CACI INTERNATIONAL INC
First Quarter FY18 Conference Call

PRESENTATION

Operator
Ladies and gentlemen, thank you for standing by. Welcome to the CACI International Q1 FY18 Earnings Conference Call. Today's call is being recorded. At this time, all lines are in a listen-only mode. Later we will announce the opportunity for questions and instructions will be given at that time.

If you should need assistance during the call, please press star (*), zero (0) and someone will help you. A special reminder to our media guests who are listening. Please remember that during the question-and-answer portion of the call we are only taking questions from the analysts. 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 Allison, 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 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 our discussion this morning, here's Ken Asbury, President and Chief Executive Officer of CACI International. Ken?

CEO OVERVIEW

Ken Asbury
Well thank you, Dave and good morning everyone. Thanks for joining us to discuss Fiscal Year 2018 first quarter results. With me this morning are John Mengucci, our Chief Operating Officer; Tom Mutryn, our Chief Financial Officer; DeEtte Gray, our President of US Operations; and Mr. Greg Bradford, President of CACI Limited, who is joining us from the United Kingdom.

Last night we released our first quarter results for FYcal year 2018. We also raised net income and earnings per share guidance. This morning I will provide you an update on the quarter results and some strategic positioning, Tom is going to give you details on the financials, and John will cover the operational aspects of the first quarter.

Let's turn to Slide 4 in the deck, please. I'll start with a quick overview. Operations delivered right in line with our revenue and profit plan for first quarter, generating positive organic revenue growth for the third consecutive quarter, and getting our FY18 plans started in excellent shape. Our net income and earnings per share benefitted from a tax reduction associated with share-based compensation accounting, which Tom is going to elaborate on in just a moment. As a result, we raised our net income and EPS guidance accounting for this benefit. We also continue to track record strong cash flow, generating $80 million of operating cash in the quarter.

Turning to contract awards, we won $1.2 billion in the quarter, which, at first, appears significantly lower than what we have done in previous years. A key factor to this quarter was that there were a number of short-term recompete bridges, which contributed fractional value to our total awards in the quarter, despite being incredibly positive for us in terms of our outlook for the year. John will have more to say on that in just a moment.

That said, we won a material amount of new business, at the 60% level of our overall awards. I really like the quality of the bids and solutions that we submitted this quarter. There were a couple outcomes which I would have loved to have seen go our way but, all in all, I think we had a really solid start to first quarter that puts us in a great place.

Our strategy will continue. To bid larger, bid less, and win more has been very successful the last two years with full-year book-to-bills of 1.4 times in both '16 and FY17. The strategy also returned the company to organic growth and built a significant backlog. I'm confident our strategy will continue to serve us well as we execute our high-quality pipeline within a large but increasingly larger addressable market.

Let's turn to Slide 5. Current indicators are that we will probably have, and I emphasize probably, a fully appropriated government Fiscal 2018 budget in place before year-end 2017. There has been movement on both the House and Senate side but authorization and appropriation bills have yet to be passed. If enacted, the current budget numbers will drive increased defense, intelligence, and homeland security spending, which will be positive for CACI, our industry, and, particularly, our country.

In closing, our strategy is working. We continue to win new business and execute with quality and value. We are pursuing larger contracts with a particular emphasis on solution content, and we are investing in growth initiatives across our 12 market areas. CACI will also continue to be a strategic consolidator through our M&A program as we deploy capital for growth.

All of this gives me confidence in our continued success and our ability to achieve our long-term financial goals of organic revenue growth 1%-to-4% better than our addressable market in addition to expanding our margins by 10 to 30 basis points annually.

Now I'm going to turn it over to Tom to take you through the details of the financials. Tom?

FINANCIAL OVERVIEW

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

Our first quarter revenue was $1.09 million, 1.2% greater than the first quarter of last year with 1.1% organic growth. Net income for the quarter was $42 million, up 15% driven by tax benefits related to equity-based compensation. Our adjusted net income, which excludes several non-cash expenses, was $56.7 million for the quarter, 35% greater than our GAAP net income.

Operating income in the quarter was down a bit. Gross margin dollars increased but indirect expenses grew modestly at 1.5% driven by spending related to various growth initiatives and investment in systems to drive future efficiencies.

Let me discuss the mechanics of the tax benefit in the quarter. A significant portion of executive compensation is tied to our equity, to align compensation with shareholder interests. In FY16, we adopted an accounting rule related to share-based payments. Previously, differences between the value of tax deductions from when share-based compensation was initially recorded and when the awards vest were treated as balance sheet adjustments. The new guidance specifies that the differences flow through the income statement. Restricted stock units are typically granted annually in the September quarter, and vest at the ends of years 3 and 4. Given the material increase in our stock price, the units that vested this September generated significantly higher tax deductions than initially recorded. This resulted is an approximately $6 million of tax savings, all of which is reflected in this quarter's effective rate.

Slide 7 please. We generated $80 million of operating cash flow in the quarter with days sales outstanding at 64 days, up from 59 days at the end of June, due to typical fluctuations in collections. Accounts payable also increased due to normal payment timing.

Operating cash flow grew 38% compared to last year and it was almost 190% of our net income. In the absence of compelling acquisitions, we have been using our cash flow to retire debt. Net debt at the end of September was $1.1 billion. And our net debt to trailing 12 month EBITDA leverage ratio is now at 3.0 times, down from 3.9 times following the NSS acquisition.

