Science Applications International Corp
Form 10-Q
September 08, 2017

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 August 4, 2017

or

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

For the transition period from to

Commission File Number	Exact Name of Registrant as Specified in its Charter, Address of Principal Executive Offices and Telephone Number	State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification No.
001-35832	Science Applications International Corporation 12010 Sunset Hills Road, Reston, VA 20190 703-676-4300	Delaware	46-1932921

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, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
			Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 25, 2017 was as follows:

43,240,542 shares of common stock ($.0001 par value per share)

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

FORM 10-Q

TABLE OF CONTENTS

Table of Contents

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	
	August 4, 2017	August 5, 2016	August 4, 2017	August 5, 2016
	(in millions, except per share amounts)			
Revenues	$1,078	$1,095	$2,181	$2,310
Cost of revenues	979	986	1,986	2,084
Selling, general and administrative expenses	40	39	73	90
Operating income	59	70	122	136
Interest expense	10	12	21	26
Income before income taxes	49	58	101	110
Provision for income taxes (Note 4)	(13)	(21)	(16)	(40)
Net income	$36	$37	$85	$70
Other comprehensive income, net of tax (Note 7)	-	-	1	-
Comprehensive income	$36	$37	$86	$70
Earnings per share (Note 2):				
Basic	$0.83	$0.83	$1.95	$1.56
Diluted	$0.80	$0.81	$1.88	$1.52
Cash dividends declared and paid per share	$0.31	$0.31	$0.62	$0.62

See accompanying notes to condensed and consolidated financial statements.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

CONDENSED AND CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	August 4, 2017 (in millions)		February 3, 2017	
ASSETS				
Current assets:				
Cash and cash equivalents	$	140	$	210
Receivables, net		639		539
Inventory, prepaid expenses and other current assets		113		152
Total current assets		892		901
Goodwill		863		863
Intangible assets (net of accumulated amortization of $45 million and $40 million at August 4, 2017 and February 3, 2017, respectively)		189		200
Property, plant, and equipment (net of accumulated depreciation of $136 million and $126 million at August 4, 2017 and February 3, 2017, respectively)		57		60
Other assets		18		18
Total assets	$	2,019	$	2,042
LIABILITIES AND EQUITY				
Current liabilities:				
Accounts payable and accrued liabilities	$	420	$	432
Accrued payroll and employee benefits		156		158

Long-term debt, current portion (Note 5)		58			25	
Total current liabilities		634			615	
Long-term debt, net of current portion (Note 5)		1,006			1,022	
Deferred income taxes		13			13	
Other long-term liabilities		41			38	
Commitments and contingencies (Note 8)						
Equity:						
Common stock, $.0001 par value, 1 billion shares authorized, 44 million shares issued and outstanding as of August 4, 2017 and February 3, 2017		-			-	
Additional paid-in capital		4			91	
Retained earnings		322			265	
Accumulated other comprehensive loss (Note 7)		(1	)		(2	)
Total equity		325			354	
Total liabilities and equity	$	2,019		$	2,042	

See accompanying notes to condensed and consolidated financial statements.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

CONDENSED AND CONSOLIDATED STATEMENT OF EQUITY

(UNAUDITED)

	Shares of common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total
	(in millions)				
Balance at February 3, 2017	44	$ 91	$ 265	$ (2)	$ 354
Net income	-	-	85	-	85
Issuances of stock	1	4	-	-	4
Other comprehensive income, net of tax	-	-	-	1	1
Cash dividends of $0.62 per share	-	-	(28)	-	(28)
Stock-based compensation	-	(13)	-	-	(13)
Repurchases of stock	(1)	(78)	-	-	(78)
Balance at August 4, 2017	44	$ 4	$ 322	$ (1)	$ 325

See accompanying notes to condensed and consolidated financial statements.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

