Leidos Holdings, Inc.

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Investment Recommendation

I recommend to SIF a **BUY** for Leidos Holdings, Inc. (NYSE: LDOS) at its current share price of $178.33 as of August 19th's market close. LDOS is a global leader in the mission-critical government services and solutions market, operating across the highly resilient defense, intelligence, and federal IT contracting industries. Leidos delivers advanced capabilities in secure IT modernization, AI-enabled analytics, cybersecurity, and systems integration that are essential to the operations of U.S. federal agencies, allied governments, and commercial partners. With strong industry tailwinds from defense modernization, cybersecurity investment, and AI adoption in government, Leidos is well-positioned to capture sustained growth.

5-Year Performance

Thesis

Mission-Critical Contract Wins and Growing Backlog: LDOS' record-contract backlog of $46.2bn showcases long-term revenue visibility and demonstrates stable cash flows. LDOS' historic, entrenched relationship with many of the U.S' top agencies and dominance in high barrier-to-entry markets (defense-oriented, Intelligence, Secure IT, and Energy) position it to consistently win large, long-term contracts. Just recently on August 7th, LDOS became an AWS TSE Vetted Partner, granting LDOS access to classified cloud modernization work for U.S. agencies and allied nations. This supports initiatives like AUKUS Pillar 2, expands LDOS' presence in secure, high-classification workloads, and strengthens its moat while opening new global growth opportunities.

Secular Tailwinds in Governmental Modernization and Spending: Federal priorities in AI, cybersecurity, cloud migration, and digital modernization align directly with LDOS' core competencies in secure systems integration, advanced analytics, and mission automation. With government IT spending projected to grow steadily and defense technology budgets accelerating, Leidos is positioned to expand market share in industries growing at 4.5–7.7% annually, leveraging early AI adoption in high-security environments.

Proven Operational Leverage and Capital Discipline: Over the past five years, Leidos has delivered a revenue CAGR of 7.9% and EPS CAGR of 20.6%, driven by margin expansion, disciplined capital allocation, and consistent share repurchases. Management's ability to translate backlog into profitable growth, coupled with targeted M&A in emerging tech areas, provides a credible path to sustained double-digit EPS growth while returning significant capital to shareholders.

Investment Overview

Leidos Holdings, Inc. is one of the largest government contractor companies and is a leader in IT-based solutions and health and civil services for the United States government, commercial partners, and other countries. Leidos finds itself operating at the intersection of three growing and strategically critical industries: Federal IT Contracting, Global Defense Solutions, and Intelligence, Surveillance, and Reconnaissance (ISR). The Federal IT market is forecasted to grow at a CAGR of ~4.5% with the other two growing at CAGR's of 7.7% and 5.6%. As defense and technological modernization trends continue, and priorities in cloud, cybersecurity, big data, AI, and health IT grow, Leidos is well-positioned to capitalize. Over the past five fiscal years, the company has delivered a revenue CAGR of 7.89% and EPS CAGR of 20.59%, demonstrating its ability to win large contracts, expand margins, and execute effectively. Its established relationships with U.S. federal agencies, deep technical expertise in AI-enabled analytics, cybersecurity, and systems integration, and history of delivering mission-critical solutions uniquely position it to capture a disproportionate share of this industry expansion. As federal agencies accelerate digital transformation and defense clients prioritize rapid technology adoption, Leidos' scale, cross-domain capabilities, and track record of innovation should allow it to deepen its competitive moat and grow revenue in line with, or faster than, its addressable markets.

What Matters?

- **Backlog Conversion to Revenue:** Leidos' ability to efficiently convert its record high $46.2bn backlog into realized revenue is one of the most critical drivers of shareholder value. Management themselves when talking about KPI's lists growth of backlog as one of their key priorities and in order to succeed, they must continue growing but also realizing these contracts into revenue. While their government contracting model does create long visibility, it must be noted that the majority of the backlog is still unfunded and can, although unlikely, be cancelled. Luckily, Leidos has a great history of successful staffing, execution, and timely delivery of awarded contracts and seeing the backlog grow and be converted provides investors with confidence in sustained revenue growth over time.
- **Continued and Growing Success in Classified Cloud and Secure IT Modernization:** The U.S. government's increasing reliance on classified cloud infrastructure and secure IT modernization represents a high-growth and high-barrier-to-entry opportunity for Leidos. Winning and expanding within these classified programs cements Leidos' role as a trusted mission partner for cyber, AI/ML, and cloud-based operations for defense and intelligence customers. Continued traction here signals durable competitive positioning against key competitors in this space like Booz Allen and SAIC.
- **Defense and Federal IT Budget Increases:** Probably the greatest possible tailwind for Leidos is increased government spending, specifically in defense and IT. The recent trends of rising defense budgets, modernization initiatives, and bipartisan support for critical national security funding create great opportunities for Leidos. Leidos' diversified portfolio of products that are utilized all across the DoD, intelligence, and other agencies position itself to disproportionately benefit as federal dollars continue to flow, in greater numbers, towards cyber defense, AI-based operations, and modernization.
- **Margin and EPS Growth:** Being further up on the S-curve, having 'good' growth won't just be enough for Leidos to position itself as a good investment. Another very important piece, that they have showed in the past couple years to be capable of, is increasing operational margins and ultimately EPS growth. While already outcompeting many of its key competitors in the growth of these metrics, to really pull away from the pack and continue to grow, sustained margin and EPS expansion is crucial.

Additional Upside Levers

- **AI Adoption in Mission-Critical Environments:** As AI/ML becomes increasingly important in our modern world, its adoption in areas such as predictive maintenance, battlefield awareness, and cyber defense presents a major growth opportunity for Leidos. As the U.S. government accelerates deployment of AI in mission-critical functions, Leidos' AI expertise (especially after their recent acquisition of Kudu Dynamics which provides AI enabled cyber capabilities for defense, intelligence, and homeland security customers), classified access, and existing programs provide a strong competitive advantage. Successful commercialization and scaling of AI solutions could meaningfully enhance margins and create additional upside not yet factored in.

- **International Expansion beyond US, Australia, and UK:** With approximately 87% of their revenue coming from the U.S. government, penetration into and a further emphasis on international markets provide great opportunities for growth. Expansion into allied nations beyond the current strong ones of Australia and the UK, like NATO and both Canada and New Zealand (the other two members of the Five Eyes) could diversify revenue streams and capture additional demand for defense, IT, and cyber capabilities. Leidos is very well positioned to leverage its successful track record of fulfilling contracts on time and successfully with the U.S. into other international deals.