Slide 8 please. And lastly, as Ken mentioned, we're raising our upper and lower net income guidance range by $6 billion to reflect the equity-based compensation tax benefit with corresponding increases to the earnings per share range. We now expect our full-year effective tax rate to be 34.5%, and we are on track to realize our annual organic growth and margin expansion goals, which Ken articulated.

With that, here is John to provide operational highlights.

OPERATIONS OVERVIEW

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

Operations delivered revenue and profit right in line with our plan for the first quarter. We had several notable accomplishments and continued to invest in strategic growth areas. We delivered positive organic revenue growth, our backlog remains healthy, and our forward indicators confirm our market-based strategy is working.

During the quarter, we continued to deliver on our contracts with quality, value, and high customer satisfaction. Positive organic revenue growth was driven by the new business we won in Fiscal Year '17, and we continue to invest in strategic growth initiatives to better position us for the future. For example, we're investing in new sophisticated and highly differentiated electronic warfare capabilities. We are also incubating other innovative approaches to address emerging threats and new customer requirements. Efforts like these are an important accelerator of future solutions and market differentiation.

We won $1.2 billion in contract awards this quarter. As Ken noted, we saw a material amount of recompete contracts bridged rather than awarded in the quarter. While this contributes positively to the continuity of our business, it resulted in lower award volume than we expected. In fact, only 40% of our contract awards in the quarter were recompetes. We would have expected at least 60% if not for the bridges.

New business awards in the quarter were quite strong at about $720 million. We also added a number of IDIQ contracts that we do not include in our awards or backlog, but which will be very important to our future growth. One example is a $480 million contract to develop and integrate technologies for the US Army night vision and electronic systems directorate.

Slide 10, please. Looking at the rest of fiscal 2018, our forward indicators remain very positive. Backlog stands at $11.1 billion, which provides more than two years' worth of revenue on a trailing 12-month basis. Our revenue composition now stands at 89% existing business, 7% recompete, and 4% new business to CACI. This profile is consistent with prior fiscal years following our first quarter results.

And our pipeline of opportunities remains very robust. Submitted bids pending award stand at $6.5 billion, with 72% of those for new business to CACI. We expect to submit another $12.9 billion over the next two quarters with 83% of that new business to CACI.

In closing, we remain focused on executing our market-based strategy. We will continue to pursue large bids in our addressable market 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 comments this morning.

Let's all turn it to Slide 11 in the package please. Before we take questions this morning, I'd like to take a moment to discuss the hurricanes that impacted Texas, Florida, Puerto Rico, and the US Virgin Islands. Our thoughts and prayers go out to everybody who has suffered from these natural events. We hope for a quick recovery, and we are thankful to all the first responders who gave so selflessly during this time. CACI had more than 1000 employees across these various storms that were impacted by these events, and we're incredibly happy to be able to report that all of them are safe.

A special thank you goes out to those employees who, with their own homes damaged and their families displaced, worked long and hard to bring our customer mission capabilities back on line immediately after the storms passed. These folks demonstrated outstanding character and commitment to our customers, our mission, our company, and our country. At the same time, our employees here that weren't impacted volunteered their time, contributed to various recovery organizations, and donated a significant amount of annual leave to help the other employees that were impacted. The response was incredible and made me incredibly proud to be part of the CACI team. I thank you all for your selfless dedication.

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

Operator
(Operator instructions for Q&A).

Our first question will come from Cai von Rumohr with Cowan and Company. Please go ahead.

QUESTION ON DIRECT COSTS AND THE TREND LINE FOR FY18

Cai von Rumohr
Thank you very much. So, in the first quarter, your direct labor was down 4%, ODCs were up 6 %. Maybe you can help us understand what kind of pattern those two items are going to have in terms of year-over-year growth over the remainder of the year?

John Mengucci
Yes, Cai, thanks. This is John.

So it's true that our direct labor, which means our headcount, did decline a bit due to a number of factors. You know, first it's the result of a couple recompete losses that we had last year, and a continued delay of an intel services program that we won. We've survived a couple of protests, and we find ourselves sitting in the middle of our third protest on it. Second, the delay of a major EIT program. I believe we spoke about that during our FY18 guidance call. We continue to see that move into the third quarter.

And then, you know, we have other contracts, which based on the phase they're in. They're running with a little bit more subcontract effort than we'll see over the life of those contracts. JIDO would be one in particular. But that initial startup phase relies on subcontracts, all of which are part of our win strategy.

So the long-term optimal growth of those types of programs in direct labor really outweigh some of the short-term subcontracting items. The bottom line is we're comfortable with where we're at, and I'm sure that Ken will share some views regarding how we're—what we're doing to attract the right talent.

Ken Asbury
Yes Cai, this is Ken. Good morning. You know, adding talent to CACI is incredibly important to delivering value to our customers, and a couple things that we've done differently this year to assure that we're able to do that. I think our full-year plan for FY18 had direct labor and ODCs up about 2 points each. So we're a little bit off in the first quarter, and John just explained what that is. I think we're going to continue to see fluctuations in ODCs as things go on around the world. Our concentration right now in on direct labor. One of the things we did institute this year is 20% of each one of our leaders incentive compensation is based on meeting direct labor goals that they put in place for the year.

So we recognize that we're in a very tight labor market and, in some cases, a very tight labor market that needs clearances. So what I've spent a great deal of time doing is we've formed a industry group amongst all of the mid-tier government services CEOs. And we've spent quite a bit of time on The Hill discussing the issue of why does it take so long to get a security clearance through the process and why are there so many rules and regulations? And to be frank, I believe that we're having an impact on that, which will benefit the entirety of the industry, not just CACI.

