Dan Flick
Great. Thanks.

John Mengucci
You bet.

Operator
Our next question will come from Louie DiPalma of William Blair. Please go ahead.

QUESTION ON WHAT'S BEHIND CACI'S SUCCESS IN WINNING THE LARGER CONTRACTS

Louie Dipalma
Good morning, John and team.

John Mengucci
Good morning.

Louie Dipalma
What has been your secret sauce that has enabled you to move upmarket and win these larger billion-dollar deals? Is it a function of how you have always been strong at software development and these large software development programs didn't previously exist? These mostly are not take-away wins? Right

John Mengucci
Correct. So, you know, a part of it is focused three to four years back as to what gaps do we have and how do we fill those. And then once we have those gaps filled, our business development and our line leadership team do an outstanding job with shaping customers. And so what we mean by shaping is not directing customers what they buy and how they buy. What it really is is them being able to come to a CACI location, or through numerous meetings, showing the customers the art of the possible. So, not just telling what we have today, but here is the augmentation, the investments we are willing to make to help you get your mission solved.

So, a lot of it is an intentional investment and intentional meetings that really drive the customer to not just buy what they believe they need, but actually buy the outcome. When a customer buys an outcome that they have seen from us, we're able to differentiate.

We have been using that term a lot during this call, because it truly matters. If we can differentiate on the technology side and deliver faster, better, cheaper, then my customers are not so focused on did I make 8% in a cost-plus model, or 12% in a fixed-price model. They are actually focused on getting something that they absolutely need.

So, you know, this didn't start overnight. We looked at some larger transformational acquisitions two years back to give us this capability sooner. Those did not go the way we wanted them to. But, you know, we then go to the next arrow in our quiver, which is, let us internally invest. And those investments are out there paying off.

So, we like to believe that the trend of our customers is going to be buying more of these larger scale jobs. But at the end of the day, we build and we make our own successes. And the more we stay disciplined and focused on how we win larger, more profitable business, the better off we'll be. And, you know, as I mentioned earlier, this train isn't going to stop anytime soon.

Tom Mutryn
Yes. And I'll add to that. John, in your prepared remarks, you talked about having a company with good character and culture. I mean it really starts with that—starts with a strong vision of

where we want to go. Everyone's rowing in the same direction. And then you get the people, processes, and technology. So it's very, highly talented and motivated people throughout the organization with some consistent processes, which gives us confidence that we have the right building blocks in place for that success.

QUESTION ON WHAT CACI NEEDS TO DO TO EXPAND ITS SIGNALS INTELLIGENCE CAPABILITIES

Louie Dipalma
Okay. On this topic of differentiation via M&A versus internal investments—you guys are obviously one of the leading providers of signals intelligence and electronic warfare sensors. Two other sensor providers over the past several years, Raytheon and FLIR, acquired drone platforms to vertically integrate their sensor capabilities. And Leidos recently acquired a key position in Gremlins. Do you feel that you need to own, or internally develop, a drone platform in order to further expand your signals intelligence capabilities?

John Mengucci
Yes, thanks, Louie. We are very careful and very focused on where we see the market going. We have been very vocal around it's our intention to be a platform provider. That's another step. Right now, it's a step too far. We think that there are companies out there that build outstanding platforms. They know how to bend metal. And some of large aerospace and defense companies, one that I am an alumni of, they do an outstanding job there. But we are really looking at Mission package as part of where all these platforms go.

If we look at the outlook, at the outcomes and the capabilities that our customers need, it is not so much they need more platforms. What they need is an ability to have a single way to find a new signal out on the battlefield, and have that reverse engineered in a manner that we cannot only detect it but we can understand how to mitigate around that signal or communicate to it. So, we believe that the far longer-term, larger dollars are in the Technology packages that ride on those platforms.

So, when a new signal comes up, I don't need a new drone capability. What I need is a new algorithm in a shared manner and this -- both our DOD and our Intel customers are really looking for shared work from multiple vendors that could help them address these needs.

So, we believe in the signals intelligence, electronic warfare, RS spectrum world that changes so dynamically, so that a digital footprint is not going to be solved with better and faster and more elegant platforms. It is going to be solved with processing power that are on those platforms, and the algorithms and the ability, and the amazing people we have within this company, core CACI, when we picked up with LGS and with Mastodon are some of the nation's leading folks on understanding signals. And how quickly can we turn around a solution to a signal, it's giving our warfighter issues. We actually believe that is where the sweet spot is. And that is where we will stay parked for some time. And so the ability to build a platform to us is not where, at the end of the day, greatest growth is coming from.

Louie Dipalma
Thanks for the color.

John Mengucci
Yes, thanks, Louie.

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

QUESTION ON THE FUTURE GROWTH OF DEFENSE SPENDING AND HOW CACI MANAGEMENT SEES IT

Joseph DeNardi
Thanks, thank you very much. Tom, I think there's a question you get asked from time-to-time. But there is a narrative out there that the topline defense budget growth is slowing, and that should translate into slower growth for your business. It doesn't seem like that number that -- the topline number really factors much into how you view your addressable market. As you look at your market as a whole in the next few years, do you see trends slowing or not?

Tom Mutryn
Yes, so we bid in a $220 billion addressable market. It is very robust. The areas that we are focused on—Mission capability, Enterprise capabilities—are swim lanes which have faster currents—probably mixing my metaphors here—which are sweet spots. And given that, we do not see the foreseeable federal defense budget, or civilian budget, to be an impediment for us to realize our goals of increasing the organic revenue and increasing margins simultaneously. We feel we are very well-positioned providing any services and technologies in a dangerous world. Our Technology solutions that John just alluded to, play key role in those areas.

Joseph Denardi
Thank you.

Operator
Again, if you have a question, please press star (*) then one (1). Our next question is also a follow-up from Gavin Parsons of Goldman Sachs. Please go ahead.

QUESTION ON HOW MUCH OF THE CURRENT BIDS OUTSTANDING CONTAIN LGS CAPABILITY AND WHERE MANAGEMENT BELIEVES IT WILL BE IN ONE YEAR

Gavin Parsons
Hi. Thanks for squeezing me in. Just a quick one to follow up on Matt's question earlier. What percent of your current outstanding kind of submitted bids include some form of LGS capability? And where do you think that will be a year from now? Thanks.

John Mengucci
Gavin, I don't have that number on the tip of my tongue. What I would tell you is that, clearly, it's involved in less today than it will be involved in more tomorrow. I'm sure you can treat it as a follow-up question to get that kind of genius response. But LGS came with a really nice book of business. They continue to perform on those. I think over the coming quarters, as we see our customers build requirements that are really pulling on the strengths of core CACI technology, the Mastodon devices and the intelligence algorithms that LGS provides, that they will be part and parcel to a larger percentage of our awards out there. To the extent that we are looking at the signal's intel, electronic warfare, anything in the electronic domain, I would expect to see both

LGS and Mastodon play more prominent roles.

Gavin Parsons
Thanks again.

John Mengucci
Yes.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to John Mengucci for any closing remarks. Please go ahead.

CEO CLOSING REMARKS

John Mengucci
Well thanks, Chuck, and thank you for your help on today's call. We would like to thank everyone who dialed and/or listened to the webcast for their participation. We know that many of you will have follow-up questions and Tom Mutryn, Dan Leckburg and George Price are available to take your call after today's call. This concludes our call. Thank you, and everyone have a great day.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

END