

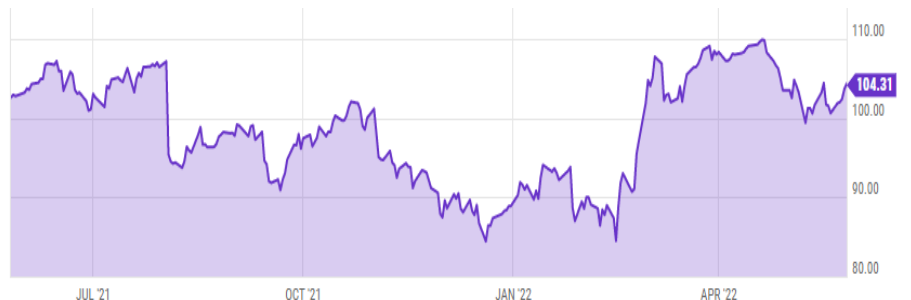
COMPANY KEY INFORMATION	
Industry	IT Services
Short Interest	1.2%
Avg. Daily Volume	770,662
Shares Outstanding	140.34 million
Institutional Holdings	81.55%
Insider Holdings	1.00%
Upside	+14.42%
Current Dividend Yield	1.56%
Market Cap	\$13.06 billion
EPS (FY2020)	\$4.36

ANALYST CONSENSUS ESTIMATE	
Consensus EPS	
FY2021	\$5.34
FY2022	\$5.52
FY2023	\$6.30
Forward P/E	
FY2021	14.1X
FY2022	13.6X
FY2023	12.3X

Source: Refinitiv, Bloomberg

Recommendation:

We issue a BUY recommendation for Leidos with a one-year target price of \$157.37, indicating a +50% upside potential (including dividend yield) on the closing price of \$105.36 on May 26, 2022. The target price is based on the Discounted Cash Flow method (DCF) and is supported by Relative Valuation. Our recommendation lies on the following key attributes: (1) growing demand for cybersecurity and Information Technology (IT) modernization being brought on by global threats, (2) government budget shifts toward non-defense spending, and (3) consolidating government contractors.



Stock Price of Leidos

Source: Yahoo Finance

Business Description

Headquartered in Reston, Virginia, Leidos Holdings Inc. was founded in 1969 and was formerly known as Science Applications International Corporation (SAIC), Incorporated. On September 27, 2013, Leidos completed the spin-off of the new SAIC and subsequently changed its name to Leidos Holdings.

Leidos Holdings, Inc. provides technology services and solutions in the United States and internationally. The company has an international presence in 30 countries, with the UK and Australia being the significant origins of international customers. Its core competencies and product portfolios include digital modernization, cyber operations, mission software systems, integrated systems, and mission operations. Leidos operates under three segments: Defense (60% of FY2020 revenues), Civil (24%), and Health (16%).

Competitive Positioning – Porter's Five Forces

Threat of New Entrants – Low: Leidos' ability to generate cash flow and its backlog record pose a credible threat to potential entrants, further enhancing their market share.

Bargaining Power of Buyer – High: Leidos has been a trusted government contractor for a long time and has regularly been in touch with government officers due to regulatory requirements. This provides opportunities to build better relations with government agencies. The products provided by Leidos are complex and are highly differentiated, making switching costs high.

Bargaining Power of Supplier – Low: 41% of Leidos' \$4.1 billion in sourcing expenses goes to US-based small businesses. Leidos is also committed to sourcing from veteran-owned firms. Leidos' support towards small companies further lowers the bargaining power of suppliers and builds a good reputation at the same time.

Threat of Substitutes – Low: Compared to its competitors, Leidos invests more heavily in R&D, making its products less imitable.

Degree of Rivalry – Moderate: The size of Leidos allows the company to bid for more contracts and improve their operating efficiency as they spread the cost across a more extensive base of contracts. A series of wins highlight that Leidos has the capability to compete against incumbents.

Valuation

We reiterate our BUY recommendation for Leidos with a 12-month target price of \$157.37 under the base scenario, indicating a 50% upside potential. Our target price is the result of discounted cash flow model. To confirm the robustness of the DCF valuation, we also performed a sensitivity analysis.

We used DCF for the valuation and made certain assumptions based on their historical data. The revenue growth rate for the forecasted year was taken from the CAGR of previous years, and SG&A growth was taken as an average of the previous years. Capex was taken as the proxy of revenue as we were unable to ballpoint a relevant rate based on CAGR and y-o-y. Depreciation is taken from Capex and depreciated through the straight-line method for 10 years. WACC was calculated using the data derived from the company’s annual report and CAPM calculations. Terminal Value was calculated using two methods: Exit Multiple and Perpetuity method. Exit multiple was found through research and Long term growth rate was taken as 2% for the calculation of terminal value through the perpetuity method.

