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Science Applications International Corp
Form 10-Q
September 01, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 31, 2015

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission	Exact Name of Registrant as Specified in its Charter,	State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification No.
File Number	Address of Principal Executive Offices and Telephone Number	Delaware	46-1932921
001-35832	Science Applications International Corporation 1710 SAIC Drive, McLean, Virginia 22102 703-676-6942		

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares issued and outstanding of the registrant's common stock as of August 21, 2015 was as follows:

46,030,058 shares of common stock (\$.0001 par value per share)

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

FORM 10-Q

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

CONDENSED AND CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended		Six Months Ended	
	July 31,	August 1,	July 31,	August 1,
	2015	2014	2015	2014
	(in millions, except per share amounts)			
Revenues	\$1,089	\$ 939	\$2,087	\$1,901
Revenues performed by former Parent (Note 1)	10	13	21	28
Total revenues	1,099	952	2,108	1,929
Cost of revenues	976	858	1,888	1,739
Cost of revenues performed by former Parent (Note 1)	10	13	21	28
Total cost of revenues	986	871	1,909	1,767
Selling, general and administrative expenses	49	22	75	44
Acquisition and integration costs (Note 3)	12	-	15	-
Operating income	52	59	109	118
Interest expense	13	4	17	9
Income before income taxes	39	55	92	109
Provision for income taxes (Note 6)	(17)	(21)	(37)	(41)
Net income	\$22	\$ 34	\$55	\$68
Other comprehensive (loss) income, net of tax (Note 9)	(1)	-	1	1
Comprehensive income	\$21	\$ 34	\$56	\$69
Earnings per share (Note 2):				
Basic	\$0.48	\$ 0.72	\$1.20	\$1.42
Diluted	\$0.46	\$ 0.70	\$1.15	\$1.38
Cash dividends declared and paid per share	\$0.31	\$ 0.28	\$0.59	\$0.56

See accompanying notes to condensed and consolidated financial statements.

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

CONDENSED AND CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	July 31,	January 30,
	2015	2015
	(in millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 163	\$ 301
Receivables, net	666	544
Inventory, prepaid expenses and other current assets	122	97
Total current assets	951	942
Goodwill	860	379
Intangible assets, net (Note 4)	246	2
Property, plant, and equipment (net of accumulated depreciation of \$104 million and \$106 million at July 31, 2015 and January 30, 2015, respectively)	75	59
Other assets	26	13
Total assets	\$2,158	\$ 1,395
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 399	\$ 365
Accrued payroll and employee benefits	189	155
Long-term debt, current portion (Note 7)	71	31
Other current liabilities	24	25
Total current liabilities	683	576
Long-term debt, net of current portion (Note 7)	1,053	455
Other long-term liabilities	38	19
Commitments and contingencies (Note 11)		
Equity:		
Common stock, \$.0001 par value, 1 billion shares authorized, 46 million shares issued and outstanding as of July 31, 2015 and January 30, 2015	-	-
Additional paid-in capital	246	234
Retained earnings	142	116
Accumulated other comprehensive loss (Note 9)	(4)	(5)
Total equity	384	345
Total liabilities and equity	\$2,158	\$ 1,395

See accompanying notes to condensed and consolidated financial statements.

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SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

CONDENSED AND CONSOLIDATED STATEMENT OF EQUITY

(UNAUDITED)

	Shares of	Additional paid-in stock (in millions)	Retained earnings	Accumulated other comprehensive loss	Total
Balance at January 30, 2015	46	\$ 234	\$ 116	\$ (5)	\$345
Net income	-	-	55	-	55
Issuances of stock	-	5	-	-	5
Other comprehensive income, net of tax (Note 9)	-	-	-	1	1
Cash dividends of \$0.59 per share	-	-	(29)	-	(29)
Stock-based compensation	-	7	-	-	7
Income tax benefits from stock-based compensation	-	8	-	-	8
Repurchases of stock	-	(8)	-	-	(8)
Balance at July 31, 2015	46	\$ 246	\$ 142	\$ (4)	\$384

See accompanying notes to condensed and consolidated financial statements.

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

CONDENSED AND CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended	
	July 31,	August 1,
	2015	2014
	(in millions)	
Cash flows from operating activities:		
Net income	\$55	\$ 68
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	24	10
Deferred income taxes	-	1
Stock-based compensation expense	17	18
Excess tax benefits from stock-based compensation	(8)	(2)
Increase (decrease) resulting from changes in operating assets and liabilities net of the effect of the acquisition:		
Receivables	(36)	(18)
Inventory, prepaid expenses and other current assets	(3)	27
Other assets	1	-
Accounts payable and accrued liabilities	(2)	(11)
Accrued payroll and employee benefits	1	5
Other long-term liabilities	1	1
Total cash flows provided by operating activities	50	99
Cash flows from investing activities:		
Cash paid for acquisition, net of cash acquired	(764)	-
Change in restricted cash	(17)	-
Expenditures for property, plant and equipment	(6)	(10)
Total cash flows used in investing activities	(787)	(10)
Cash flows from financing activities:		
Proceeds from borrowings	670	-
Dividend payments to stockholders	(28)	(27)
Principal payments on borrowings	(16)	-
Issuances of stock	2	1
Stock repurchased and retired or withheld for taxes on equity awards	(18)	(72)
Excess tax benefits from stock-based compensation	8	2
Disbursements for obligations assumed from Scitor acquisition	(2)	-
Deferred financing costs	(17)	-
Total cash flows provided by (used in) financing activities	599	(96)
Total decrease in cash and cash equivalents	(138)	(7)
Cash and cash equivalents at beginning of period	301	254
Cash and cash equivalents at end of period	\$163	\$ 247

See accompanying notes to condensed and consolidated financial statements.

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SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1—Business Overview and Summary of Significant Accounting Policies:

Overview

Description of Business. Science Applications International Corporation (collectively, with its consolidated subsidiaries, the “Company”) is a leading provider of technical, engineering and enterprise information technology (IT) services primarily to the U.S. government. The Company provides systems engineering and integration services for large, complex projects and offers a broad range of services with a targeted emphasis on higher-end, differentiated technology services. Each of the Company’s operating segments is focused on providing the Company’s comprehensive technical and enterprise IT service offerings to its respective customer base. The Company’s operating segments have been aggregated into one reporting segment for financial reporting purposes.