Questions Researched and Outstanding Questions

- What is the spending outlook for US defense, IT, and health-related items in the next 3-5 years?
- How sustainable is Leidos' contract pipeline?
- Is Leidos positioned well against its competitors in terms of capabilities and price?
- Does Leidos have a plan to expand their international revenue streams?
- What impact could AI/cybersecurity advances have on growth?
- How will Leidos navigate international expansion?
- Could further goodwill impairments or accounting issues resurface, harming EPS?
- Can Leidos sustain its margin expansion given increasing labor costs and a competitive contract bidding environment?

Business Overview

Leidos Holdings, Inc. (NYSE: LDOS) is a leading science, engineering, and technology solutions provider headquartered in Reston, VA. It was founded back in 1969, and the company is a major government contractor that delivers mission-critical solutions to U.S. federal government agencies, allied nations (Britain and Australia) and select commercial customers. Leidos focuses heavily on systems integration, data analytics, cybersecurity, and engineering support across defense, civil, and health markets. The business is split into these four revenue segments:

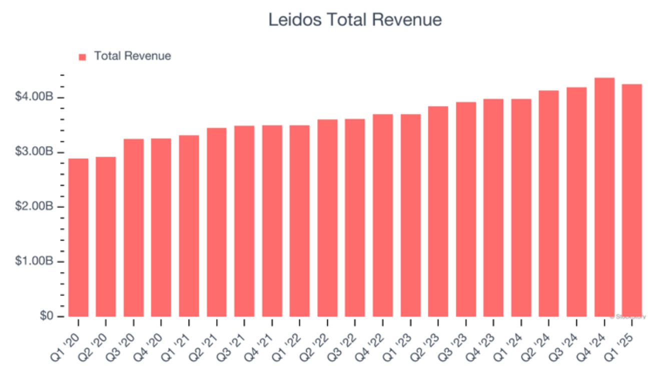
- **National Security and Digital (~44% of revenue)**: **P**rovides advanced technology solutions, mission software, and IT services for U.S. defense, intelligence, and federal government agencies, specializing in cyber operations, logistics, security, decision analytics, and large-scale digital transformation.
  - Key offerings:
    - "Mission Software", "Multi-Domain Solutions", "Cyber Operations", "Intelligence Analysis, Mission support, and Global Logistics Services", "Digital Modernization", and "Digital Transformation"
- **Health and Civil (~30% of revenue):** Delivers services and solutions for federal and commercial clients in public health, life sciences, environmental sciences, and transportation, with a focus on supporting the health and well-being of people—especially service members and veterans—through health information management, managed health services, infrastructure modernization, and life sciences R&D.
  - Key offerings:
    - "Transportation Solutions", "Health Mission Software", "Managed Health Services", "Climate, Energy, and Environmental", and "Life Sciences Research and Development"
- **Commercial and International (~14% of revenue):** Provides products, services, and solutions to protect national assets, modernize critical infrastructure, and improve mission outcomes for customers such as utilities, U.K. and Australian government agencies, TSA, CBP, and global transportation authorities, offering expertise in engineering, security, digital modernization, mission software, logistics, and airborne solutions.
  - Key offerings:
    - "Energy Infrastructure", "Global Security Products and Services", and "International"
- **Defense Systems (~12% of revenue):** Develops and delivers advanced hardware, software, and integrated systems to address national security threats, serving the U.S. Department of Defense, military branches, intelligence agencies, NASA, DARPA, and international allies, with a focus on rapid prototyping and mission-ready solutions.
  - Key offerings:
    - "Airborne Systems", "Land Systems", "Maritime Systems", "Aerospace systems", and "Cyber and Threat Systems"
- **Contract and Procurement Model:**
  - **Contract Types:** Firm-Fixed-Price, Cost-Reimbursement, Time-and-Materials, Fixed-Price-Incentive-Fee
  - **Procurement Vehicles:** Definitive contracts, IDIQ (Indefinite Delivery Indefinite Quantity), GSA (General Service Administration)) schedules, and TA (Teaming Agreement)

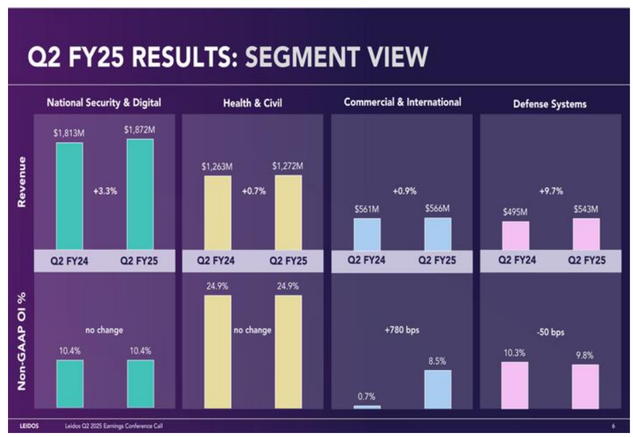
Mix of multi-year, IDIQ, and recompete contracts provides revenue visibility but requires constant pipeline replenishment.

1. Sustainable Above-Average Earnings Growth

Revenue Growth

Over the last five years, Leidos has seen consistent growth. In FY20, Leidos had a revenue $12.3bn which has since grown to $16.7bnin FY24, with Q2 ending at an all time quarterly high of $4.3bn, beating the respective 3 months ended of the year prior. This growth, including the recent quarterly data, represents a CAGR of 7.64%, which has outpaced the 3.94%% CAGR of the U.S. Defense budget and the 5-7% IT services CAGR. Leidos segments their revenue into four categories: National Security & Digital (~44%), Health & Civil (~30%), Commercial & International (~14%), and Defense Systems (~12%). Furthermore, these four categories are broken down into subcategories of revenue coming from: DoD & U.S. Intelligence Community, Other U.S. Government Agencies, and Commercial & Non-U.S. Customers. The fastest growing of these subcategories was Other U.S. Government Agencies which grew with a CAGR of 11.27% due to the expansion of civilian IT modernization programs, healthcare IT demand, and increased digital transformation initiatives across agencies.