Finally, one of the investments that we've talked about it in efficiencies a couple of years ago, we went from, you know, being a company that built all of our own CHRM management systems and we've adopted Workday. We just completed our second phase, which is Workday Recruiting, which we believe will make a more efficient opportunity for us to attract and retain people in this marketplace.

QUESTION ON THE FORECASTED INCREASE OF DIRECT LABOR AND OTHER DIRECT COSTS IN FY18

Cai von Rumohr
A quick followup. You mentioned that the plan was two points in DL and ODCs for the year. It looks like—that looks a bit aggressive. Is it realistic that both of them can be up, you know, a slight bit, like 1% or so?

Tom Mutryn
Yes, so Cai, this is Tom. As Ken mentioned, the primary focus is on DL. It's more predictable, more in our control—wins with staffing, you get the DL. And given the forecast that we do on a monthly basis, we're comfortable with the 2% DL growth. ODCs, if they grow more than 2%, that's okay. A lot of it is episodic. Ken mentioned the unpredictability of some of the material purchases, some activity to support larger fixed-price contracts. So, we're convinced, or comfortable with the 2% DL growth, ODC at least 2%, but if higher, so be it.

Cai von Rumohr
Thank you.

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

QUESTION WHAT IS DRIVING THE INCREASE IN CONTRACT BRIDGING ACTIVITY AND IN WHAT AREAS IT IS OCCURRING

Jon Raviv
Hi, good morning. Thanks for taking the question. Can you just give some perspective on what's driving some of this customer behavior with the bridging activities? And are you seeing it more in defense or in civil? And how do you see that resolving itself, or not?

John Mengucci
Yes, Jon, this is John. I mean, it's true. We have seen some material increases in the bridge and some of our delayed recompete programs. You know, some are with agencies that are frankly in the midst of major reorganizations, and it's clear that those are directly related to what we would call administrative delays. In addition, on our OCONUS, high OPTEMPO programs, which is really in our intel services market, we are seeing customers bridge and postpone some of our larger recompetes.

I mean, now clearly those customers are not looking for a break in the services we provided them in the middle of prosecuting some really important missions. And our intel services folks, frankly, are very much relevant to the data analytics and the intel work critical to that fight.

So you know what I would tell you, Jon, is that the delta in recompete awards during the flush period was about $500 million, and that impacts our award numbers. But as a reminder, it's not related to revenue because we're simply remaining under contract to continue our delivery. We're very pleased to say that, through the first quarter, we've continued to achieve greater than 90% win rate on all of our recompetes.

QUESTION ON WHAT GIVES MANAGEMENT THE CONFIDENCE THAT THE MARGIN IMPROVEMENT GOAL WILL BE ATTAINED IN FY18

Jon Raviv
Got it. And then a quick follow-up on the margin. You guys referenced some of the efficiency initiatives that you have ongoing—investing in growth. Some of those sorts of items tend to be sticky. In addition, you've highlighted some of the programs that are running at perhaps lower margin levels. So what gives you the confidence, or the visibility, into improving off of fiscal 1Q's EBITDA margin, which is down year-on-year, to achieving year-on-year margin growth on a full-year basis?

Tom Mutryn
Yes, so I'll start it off Jon. If I look at the top of the income statement—the DL/ODC mix is driving gross margin, the gross margin percentage. That, in turn, drives EBITDA margin. That, in turn, drives operating margin. So if we have a richer DL mix, or grow DL, that's going to flow down the balance sheet [income statement].

So the answer we had on direct labor is in effect the same answer on margin. We have spent some indirect expense to support some growth initiatives and efficiency initiatives. In the grand scheme of things, it's not large, material amounts—$2 to $3 million—but worthy enough to comment upon.

Indirect expense for the quarter was up 1.5%, somewhat modest considering that year-over-year there is inflationary pressures—employees get annual increases, lease expenses increase, and the like. So, we're controlling the expenses. We're able to make some incremental investments. But the major margin focus is to drive DL. Greater program performance, larger programs, fixed-price solution content are going to be higher margin programs, which flow down the P&L.

John Mengucci
Yes, Jon, you also mentioned about where some of those investments were. You know, we're--as this world continues to change, so does our need to invest. And beyond the need, it's the timing. And the timing today is, you know, slightly different than the timing we may have laid out in June when we put forward our FY18 plan.

We're investing in protection against cyber threats, against, that will protect critical platforms and data links. Our machine learning, data analytics, we're looking at bringing in just amazing amounts of ISR data from airborne and space-based sensor, and training machines as to how to do some of the preliminary intel analyst work. We mentioned in the past electronic warfare and the need for the current and future fights.

You know, those are just a few. And I have to tell you, those align very well to real solutions that we provide today. We're going to continue to invest in those for long-term growth in those growing domains. And unfortunately, at times, the timing of those investments, I mean, they don't fit neatly into a quarterly plan. However, we do remain confident these investments are very critical to our long-term growth, while at the same time being extremely vigilant to the financial plans that we put forward.

Operator
Our next question will come from Krishna Sinha with Vertical Research Partners. Please go ahead.