Leidos Holdings Inc. DCF - Equity Value								
(values in millions)	Historical			Forecast				
	2019	2020	2021	2022	2023	2024	2025	2026
	Year1	Year2	Year3	Year4	Year5			
Revenue	11,094	12,297	13,737	14,337	14,963	15,616	16,298	17,010
COGS	9,546	10,560	11,723	12,294	12,831	13,391	13,976	14,586
Gross Profit	1,548	1,737	2,014	2,043	2,132	2,225	2,322	2,423
Net Operating Expense	636	739	862	914	969	1,027	1,088	1,154
Operating Income	912	998	1,152	1,129	1,163	1,198	1,233	1,269
Non operating expense:								
Interest Expense	(133)	(179)	(184)					
Pretax Income	779	819	968	1,129	1,163	1,198	1,233	1,269
Tax	(196)	(152)	(208)	237	244	252	259	267
Net Income	583	667	760	1,366	1,407	1,450	1,492	1,536

Adjustments to Net Income								
D&A		282	73	14	15	16	16	17
Net Working Capital	-	132	(113)	97	29	30	31	32
Capex	65	(2,815)	(730)	(143)	(150)	(156)	(163)	(170)
Levered Free Cash Flow	648	(1,735)	(10)	1,334	1,301	1,339	1,377	1,415
Discount Factor				0.94	0.88	0.83	0.78	0.73
PV of LFCF				1,254.11	1,149.82	1,112.10	1,075.15	1,038.96
Sum of PV of LFCF				5,630.13				

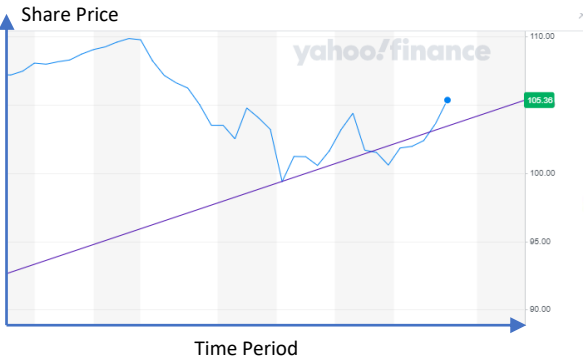
Terminal Value		Equity Value	
Terminal Value - Exit Multiple	10,291.63	Equity Value - Exit Multiple	13,184.46
PV of Terminal Value - Exit Multiple	7,554.32	Equity Value - Perpetuity Method	29,828.09
Terminal Value - Perpetuity Method	32,966.06	Average Equity Value	21,506.27
PV of Terminal Value - Exit Multiple	24,197.95		
		Share Price	157.37

Long Term Growth Rate						
	157.37	1.00%	1.500%	2%	2.500%	3.000%
WACC	4.38%	198.83	221.24	253.07	301.82	385.89
	5.38%	163.21	175.57	191.58	213.15	243.78
	6.38%	140.20	147.90	157.36	169.25	184.67
	7.38%	123.89	129.09	135.24	142.66	151.77
	8.38%	111.61	115.31	119.58	124.59	130.52

Ratio Analysis			
	2019	2020	2021
Liquidity Ratio			
Current Ratio	1.21	1.15	1.12
Solvency Ratio			
Debt Equity Ratio	1.74	2.23	2.05
Debt to Total Asset	0.64	0.69	0.67
Interest Coverage Ratio	4.42	5.14	4.65
Profitability Ratios			
Gross Profit Margin	13.95%	14.13%	14.66%
Net Profit Margin	6.01%	5.11%	5.48%
ROA	7.12%	5.02%	5.68%
ROE	19.52%	16.22%	17.33%

Fundamental Analysis

The current ratio of Leidos is dropping but the reason for drop is the recent acquisition carried by the company. Leidos focuses on strategic acquisition in order to expand its business and generate more revenue. Due to this reason, the gross profit margin for the company is also growing over the years and is expected to grow in the future. Return on Equity dropped in 2020 due to the acquisition of L3Harris Technologies (used at airports) and the sudden hit of covid. Leidos has strong potential to grow as the restrictions for covid lighten and travel resumes as usual. The company is also expanding in the defense sector and with an increase in the defense budget, it is expected to grow more in revenue.



Source: Yahoo finance, Team Analysis



Source: tradingview.com

Technical Analysis

The chart clearly indicates an upward trendline for Leidos from last month. Hence, even the triple top pattern predicts upward growth for Leidos. Apart from the triple top, the moving average also predicts a strong buy which resonates with our DCF valuation.