Earnings Growth: In FY2024, Leidos recorded a record high earnings of $1.25bn, representing an incredible 530% showcasing their ability to recover from down years while demonstrating improved margins as well. More importantly, Leidos' earnings have grown faster than their revenues, CAGRing at 18.87% Vs. the still impressive 7.64%. This rapid earnings increase comes from sustained cost discipline, with COGS as a percentage of revenue improving from 86% in FY2020 to 83% in FY2024, and SG&A leverage declining from 6.3% to 5.9%, decreasing relative interest expenses, and general minimization of harmful impairment costs, over the same period. These efficiency gains have driven margin expansion, with its current net income margin of 7.5% being almost 50% higher than it was in 2020. Similarly, their EBIT margin in FY24 has risen to a high of 11.4%, from 8.1% in FY20, and management projects it to continue increasing into the next FY between 11.5-12%. Furthermore, through this combinations of earnings growth and consistent share buybacks, their EPS has grown from 4.36 to 9.22, a CAGR of 20.87%.

Revenue Drivers:

Backlog Growth Apart from industry trends, Leidos' revenue growth is underpinned by its record backlog of ~$46bn in contracts, providing multi-year visibility provides a shield against any short-term budget uncertainty. Over the past 5 years, Leidos' backlog has grown at a CAGR of ~20.59%, which has outpaced all of their key competitors in SAIC (0.46%), Booz Allen (15.61%), and CACI (6.73%), and has positioned them with the largest contracted revenue base in the sector. Their backlog is diversified across their revenue segments within long-cycle programs in national security, IT modernization, and digital transformation, all generally bipartisan issues that should continue no matter who is in office.

1. Sustainable Above-Average Earnings Growth

Backlog Growth Continued: Leidos' execution has historically been extremely strong boasting book-to-bill ratios consistently over 1.0x and most recently at 1.7 in FY24, suggesting strong demand and likely high future growth.

Industry Growth Tailwinds: Leidos' core markets benefit from resilient and expanding long-term industry tailwinds. Steadily, the U.S. Defense budget is expected to grow at a CAGR of 3-4% (barring any new conflicts) through the next decade, fueled by military modernization, investments in cyber defense, space, and unmanned systems. However, a much greater tailwind with even greater specificity to their core competencies, is the growth of the IT service market with an expected CAGR of 9.4% over the next 5 years and with general contractor supplied IT projected to grow at a CAGR of ~5%, as IT Modernization tops priorities with agencies as they continue to prioritize investments in areas like cloud, cyber, big data, AI, health IT, mobility/5G, and network modernization. Importantly, Leidos has consistently grown faster than these benchmarks, with a five-year revenue CAGR of 7.6% versus the 3.9% defense budget CAGR and 5–7% IT services CAGR. This historical outperformance underscores their competitive positioning: Leidos leverages scale, program depth, and a diversified portfolio across National Security, Civil, Health, and Commercial markets to capture incremental share above baseline industry growth.

Project North Star 2030: A key forward-looking driver for margin and earnings expansion is Leidos' internal transformation initiative, Project North Star 2030. This initiative emphasizes the company's strengths in modernization, rapid capability development, and commercial healthcare delivery practices, which align with the government's current efforts to reduce costs and regulations and increase efficiency. It focuses mainly on securing contracts within "IT modernization" (reducing government costs, bridge outdated and disparate data silos and facilitate the adoption of enabling technologies), "Transformational War Fighting Capability" (rapidly transform innovative ideas into market-ready solutions needed for next-generation warfighting capabilities), and "Increased Privatization" (Expand public-private partnerships for citizen services to create more efficient and effective outcomes). Already through these goals, Leidos has won contracts with the Social Security Administration, Defense Enclave Services Program, U.S. Navy, the VA, and the FAA. Importantly, the initiative leverages Leidos' unique workforce of Top Secret/SCI-cleared professionals, giving the company a structural advantage in pursuing classified, mission-critical programs that competitors cannot access. Recent achievements such as attaining AWS Trusted Secure Enclave (TSE) Vetted Partner status and launching the Leidos Secure Environment (LSE) demonstrate how North Star is translating into innovation leadership. These capabilities not only support large-scale U.S. government IT modernization but also extend to international defense cooperation, including AUKUS Pillar 2 initiatives in AI, cyber, and hypersonics, where secure, cross-border collaboration is essential.

2. Leadership in an Attractive Business Space

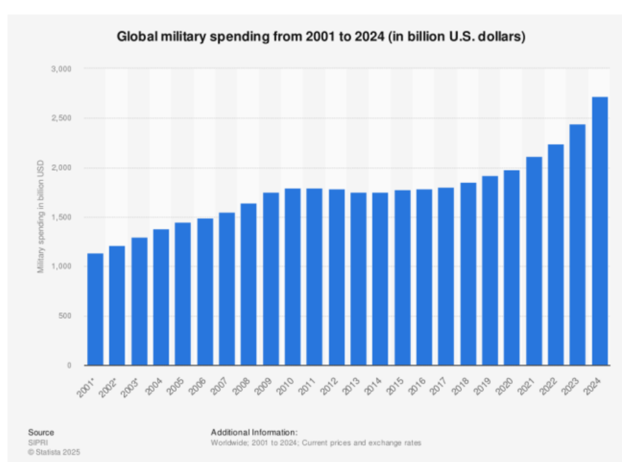
Leadership

Market Leader:

Outside of the major weapons and ship manufacturers, Leidos is the largest of all other U.S. government contractors and by far the largest government service provider. Leidos is concentrated largely within the Health and Engineering as well as the National Security Solutions sectors within the government with key their key competitors being Booz Allen Hamilton, SAIC, and CACI. Over the years, Leidos has cemented themselves as far ahead of the rest in terms of many metrics. In the past 5 years, Leidos has delivered EPS growth at a CAGR of 20.6%, outpacing Booz Allen Hamilton (13.5%), CACI (5.1%), and SAIC (19.1%). Revenue has grown at a CAGR of 7.9%, ahead of SAIC (1.5%) and CACI (9.4%), while backlog has expanded at a 16.0% CAGR, more than double Leidos' own revenue growth and significantly higher than Booz Allen (15.6%), CACI (6.7%), and SAIC (0.5%). This robust backlog expansion translates into superior revenue visibility, with Leidos' backlog-to-revenue growth ratio of 2.0x, compared to Booz Allen (1.24x), CACI (0.72x), and SAIC (0.32x). Operationally, Leidos also demonstrates stronger profitability, with operating income margins of 10.9% versus CACI (9.0%), Booz Allen (10.0%), and SAIC (7.5%). Within the National Security & Digital segment (~44% of revenue), Leidos is a top contractor to the Department of Defense and Intelligence Community, where it competes for highly classified, billion-dollar programs that many competitors cannot access due to clearance barriers. This combination of scale, program depth, and clearance access has positioned Leidos as the clear market leader in the U.S. government services industry.

