

Parsons Corporation

Clear pathway to margins & growth ahead; Raise PO to \$83

Resuming Coverage: BUY | PO: 83.00 USD | Price: 79.27 USD

Strong finish to 2023, well positioned for 2024

Parsons (PSN) reported a quarter of impressive organic growth (34% Y/Y) with greater than 20% organic growth in both Federal Solutions (FS) and Critical Infrastructure (CI). Organic growth benefitted from the ramp up of new contract work and on-contract growth. As a result of the strong 2023, management increased the 2025 targets set forth at the investor day ([see our note here](#), and comparison inside). Margin expansion has lagged expectations. Nevertheless, we see a pathway to stronger margins driven by de-risking and sunseting lower-margin contracts at CI, margin-accretive M&A, and disciplined cost management. Additionally, the recently announced convertible offering de-risks the balance sheet and provides strong dry powder for future organic and inorganic opportunities. We reiterate our Buy rating and raise our PO to \$83 from \$70. See inside for details.

FS: strategic portfolio allows FS to outpace DoD budget

We continue to see PSN's FS portfolio as well positioned to benefit from key priority and high-growth areas included in the proposed FY2024 Defense Budget. While the proposed budget would increase defense spending 3% Y/Y, we anticipate FS will outpace this and grow in the mid- to high- single digits in 2024. This is primarily due to the segment's work in offensive cyber and critical defense systems.

CI: Middle East and IJJA to drive growth

PSN's CI segment reported another quarter of strong performance across all end markets and major geographies. The Middle East, particularly projects in Saudi Arabia and the United Arab Emirates (UAE), continues to be a strong revenue contributor, growing 30% Y/Y. North American revenue grew 16%, and we anticipate it will continue to grow as funding from the Infrastructure Investment and Jobs Act (IIJA) is expected to reach peak levels in the 2027 timeframe. We look favorably on the long-term outlook of the segment given the 2027 IIJA revenue peak will be followed by the anticipated Middle East revenue peak in 2028-2030. While margins in the segment were pressured in the quarter, we note CI suffered from a \$20mn net adjustment headwind, without which margins would have come in ~10.1%. See inside for more details.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	1.81	2.43	2.70	2.95	3.20
GAAP EPS	0.92	1.52	2.01	2.36	2.63
EPS Change (YoY)	9.7%	34.3%	11.1%	9.3%	8.5%
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	43.8x	32.6x	29.4x	26.9x	24.8x
GAAP P/E	86.2x	52.2x	39.4x	33.6x	30.1x
EV / EBITDA*	28.9x	22.4x	19.6x	17.9x	16.7x
Free Cash Flow Yield*	2.5%	4.4%	3.8%	4.2%	4.5%

* For full definitions of *IQmethod*SM measures, see page 6.

26 February 2024

Equity

Mariana Perez Mora

Research Analyst
BofAS
+1 646 855 5696
mariana.perez mora@bofa.com

Ronald J. Epstein

Research Analyst
BofAS
+1 646 855 5695
r.epstein@bofa.com

Samantha Stiroh

Research Analyst
BofAS
+1 646 855 5725
samantha.stiroh@bofa.com

Andre Madrid

Research Analyst
BofAS
+1 646 725 3107
andre.madrid@bofa.com

Jordan Lyonnais

Research Analyst
BofAS
+1 646 855 5204
jordan.lyonnais@bofa.com

Stock Data

Price	79.27 USD
Price Objective	83.00 USD
Date Established	26-Feb-2024
Investment Opinion	B-1-9
52-Week Range	40.61 USD - 79.99 USD
Mkt Val (mn) / Shares Out (mn)	8,389 USD / 105.8
Free Float	43.2%
Average Daily Value (mn)	70.59 USD
BofA Ticker / Exchange	PSN / NYS
Bloomberg / Reuters	PSN US / PSN.N
ROE (2024E)	12.6%
Net Dbt to Eqty (Dec-2023A)	-11.5%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

ID/IQ = Indefinite Delivery / Indefinite

Quantity

PwC = PricewaterhouseCoopers

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Timestamp: 26 February 2024 11:04AM EST

iQprofileSM Parsons Corporation

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	4.8%	7.1%	8.3%	8.6%	8.7%
Return on Equity	9.6%	11.9%	12.6%	12.7%	12.0%
Operating Margin	4.4%	5.3%	6.7%	7.1%	7.4%
Free Cash Flow	207	367	318	348	380