Acquisition of Scitor Holdings, Inc. On May 4, 2015, the Company acquired 100% of privately held Scitor Holdings, Inc. (Scitor), a leading provider of technical services primarily to the intelligence community. As discussed in Note 3, the Company funded the transaction from increased borrowings and cash on hand.

Separation from Former Parent. The Company commenced its operations on September 27, 2013 (the Distribution Date) following completion of a tax-free spin-off transaction from its former parent company, Leidos Holdings, Inc. (formerly SAIC, Inc., collectively with its consolidated subsidiaries, “former Parent”). In the spin-off transaction, former Parent’s technical, engineering and enterprise IT services business was separated (the “separation”) into an independent, publicly traded company named Science Applications International Corporation (formerly SAIC Gemini, Inc.).

Principles of Consolidation and Basis of Presentation

The accompanying financial information has been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission for interim reporting purposes. References to “financial statements” refer to the condensed and consolidated financial statements of the Company, which include the statements of income and comprehensive income, balance sheets, statement of equity and statements of cash flows. These financial statements were prepared in accordance with U.S. generally accepted accounting principles (GAAP). All intercompany transactions and account balances within the Company have been eliminated. The financial statements are unaudited, but in the opinion of management include all adjustments, which consist of normal recurring adjustments, necessary for a fair presentation thereof. The results reported in these financial statements are not necessarily indicative of results that may be expected for the entire year and should be read in conjunction with the information contained in the Company’s Annual Report on Form 10-K for the year ended January 30, 2015.

Revenues and Cost of Revenues Performed by Former Parent

As a part of former Parent, the Company entered into contracts jointly with former Parent and continues to be a party to contracts jointly performed by former Parent and the Company following the separation. These transactions are recorded at revenue equal to cost to reflect that no additional profit is charged to the customer for work performed by former Parent and are presented separately in the condensed and consolidated statements of income and comprehensive income.

Use of Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Management evaluates these estimates and assumptions on an ongoing basis, including those related to allowances for doubtful accounts; depreciation and amortization; leases; inventories; income taxes; estimated profitability of long-term contracts; bonus and other incentive compensation; stock-based compensation expense; fair value of financial instruments; accrued liabilities; contingencies and litigation; and the fair value of assets and liabilities recorded in connection with business combinations (goodwill and other intangible assets, asset valuation allowances and impairments, among others). Estimates have been prepared by management on the basis of the most current and best available information at the time of estimation and actual results could differ from those estimates.

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Changes in estimates of revenues, cost of revenues or profits related to contracts accounted for using the cost-to-cost percentage-of-completion method of accounting are recognized in operating income in the period in which such changes are made for the inception-to-date effect of the changes. If it is determined that a loss will result from the performance of a contract, the entire amount of the estimable future loss is charged against income in the period the loss is identified. Changes in these estimates can routinely occur over the contract performance period for a variety of reasons, including changes in contract scope, changes in contract cost estimates due to unanticipated cost growth or reassessments of risks impacting costs, changes in estimated incentive or award fees, and performance being better or worse than previously estimated. Aggregate changes in contract estimates increased operating income by \$7 million (\$0.08 per diluted share) and \$8 million (\$0.10 per diluted share) for the three and six months ended July 31, 2015, respectively, and increased operating income by \$2 million (\$0.03 per diluted share) and \$5 million (\$0.06 per diluted share) for the three and six months ended August 1, 2014, respectively.

Reporting Periods

The Company utilizes a 52/53 week fiscal year ending on the Friday closest to January 31, with fiscal quarters typically consisting of 13 weeks. Fiscal 2015 began on February 1, 2014 and ended on January 30, 2015, while fiscal 2016 began on January 31, 2015 and ends on January 29, 2016. The second quarter of fiscal 2015 ended on August 1, 2014, while the second quarter of fiscal 2016 ended on July 31, 2015.

Cash and Cash Equivalents

Cash equivalents are comprised of cash in banks and highly liquid instruments, primarily consisting of investments in institutional money market funds which invest primarily in short-term debt securities. The Company does not invest in high yield or high risk securities. The cash in bank accounts at times may exceed federally insured limits.

Restricted Cash

Restricted cash consists of cash on deposit in rabbi trusts that are contractually restricted from use in operations, but are subject to future claims of creditors. At July 31, 2015, \$11 million of restricted cash was held in rabbi trust accounts restricted to fund future payment obligations through April 2017 assumed in connection with the acquisition of Scitor, of which \$5 million is presented in other assets and \$6 million in inventory, prepaid expenses and other current assets in the condensed and consolidated balance sheets. In addition, \$6 million of restricted cash is held in rabbi trusts to fund obligations in connection with deferred compensation plans, and is included in other assets on the condensed and consolidated balance sheets.

Operating Cycle

The Company's operating cycle for long-term contracts may be greater than one year and is measured by the average time intervening between the inception and the completion of those contracts. Contract-related assets and liabilities are classified as current assets and current liabilities.

Derivative Instruments Designated as Cash Flow Hedges

Derivative instruments are recorded on the condensed and consolidated balance sheets at fair value. Unrealized gains and losses on derivatives designated as cash flow hedges are reported in other comprehensive (loss) income and reclassified to earnings in a manner that matches the timing of the earnings impact of the hedged transactions. The ineffective portion of all hedges, if any, is recognized immediately in earnings.

The Company's fixed interest rate swaps are considered over-the-counter derivatives, and fair value is calculated using a standard pricing model for interest rate swaps with contractual terms for maturities, amortization and interest rates. Level 2, or market observable inputs such as yield and credit curves, are used within the standard pricing models in order to determine fair value. The fair value is an estimate of the amount that the Company would pay or receive as of a measurement date if the agreements were transferred to a third party or canceled. See Note 8 for further discussion on the Company's derivative instruments designated as cash flow hedges.