CONDENSED AND CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended August 4, 2017	August 5, 2016
	(in millions)	
Cash flows from operating activities:		
Net income	$ 85	$ 70
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	22	28
Stock-based compensation expense	15	18
Excess tax benefits from stock-based compensation	-	(9)
Increase (decrease) resulting from changes in operating assets and liabilities:		
Receivables	(100)	(20)
Inventory, prepaid expenses and other current assets	38	(19)
Other assets	-	(1)
Accounts payable and accrued liabilities	(8)	(5)
Accrued payroll and employee benefits	(2)	(4)
Other long-term liabilities	3	-
Net cash provided by operating activities	53	58

Cash flows from investing activities:						
Expenditures for property, plant, and equipment		(7	)		(8	)
Net cash used in investing activities		(7	)		(8	)
Cash flows from financing activities:						
Dividend payments to stockholders		(28	)		(27	)
Principal payments on borrowings		(9	)		(26	)
Issuances of stock		3			2	
Stock repurchased and retired or withheld for taxes on equity awards		(105	)		(88	)
Excess tax benefits from stock-based compensation		-			9	
Disbursements for obligations assumed from Scitor acquisition		(2	)		(3	)
Proceeds from borrowings		25			-	
Net cash used in financing activities		(116	)		(133	)
Net decrease in cash, cash equivalents and restricted cash		(70	)		(83	)
Cash, cash equivalents and restricted cash at beginning of period		218			209	
Cash, cash equivalents and restricted cash at end of period (Note 1)	$	148		$	126	

See accompanying notes to condensed and consolidated financial statements.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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

Overview

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 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. The Company is organized as a matrix comprised of five customer facing organizations supported by several service line organizations. Each of the Company's customer facing organizations is focused on providing the Company's comprehensive technical and enterprise IT service offerings to one or more agencies of the U.S federal government. During the quarter, the Company made operational and organizational changes to its management reporting structure resulting in the identification of a single operating and reportable segment.

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 February 3, 2017.

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. Significant estimates inherent in the preparation of the financial statements may include, but are not limited to estimated profitability of long-term contracts, income taxes, fair value measurements, fair value of goodwill and other intangible assets, and contingencies. 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.

Changes in estimates of revenues, cost of revenues or profits related to contracts accounted for using the cost-to-cost and efforts expended methods of percentage-of-completion accounting are recognized in operating income in the period in which such changes are made for the inception-to-date effect of the changes. Changes in these estimates can routinely occur over the contract performance period for a variety of reasons, which include: 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 $1 million ($0.01 per diluted share) for the three months ended August 4, 2017, decreased operating income by $4 million ($0.06 per diluted share) for the six months ended August 4, 2017, and increased operating income by $7 million ($0.10 per diluted share) and $13 million ($0.18 per diluted share) for the three and six months ended August 5, 2016, respectively.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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 2017 began on January 30, 2016 and ended on February 3, 2017, while fiscal 2018 began on February 4, 2017 and ends on February 2, 2018. The number of weeks for each quarter for fiscal 2018 and 2017 are as follows:

	Fiscal 2018	Fiscal 2017
	(weeks)	
First Quarter	13	14
Second Quarter	13	13
Third Quarter	13	13
Fourth Quarter	13	13
Fiscal Year	52	53

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 6 for further discussion on the Company's derivative instruments designated as cash flow hedges.

Cash, Cash Equivalents and Restricted cash

The following table provides a reconciliation of cash, cash equivalents and restricted cash to amounts reported within the condensed and consolidated balance sheets for the periods presented:

	August 4, 2017	February 3, 2017
	(in millions)	
Cash and cash equivalents	140	210
Restricted cash included in inventory, prepaid expenses and other current assets	-	1
Restricted cash included in other assets	8	7
Cash, cash equivalents and restricted cash	$148	$ 218

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 and some cost guidance included in the Accounting Standards Codification (ASC). 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. In August 2015, the FASB issued ASU 2015-14, Deferral of the Effective Date, resulting in a one-year deferral of the effective date of ASU 2014-09, which will become effective for the Company in the first quarter of fiscal 2019, using one of two retrospective methods of adoption.

The Company intends to adopt the standard as of February 3, 2018, using the modified retrospective transition method. Upon adoption, the Company will recognize the cumulative effect of adopting this standard as an adjustment to our opening balance of retained earnings. Prior periods will not be retrospectively adjusted, but the Company will maintain dual reporting for the year of initial application disclosing the effect of adoption.