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.3x	1.6x	1.3x	1.3x	1.3x
Asset Replacement Ratio	0.3x	0.3x	0.7x	0.7x	0.8x
Tax Rate	23.9%	21.3%	24.0%	25.0%	25.0%
Net Debt-to-Equity Ratio	-12.5%	-11.5%	-27.9%	-30.7%	-34.1%
Interest Cover	8.0x	9.2x	8.2x	8.0x	8.2x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	4,195	5,443	5,950	6,334	6,685
% Change	14.6%	29.7%	9.3%	6.4%	5.6%
Gross Profit	947	1,206	1,305	1,412	1,512
% Change	11.0%	27.4%	8.2%	8.2%	7.1%
EBITDA	322	417	477	521	560
% Change	13.3%	29.4%	14.4%	9.2%	7.4%
Net Interest & Other Income	(19)	(24)	(47)	(27)	(21)
Net Income (Adjusted)	189	258	291	322	354
% Change	11.0%	36.6%	12.7%	10.7%	9.9%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	127	208	267	315	355
Depreciation & Amortization	121	120	90	88	82
Change in Working Capital	(103)	(103)	(70)	(86)	(87)
Deferred Taxation Charge	(1)	(9)	(7)	(7)	(8)
Other Adjustments, Net	95	192	97	101	105
Capital Expenditure	(31)	(40)	(60)	(63)	(67)
Free Cash Flow	207	367	318	348	380
% Change	12.2%	77.5%	-13.4%	9.5%	9.2%
Share / Issue Repurchase	(22)	(11)	(20)	(20)	(20)
Cost of Dividends Paid	(18)	(7)	0	0	0
Change in Debt	149	0	0	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	263	273	678	868	1,114
Trade Receivables	717	916	967	1,073	1,178
Other Current Assets	740	949	1,019	1,084	1,145
Property, Plant & Equipment	96	99	118	162	184
Other Non-Current Assets	2,382	2,568	2,639	2,717	2,802
Total Assets	4,198	4,804	5,421	5,903	6,422
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	1,108	1,411	1,462	1,548	1,626
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	994	1,016	1,528	1,528	1,528
Total Liabilities	2,102	2,427	2,990	3,076	3,154
Total Equity	2,096	2,377	2,431	2,827	3,267
Total Equity & Liabilities	4,198	4,804	5,421	5,903	6,422

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Defense Electronics

Company Description

Parsons Corporation (ticker: PSN) provides design, engineering, software, and prototype hardware solutions for defense, intelligence, and critical infrastructure projects. The company is organized in two reporting segments: Federal Solutions and Critical Infrastructure. The company employs approx. 16,000 people globally..

Investment Rationale

PSN is well positioned to benefit from the Biden administration's priorities at both Federal Solutions (FS) and Critical Infrastructure (CI), given the emphasis on legacy system modernization and the US Infrastructure Bill. PSN's M&A strategy has allowed the company to unlock value and expand its customers, capabilities, and contracts. On a macro level, PSN is a beneficiary to a stronger award environment, increased global infrastructure spend, and environmental remediation efforts..

Stock Data

Average Daily Volume 890,489

Quarterly Earnings Estimates

	2023	2024
Q1	0.43A	0.60E
Q2	0.63A	0.64E
Q3	0.69A	0.70E
Q4	0.69A	0.77E

Margin expansion lags from CI adjustment headwind

While PSN reported impressive growth in the quarter, margin expansion lags expectations. Company adj. EBITDA margins in the quarter came in at 8.6%, below BofAe of 8.8% and consensus of 8.7%. However, we highlight that the company was impacted by a \$20mn net adjustment headwind on two Critical Infrastructure programs. PSN recognized a \$38mn favorable impact to 4Q EBITDA related to a rail and transit project. On a separate program, the company recognized a \$58mn adjusted EBITDA charge as a result of supply chain challenges identified during the procurement of materials. Normalized adj. EBITDA margins for the quarter would have been 9.9%. Normalized adj. EBITDA margins for FY23 would have been 8.9%, above management's guide of 20-30bps of margin expansion a year.

Taking steps to rectify risky margins

Despite the headwind to reported margins in 4Q, we look favorably on the steps management is taking to de-risk the CI margin profile. The \$58mn write down of material procurement stems from an initial contract quoted prior to the pandemic. Management highlighted that the company is no longer engaged in large contracts with a significant amount of material pass through. Additionally, the new work PSN is bidding on is trending towards double-digit margins. We believe these actions de-risk the company's margin profile and provide a pathway towards stronger margin expansion.