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SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Accounting Standards Updates

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in Accounting Standards Codification (ASC) Section 605, Revenue Recognition and some cost guidance included in ASC Subtopic 605-35, Revenue Recognition – Construction-Type and Production-Type Contracts. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. The ASU was originally scheduled to become effective for the Company beginning in the first quarter of fiscal 2018, using one of two retrospective methods of adoption. In July 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which resulted in a one-year deferral of the effective date of the ASU to December 15, 2017, with an option to early adopt the standard on the original effective date. Early adoption prior to the original effective date is not permitted. The Company has not selected a method for adoption nor determined the potential effects on its financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest – Imputation of Interest (Subtopic 835-30) – Simplifying the Presentation of Debt Issuance Costs. ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented as a direct deduction from the carrying amount of the related debt liability, consistent with the presentation of debt discounts. Prior to the issuance of ASU 2015-03, debt issuance costs were required to be presented as deferred assets, separate from the related debt liability. ASU 2015-03 does not change the recognition and measurement requirements for debt issuance costs. The Company early adopted ASU 2015-03 as of the end of the second quarter of fiscal 2016, and applied its provisions retrospectively. This resulted in reclassification of \$1 million of the current portion of unamortized debt issuance costs related to the Company's Term Loan Facility from inventory, prepaid expenses and other current assets to the current portion of long-term debt, and \$2 million of the non-current portion of unamortized debt issuance costs from other assets to long-term debt, net of current portion, within the condensed and consolidated balance sheets as of January 30, 2015. Other than this reclassification, the adoption of ASU 2015-03 did not have an impact on the Company's condensed and consolidated financial statements.

Other Accounting Standards Updates effective after July 31, 2015 are not expected to have a material effect on the Company's financial statements.

Note 2—Earnings Per Share (EPS):

Basic EPS is computed by dividing net income by the basic weighted-average number of shares outstanding. Diluted EPS is computed similarly to basic EPS, except the weighted-average number of shares outstanding is increased to include the dilutive effect of outstanding stock options and other stock-based awards.

A reconciliation of the weighted-average number of shares outstanding used to compute basic and diluted EPS was:

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	Three Months Ended		Six Months Ended	
	July 31,	August 1,	July 31,	August 1,
	2015	2014	2015	2014
	(in millions)			
Basic weighted-average number of shares outstanding	46.0	47.5	45.9	47.8
Dilutive common share equivalents - stock options and other stock-based awards	1.6	1.4	1.7	1.4
Diluted weighted-average number of shares outstanding	47.6	48.9	47.6	49.2

The following stock-based awards were excluded from the weighted-average number of shares outstanding used to compute diluted EPS:

	Three Months Ended		Six Months Ended	
	July 31,	August 1,	July 31,	August 1,
	2015	2014	2015	2014
	(in millions)			
Antidilutive stock options excluded	0.3	0.6	0.3	0.7

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SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 3—Scitor Acquisition:

On May 4, 2015 the Company completed the acquisition of Scitor, a leading global provider of technical services to the U.S. intelligence community and other U.S. government customers. The acquisition was funded from cash on hand and, as discussed in Note 7, proceeds from additional debt incurred during the quarter.

This strategic acquisition enables the Company to gain access to new customers primarily in the intelligence community, and leverage capabilities of the combined company to better serve the Company's customers. The acquisition increases the Company's employees by approximately 1,500, many of whom hold security clearances necessary to perform work on classified contracts.

Purchase consideration paid to acquire Scitor was \$764 million (net of cash acquired), including \$43 million which was deposited to escrow accounts pending final determination of the working capital adjustment and to secure the sellers' indemnification obligations. Any remaining amount in escrow at the end of the indemnification period will be distributed to the sellers. The working capital adjustment was finalized in August 2015 and \$3 million of the amount deposited to escrow was released to the sellers.

The purchase price has been allocated among assets acquired and liabilities assumed at fair value based on information currently available, with the excess purchase price recorded as goodwill. The Company's allocation of the purchase price is subject to change on receipt of additional information, including, but not limited to, the finalization of intangible asset valuations and the Company's review of Scitor's government accounting practices that could potentially result in the recognition of additional liabilities on Scitor's opening balance sheet and an adjustment to goodwill. The Company expects to have sufficient information available to resolve these items by the first quarter of fiscal 2017. The Company has recorded purchase accounting entries on a preliminary basis as follows:

	(in millions)
Cash and cash equivalents	\$ 39
Accounts receivable	86
Deferred income taxes, current	6
Prepaid and other current assets	7
Deferred income taxes, non-current	4
Equipment and leasehold improvements	21
Intangible assets	255
Goodwill	481
Other noncurrent assets	1
Total assets acquired	900
Accounts payable and accrued liabilities	44
Accrued payroll and employee benefits	35
Other noncurrent liabilities	18

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Total liabilities assumed	97
Net assets acquired	\$ 803
Amount of tax deductible goodwill	\$ 136

As discussed in Note 6, the Company inherited Scitor's historical tax basis in deductible goodwill, certain other intangible assets, and net operating loss carryforwards.

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The intangible assets included above consist of the following:

	Amount (in millions)	Weighted-Average Amortization Period (in years)
Backlog	\$ 14	1
Trade name	9	2
Customer relationships	232	12
Total intangible assets	\$ 255	11

The backlog intangible asset is comprised solely of funded backlog as of the acquisition date. The customer relationships intangible asset consists of unfunded backlog as of the acquisition date and estimated future renewals. The backlog and customer relationships intangible assets were valued using the excess earnings method (income approach) in which the value is derived from an estimation of the after-tax cash flows specifically attributable to backlog and customer relationships. The analysis included assumptions for projections of revenues and expenses, contributory asset charges, discount rates, and a tax amortization benefit.

The trade name intangible asset was valued using the relief from royalty method (income approach) in which the value is derived by estimation of the after-tax royalty savings attributable to owning the assets. Assumptions in this analysis included projections of revenues, royalty rates representing costs avoided due to ownership of the assets, discount rates, and a tax amortization benefit.