Trusted Government Partner and Mission-Critical Role:

A core driver of Leidos' leadership is its entrenched, long-term relationships with the U.S. government. The company has decades-long partnerships across defense, intelligence, healthcare, and civilian agencies, enabling consistent access to large, recurring contracts. Leidos frequently delivers on programs with mission-critical importance, from supporting defense and intelligence operations to modernizing civilian health IT systems, further strengthening its status as a trusted partner. Moreover, the company is a leader in modernization efforts, helping agencies transition to secure cloud, AI-enabled analytics, and digital transformation initiatives. These deep relationships and proven performance create high switching costs for the government and reinforce Leidos' moat as the go-to integrator for critical national priorities.



2. Leadership in an Attractive Business Space

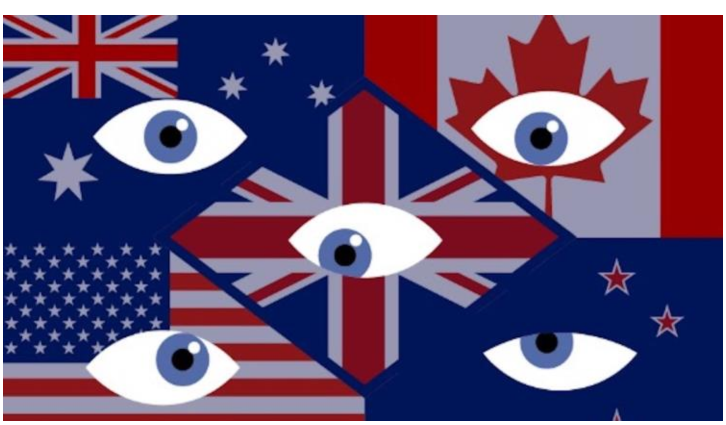
Attractive Industry

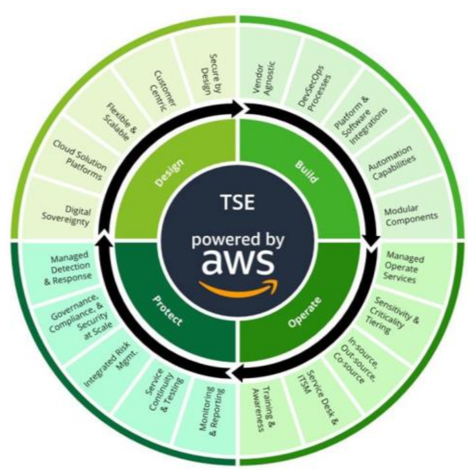
Industry Growth

As I mentioned before, at a baseline level, Leidos has a solid cushion of growth they can rest on due to the U.S. defense budget being projected to grow at a CAGR of ~3-4% through 2030, fueled by modernization priorities. Leidos specializes heavily in many of the key tailwinds driving these budget increases and, similar to has it has done historically, is well positioned to capture growth much higher than the baseline 3-4% due to its core competencies in cyber and intelligence. Additionally, Federal civilian IT modernization and healthcare IT spending are expected to expand even faster, at ~5–7% CAGR, with classified budgets for cyber and intelligence growing at rates above the overall topline, creating additional opportunities for cleared contractors. With Leidos' strong current presence, they are already very strong contenders to win major contracts, but their emphasis on collaboration further strengthens this positioning. By frequently partnering with other firms, like a recent partnership with Second Front Systems to accelerate secure software delivery for government agencies, Leidos enhances its probability of securing large-scale, complex programs while also improving delivery speed and efficiency. This strategy not only increases contract win-rates but also accelerates execution, enabling Leidos to grow materially faster than the underlying industry CAGRs and capture incremental market share.

Industry Trends

Beyond basic topline budget growth, the industry is undergoing structural shifts toward digital transformation, secure cloud, conglomerated health databases, AI cyber defense, and other emerging technologies. International initiatives such as the AUKUS Pillar 2 further expand the market for these technologies, particularly among the Five Eyes intelligence alliance countries. Leidos is uniquely positioned to capitalize on these trends due to its large pool of Top Secret/SCI-cleared employees, partnerships with leading technology firms (their new AWS TSE Vetted Partner status), and established track record of delivering secure, scalable solutions.





3. Sustainable Competitive Advantage

Deep Entrenchment in U.S. Government Contracts

Leidos' greatest sustainable advantage lies in its deeply entrenched role as a mission-critical contractor for the U.S. government, particularly with the DoD, intelligence community, and civilian agencies. With the majority of revenues coming from long-term federal contracts, many spanning multiple years and many others waiting to be started in the backlog. These contracts are very difficult for competitors to displace due to the government's reliance and trust in Leidos' track record of performance, classified clearances, and trusted relationships. The company consistently maintains one of the largest funded backlogs in the industry, creating visibility into future cash flows and shielding it from economic cycles. Leidos has contracts all across many deeply important agencies within the government and has built a rapport where these contract awarders would rather choose Leidos then unproven newcomers.

Scale of Business and Economies of Scope

As one of the largest U.S. defense and IT solutions providers, Leidos benefits from substantial economies of scale in bidding, program execution, and recruiting specialized talent. Its size allows it to both spread fixed costs like R&D, compliance, and cybersecurity infrastructure across a broad revenue base, but also to compete for contracts with other firms as both a sub or primary contractor. Scale is also incredibly important in the federal procurement process where smaller firms often cannot meet the contract size or requirements that Leidos routinely handles. This creates a barrier to entry for new competitors, and even larger competitors like Booz Allen Hamilton and SAIC cannot match Leidos' breadth across defense, health, and civil markets simultaneously. With Leidos being so heavily involved in the building of databases, AI integration, modernization, and mission-related software, there broad scope across many critical agencies makes it very hard to displace them once embedded, as agencies benefit from Leidos' ability to integrate across domains and provide end-to-end solutions that few peers can match.