Raising medium term targets

We were particularly pleased to see management raise the company's 2025 goals set forth at the March 2023 investor day ([read our takeaways here](#)). Management now expects mid-single digit organic growth or better (vs. 3%-5% prior) on an increased revenue base. The company continues to expect 20-30bps of margin expansion per year (unchanged) and at least 100% FCF conversion (unchanged). Given outperformance throughout 2023, this guidance raise is unsurprising but does provide reassurance that continued robust performance is expected.

Beneficiary to strong awards environment

PSN benefitted from a strong awards environment with total contract awards increasing 13% Y/Y to over \$1.2bn. This resulted in a trailing-twelve-month book to bill of 1.1x. PSN reported a backlog of \$8.6bn (59% funded), up 5% Y/Y. As we mentioned last quarter, the company also has \$14bn in deals that have been awarded but not yet booked (primarily option periods and unbooked ceiling value). We believe this helps de-risk PSN's performance skyline amidst an uncertain budgetary environment. Key awards in the quarter include:

- Potential five-year \$250mn single-award classified contract in support of the US Government. PSN Booked \$50mn in 4Q23.
- \$150mn single-award contract to serve as lead designer on a major infrastructure replacement project in the northeast United States. The entirety of the contract is expected to be booked in 1Q24.
- \$80mn contract to provide environmental remediation of lead contaminated soil for a US customer. This contract represents new work and \$73mn was booked in 4Q23.
- A prime position on a multiple-award ID/IQ potential \$250mn contract for the US Army Corps of Engineers to provide environmental remediation work. This contract represents new work and funding stems from the Infrastructure Investment and Jobs Act (IIJA).
- A prime position on a potential five-year \$200mn multiple-award ID/IQ General Services Administration Public Building Service contract. This contract is new work for the company.



Strong labor and hiring supports future growth

PSN's strong performance on hiring and retention bolstered growth throughout the quarter. Retention has improved by over 1% Y/Y and the company remains above PwC industry benchmarks. Management highlighted that new classified and top-secret clearance wait-times have improved in recent years, benefitting the company as PSN continues to win an increasing share of classified work, particularly within the cybersecurity end-market.

Workforce largely in place to execute on \$14bn of unbooked ceiling

Importantly, of the \$14bn of unbooked contract value, ~50% is comprised of option years. As this represents a continuation of existing work, management highlighted that they largely already have the workforce in place to execute on that increase. The remaining ~50% is comprised of unbooked ceiling value. In general, the task orders PSN wins here represent new work and would be an area where potential additional labor is required. However, we believe PSN's history of robust hiring positions the company well to ultimately execute on these task orders if/when they are awarded.

\$700mn Convertible offering to repurchase 2025 debt

Subsequent to the end of the quarter, PSN announced a \$700mn (with an additional \$100mn greenshoe option) convertible debt offering. Concurrent with the convertible notes, PSN is also engaging in a Capped Call Transaction to offset any potential dilution. The net proceeds from the debt offering will likely be approximately \$683.7mn (\$781.4mn if the greenshoe is exercised). PSN is planning to use the proceeds to retire ~71% of the company's \$400mn outstanding convertible notes due in 2025. Including the premium required to recover the outstanding debt and the \$77mn expected to be used to pay for the new hedge, PSN will be left with ~\$115-120mn in extra cash. We note that this does not include any upside from recovering some of the premium through hedges and/or the greenshoe option.

As this debt is being issued at a higher rate than the existing convertible notes (2.625% vs. prior 0.25%), we expect to see a ~\$20mn incremental annual interest expense. We now expect PSN to pay ~\$50mn of interest expense in 2024. On an adjusted basis, we do not expect share count to be impacted in 2024.

Raising 2024e and outyear EPS

Strong 2023 performance and future growth opportunities are partially offset by higher interest expense. We are raising adj. EPS estimates in 2024 and the outyears. We raise our 2024e adj. EPS to \$2.70 (vs. \$2.60 prior), 2025e to \$2.95 (vs. \$2.90 prior), 2026e to \$3.20 (vs. \$3.15 prior).