QUESTION ON THE TREND LINE FOR MARGINS FOR THE REMAINDER OF FY18

Krishna Sinha
Hi, thanks for taking my question. Um, so last quarter you talked about three margin tailwinds and you highlighted: one was the higher direct labor on consolidation contracts. Obviously you just talked about that. The other two were some contracts converting from cost plus to fixed price. And then, of course, you had 20 basis points of long-term incentive payments that happened in the third quarter last year that are not, and a building charge, I believe. And both of those things are not expected to repeat again this year.

So if take those three pieces and I compare that to your 10 bps-to-30 bps of margin improvement that you've laid out in your long-term guidance, you get 20 basis points already from just not having the long-term incentive payments and the building charge not recur. And then based on what you're telling me about higher direct labor and contracts converting from cost plus to fixed price, it sounds like you have significant lever to the upside on your margins. So, can you just run through the moving pieces there and what you're expecting through the year on margins and maybe what the trend is going be in the next three quarters?

Tom Mutryn
Yes, Krishna, I'll take the first stab at it in terms of some of the numbers. And maybe Ken or John will want to articulate it. You're absolutely right. Last year we had some one-time charges: LTIP, building expenses, which were helpful moving into FY18 in terms of year-over-year comparisons. We did guide to 10-to-30 basis point margin improvement, and we're sticking to that guidance.

The factors—the knobs are the DL. Let's grow DL. Let's grow more profitable programs—fixed-price programs—and that will drive margin. We've also had some products, which are higher margin. John, in a previous call, has talked about SkyTracker, which is, it appears to be a significant demand for those types of solutions that we're driving. So, I think that will allow us to get a higher margin throughout the year.

And I will point out that this year, for the last year, we still have award fees impacting our quarterly numbers. The second and the fourth quarter are very high with regard to award fees; first and third are lower. And so, that's always a factor when I look at one particular quarter. Again, with the new revenue standard in FY19 we will smooth award fees during the periods of performance.

QUESTION ON THE HOW MUCH IN AWARDS IS NEEDED TO FILL THE GAP OF SUNSETTING PROGRAMS

Krishna Sinha
Okay. And then just one follow-up on your revenues. So, you talked earlier—I think someone made the comment that you're still winning 90% plus of your recompetes. Can you give us the other two portions of that? So how many—how much of your revenues this year are just going to naturally sunset? And then how much new awards do you need to win in order to fill the gap? So you have recompetes, you know, naturally sun-setting awards, and then new awards. So can you just give us those three pieces of the revenue bridge?

John Mengucci
Yes, sure Krishna. This is John. I think, I believe during our FY18 guidance call we shared that coming into the year about $0.5 billion of revenue would come to a natural program lifecycle end. I guess what I'll do is I'll answer this in terms of book-to-bill, because that's a—seems to be a leading indicator that everyone watches.

If we figure $500 million out of our $4.3 or $4.4 billion is going to naturally sunset, that's about 12% for FY18. If you apply about 25% of our new, of our awards, our recompetes, a 1.3 or 1.4 book-to-bill ratio pretty much keeps us flat, if not slight organic growth. And that's right in line where we see our trends working out through all of FY18. Now it is true that we've had a lot of recompetes bridge. That makes that level easier for us to achieve, and I think we also shared 89% of our revenue is existing today. So, beyond what the first quarter appears to be financially, numerically, we are absolutely on track to achieve our FY18 financial goals.

Operator
Our next question will come from Ben Klieve of Noble Capital Markets. Please go ahead.

QUESTION ON WHETHER THE AMOUNT OF BRIDGING OF CONTRACTS IS A ONE QUARTER EVENT OR THE BEGINNING OF A TREND

Ben Klieve

All right. Thank you. Just one quick question regarding recompete bridges here. Do you have a sense that what you saw this quarter from agencies with administrative challenges is going to continue into the near term? Or do you see these agencies kind of evolving such that you believe this will largely be a first-quarter event with things kind of moving towards business as usual now?

Ken Asbury
Hi Ben, this is Ken. I think on some of the ones that we were referring to as reorganizations—and there are two in particular in the intelligence community that we believe some of these impacts emanate from—I think that's going to be a little bit longer term. Not all of the bridges have been of uniform duration. A couple of them have been full-year. A couple of them have been six months. And then we've seen several that are even shorter term, just maybe to buy them some time to get it done. So there's no uniformity around that.

I would suggest, though, that the idea of their reorganization will take somewhat longer. So maybe we won't see an impact of the same magnitude as we saw in first quarter. But we're more than likely to see a little bit more bridging. Bridging's become a very common behavior. It's the first time we've seen it at this level.

The other component that I believe is going to be persistent for a long time is on contracts where we are—I'm not sure how to say it—we are critical mission providers, particularly in the intelligence services arena. Some of those contracts could be extended just in perpetuity because nobody wants to take the time to try to disrupt the operational rhythm of those contracts. So it's hard to predict.

When we were sitting here putting our plan together last May and June, we saw a little bit of this. But we didn't anticipate it at the level that we saw first quarter. You know, good news is we still have the work. The better news is we're performing well on all these contracts that we might have been recompeting. And it's going to build for a bigger future at some point in time when they decide to recompete.

Ben Klieve
Very good, Ken. Thanks so much. I appreciate the call.

Operator
Our next question will come from Sheila Kahyaoglu of Jefferies. Please go ahead.

QUESTION ON HOW THE BIDS TO BE SUBMITTED OVER THE NEXT SIX MONTHS MAY AFFECT MARGINS

Sheila Kahyaoglu
Hi, good morning. Thanks for taking my questions. So just on the broader line of questioning around margins and profitability, you do have a big pipeline of bids coming up. And I think you mentioned $12.9 billion with 83% towards new business. How does that sort of impact margins?