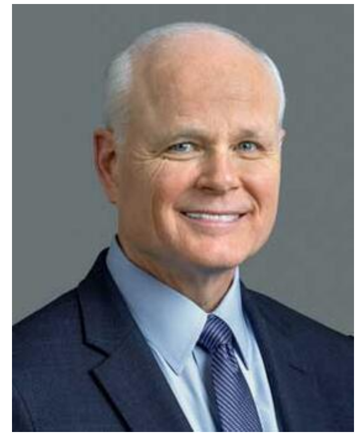
Technical Expertise and Human Capital

As their core competencies and through smart acquisitions, Leidos has carved out expertise in advanced fields such as cybersecurity, electronic warfare, hypersonics, and AI/ML-enabled systems. Many of these programs require high-level security clearances and years of institutional knowledge, which competitors cannot quickly replicate and wouldn't have the scale to implement them as well as Leidos. Beyond technology, Leidos' human capital is a key advantage. Their workforce of more than 42,000 includes thousands of cleared engineers and analysts, with over 52% of their employees possessing security clearances and almost 20% being veterans. Given how scarce this type of talent is, Leidos' ability to attract, train, and retain such personnel gives it a durable edge that strengthens over time.

High Switching Costs and Integration Complexity

Once Leidos deploys a mission-critical system, like their work with the FAA, the VA for healthcare IT, or intelligence analytics, the cost and risk of switching to another vendor is extremely high. For example, air traffic modernization or nuclear security programs involve billions of dollars, years of engineering, and extensive regulatory oversight. Clients and systems are effectively locked in, because changing providers mid-program could jeopardize national security or critical infrastructure. As a result, Leidos enjoys added contract security, with these high switching costs acting as a durable source of competitive advantage that ensures customer retention and recurring revenues.

4. Strong Management Team and Culture



Experienced Management Team

Over the past couple years, Leidos has seen great growth for their industry and has showcased a great amount of stability and consistency, largely in part to the strong management and team culture. Some key NEOs Involved in this were the CEO, Thomas A. Bell and the CFO, Chris Cage. Thomas became CEO in May of 2023 where they have seen their stock rise 128%, and key metrics like backlog, revenue, and EBITDA margin grow, while also putting forth clear initiatives like Project North Star 2030 in motion, Seeing Leidos grow much faster than their key competitors. His background is also very relevant as he has held many varied positions in manufacturing engineering, contracts and pricing, sales and marketing, and program management while also serving in executive roles at Boeing and was previously Chairman and CEO of Rolls-Royce North America, Inc. He currently serves on the Executive Committee for the Aerospace Industries Association. Chris on the other hand has been with the company since 1996, formerly at SAIC (a key competitor). He has held many finance and accounting related roles in the company and has a strong history of managing successful acquisitions, such as the integration of Lockheed Martin's IS&GS business.

Skin in the Game

Another good indicator of Leidos' strong team are their ownership policies and behaviors. Leidos has an ownership requirement where all of their directors and key NEOs must own at least 5x their annual cash retainer in the company, ensuring that they cannot afford to just rely on salary. Another good sign is the NEO's compensation breakdown which is heavily weighted toward performance and key metrics in revenue, operating cash flow, and adjusted EBITDA margin. For CEO Thomas Bell, only 13% of total compensation comes from fixed base salary, while 87% is variable or equity-based, including 34% in annual cash incentives and 33% in long-term equity (20% performance share awards, 13% restricted stock units, plus 20% in stock options). Other NEOs follow a similar model with base salaries higher at about 22% but all other metrics very similar to that of the CEO. Long-term incentives, include performance shares and RSUs that vest over three years based on cumulative EPS growth, relative total shareholder return, and revenue performance, discouraging short-term thinking and promoting disciplined, long-horizon growth.

Leidos has steadily returned capital to investors through both dividends and buybacks. Dividends have increased annually since 2015, growing at ~3.5% CAGR over the past five years, while share repurchases have reduced the share count from ~142 million in 2020 to ~134 million in 2024. Together, these reinforce management's disciplined focus on long-term shareholder value creation.

Culture

Leidos is very well known for its exceptional culture and workplace Environment, consistently being voted into Forbes workplace lists and For the seventh consecutive year, the Ethisphere Institute named Leidos one of the World's Most Ethical Companies in 2024. They build Their culture around the six key values of integrity, inclusion, innovation, agility, collaboration and commitment. This has led to strong company reviews with over 86% approving of the CEO on Glassdoor.

5. Financial Strength

Key Metrics:

Operating Margin (2024): 11.0%
Profit Margins (2024): 7.5% (competitor average: 5.44%)
Revenue Growth from (2019-2024): $12.297 billion to $16.662 billion, a 5-year CAGR of 7.64%
Free Cash Flow Conversion (2024): 99%
ROIC (2024): 17.03% (typical cost of capital of 8-10%, 5-year CAGR of 14.2%)
Debt-to-Equity Ratio (2024): 1.05x (down from 1.23x in 2020)
Current Ratio (2024): 1.21x

Revenue Visibility:

Leidos benefits from exceptional revenue visibility through its +$46bn backlog, which covers over two years of forward sales. This helps to provide a buffer against any short-term issues such as budget uncertainty or demand dips, as contracts with the U.S. government tend to be multi-year and mission-critical. Other than stability, this backlog aids in growth, and was a primary factor in Leidos' revenue growing at a CAGR of 7.64%.

Cash Flow Resilience:

Leidos had a free cash flow conversion rate of 99% in 2024, well above the guideline of 80% we set at SIF. This highlights the stability of its operating model and is at the higher end of its closest peers. Government contracting provides consistent payment schedules that limit working capital volatility, enabling Leidos to generate cash even during macroeconomic disruptions. However, It is important to note that Leidos' FCF conversion rate has seen a decline from 183% in 2020 to 99% today. This is largely due to Leidos' increase in net income relative to its FCF, but it's still great to see such high numbers.

Capital Efficiency:

Unlike other large military defense contractors that require significant investment in physical assets, Leidos operates with a relatively low capital intensity, with CapEx averaging at only 1.06% of total revenue over the past 5 years. In addition, its ROIC has historically been in line with the industry average of 9.5% but has seen great leaps in the past year, going from 3.9% to 17.03% in 2024. This demonstrates that Leidos is not only efficient at converting revenue into profits, but also highly effective in deploying capital to generate excess returns.

Debt Management:

Leidos has steadily reduced its debt-to-equity ratio from 1.23x in 2020 to 1.05x in 2024, showcasing a disciplined deleveraging strategy. This debt-to-equity ratio places it at the upper ends of its best industry competitors, much better than Booz Allen Hamilton (393%) and SAIC (162%) but slightly above CACI (86%). Additionally, Total debt declined modestly from $4.74 billion in 2020 to $4.67 billion in 2024, while cash and equivalents increased from $524 million to $943 million over the same period, strengthening the balance sheet. The company also maintains a strong interest coverage ratio of 9.5x in 2024, up from 2.9x in 2023, showcasing its ability to comfortably meet obligations.