The Company incurred \$33 million in acquisition-related costs, including \$17 million of deferred financing fees that will be amortized to interest expense using the interest method. Acquisition-related expenses were \$8 million and \$10 million for the three and six months ended July 31, 2015, and are included in acquisition and integration costs on the condensed and consolidated statements of income and comprehensive income. \$1 million of acquisition-related expenses were incurred in the fourth quarter of fiscal 2015. For the three and six months ended July 31, 2015, the Company also incurred \$4 million and \$5 million, respectively, of costs in connection with the integration of Scitor, primarily for strategic consulting services, vacant space reserves, severance costs, and other integration-related costs.

The amount of Scitor's revenue included in the condensed and consolidated statements of income and comprehensive income for the three and six months ended July 31, 2015 was \$147 million and the amount of net income included in the condensed and consolidated statements of income and comprehensive income for the three and six months ended July 31, 2015 was \$2 million.

The following unaudited pro forma financial information presents the combined results of operations for Scitor and the Company for the three and six months ended July 31, 2015 and August 1, 2014, respectively:

Three Months Ended		Six Months Ended	
July	August	July	August
31,	1,	31,	1,

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	2015	2014	2015	2014
	(in millions, except per share amounts)			
Total revenues	\$1,099	\$1,108	\$2,256	\$2,237
Net income	\$32	\$23	\$68	\$52
Earnings per share:				
Basic	\$0.70	\$0.48	\$1.48	\$1.09
Diluted	\$0.67	\$0.47	\$1.43	\$1.06

The unaudited pro forma combined financial information presented above has been prepared from historical financial statements that have been adjusted to give effect to the acquisition of Scitor as though it had occurred on February 1, 2014. They include adjustments for intangible asset amortization; interest expense and debt issuance costs on long-term debt; acquisition, integration, and other transaction costs; and the elimination of intercompany revenue and costs.

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 4—Goodwill and Intangible Assets:

Goodwill

Goodwill had a carrying value of \$860 million and \$379 million as of July 31, 2015 and January 30, 2015, respectively. Goodwill increased by \$481 million during the three months ended July 31, 2015 due to the acquisition of Scitor. There were no impairments of goodwill during the periods presented.

Intangible Assets

Intangible assets, all of which were finite-lived, consisted of the following:

	July 31, 2015			January 30, 2015		
	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
	(in millions)					
Intangible assets:						
Customer relationships	\$ 242	\$ (13)	\$ 229	\$ 10	\$ (8)	\$ 2
Trade name	9	(1)	8	-	-	-
Backlog	14	(5)	9	-	-	-
Software technology	25	(25)	-	25	(25)	-
Total intangible assets	\$ 290	\$ (44)	\$ 246	\$ 35	\$ (33)	\$ 2

Amortization expense related to intangible assets was \$11 million and \$11 million for the three and six months ended July 31, 2015, respectively, and zero and \$1 million for the three and six months ended August 1, 2014, respectively. There were no intangible asset impairment losses during the periods presented.

The estimated annual amortization expense related to intangible assets as of July 31, 2015 was as follows:

Fiscal Year Ending	Total (in millions)
Remainder of 2016	\$ 22
2017	26
2018	20
2019	20
2020	20
2021 and thereafter	138
Total	\$ 246

Actual amortization expense in future periods could differ from these estimates as a result of future acquisitions, divestitures, impairments and other factors.

Note 5—Stock-Based Compensation:

Stock Options

During the six months ended July 31, 2015, the Company granted certain employees 0.3 million stock options with a weighted-average exercise price and weighted-average grant date fair value of \$52.18 and \$11.76, respectively. These options will expire on the seventh anniversary of the grant date and will vest ratably on each anniversary of the grant date over a three-year period.

Restricted Stock Units (RSUs)

During the six months ended July 31, 2015, the Company granted certain employees 0.5 million RSUs with a weighted-average grant date fair value of \$51.98, which will vest ratably on each anniversary of the grant date over a four-year period.

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Performance Shares

During the six months ended July 31, 2015, the Company granted to certain employees 0.1 million performance share awards with a grant date fair value of \$52.11 per award. These awards will cliff vest on the third anniversary of the grant date, subject to meeting the minimum service requirements and the achievement of certain annual and cumulative financial metrics of the Company's performance, with the number of shares ultimately issued, if any, ranging up to 150% of the performance share awards granted.

Note 6—Income Taxes:

As of July 31, 2015, the Company has evaluated its tax positions and determined that it does not have a liability for any uncertain tax positions. The tax authorities, however, may determine that the Company owes additional taxes upon review of the Company's tax filings.

Provision for income taxes as a percentage of income before income taxes was 43.4% and 40.3% for the three and six months ended July 31, 2015, respectively, and 37.3% and 37.6% for the three and six months ended August 1, 2014, respectively. Tax rates for the three and six months ended July 31, 2015 were higher than for the three and six months ended August 1, 2014 primarily due to non-deductible transaction costs to acquire Scitor and lower permanent tax benefits for fiscal 2016. Tax rates for the period ended July 31, 2015 were higher than the combined federal and state statutory rates due to non-deductible transaction costs to acquire Scitor and lower permanent book versus tax differences, such as the manufacturer's deduction. The Company had \$14 million in prepaid taxes as of July 31, 2015 that are included in inventory, prepaid expenses and other current assets on the condensed and consolidated balance sheet. There were no prepaid taxes as of January 30, 2015.

On May 4, 2015, the Company acquired all of Scitor's stock in a transaction taxable to the selling shareholders. The Company inherited Scitor's historical tax basis in deductible goodwill, certain other intangible assets, and operating loss carryforwards. The tax deductible goodwill is \$136 million and the tax deductible identified intangible assets are \$163 million. The Company inherited a federal and state net operating loss of \$89 million subject to Internal Revenue Service Section 382 limitations. The Company expects to utilize these losses over the next 7-8 years.