Ken Asbury
Well ultimately there's a mix in each one of those. We don't look at each for the margin profile. The general strategy of our business these days is to do more solutions than services. But if there's not a solutions' contract available in the particular market area that a business leader is pursuing at that period of time, then they're going to look at the higher end of those services.

Ultimately, what we really would like to do is replace—we'd like to have a business that is responsive to our customers' needs. So there's going to be a mix of things that may continue to have some elements of pass-through contracting, such as the R23G program, where they do a lot of that, or S3 in the past.

But on the other hand, we'd much rather go after the consolidation of Air Force satellite control network, which we did a few years ago. That had a couple things that were interesting. It took three large elements of a very important set of engineering and sustained engineering tasks, put them together, and you did it on a fixed-price basis. So, you get to control your performance. It's, over time, will be driving to a much higher margin. That's the kind of business that we see in our portfolio. And the more we get in our portfolio over time of that kind of business, that's what's going to support our 10-to-30 basis points above the addressable market, which is our goal for margin improvement.

Sheila Kahyaoglu
So I guess for the remainder of 2018, when we think about new business impact or contract mix, does that improve throughout the year?

Tom Mutryn
Yes, so for the remainder of '18, when we looked at the composition of revenue, 4% of the revenue for the rest of the year is new business. And let's assume for a minute that the new business has higher margins. The mathematics are such that it's not going to have a material impact on it. The margin improvements are going to fundamentally—it's the increasing direct labor that we're expecting on both existing and recompete activities.

John Mengucci
Yes, Sheila, I might also add that if we look at the bids to be submitted over the next six months, as Ken and both Tom mentioned, it's all about mix plus timing, right? So, if we were to look at the mix of professional services and managed services and solution bids, it's about one-third, one-third, one-third as we look out another six-to-12 months, which is a slightly better mix than what we're experiencing now.

Ken Asbury
And Sheila, let me just add, as we ask our business development teams to go out there and look, what I'm really interested in is bigger, fewer, more complex jobs that we believe will deliver higher margin. If you bring something that's just bigger and has no margin—really not interested in pursuing that kind of business. There may be others in the industry that want that, but that's not going to deliver the plans for this business over time.

On the other hand, we are looking to build on our product side. And that's where we talked about investing in electronic warfare, in some of the machine learning on that. We have some very small but very powerful programs going on right now that we believe that we could expand. It's very similar to what we did with SkyTracker. We were doing a core mission related to foreign intelligence, signals intelligence, and now we've converted that now to a completely different derivative, anti-drone product that many people are buying. So, there's going to be part of us that are innovation, but the whole business will be moving, I mean, really product and, I would say, outcome focused, which will change the nature of our discussion about DL and ODC.

But, in general, we really want to be in the parts of the business that are going to be more enduring, such as the work that we're doing with IPPS Army. And there's a whole series of modernization activities going on in the various services. We have a great position on IPPS Army today. We've performed incredibly well, and we think that's a reference for where we go in the future with that. So, that's just a little bit of a cross look at some of the things we're doing in the company, and I hope it gives you a better idea of what we're attempting to do.

Sheila Kahyaoglu
Great. Thank you. That's very helpful.

Operator
Our next question will come from Brian Kinstlinger of Maxim Group. Please go ahead.

QUESTION ON CACI'S SUCCESS RATE ON RECENT $500 MILLION PLUS OPPORTUNITIES BEING PURSUED

Brian Kinstlinger
Great. Thanks so much. Last quarter you mentioned you had five-to-seven deals submitted worth about $500 million or more. And from your comments, it sounds like some of those bids didn't go your way—at least I assume that. So maybe can you talk about the success rate on these large deals, and if there was any common feedback from the customers?

Ken Asbury
Yes Brian, this is Ken. We did, and we weren't as successful as we would have liked to have been on some of them. And, you know, as we look at the forensics of each one of them, we had a couple of them where we actually outpointed the incumbent contractors. But it probably wasn't enough for the customer to take the risk to be able to do it. And so, it was sort of a close but no cigar. And another one we submitted a superior proposal and the customer kind of went bottom feeding, and took somebody that was marginally qualified but had a much lower cost. So, we'll learn from those. But if I go back a year ago, we put a bunch of those into our—we put CAMMO in place; we put JIDO in place. So we're going to continue to try to win those kinds of jobs.

I will tell you it's harder. And I don't think our 30%-to-50% capture rate is going to be the same. So were looking at how we balance the portfolio of those bids. I think we're probably in a pretty good place. If you look at how we started this year, we're directly on plan, based on two really fulsome years of basically almost 1.4—1.5 book-to-bills. The last couple years have built up a lot of—with a lot of that new—built up a lot of momentum. And so, first quarter is sort of representative of that.

QUESTION ON WHETHER THERE ARE STILL LARGE OPPORTUNITIES IN CACI'S BID PIPELINE

Brian Kinstlinger
Okay. And I assume, in my follow-up, there's still a handful of large-type deals in the pipeline? Or were they all awarded in the quarter?