The Company continues to evaluate the potential effects on its financial statements and is currently in the process of revising its accounting policies, business processes, systems, controls and procedures to conform to the new standard. The Company has not yet determined the potential impact from the future adoption of the new standard.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which supersedes the existing lease accounting standards (Topic 840). Under the new guidance, a lessee will be required to recognize lease assets and lease liabilities for all leases with lease terms in excess of twelve months. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as either a finance lease or operating lease. The criteria for distinction between a finance lease and an operating lease are substantially similar to existing lease guidance for capital leases and operating leases. Some changes to lessor accounting have been made to conform and align that guidance with the lessee guidance and other areas within GAAP, such as Revenue from Contracts with Customers (Topic 606). ASU 2016-02 becomes effective for the Company in the first quarter of fiscal 2020 and will be adopted using a modified retrospective approach. The Company has commenced the assessment phase of the project and is evaluating the impact on its financial statements from the future adoption of the standard.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which provides amendments to simplify several aspects of the accounting for share-based payment transactions. Among other requirements in the new standard, the ASU requires that an entity, (i) recognize excess tax benefits and deficiencies related to employee share-based payment transactions in the provision for income taxes, instead of in equity; (ii) classify excess tax benefits as an operating activity on the statement of cash flows, instead of the previous classification as a financing activity; (iii) classify all cash payments made to the taxing authorities on the employees' behalf for withheld shares as financing activities on the statement of cash flows; and (iv) make a policy election to either estimate expected forfeitures or to account for them as they occur. The Company adopted the standard in the first quarter of fiscal 2018. As a result for the three and six months ended August 4, 2017, the Company recognized a $4 million and $20 million tax benefit, respectively, which is included in the provision for income taxes on the condensed and consolidated statements of income and comprehensive income and as an operating activity in the condensed and consolidated statement of cash flows. The Company will continue to classify cash paid for tax withholding purposes as a financing activity in the statement of cash flows and to estimate forfeitures rather than account for them as they occur.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that restricted cash be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The Company early adopted this new standard during the first quarter of fiscal 2018, which resulted in a $3 million reduction to cash flows from investing activities for the six months ended August 5, 2016. A reconciliation of cash, cash equivalents and restricted cash for each period presented is provided above under the heading “Cash, Cash Equivalents and Restricted Cash.”

Other Accounting Standards Updates effective after August 4, 2017 are not expected to have a material effect on the Company’s financial statements.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 2—Earnings Per Share:

Basic earnings per share (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:

	Three Months Ended		Six Months Ended	
	August 4, 2017	August 5, 2016	August 4, 2017	August 5, 2016
	(in millions)			
Basic weighted-average number of shares outstanding	43.6	44.7	43.7	44.9
Dilutive common share equivalents - stock options and other stock-based awards	1.1	1.3	1.4	1.3
Diluted weighted-average number of shares outstanding	44.7	46.0	45.1	46.2

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	
	August 4, 2017	August 5, 2016	August 4, 2017	August 5, 2016
	(in millions)			
Antidilutive stock options excluded	0.2	0.3	0.2	0.5

Note 3—Stock-Based Compensation:

Stock Options

During the six months ended August 4, 2017, the Company granted certain employees 0.2 million stock options with a weighted-average exercise price and weighted-average grant date fair value of $73.36 and $16.34, 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 August 4, 2017, the Company granted certain employees 0.4 million RSUs with a weighted-average grant date fair value of $72.99, which will vest ratably on each anniversary of the grant date over a four-year period.