Note 7—Debt Obligations:

The Company's long-term debt as of the periods presented was as follows:

July 31, 2015			January 30, 2015		
Stated interest rate	Effective interest rate	Unamortized Debt Issuance Costs	Unamortized Debt Issuance Costs	Net	Net
rate	rate	Principal	Principal		
		(in millions)			
2.94%	3.11%	\$574	\$ (3)	\$571	\$489
					\$ (3)
					\$486

Term loan A facility due September 2018												
Term loan B facility due May 2022	3.75%	4.26%	569	(16)	)	553	-	-	-			
Total long-term debt			\$1,143	\$	(19)	)	\$1,124	\$489	\$	(3)	)	\$486
Less current portion			75	(4)	)	71	32	(1)	)	31		
Total long-term debt, net of current portion			\$1,068	\$	(15)	)	\$1,053	\$457	\$	(2)	)	\$455

As of July 31, 2015, the Company has a \$1.3 billion credit facility (the Credit Facility) between the Company, as borrower, and Citibank, N.A. (Citibank), as administrative agent, which consists of a \$200 million secured revolving credit facility (the Revolving Credit Facility), a \$574 million secured term facility (Term Loan A Facility), and a \$569 million secured term facility (Term Loan B Facility) (together, the Term Loan Facilities). The Revolving Credit Facility capacity is available to the Company through September 2018, but no draws have been made. Borrowings under the Revolving Credit Facility must be repaid in full by September 2018.

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The Term Loan A Facility was funded in September 2013 in an initial aggregate principal amount of \$500 million (Initial Term Loan A Facility). In order to fund the Scitor acquisition and related transaction costs, on May 4, 2015, through an amendment to the Credit Facility (Second Amended Credit Agreement), the Term Loan A Facility principal amount was increased by \$100 million (Incremental Term Loan A); the Term Loan B Facility was funded with an initial aggregate principal amount of \$570 million; and the prior existing Term Loan A and Revolving Credit Facility were converted from unsecured to secured facilities. Any obligations under the Credit Facility are secured by liens on substantially all of the assets of the Company and its subsidiaries.

Borrowings under the Credit Facilities bear a variable rate of interest based on Eurocurrency Rate or Base Rate, plus applicable margin. The applicable margin with respect to Term Loan A Facility and borrowings under the Revolving Credit Facility range from 1.50% to 2.75% for Eurocurrency Rate loans, and 0.50% to 1.75% for base rate loans. Interest rate margins for the Term Loan B Facility are 3.00%, subject to a 0.75% floor for Eurocurrency Rate loans or 2.00% for Base Rate loans. The Company also pays a commitment fee with respect to undrawn amounts under the Revolving Credit Facility ranging from 0.25% to 0.50%. Except for the Term Loan B Facility, the applicable margin and commitment fees will vary based on the Company's leverage ratio.

Interest payments under the terms of the Second Amended Credit Agreement are due based on the type of loan selected. Interest in respect of Base Rate loans will be payable quarterly in arrears on the last day of each calendar quarter. Interest in respect of Eurocurrency Rate loans will be payable in arrears on the last day of the applicable interest period and every three months in the case of interest periods in excess of three months.

Initially funded as Base Rate loans, on May 7, 2015 the Company converted the Incremental Term Loan A and the Term Loan B Facility to the Eurocurrency Rate indexed to 1-month LIBOR and 3-month LIBOR, respectively. The interest period for Incremental Term Loan A is aligned with the Initial Term Loan A Facility, such that interest is due on the last business day of every month. Interest on the Term Loan B Facility is paid quarterly on the 7th of every August, November, February, and May.

The Term Loan A Facility principal will be repaid quarterly on the last business day of each July, October, January, and April, commencing on July 31, 2015 in an amount equal to a percentage of the Term Loan A Facility aggregate principal amount outstanding as of May 4, 2015 (1.299% for July 31, 2015; 1.948% for October 31, 2015 to July 31, 2016; and 2.597% for October 31, 2016 until the Term Loan A Facility matures). Prior to the Second Amended Credit Agreement, the Company repaid principal on the Initial Term Loan Facility in quarterly installments of \$6 million commencing October 2014 through April 2015. The Term Loan B Facility principal will amortize quarterly in an amount equal to 0.25% of the initial aggregate principal amount of Term Loan B Facility plus accrued interest on the amount of principal repaid, which is payable beginning on July 31, 2015, and on each October 31, January 31, April 30, and July 31 occurring thereafter until it matures.

The Credit Facility requires the maintenance of a Senior Secured Leverage Ratio (as defined in the Second Amended Credit Agreement) of not greater than 4.00 to 1.00 until July 31, 2016, and not greater than 3.75 to 1.00 thereafter, and requires the Company to make an annual prepayment as a portion of its Excess Cash Flow (as defined in the Second Amended Credit Agreement). As of July 31, 2015, the current portion of long-term debt includes estimated mandatory

prepayments for Excess Cash Flow of \$26 million due in the first quarter of fiscal 2017.

The Credit Facility contains certain restrictive covenants applicable to the Company and its subsidiaries, which include limitations on the ability to merge or consolidate with other entities, property sale and lease-back transactions and dividend and stock repurchases under certain leverage ratios. The Credit Facility also contains certain customary events of default, including, among others, defaults based on certain bankruptcy and insolvency events, nonpayment, cross-defaults to other debt, breach of specified covenants, ERISA events, material monetary judgments, change of control events and the material inaccuracy of the Company's representations and warranties. If an event of default occurs and is continuing under the Credit Facility, the administrative agent shall at the request of the required lenders or may with the consent of the required lenders terminate the commitments thereunder, declare amounts outstanding (including principal and accrued interest and fees) payable immediately, and enforce any and all rights and interests. As of July 31, 2015 the Company was in compliance with the covenants under its Credit Facility.

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Maturities of long-term debt as of July 31, 2015 are:

Fiscal Year Ending	Total (1) (in millions)
Remainder of fiscal 2016	\$ 24
2017	61
2018	66
2019	443
2020	6
2021 and thereafter	543
Total principal payments	\$ 1,143

(1) Amounts exclude the effect from estimated mandatory prepayments for Excess Cash Flow.