6. Fair Price

Leidos' IRR analyses are both well above the 15% threshold that the Smith Investment Fund's investment criteria aims for. The P/E 5-Year IRR is 52%, while the EV/EBITDA 5-Year IRR is 46%, both reflecting extreme upside in price potential for Leidos. The DCF however is not as bullish, reflecting a 19.3% premium to current share price, one that may not provide enough upside at Leidos' current price to be invested into at this time.

IRR	2024A	2025E	2026E	2027E	2028E	2029E
Net Income	1,254	1,389	1,578	1,762	1,941	2,101
Shares	136,009	134,084	132,186	130,315	128,470	126,652
EPS	9.22	10.36	11.94	13.52	15.11	16.59
Current Price	178.33					
Current P/E	16.83					
Forward P/E	16.31					
Implied Price		$ 169.00	$ 194.73	$ 220.57	$ 246.48	$ 270.52

	2024A	2025E	2026E	2027E	2028E	2029E	IRR
Returns Analysis	$ (178.33)	$ 169.00					-5%
	$ (178.33)		$ 194.73				9%
	$ (178.33)			$ 220.57			24%
	$ (178.33)				$ 246.48		38%
	$ (178.33)					$ 270.52	52%

EV/EBITDA IRR	2024A	2025E	2026E	2027E	2028E	2029E
Price per share	178.33	$ 169.00	$ 194.73	$ 220.57	$ 246.48	$ 270.52
Market cap	24,254.43	22,659.45	25,740.40	28,743.48	31,665.78	34,262.05
Net debt	3,109	3,540	3,152	2,659	2,061	1,351
EV	21,145.43	19,119.29	22,588.32	26,084.75	29,604.85	32,910.67
EBITDA	1,918	2,098	2,353	2,581	2,806	3,002
Multiple	11.02472749	9.113056	9.5982047	10.105489	10.550443	10.961902
Current Price	178.33					
Implied Price		142.59	170.88	200.17	230.44	259.85

	2024A	2025E	2026E	2027E	2028E	2029E	IRR
Returns Analysis	$ (178.33)	$ 142.59					-20%
	$ (178.33)		$ 170.88				-4%
	$ (178.33)			$ 200.17			12%
	$ (178.33)				$ 230.44		29%
	$ (178.33)					$ 259.85	46%

COST DCF	Expected				
	2025E	2026E	2027E	2028E	2029E
net change in cash	733.59	790.46	858.79	933.24	972.98
+ Dividends	358.56	407.32	454.84	501.08	542.17
FCFE	**1,092.16**	**1,197.78**	**1,313.63**	**1,434.32**	**1,515.15**
Discount Factor	0.37	1.37	2.37	3.37	4.37
PV of FCFE	1,063.93	1,086.98	1,110.54	1,129.59	1,111.59

Terminal Assumption	
Valuation date	8/20/25
FY End	1/3/26
Terminal Growth Rate	2%

Current Valuation	
Terminal Valuation	$ 31,372.04
PV of TV	$ 23,016.23
PV of Equity	$ 28,518.86
Diluted Shares	134,084
share price	$ 212.69

Capital Asset Pricing Model

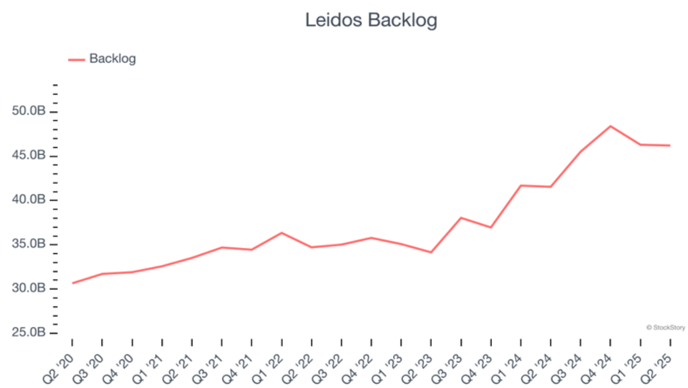
Cost of Equity	
Risk Free rate	4.33%
Beta	0.66
Expected Market Return	8.90%
Cost of Equity	7.3455200%

Coverage Plan

Defense Budget Outlook: One of the most critical things to monitor going forward will be the state of the U.S. defense and relevant agencies budget and funding. Leidos generates 87% of total revenues from contracts with the U.S. government and its growth is largely dependent on not only winning more contracts, but also the idea that there is more money up for grabs. With the FY26, and future budgets, yet to be finalized, there remains uncertainty around potential topline growth, delays, or political decisions that could restrict program funding. A growing and supportive budget environment would reinforce the ideas brought forth in this pitch while any flattening or contraction would create a meaningful headwind to both revenue growth and long-term earnings potential.

Contract Wins and Backlog Execution: Leidos' future performance is closely tied to its ability to both secure new contract awards and efficiently convert its record backlog of over $46bn into revenue. Fortunately, Leidos is very well positioned in this respect through its many years of successful contract competition, year-on-year backlog expansion, and increased security clearance, increasing its moat and giving it new contract opportunities. With Leidos' expertise in IT modernization, AI integration, and mission-critical operations, not only do they have a competitive advantage in high-value single contracts, but they can also provide value when teaming with other firms in their contract bids as either a prime contractor or subcontractor. This flexibility, alongside its great customer relationships, positions the company well for sustained contracts wins across defense, intelligence, and civil agencies. Continued trends in award volumes and backlog execution will be essential in my growth thesis and any slow downs would be concerning.

Margin Expansion Progress: Finally, margin expansion and general financial stability remains a very important lever for shareholder value creation. Over the past 5 years, Leidos has seen its operating margins grow from 8% to over 11%, recovering from a significant down decrease in FY23 due to impairment charges. So, while Leidos is further up on the S-curve than other companies, what must remain true for them to have showcase successful earnings growth is to expand their margins into the future. In fiscal 2024, Leidos delivered an adjusted EBITDA margin of ~12.7%. Looking ahead, management has guided to an even stronger margin profile of 13.0–13.5% for FY25, signaling confidence in both cost discipline and operating leverage.