Performance Shares

During the six months ended August 4, 2017, the Company granted to certain employees 0.1 million performance share awards with a grant date fair value of $72.91 per award. These awards will cliff vest at the end of the third fiscal year following 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 specified target shares.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 4—Income Taxes:

Provision for income taxes as a percentage of income before income taxes was 26.5% and 15.8% for the three and six months ended August 4, 2017, respectively, and 36.3% and 36.4% for the three and six months ended August 5, 2016, respectively. Tax rates were lower as compared to the same periods in the prior year primarily due to a $4 million and $20 million excess tax benefit recognized for the three and six months ended August 4, 2017, respectively, related to employee share-based compensation as a result of the adoption of ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, see “Accounting Standards Updates” in Note 1. Increased research and development credits in the current periods were offset by a decreased domestic manufacturing tax deduction. Tax rates for the periods ended August 4, 2017 were lower than the combined federal and state statutory rates due to excess tax benefits related to employee share-based compensation and due to permanent tax benefits, including research and development credits and the manufacturer’s tax deduction.

As of August 4, 2017, the balance of unrecognized tax benefits included liabilities for uncertainty in income taxes of $6 million, $5 million of which is classified as other long-term liabilities on the condensed and consolidated balance sheets and $1 million of which is classified as a reduction to the corresponding deferred tax asset and is presented in other assets on the condensed and consolidated balance sheets. $6 million of unrecognized tax benefits, if recognized, would affect the effective income tax rate for the Company. While the Company believes it has adequate accruals for uncertainty in income taxes, the tax authorities, on review of the Company’s tax filings, may determine that the Company owes taxes in excess of recorded accruals, or the recorded accruals may be in excess of the final settlement amounts agreed to by tax authorities. Although the timing of such reviews is not certain, we do not believe that it is reasonably possible that the unrecognized tax benefits will materially change in the next 12 months.

Note 5—Debt Obligations:

The Company’s long-term debt as of the dates presented was as follows:

	August 4, 2017					February 3, 2017		
	Stated interest rate	Effective interest rate	Principal	Unamortized Debt Issuance Costs	Net	Principal	Unamortized Debt Issuance Costs	Net
			(in millions)					
Term Loan A Facility due August 2021	3.25%	3.36%	$651	$ (2)	$649	$660	$ (2)	$658
Term Loan B Facility due May 2022	3.69%	4.28%	400	(10)	390	400	(11)	389
Revolving Credit Facility due August 2021	5.25%		25	-	25	-	-	-

Total long-term debt	$1,076	$ (12)	$1,064	$1,060	$ (13)	$1,047
Less current portion	58	-	58	25	-	25
Total long-term debt, net of current portion	$1,018	$ (12)	$1,006	$1,035	$ (13)	$1,022

As of August 4, 2017, the Company has a $1.3 billion credit facility (the Credit Facility), which consists of a $200 million secured revolving credit facility (the Revolving Credit Facility) with an available capacity of $175 million for additional borrowings, a $651 million secured term facility (Term Loan A Facility), and a $400 million secured term facility (Term Loan B Facility) (together, the Term Loan Facilities). On August 2, 2017, the Company borrowed $25 million under the Revolving Credit Facility, which was repaid in full subsequent to quarter end on August 18, 2017. As of August 4, 2017, the outstanding principal under the Revolving Credit Facility was classified as current portion of long-term debt on the condensed and consolidated balance sheets.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The Credit Facility contains certain restrictive covenants applicable to the Company and its subsidiaries including a requirement to maintain a Senior Secured Leverage Ratio (as defined in the Second Amended and Restated 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 and Restated Credit Agreement). As of August 4, 2017, the Company was in compliance with the covenants under its Credit Facility.

As of August 4, 2017 and February 3, 2017, 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 6—Derivative Instruments Designated as Cash Flow Hedges:

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

	Notional Amount at August 4, 2017 (in millions)	Pay Fixed Rate	Receive Variable Rate	Settlement and Termination	Liability Fair Value (1) at August 4, 2017 (in millions)	February 3, 2017
Term loan A interest rate swaps	$ 388	1.41 %	1-month LIBOR	Monthly through September 26, 2018	$ -	$ 1
Term loan B interest rate swaps	350	1.88 %	3-month LIBOR (2)	Quarterly through May 7, 2020	3	2
Total	$ 738				$ 3	$ 3

(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. The counterparties to all swap agreements are financial institutions. See Note 7 for the effective portion of the unrealized change in fair values on cash flow hedges recognized in other comprehensive 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 $2 million of unrealized losses from accumulated other comprehensive loss into earnings in the twelve months following August 4, 2017.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 7—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 6.