As of July 31, 2015 and January 30, 2015, the carrying value of the Company's outstanding debt obligations approximated its fair value. The fair value of long-term debt is calculated using Level 2 inputs, based on interest rates available for debt with terms and maturities similar to the Company's Term Loan Facilities.

Note 8—Derivative Instruments Designated as Cash Flow Hedges:

The Company's derivative instruments designated as cash flow hedges consist of:

	Notional Amount at July 31, 2015 (in millions)	Pay Fixed Rate	Receive Variable Rate	Settlement and Termination	Liability Fair Value (1) at	
					July 31, 2015	January 30, 2015
Term Loan A Interest Rate Swaps	\$ 475	1.41 %	1-month LIBOR	Monthly through September 26, 2018	\$ 5	\$ 8
Term Loan B Interest Rate Swaps	350	1.88 %	(2) 3-month LIBOR	Quarterly through May 7, 2020	2	-
Total	\$ 825				\$ 7	\$ 8

(1) The fair value of the fixed interest rate swaps liability is included in accounts payable and accrued liabilities on the condensed and consolidated balance sheets.

(2) Subject to a 0.75% floor.

The Company is party to fixed interest rate swap instruments that are designated and accounted for as cash flow hedges to manage risks associated with interest rate fluctuations on a portion of the Company's floating rate debt. In September 2013, the Company entered into fixed interest rate swaps that aggregate to the same notional amount and tenor as the Initial Term Loan A Facility to hedge the variability in interest payment cash flows. The Company did not hedge the Incremental Term Loan A draw of \$100 million. Effective on May 7, 2015, the Company entered into fixed interest rate swaps to hedge the variability in interest payments on the first \$350 million of Term Loan B Facility over the next five years and will account for this as a cash flow hedge. The counterparties to all swap agreements are financial institutions. See Note 9 for the effective portion of the unrealized change in fair values on cash flow hedges recognized in other comprehensive income (loss) and the amounts reclassified from accumulated other comprehensive loss into earnings for the current and comparative periods presented. There was no ineffectiveness during any of the periods presented. The Company estimates that it will reclassify \$8 million of unrealized losses from accumulated other comprehensive loss into earnings in the twelve months following July 31, 2015.

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Note 9—Changes in Accumulated Other Comprehensive Loss by Component:

The following table presents the changes in accumulated other comprehensive loss attributable to the Company's fixed interest rate swap cash flow hedges that are discussed in Note 8.

	Unrealized Losses on Fixed Interest Rate		
	Swap Cash Flow Hedges		
	Pre-Tax		
	Income	Net	
	Amount	(a)	(b)
		Tax	Amount
	(in millions)		
Three months ended July 31, 2015:			
Balance at May 1, 2015	\$5	\$ (2)	\$ 3
Other comprehensive loss before reclassifications	3	(1)	2
Amounts reclassified from accumulated other comprehensive loss	(2)	1	(1)
Net current-period other comprehensive loss	1	-	1
Balance at July 31, 2015	\$6	\$ (2)	\$ 4
Three months ended August 1, 2014:			
Balance at May 2, 2014	\$1	\$ -	\$ 1
Other comprehensive loss before reclassifications	2	(1)	1
Amounts reclassified from accumulated other comprehensive loss	(1)	-	(1)
Net current-period other comprehensive loss	1	(1)	-
Balance at August 1, 2014	\$2	\$ (1)	\$ 1
Six months ended July 31, 2015:			
Balance at January 30, 2015	\$8	\$ (3)	\$ 5
Other comprehensive loss before reclassifications	2	(1)	1
Amounts reclassified from accumulated other comprehensive loss	(4)	2	(2)
Net current-period other comprehensive income	(2)	1	(1)
Balance at July 31, 2015	\$6	\$ (2)	\$ 4
Six months ended August 1, 2014:			
Balance at January 31, 2014	\$3	\$ (1)	\$ 2
Other comprehensive loss before reclassifications	2	(1)	1
Amounts reclassified from accumulated other comprehensive loss	(3)	1	(2)
Net current-period other comprehensive income	(1)	-	(1)

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Balance at August 1, 2014

\$2 \$ (1) \$ 1

- (a) The amount reclassified from accumulated other comprehensive loss was included in interest expense.
- (b) The amount reclassified from accumulated other comprehensive loss was included in the provision for income taxes.

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Note 10—Operating Leases:

The Company occupies most of its facilities under operating leases. Most of the leases require the Company to pay maintenance and operating expenses such as taxes, insurance, and utilities, and also contain renewal options to extend the lease and provisions for periodic rate escalations to reflect inflationary increases. Certain equipment is leased under short-term or cancelable operating leases. Rental expense for facilities and equipment was \$17 million and \$28 million for the three and six months ended July 31, 2015, respectively, and \$11 million and \$20 million for the three and six months ended August 1, 2014, respectively.

Future minimum operating lease commitments at July 31, 2015 are:

Fiscal Year Ending	(in millions)
Remainder of 2016	\$ 23
2017	43
2018	37
2019	32
2020	26
2021 and thereafter	38
Total	\$ 199

Note 11—Legal Proceedings and Other Commitments and Contingencies:

Legal Proceedings

The Company is involved in various claims and lawsuits arising in the normal conduct of its business, none of which the Company's management believes, based on current information, is expected to have a material adverse effect on the Company's financial position, results of operations or cash flows.

Agreements with Former Parent

Former Parent and the Company executed various agreements to provide mechanisms for an orderly transition and to govern certain ongoing relationships between the companies following the separation. The agreements include a Distribution Agreement, Employee Matters Agreement, Tax Matters Agreement, Master Transition Services Agreement, and Master Transitional Contracting Agreement (MTCA). These agreements generally provide that each party is responsible for its respective assets, liabilities and obligations, including employee benefits, insurance and tax-related assets and liabilities.

Contingent losses that were unknown at the time of separation and arise from the operation of the Company's historical business or the former Parent's corporate losses will be shared between the parties to the extent that losses in any such

category exceed \$50 million in the aggregate. If they arise and exceed the \$50 million threshold, the Company will be responsible for 30% of the former Parent's incremental contingent losses on corporate claims (and former Parent will be responsible for 70% of the Company's incremental losses on claims relating to operations that exceed \$50 million).