Ken Asbury
No, there's still some in the pipeline. There were, probably the biggest one was the, and I don't even think it was this quarter, was it? It was the SOF GLSS one that we had talked about that

was, you know, truly a game changer. And we put up a good fight but that was one of those where, you know, you really had to be spectacular, and I think we were close to it but not enough to compel the customer to be able to switch. But would I do it again? Yes. Yeah, I'd take it on again. Different circumstances, different people making decisions, we might have had, you know, a different outcome. That being said, I will say about that procurement, it was probably one of the best run procurements I have seen in government contracting in a long time. So it was a pleasure to see that. I hope we see more like that.

Brian Kinstlinger
Great. Thanks so much.

Operator
Our next question will come from Tobey Sommer of SunTrust. Please go ahead.

QUESTIONS ON HOW MUCH OF THE NEW AWARDS WAS TAKEAWAY WORK AND IF THERE WERE ANY IMPENDING ACCOUNTING CHANGES

Tobey Sommer
Thank you. In a follow-up question on your pipeline commentary, with 83% of it being new, how much of that would represent takeaways versus new-new work? And then, could you comment if there are any accounting changes on the horizon to think about, including in particular kind of guidance on book-to-bill calculations? Thanks.

Ken Asbury
We've never done a book-to-bill calculation, have we? So, I don't think you'll see any change in guidance.

Tobey Sommer
Contract awards, I should say. Thanks.

Ken Asbury
Okay. Tom, you want to take…

Tom Mutryn
Yes, I think there were two questions, one in terms of accounting changes as we move into FY18 and '19 we will have to adjust to the new revenue recognition standards, primarily impacting the treatment of award fees. There are some other minor issues for us. The following year, there will be new guidance associated with government lease accounting, which we will adopt in 2020.

In terms of the way we're describing funding and awards, definition of what's new and recompete, backlog, cleaning up the backlog—I do not anticipate any changes. I think we have a very well-defined set of rules and principles. We're applying them on a consistent basis. So, I do not anticipate any changes there.

Ken Asbury
Yes, Tobey, and those, go ahead, Tobey.

QUESTION ON WHETHER THERE ARE ANY ACCOUNTING CHANGES FOR THE

TREATMENT OF OTHER DIRECT COSTS

Tobey Sommer
Well, on the revenue recognition, is there any change to the treatment of pass-through revenues? Or is that going to remain consistent under the new guidelines?

Tom Mutryn
That will remain consistent under the new guidelines.

Tobey Sommer
Thank you very much.

Operator
Our next question will come from Josh Sullivan of Seaport Global. Please go ahead.

QUESTION ON WHETHER CACI IS CONTINUING TO WIN LONGER DURATION CONTRACTS AND IN ANY SPECIFIC MARKET AREA

Adam Friedman
Hi guys. This is actually Adam Friedman on for Josh. Thank you for taking my question. Are you guys continuing to win longer duration contracts and can you point to any areas of particular strength there?

Ken Asbury
I think that in general the industry's moved back towards a five-year sort of program base. When we first got into the Budget Control Act—and nobody knew where the money was coming from and how or when it was going to come, and all of that—we saw some pretty silly short-duration contracts being put in place. But we seem to be on the other side of those. A couple that we've competed for recently have been in the eight-year realm. And there's a couple more that are in the pipeline that are maybe even 10.

So, we are seeing things where, particularly on the enterprise side, where you're coming in and you're basically delivering the infrastructure for a customer. Those contracts tend to be longer, which is great, because maybe you have a cash outlay at the beginning. And, over time, it becomes reasonably profitable activity once you get your operations down. So, I think, in general where we see opportunities to go after longer-duration things—I'm not sure I want to go after long-duration professional services jobs, because there's a different level of competition.

What I do want to do is go after jobs that require you to have a differentiated approach to be able to do it. And frankly, we're able to assess the risk of being able to do that over a period of time and hopefully deliver above average profit as a result.

QUESTION ON THE PERCENTAGE OF CACI'S REVENUE FROM ITS TEN LARGEST CUSTOMERS AND EXPECTED CHANGE OVER TIME

Adam Friedman
Okay, great. And then, in the past, you guys have sort of broken this out. But what percentage of your revenue are you generating from your top 10 customers and how do you see that sort of changing over the next few quarters or years?

Tom Mutryn
I'm not sure if we break that out. Part of that is the definition of a customer. I mean, we do show Department of Defense, Civilian Agency. We do break it down to Army, Navy sometimes. John, do you have something out there?

John Mengucci
Yes, you know, the way I'd answer that, looking at current year, Adam, we like to talk about things in terms of markets. If you looked at our Business Systems market, our Intel Systems and Support market, those are large markets for us. I'd also tell you that in the Intel Services, Enterprise IT area, three out of those four areas were actually driven, one by the Six3 acquisition and, second, by the L-3 acquisition, because we expected the Federal government would be having a higher level of spend there. So those four-to-five markets drive a—I guess I'd say a larger percentage of our FY18 revenue.

Adam Friedman
Okay, great. Thanks for your help, guys.

Operator
Our next question will come from Brian Ruttenbur with Drexel Hamilton. Please go ahead.

QUESTION ON FUTURE MERGER AND ACQUISITION ACTIVITY

Brian Ruttenbur
Yes. A couple questions. First of all, now that you are fully integrated, I assume, with all the L-3 issues from that acquisition, what are your plans going forward? Do you see another potential transformational acquisition on the horizon?

You guys have already gotten beat up a lot on the bidding activity, so I thought I'd take my foot off the pedal on that one and talk a little bit about what's going on in terms of M&A.