	Unrealized Losses on Fixed Interest Rate Swap Cash Flow Hedges		
	Pre-Tax Amount (1)	Income Tax (2)	Net Amount
	(in millions)		
Three months ended August 4, 2017			
Balance at May 5, 2017	$2	$ (1)	$ 1
Other comprehensive loss before reclassifications	1	-	1
Amounts reclassified from accumulated other comprehensive loss	(1)	-	(1)
Net other comprehensive income	-	-	-
Balance at August 4, 2017	$2	$ (1)	$ 1
Three months ended August 5, 2016			
Balance at May 6, 2016	$14	$ (5)	$ 9
Other comprehensive loss before reclassifications	2	(1)	1
Amounts reclassified from accumulated other comprehensive loss	(2)	1	(1)
Net other comprehensive income	-	-	-
Balance at August 5, 2016	$14	$ (5)	$ 9
Six months ended August 4, 2017			
Balance at February 3, 2017	$3	$ (1)	$ 2
Other comprehensive loss before reclassifications	1	-	1
Amounts reclassified from accumulated other comprehensive loss	(2)	-	(2)
Net other comprehensive income	(1)	-	(1)
Balance at August 4, 2017	$2	$ (1)	$ 1
Six months ended August 5, 2016			
Balance at January 29, 2016	$14	$ (5)	$ 9
Other comprehensive loss before reclassifications	4	(2)	2
Amounts reclassified from accumulated other comprehensive loss	(4)	2	(2)

Net other comprehensive income	-	-	-
Balance at August 5, 2016	$14	$ (5)	$ 9

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

Note 8—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.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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 increased borrowings. Purchase consideration paid to acquire Scitor was $764 million (net of cash acquired), including $43 million which was deposited to escrow accounts. In August 2015 $3 million was released from escrow to the sellers after finalizing the working capital adjustment and another $13 million was released in September 2016 that was held to secure a portion of the sellers' indemnification obligations. Any remaining amount in escrow at the end of the indemnification period will be distributed to the sellers.

Agreements with 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.).

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. 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.

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 historical 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).

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 (DCAA), 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. Due to the Company’s reliance on government contracts, adverse findings could also have a material impact on the Company’s business, including its financial position, results of operations and cash flows.

The indirect cost audits by the DCAA of the Company’s business remain open for fiscal 2012 and subsequent years. Although the Company has recorded contract revenues subsequent to and including fiscal 2012 based on an estimate of costs that the Company believes will be approved on final audit, the Company does not know the outcome of any ongoing or future audits. If future completed audit adjustments exceed the Company’s reserves for potential adjustments, the Company’s profitability could be materially adversely affected.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The Company has recorded reserves for estimated net amounts to be refunded to customers for potential adjustments for indirect cost audits and compliance with Cost Accounting Standards, which include indemnification obligations owing to former Parent for periods prior to the Distribution Date. As of August 4, 2017, the Company has recorded a total liability of $39 million for estimated net amounts to be refunded to customers for potential adjustments from audits of contract costs, which is presented in accounts payable and accrued liabilities on the condensed and consolidated balance sheets. 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.

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 provision that allowed the Company to receive a provisional fixed fee (contract profit) lower than the estimated fixed fee due, pending completion of contract negotiations. The Company recognized revenues of approximately $480 million (including provisional fixed fee) from October 2009 through August 2013 under the undefinitized change order. In July 2017 the final contract termination proposal was accepted by the DoD. The Company had an outstanding receivable of approximately $2 million on this contract as of August 4, 2017. The remaining administrative actions related to the finalization of the contract termination are expected to be completed in the second half of fiscal 2018.