In accordance with the MTCA, former Parent agreed to seek the U.S. government's approval to novate all of the contracts under which the Company is obligated to fulfill the remaining terms. In July 2014, the government signed an agreement authorizing the novation of these contracts from former Parent to the Company and, as of July 31, 2015, the novation process is substantially complete. The MTCA also governs the relationship between former Parent and the Company with regard to the treatment of contracts, proposals, and teaming arrangements where both companies are or will be jointly performing work after separation. Each of former Parent and the Company indemnify the other party for work performed by it under the MTCA.

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Government Investigations, Audits and Reviews

The Company is routinely subject to investigations and reviews relating to compliance with various laws and regulations with respect, in particular, to its role as a contractor to federal, state and local government customers and in connection with performing services in countries outside of the United States. U.S. government agencies, including the Defense Contract Audit Agency, the Defense Contract Management Agency and others, routinely audit and review a contractor's performance on government contracts; indirect rates and pricing practices; and compliance with applicable contracting and procurement laws, regulations and standards. They also review the adequacy of the contractor's compliance with government standards for its business systems. Adverse findings in these investigations, audits, or reviews can lead to criminal, civil or administrative proceedings, and the Company could face disallowance of previously billed costs, penalties, fines, compensatory damages and suspension or debarment from doing business with governmental agencies.

Adverse findings could also have a material adverse effect on the Company's business, financial position, results of operations and cash flows due to its reliance on government contracts.

The Company has recorded reserves for estimated net amounts to be refunded to customers for potential adjustments for indirect cost audits and compliance with U.S. government cost accounting standards for fiscal 2006 through 2015, which include indemnification obligations owing to former Parent for periods prior to the Distribution Date. As of July 31, 2015, the Company has recorded a total liability of \$23 million for estimated net amounts to be refunded to customers for potential adjustments from such audits of contract costs. Any additional amounts which may be determined to be owed for periods prior to the separation will be allocated to former Parent and the Company in proportions determined in accordance with the Distribution Agreement.

Timekeeping Contract with City of New York

In March 2012, in connection with the resolution of certain investigations related to an automated time and attendance and workforce management system (CityTime) that former Parent developed and implemented for certain New York City agencies, former Parent entered into a three year deferred prosecution agreement (DPA) with the U.S. Attorney's Office for the Southern District of New York. Under the terms of the DPA, the U.S. Attorney's Office deferred prosecution of a single criminal count against former Parent. As of March 2015, former Parent fully satisfied the requirements of the DPA, and the DPA expired with the conclusion of the three year term. As a result, the U.S. Attorney's Office filed an application with the court to dispose of the charge and, on March 16, 2015, the court entered an order disposing of the pending charge against former Parent. Although the Company was not subject to the DPA, it previously had complied with applicable compliance provisions of the DPA. Following expiration of the DPA, the compliance provisions under the DPA also terminated.

In August 2012, former Parent entered into an administrative agreement with the U.S. Army as lead agency on behalf of the U.S. government relating to the resolution of its investigation into the CityTime contract that confirms former Parent's continuing eligibility to enter into and perform contracts with the U.S. government. Under the terms of the administrative agreement, former Parent has agreed, among other things, to maintain a contractor responsibility program having the specific elements described in the administrative agreement, including retaining an independent monitor and providing certain reports to the U.S. Army. The administrative agreement will continue in effect for five

years, or until August 2017, but former Parent may request earlier termination following completion of three years (any time after the three-year anniversary date of the agreement which occurred in August 2015). In conjunction with the separation, the Company notified the U.S. Army that it will comply with the obligations set forth in the administrative agreement following the separation. These obligations include retaining an independent monitor and maintaining a similar contractor responsibility program.

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Army Brigade Combat Team Modernization Engineering, Manufacturing and Development (BCTM) Program

The BCTM program was terminated for convenience by the Department of Defense (DoD) effective in September 2011. From October 2009 through termination, the Company and its prime contractor performed on this program under an undefinitized change order with a provisional billing rate that allowed the Company to receive a lesser amount of the projected fixed fee (contract profit) than the estimated fixed fee due until completion of contract negotiations. The Company has recognized revenues of approximately \$480 million (including estimated fees) from October 2009 through August 2013 under the undefinitized change order. During fiscal 2013, an agreement in principle was reached between the prime contractor and the DoD; however, a formal contract modification has not yet been received. The Company had an outstanding receivable of approximately \$2 million on this contract as of July 31, 2015.

Letters of Credit and Surety Bonds

The Company has outstanding obligations relating to letters of credit of \$8 million as of July 31, 2015, principally related to guarantees on insurance policies. The Company also has outstanding obligations relating to surety bonds in the amount of \$11 million, principally related to performance and payment bonds on the Company's contracts. The surety bonds initially were obtained by former Parent and the Company is required to satisfy these obligations under the terms of the Distribution Agreement.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations and quantitative and qualitative disclosures about market risk should be read in conjunction with our unaudited condensed and consolidated financial statements and the related notes. It contains forward-looking statements (which may be identified by words such as those described in "Risk Factors—Forward-Looking Statement Risks" in Part I of the most recently filed Annual Report on Form 10-K), including statements regarding our intent, belief, or current expectations with respect to, among other things, trends affecting our financial condition or results of operations (including our financial targets discussed below under "Management of Operating Performance and Reporting" and "Liquidity and Capital Resources"); backlog; our industry; government budgets and spending; the impact of competition; and the impact of the Scitor acquisition. Such statements are not guarantees of future performance and involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statements as a result of various factors. Factors that could cause or contribute to these differences include any discussed in "Risk Factors" in Part II of this Quarterly Report on Form 10-Q and in Part I of the most recently filed Annual Report on Form 10-K. Due to such uncertainties and risks, you are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to update these factors or to publicly announce the results of any changes to our forward-looking statements due to future results or developments.

References herein to "former Parent" refer to Leidos Holdings, Inc. (formerly SAIC, Inc.) collectively with its consolidated subsidiaries. We use the terms "Company," "we," "us" and "our" to refer to Science Applications International Corporation and its consolidated subsidiaries.