Raising PO to \$83 on strong opps at CI and FS

We reiterate our Buy rating and raise our PO to \$83 from \$70. We roll our valuation forward one year. Our PO of \$83 is based on a SOTP valuation that factors in a 15x EV/EBITDA multiple on Federal Solutions (vs. 14x prior to account for the company's strategic portfolio and high-growth profile) and 19x EV/EBITDA on Critical Infrastructure (vs. 17x prior as the company focuses continues to benefit from higher margin, lower-risk, high-tech M&A).

Price objective basis & risk

Parsons Corporation (PSN)

Our PO of \$83 is based on a SOTP valuation that factors in a 15x EV/EBITDA multiple on Federal Solutions (to account for the company's strategic portfolio and high-growth profile) and 19x EV/EBITDA on Critical Infrastructure (as the company focuses continues to benefit from higher margin, lower-risk, high-tech M&A).

Risks to the upside are a better than anticipated upturn in the federal budget, inexpensive and well-integrated M&A activity (beyond our current expectations) and unexpected capital return to shareholders in the form of buybacks or special dividends.

Risks to the downside are cuts to the Department of Defense budget vs. anticipated or a prolonged continuing resolution (CR), which could negatively impact our estimates. Should PSN run into any problems with integrating M&A, containing its costs or a heightened competitive environment there could be downside risk to our estimates.

Analyst Certification

I, Mariana Perez Mora, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AerCap Holdings N.V.	AER	AER US	Ronald J. Epstein
	Air Lease Corporation	AL	AL US	Ronald J. Epstein
	Booz Allen Hamilton	BAH	BAH US	Mariana Perez Mora
	BWX Technologies, Inc.	BWXT	BWXT US	Ronald J. Epstein
	CACI International	CACI	CACI US	Mariana Perez Mora
	Cadre Holdings Inc	CDRE	CDRE US	Ronald J. Epstein
	Crane Co.	CR	CR US	Ronald J. Epstein
	Embraer	ERJ	ERJ US	Ronald J. Epstein
	General Dynamics	GD	GD US	Ronald J. Epstein
	HEICO Corporation	HEI	HEI US	Ronald J. Epstein
	Howmet Aerospace Inc.	HWM	HWM US	Ronald J. Epstein
	KBR	KBR	KBR US	Mariana Perez Mora
	Leidos Holdings	LDOS	LDOS US	Mariana Perez Mora
	Leonardo DRS, Inc.	DRS	DRS US	Ronald J. Epstein
	Northrop Grumman	NOC	NOC US	Ronald J. Epstein
	Palantir Technologies	PLTR	PLTR US	Mariana Perez Mora
	Parsons Corporation	PSN	PSN US	Mariana Perez Mora
	RBC Bearings Inc	RBC	RBC US	Ronald J. Epstein
	Rocket Lab	RKLB	RKLB US	Ronald J. Epstein
	Teledyne Technologies Inc	TDY	TDY US	Ronald J. Epstein
	TransDigm Group Inc.	TDG	TDG US	Ronald J. Epstein
	Triumph Group	TGI	TGI US	Ronald J. Epstein
NEUTRAL				
	Albany International	AIN	AIN US	Ronald J. Epstein
	Boeing	BA	BA US	Ronald J. Epstein
	Garmin	GRMN	GRMN US	Ronald J. Epstein
	Hexcel Corporation	HXL	HXL US	Ronald J. Epstein
	L3Harris	LHX	LHX US	Ronald J. Epstein
	Lockheed Martin	LMT	LMT US	Ronald J. Epstein
	RTX Corp	RTX	RTX US	Ronald J. Epstein
	Textron	TXT	TXT US	Ronald J. Epstein
UNDERPERFORM				
	Bombardier	BDRBF	BDRBF US	Ronald J. Epstein
	Bombardier Inc.	YBBD B	BBD/B CN	Ronald J. Epstein
	CAE Inc.	YCAE	CAE CN	Ronald J. Epstein



US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	CAE Inc.	CAE	CAE US	Ronald J. Epstein
	Huntington Ingalls Industries	HII	HII US	Ronald J. Epstein
	Mercury Systems	MRCY	MRCY US	Ronald J. Epstein
	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales
Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

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Disclosures

Important Disclosures

Parsons (PSN) Price Chart



PSN — Restricted PO
B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Aerospace/Defense Electronics Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	31	62.00%	Buy	23	74.19%
Hold	11	22.00%	Hold	9	81.82%
Sell	8	16.00%	Sell	6	75.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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