Risks and Mitigation

Heavy Dependence on U.S. Government Funding

Leidos generated 87% of its total revenue in Q2 of FY25 from U.S. government contracts, with ~48% of total revenue coming from the DoD and U.S. Intelligence Community. This concentration exposes Leidos to political and fiscal risks such as budget cuts, debt ceiling standoffs, or delays in the appropriations or contract awarding process. Any flattening or contraction in defense or civil agency spending could significantly constrain Leidos' ability to grow and future prospects.

Mitigation: While Leidos' business is very heavily concentrated within U.S. government contracts and that won't really be changing, Leidos can offset this risk by continuing to diversify their portfolio into civil and international markets (currently ~8%) of revenue). Additionally, Leidos is already pretty well insulated against this dependence risk through its broad customer base across many different agencies, spreading exposure beyond just one department. Leidos also has lots of its revenue coming from multi-year contracts and is still considered as a mission-critical partner for many high-priority government operations.

Contract Termination and Backlog Conversion Risk

Leidos' record backlog of over $46bn provides a strong visibility but not all of it ay ultimately convert into revenue. Currently, only $7.1bn of that backlog is funded with over $39bn still being unfunded (work that the government has authorized or intends to procure but for which funds have not yet been appropriated). While these are very common figures for Leidos' industry, it's still true that U.S. government contracts can be canceled, modified, or renewed on less favorable terms at any time, which could undermine expected revenue streams.

Mitigation: Leidos has not yet faced any major contract termination threats and even during the pandemic, they were able to make themselves valuable to where they didn't see meaningful disruption in revenue growth. Leidos has maintained deep government relationships and consistent year-over-year backlog growth, mitigating these cancellation risks. By maintaining operational excellence and through its increased clearance levels, Leidos has improved its ability to execute contracts on time and is among a smaller and smaller pool of companies that can be relied upon for these high security missions. Its flexibility to act as both a prime and subcontractor also increases contract resilience.

High Goodwill Concentration on BS and Impairments

As of Q2 of FY25, goodwill represented ~46% of Leidos' total assets. This creates a balance sheet risk, as unfavorable shifts in many macroeconomic factors, federal budgets, or industry conditions, could trigger a goodwill impairment, heavily impacting earnings. In FY23, for example, a $596mm goodwill impairment caused Leidos' operating margin to half from ~8% to 4%. Such non-cash charges can have huge impacts on investor sentiments, destroy shareholder value, and negatively impact financial flexibility.

Mitigation: Leidos has a good history of making relevant acquisitions (like the recent Kudu Dynamics) and properly integrating them into their business to drive portfolio strength and cost efficiencies. Margin growth over the past couple years and its projected future expansion will also do a job of providing a buffer against impairment triggers. But it is also important to note that these impairments are very rare, and ones of meaningful size are especially rare.

Appendix

	Income Statement- USD($) and shares in millions			Actual					Expected		
		2020A	2021A	2022A	2023A	2024A	2025E	2026E	2027E	2028E	2029E
	REVENUE										
	Revenues	12,297	13,737	14,396	15,438	16,662	18,106	19,502	20,771	21,935	22,849
x	**Total revenue**	**12,297**	**13,737**	**14,396**	**15,438**	**16,662**	**18,106**	**19,502**	**20,771**	**21,935**	**22,849**
	Revenue Growth		*11.7%*	*4.8%*	*7.2%*	*7.9%*	*8.7%*	*7.7%*	*6.5%*	*5.6%*	*4.2%*
	OPERATING EXPENSES										
	COGS	10,560	11,723	12,312	13,194	13,864	14,919	15,992	16,949	17,811	18,462
	Selling, general and administrative	770	860	951	942	983	1,127	1,214	1,293	1,366	1,423
	Acquisition, integration, and restructuring costs	(68)	(9)	17	24	16	(4)	9	12	11	9
	Goodwill impairment charges	39	27	-	596	-	-	-	-	-	-
	Asset Impairment Charged	12	4	40	91	11	32	36	42	42	32
	Equity earnings of non-consolidated subsidiaries	(14)	(20)	(12)	(30)	(39)	(23)	(25)	(26)	(29)	(28)
	Total Operating Expense	11,299	12,585	13,308	14,817	14,835	16,046	17,206	18,242	19,177	19,885
x	**EBIT**	**998**	**1,152**	**1,088**	**621**	**1,827**	**2,059**	**2,296**	**2,529**	**2,758**	**2,964**
	EBIT Margin	*8.1%*	*8.4%*	*7.6%*	*4.0%*	*11.0%*	*11.4%*	*11.8%*	*12.2%*	*12.6%*	*13.0%*
				9.9%	6.2%	12.7%	13-13.5 ebitda				
	OTHER INCOME (EXPENSE)										
	Interest expense	(179)	(184)	(199)	(212)	(193)	(193)	(193)	(193)	(193)	(193)
	Interest income and other, net	(38)	(1)	(3)	(6)	5	5	5	5	5	5
	Interest, net	(217)	(185)	(202)	(218)	(188)	(188)	(188)	(188)	(188)	(188)
x	**INCOME BEFORE INCOME TAXES (EBT)**	**781**	**967**	**886**	**403**	**1,639**	**1,871**	**2,108**	**2,340**	**2,570**	**2,776**
	Provision for income taxes	(152)	(208)	(193)	(195)	(388)	485	533	581	631	678
	Net income including noncontrolling interests	629	759	693	208	1,251	1,386	1,575	1,759	1,938	2,098
	Net income attributable to noncontrolling interests	1	6	8	9	(3)	(3)	(3)	(3)	(3)	(3)
x	**NET INCOME ATTRIBUTABLE TO LEIDOS**	**628**	**753**	**685**	**199**	**1,254**	**1,389**	**1,578**	**1,762**	**1,941**	**2,101**
	Net Income Margin	*5.1%*	*5.5%*	*4.8%*	*1.3%*	*7.5%*	*7.7%*	*8.1%*	*8.5%*	*8.9%*	*9.2%*
x	**NET INCOME PER COMMON SHARE ATTRIBUTABLE TO LEIDOS:**										
	Basic	4.42	5.34	5.00	1.45	9.36	10.52	12.13	13.74	15.36	16.87
	Diluted	4.36	5.27	4.96	1.44	9.22	10.36	11.94	13.52	15.11	16.59
			17%	-6%	-244%	84%					
	Shares used in calculation (000's)										
	Basic	142,081	141,011	137,000	137,241	133,974	132,031	130,116	128,228	126,368	124,535
	Diluted	144,037	142,884	138,105	138,194	136,009	134,084	132,186	130,315	128,470	126,652