Ken Asbury
Brian, thank you. You're very kind this morning. Look we're a strategic integrator. We've done 67 acquisitions. I will tell you that if I could find another L-3—because that turned out to be such a wonderful addition to our team and it was very good financially, and it put us in some really, really key markets—then we would have already done it. But we're active, were looking. We spent a little bit of time in the first quarter looking at a couple of different properties. It turned out we didn't think that they were the correct fit.

We are finicky about the kind of things that we want to add. Today, our bias is towards adding technological solutions, particularly in a number of the areas that John referred to. We are very strong in digital signal processing today. Additions to that would be helpful.

We picked up quite a bit of work in machine learning and in data analytics. That's going to be an area that we think is going to—you know, we had our asymmetric threat conference last week and while I'm not going to get into—it's a non-attribution meeting—but I will tell you the two fundamental themes that came out of it on the part of our uniformed military folks, and what they were concerned about, all the commanders, was what do we do with all the data we've got, how do we turn that into speed of decision making. And, you know, in fact, I've been saying internally we're no longer a government IT business, we're a business that helps our customers make decisions faster.

So that's where we're going to be. As far as a transformational one, that's just going to depend. We are very active in looking. The market is okay. There has been some properties that have come up. There has been some issues with valuation. People believe they're worth more than they are. And so we're going to make sure that we do the proper thing in evaluating them. But most importantly, it's got to be what they add in terms of capability or customer exposure and their financials have to fit.

And I would say the final one is cultural. We've come across a couple companies that were really cool, but we didn't see a way that they would really fit with us. So it's not worth—there's some things that are just not worth trying to do. And, so that's that.

QUESTION ON MANAGEMENT'S OPINION OF THE DXC ROLLUP

Brian Ruttenbur
Okay. And then just as a followup real quick, on your opinion and positioning versus a DXC with a Vencore, KeyPoint rollup, I guess you would call it to put together those three. Are you directly competing against that entity, that new combined entity? I guess it won't be for another quarter or two. And what's your opinion on that?

Ken Asbury
Well, Mac Curtis is a good friend. He'll do a good job with it. But in terms of commenting on where I see them, we do compete with them. And we also team with them.

So, you know, in this world were all "competimates" in one way, shape, or form, to be able to deliver into the requirements that the Federal Government has. So I think that we directly—the KeyPoint part is a competitor for our OPM work. On the other hand, maybe some of the DXC, I'm not as familiar with that, but I believe that's enterprise IT, so yeah, I think that generally is. But in the core business, that was Vencore before. We were doing quite a bit of teaming and we'd spent some time talking.

So, I'm sure just the very nature of Mac and myself, we'll continue to look for places to continue to do that. And if we have to slug it out, we'll slug it out. But I welcome them to the market. There's an awful lot of work in this market, an awful lot of important things that need to be done. I think they'll do a good job.

Brian Ruttenbur
Thank you.

Operator
Our next question will come from Justin Donati with Wells Fargo Securities. Please go ahead.

QUESTION ON THE MARGIN PROFILE OF SOME OF THE BRIDGED CONTRACTS

Justin Donati
Hi. Thanks for taking my question as I fill in for Ed here. Can you shed some more color on the margin profile of some of those bridge contracts? Wondering if they're higher and if that creates kind of a natural headwind as those start to blow off?

John Mengucci
Yes, Justin. There are some of these clearly as the government looks for potentially, in some areas, better pricing, by this recompete nature, perhaps. But I think Ken also mentioned earlier, you know, we're being very cautious on making sure that this company's only differentiator is not just price, okay? Which is why we're looking to move and get ourselves into more highly differentiated markets, more managed services, as Ken mentioned earlier, as well as solutions work.

You know, the only thing that we're watching—someone asked earlier around the mix of cost plus and firm fixed-price work. There's a couple of these recompetes that we've actually put forward to do more of that work in a firm fixed-price manner versus a traditional kind of material or cost-plus manner. So that would help us on some of the margins. But I'm sure if I looked at all the details, there's a few that are going to be price-driven. So overall, you know, net-net, I don't see that being a deterrent nor a large positive based on timing of those recompete awards.

Ken Asbury
And, Justin, I would say what we're looking for is the pockets of product and product development that are very relevant that we believe will sustain higher margins. It's not going to be a huge volume, but it is going to be disproportionally accretive to the bottom line, just simply because they're unique, we can sell them for a price that is reasonable but we can build them for a whole lot less. And so, that's never going to be 50% of our business. It's just not who we are, but we are reaching a level where it will be impactful. Those sorts of innovations will be impactful.

QUESTION ON WHERE MANAGEMENT BELIEVES REVENUE GROWTH WILL COME FROM IN FY18

Justin Donati
Got it. And then just as a follow-up to Josh's question earlier about your customers. Can you kind of break out where you see your revenue growth coming from this year so you're 1%-to-4% above market target? Is most of that going to come from the Defense segment? Do you see the Civilian agencies getting back to flat growth for the year?

John Mengucci
Yes, Justin, this is John. We like to look at that in terms of markets. Like we said in the past, Business Systems, Enterprise IT, Intel Services, and Intel Systems and Support would be those four markets that would drive the larger share of our growth as we have it in our '18 plan.

Justin Donati
Okay. Thank you.

Operator
Our next question will come from Cai von Rumohr of Cowen and Company. Please go ahead.