The Company utilizes a 52/53 week fiscal year, ending on the Friday closest to January 31, with fiscal quarters typically consisting of 13 weeks. Fiscal 2015 began on February 1, 2014 and ended on January 30, 2015, while fiscal 2016 began on January 31, 2015 and ends on January 29, 2016. The second quarter of fiscal 2015 ended on August 1, 2014, while the second quarter of fiscal 2016 ended on July 31, 2015.

Business Overview

We are a leading provider of technical, engineering and enterprise information technology (IT) services, primarily to the U.S. government. We provide engineering and integration offerings for large, complex government projects and offer a broad range of services with a targeted emphasis on higher-end, differentiated technology services. Our end-to-end enterprise IT offerings span the entire spectrum of our customers' IT infrastructure.

On May 4, 2015 the Company completed the acquisition of privately held Scitor Holdings, Inc. (Scitor), a leading provider of services primarily to the intelligence community. The acquisition was funded from increased borrowings and cash on hand, and enables us to gain access to new customers primarily in the intelligence community, and leverage capabilities of the combined company to better serve our customers. Refer to Notes 3 and 7 of the notes to the condensed and consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding the acquisition of Scitor and related financing.

Economic Opportunities, Challenges, and Risks

In fiscal 2015, we generated greater than 90% of our total revenues from contracts with the U.S. government and greater than 70% of our total revenues from contracts with the Department of Defense (DoD), including subcontracts on which we perform. Our business performance is affected by the overall level of U.S. government spending (especially defense spending) and the alignment of our offerings and capabilities with the budget priorities of the U.S.

government. While we believe that national security, including defense, will continue to be a priority, the U.S. government budget deficit and the national debt have created pressure to examine and reduce spending across all federal agencies. Baseline spending for the DoD through government fiscal year 2023 has been reduced, and there may be further changes that negatively impact discretionary spending trends across all government agencies. Adverse changes in fiscal and economic conditions could materially impact our business. Some changes that could have an adverse impact on our business are the manner in which spending reductions are implemented (including sequestration), future government shutdowns, and issues related to required increases to the nation's debt ceiling.

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The U.S. government has increasingly relied on contracts that are subject to a competitive bidding process (including indefinite delivery/indefinite quantity (IDIQ), U.S. General Services Administration (GSA) schedules and other multi-award contracts) which has resulted in greater competition and increased pricing pressure. We expect that a majority of the business that we seek in the foreseeable future will be awarded through a competitive bidding process. Despite the budget and competitive pressures impacting the industry, we believe we are well positioned to expand customer penetration and benefit from opportunities that we have not previously pursued.

Our scale, size and prime contractor leadership position are expected to help differentiate us from our competitors, especially on large contracts. We believe our long-term, trusted customer relationships and deep technical expertise provide us with the sophistication to handle highly complex mission-critical contracts. Our recent acquisition of Scitor adds differentiated capabilities, primarily in the classified work environment, and provides us access to the intelligence community market. We also believe there is an opportunity to leverage our existing capabilities to provide expanded services to Scitor's customers. In addition to expanding our addressable market and the focus on competitive differentiation provided by the Scitor acquisition, our current cost structure, as well as our ongoing efforts to reduce costs by strategic sourcing and developing repeatable offerings, is expected to allow us to compete effectively on price in an evolving environment.

Management of Operating Performance and Reporting

We manage our business to achieve our long-term financial targets, which we expect to accomplish on average and over time. These financial targets include low single digit internal revenue growth, operating margin expansion of 10 to 20 basis points annually, and return of capital in excess of operating needs.

Our business and program management process is directed by professional managers focused on satisfying our customers by providing high quality services in achieving contract requirements. These managers carefully monitor contract margin performance by constantly evaluating contract risks and opportunities. Through each contract's life cycle, program managers review performance and update contract performance estimates to reflect their understanding of the best information available. For contracts accounted for under the percentage-of-completion method of revenue recognition, updates to estimates are recognized on inception-to-date activity, during the period of adjustment, resulting in either a favorable or unfavorable impact to operating income.

We evaluate our results of operations through an understanding of the drivers causing changes in revenues, operating income and operating cash flows. Changes in revenues and operating income are generally explained with regard to volume from fluctuations in cost of revenues related to the delivery of our services and, where the impact is significant, individual contracts or programs are described. We also analyze our revenues by type of cost (labor, subcontractor or materials) to find opportunities to improve operating margin. Changes in operating income performance due to factors other than volume are normally driven by fluctuations in shared or corporate costs and changes in contract estimates. Changes in operating cash flows are described with regard to changes in cash generated through the delivery of services, significant drivers of fluctuations in assets or liabilities and the impacts of changes in timing of cash receipts or disbursements.

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Results of Operations

The primary financial performance measures we use to manage our business and monitor results of operations are revenue, operating income and cash flows from operating activities. The following table summarizes our results of operations:

	Three Months Ended			Six Months Ended		
	July 31, 2015	Percent change	August 1, 2014	July 31, 2015	Percent change	August 1, 2014
	(dollars in millions)					
Revenues	\$1,089	16 %	\$ 939	\$2,087	10 %	\$1,901
Revenues performed by former Parent	10	(23 %)	13	21	(25 %)	28
Total revenues	1,099	15 %	952	2,108	9 %	1,929
Cost of revenues	976	14 %	858	1,888	9 %	1,739
Cost of revenues performed by former Parent	10	(23 %)	13	21	(25 %)	28
Total cost of revenues	986	13 %	871	1,909	8 %	1,767
Selling, general, and administrative expenses	49	123 %	22	75	70 %	44
Acquisition and integration costs	12	100 %	-	15	100 %	-
Operating income	52	(12 %)	59	109	(8 %)	118
As a percentage of revenues	4.8 %		6.3 %	5.2 %		6.2 %
As a percentage of revenues, excluding acquisition and integration costs (a)	5.9 %		6.3 %	5.9 %		6.2 %
Net income	\$22	(35 %)	\$ 34	\$55		