Appendix

	Balance Sheet - USD($) in millions	Actual					Expected					
x		2020A	2021A	2022A	2023A	2024A	2025E	2026E	2027E	2028E	2029E	
	ASSETS											
	CURRENT ASSETS											
	Cash and cash equivalents	524	727	516	777	943	#########	2,467.06	3,325.85	4,259.09	5,232.07	
	Receivables, net	2,137	2,189	2,350	2,429	2,645	#########	3,168.96	3,375.06	3,564.23	3,712.79	o
	Inventory, net	276	274	287	310	315	366.87	395.17	420.87	444.46	462.98	o
	Other current assets	402	429	490	489	525	583.52	628.53	669.40	706.92	736.39	o
x	**Total current assets**	**3,339**	**3,619**	**3,643**	**4,005**	**4,428**	**5,569**	**6,660**	**7,791**	**8,975**	**10,144**	
	OTHER ASSETS											
	Property and equipment, net	604	670	847	961	991	#########	1,186.20	1,263.74	1,334.37	1,390.09	i
	Intangible Assets, net	1,216	1,177	952	667	517	517.00	517.00	517.00	517.00	517.00	i
	Goodwill	6,313	6,744	6,696	6,112	6,084	#########	6,084.00	6,084.00	6,084.00	6,084.00	
	Operating lease right-of-use assets, net	581	612	545	512	560	631.48	680.19	724.43	765.03	796.92	o
	Other long-term assets	458	439	388	438	524	565	608	648	684	713	
x	**TOTAL ASSETS**	**12,511**	**13,261**	**13,071**	**12,695**	**13,104**	**14,468**	**15,735**	**17,028**	**18,359**	**19,645**	
	LIABILITIES AND EQUITY											
	CURRENT LIABILITIES											
	accounts payable	731	692	733	736	705	814.49	873.35	925.94	973.38	1,009.32	o
	accrued liabilities	939	1,053	772	826	883	927	994	1,054	1,108	1,149	o
	deferred revenue	481	364	380	442	333	509	549	584	617	643	o
	other (A/P and Acc Lia)	24	32	369	273	304	315	315	315	315	315	o
	acrued payroll and employee benefits	632	605	701	695	811	829	889	942	991	1,027	o
	current portion of long term debt	100	483	992	18	618	690	744	792	836	871	o
x	**Total current liabilities**	**2,907**	**3,229**	**3,947**	**2,990**	**3,654**	**4,085**	**4,363**	**4,613**	**4,840**	**5,014**	
	OTHER LIABILITIES											
	Long-term debt, excluding current portion	4,644	4,593	3,928	4,664	4,052	#########	5,619.14	5,984.59	6,320.02	6,583.45	f
	Long-term operating lease liabilities	564	589	570	516	621	643.58	693.22	738.30	779.68	812.18	o
	Deferred tax liabilities	234	239	40	-	-	-	-	-	-	-	o
	Other long-term liabilities	291	267	233	267	317	317	317	317	317	317	
x	**TOTAL LIABILITIES**	**8,640**	**8,917**	**8,718**	**8,437**	**8,644**	**10,262**	**10,993**	**11,653**	**12,257**	**12,727**	
	EQUITY											
	Preferred stock	-	-	-	-	-	-	-	-	-	-	
	Common stock	-	-	-	-	-	-	-	-	-	-	
	Additional paid-in capital	2,580	2,423	2,005	1,885	1,112	1,021	924	820	710	596	o
	Accumulated other comprehensive loss	1,328	1,880	2,367	2,364	3,410	2,714	2,714	2,714	2,714	2,714	
	Retained earnings	(46)	(12)	(73)	(48)	(110)	422.72	1,057.17	1,793.34	2,630.41	3,560.44	f
	Total Costco stockholders' equity	3,862	4,291	4,299	4,201	4,412	4,158	4,695	5,327	6,055	6,870	
	Noncontrolling interests	9	53	54	57	48	48	48	48	48	48	
x	**TOTAL EQUITY**	**3,871**	**4,344**	**4,353**	**4,258**	**4,460**	**4,206**	**4,743**	**5,375**	**6,103**	**6,918**	
x	**TOTAL LIABILITIES AND EQUITY**	**12,511**	**13,261**	**13,071**	**12,695**	**13,104**	**14,468**	**15,735**	**17,028**	**18,359**	**19,645**	

Appendix

Derived Cash Flow- USD($) in millions			Expected		
	2025E	2026E	2027E	2028E	2029E
x **Operating Activities**					
Net Income	1,389	1,578	1,762	1,941	2,101
+ Depreciation	39	57	53	48	38
+ Stock Based Comp	(90.53)	(97.51)	(103.85)	(109.67)	(114.25)
x Changes in operating assets and liabilities:					
Receivables, net	(297.03)	(226.93)	(206.10)	(189.17)	(148.56)
Inventories	(51.87)	(28.30)	(25.70)	(23.59)	(18.53)
Other current assets	(58.52)	(45.01)	(40.88)	(37.52)	(29.47)
Operating lease right-of-use assets	(71.48)	(48.71)	(44.24)	(40.60)	(31.89)
Accounts payable	109	59	53	47	36
accrued liabilities	44	67	60	54	41
deferred revenue	176	39	36	33	26
aoci	(696)	-	-	-	-
acrued payroll and employee benefits	18	60	54	48	37
Long-term operating lease liabilities	22.58	49.64	45.08	41.38	32.50
other long term-assets	(40.81)	(43.56)	(39.57)	(36.32)	(28.52)
other (A/P and Acc Lia)	11.33	-	-	-	-
x **Cash from operating activities**	**502.65**	**1,420.02**	**1,601.28**	**1,776.38**	**1,938.88**
x **Investing Activities:**					
CapEx/PPE	(149.58)	(141.44)	(130.14)	(118.55)	(93.53)
Intangible Assets, net	-	-	-	-	-
x **Cash from investing activities**	**-150**	**-141**	**-130**	**-119**	**-94**
x **Financing Activities:**					
current portion of long term debt	72	53	48	44	35
Long-term debt, excluding current portion	1,164.76	455.63	413.81	379.83	298.29
Dividends	(358.56)	(407.32)	(454.84)	(501.08)	(542.17)
Other stuff	(498.02)	(536.43)	(571.32)	(603.34)	(628.49)
x **Cash from financing activities**	**380.53**	**(488.12)**	**(612.34)**	**(724.59)**	**(872.36)**
x **Net Change in Cash**	**733.59**	**790.46**	**858.79**	**933.24**	**972.98**

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