QUESTION ON THE GROWTH OF DIRECT LABOR TO MEET FY18 DIRECT LABOR GUIDANCE

Cai von Rumohr
Yes, thank you very much. So, Tom, your direct labor was down 4% in the first quarter and normally, you know, the December quarter with vacations is kind of close to the first quarter or a little lower. And yet you've said you're still looking at 2% for the year. By my math, that implies by the fourth quarter you have to be going up 5%-to-7% and it looks like to get to that sort of a pattern you really have to have sequential growth in direct labor over the next three quarters. Is that correct?

Tom Mutryn
Yes. So I'm not going to correct your math. We give annual guidance, not quarterly guidance. But mathematically, if we expect a 2% increase for the full year and the first quarter were down 4%, we have to have increases on average in quarters two, three, and four.

You mention seasonality. There is some seasonality. There is more vacations in our first quarter—July, August vacations versus the second quarter—which is impacted a little bit by Thanksgiving and Christmas. But the big driver is getting to our staffing levels. Some of the new business kicks in. Some of the new activities ramp up. And so those are all the factors that go into it. But directionally, we need to grow labor to hit those targets.

Cai von Rumohr
Thank you.

Ken Asbury
You know, Cai, this is Ken. I also think that there's going to be a point in time where we're going to have to factor in how the solution content of our business, which really has a different labor profile, particularly if you're doing solution development. We've got to figure out how to explain that better, because it's just not a straight—it's not like we need 100 intel analysts to do such and such. The profile is going to be very different and it's probably going to have an impact on how we discuss direct labor goals versus ODC goals and the like. So, we'll work on that to make that better as time goes on.

Cai von Rumohr
Thank you.

Operator
Our next question will come from Joseph Vafi of Loop Capital. Please go ahead.

QUESTION ON THE TYPE OF GROWTH MANAGEMENT SEES GOING FORWARD

Joseph Vafi
Hi guys, good morning. Just kind of looking across the sector and the landscape of deal activity and M&A. It does seem like there's a bit of a shift going on towards what I call more pure or commercial-centric, commercial-like IT services work, cloud—the cloud internet-type of demand activity. And a lot is coming out of the civilian side of the business. I was wondering what your commentary is, or views, on that type of growth moving forward versus what we may perhaps call some of the more classic C4ISR work that CACI and peers have focused on over the last say five

or seven years? Thanks.

Ken Asbury
Yes, Joe, I think your observation is a good one. I think what we see in that part, from a next generation IT point of view—frankly, that was one of the primary reasons why we bought the L-3 business a little over a year ago. They had some pretty good offerings in that arena. They had an installed base, particularly in the early adopters, of the folks that were adopting cloud and a lot of those things in the intelligence community. So it gave us some very, very good references for doing that kind of work.

In the meantime, what we've done—there's a couple ways to do it. We've seen a couple companies out there that have been for sale for doing it. But what we also found was just related to cloud and AWS and Azure development. We started investing in our people to get the certifications to be able to do that. And I think we're north of 400 people that are highly certified for being able to do this and assist other people to do it. So we haven't seen the absolute.

You know, there was a basis of that in L-3, but when we started making that available—and we're starting to do it for a whole bunch of other things now just inside the company—we think it's having a really good advantage on retention. And were expanding in the skill space that really customers are looking for. There has been a slow rate of adoption for this. I mean, there's still government customers out there who don't think the cloud is secure or this, that, or the other thing. And so I think there's a market there for quite some time.

At the same time, you know, that's one aspect of the Enterprise IT market. As I answered one of the questions earlier, what you do with the data that comes out of the cloud is probably even more important. Just think of the cloud as storage and the ability to do virtualization in a sense. But what you do with all that data that you've stored is, I think, an even better value proposition. And so companies that have that kind of capability would be of interest to us from an acquisition point of view.

Joseph Vafi
Thanks very much.

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

QUESTIONS ON CAPITAL EXPENDITURE GUIDANCE AND MARGIN GROWTH FOR THE REMAINDER OF FY18

Jon Raviv
Hi, thanks for taking the followup. Just a quick clarification. Capex guidance is unchanged for the year?

Ken Asbury
That is correct.

Jon Raviv
Okay. And then on margin. Not to beat the dead horse but just trying to understand the cadence for how margins pick up over the rest of the year. Again, EBIT margins down in the first quarter

on a year-on-year basis. Should we expect more of the same in the second quarter? Are there some more investments you have planned? Or should we start to see that margin expansion starting in the next quarter? Just trying to get a sense of when we see that margin growth to get that kind of 30 for the year.

Tom Mutryn
Yes. So, in terms of absolute margins in the first and fourth quarter, we have more award fees. So we expect those—excuse me, the second and fourth will be—margin, you know, higher than average. And so we expect to see those increases. I don't have the numbers here, how they do versus last year's quarterly margin. So, we can have a follow-up later on, Jon.

Jon Raviv
All right. Thank you.

Operator
Once again, ladies and gentlemen, if you'd like to ask a question please press star (*), then one (1).

Showing no further questions, this will conclude our question-and-answer session.

I would like to turn the conference back over to Ken Asbury for any closing remarks.

CEO CONCLUDING REMARKS

Ken Asbury
Well, thank you, Allison, and thanks for your help today on the call. We would like to thank everybody who logged on to the webcast for their participation as well.

We know many of you will have followup questions. Tom Mutryn, Dave Dragics, and Dan Leckburg are available for calls throughout the day and into tomorrow. So this concludes our call. Thank you for your interest in CACI and have a very good day.

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

End