Letters of Credit and Surety Bonds

The Company has outstanding obligations relating to letters of credit of $9 million as of August 4, 2017, principally related to guarantees on insurance policies. The Company also has outstanding obligations relating to surety bonds in the amount of $17 million, principally related to performance and payment bonds on the Company’s contracts. The majority of the surety bonds outstanding were initially obtained by former Parent and the Company is required to satisfy these obligations under the terms of the Distribution Agreement.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

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; market opportunities; the impact of competition; and the impact of the Scitor acquisition. Such statements are not guarantees of future performance and involve risk, uncertainties and assumptions, and actual results may differ materially from those in the forward-looking statements as a result of various factors. Risks, uncertainties and assumptions that could cause or contribute to these material differences include those discussed below, in "Risk Factors" in Part II of this report and in Part I of the most recently filed Annual Report on Form 10-K. Due to such risks, uncertainties and assumptions 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.

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 2017 began on January 30, 2016 and ended on February 3, 2017, while fiscal 2018 began on February 4, 2017 and ends on February 2, 2018. The number of weeks for each quarter for fiscal 2018 and 2017 are as follows:

	Fiscal 2018	Fiscal 2017
	(weeks)	
First Quarter	13	14
Second Quarter	13	13
Third Quarter	13	13
Fourth Quarter	13	13
Fiscal Year	52	53

Business Overview

We are a leading technology integrator providing full life-cycle services and solutions in the technical, engineering and enterprise information technology (IT) markets. We developed our brand by addressing our customers' mission critical needs and solving their most complex problems for over 45 years. As one of the largest pure-play technical service providers to the U.S. government, we serve markets of significant scale and opportunity. Our primary customers are the departments and agencies of the U.S. government. Our long history of serving the U.S. government has afforded us the ability to develop strong and longstanding relationships with some of the largest customers in the markets we serve.

Economic Opportunities, Challenges, and Risks

In fiscal 2017, we generated greater than 95% of our revenues from contracts with the U.S. government, including subcontracts on which we perform. Our business performance is affected by the overall level of U.S. government spending and the alignment of our offerings and capabilities with the budget priorities of the U.S. government. While we believe that national security 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 Department of Defense (DoD) through U.S. 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.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

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 protect and expand existing customer relationships 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. SAIC’s value proposition is found in the proven ability to serve as a trusted adviser to our customers. In doing so, we leverage our expertise and scale to help them execute their mission.

We succeed as a business based on the solutions we deliver, our past performance and our ability to compete on price. Our solutions, inspired through innovation, are based on best practices and technology transfer. Our past performance was achieved by employee dedication and customer focus. 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. Our ability to be competitive in the future will continue to be driven by our reputation of successful program execution, competitive cost structure and efficiencies in assigning the right people, at the right time, in support of our contracts.

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 annual internal revenue growth percentage,
- margin expansion of 10 to 20 basis points annually, and
- return of capital in excess of operating needs.

Internal revenue growth (or internal revenue contraction if negative) is the method by which we evaluate the growth generated by SAIC. We calculate internal revenue growth percentage by comparing our reported revenue for the current year to the reported revenue for the prior year comparable period adjusted to include any pre-acquisition historical revenue of acquired businesses. Internal revenue growth percentage is a non-GAAP financial measure described in more detail in “Non-GAAP Measures” below.

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 in which incurred costs or efforts expended are used as a measure of progress to project completion, 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 by considering the drivers causing changes in revenues, operating income and operating cash flows. Given that revenues fluctuate on our contract portfolio over time due to contract awards and completions, changes in customer requirements, and increases or decreases in ordering volume of materials, we evaluate significant trends and fluctuations in these terms. Whether performed by our employees or by our subcontractors, we primarily provide services and, as a result, our cost of revenues are predominantly variable. We also analyze our cost mix (labor, subcontractor or materials) in order to understand operating margin because contracts performed with a higher proportion of SAIC labor are generally more profitable. Changes in costs of revenues as a percentage of revenue other than from revenue volume or cost mix are normally driven by fluctuations in shared or corporate costs or cumulative revenue adjustments due to changes in contract estimates.

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

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.

Results of Operations

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

	Three Months Ended			Six Months Ended		
	August 4, 2017	Percent change	August 5, 2016	August 4, 2017	Percent change	August 5, 2016
	(in millions)					
Revenues	$1,078	(2 %)	$1,095	$2,181	(6 %)	$2,310
Cost of revenues	979	(1 %)	986	1,986	(5 %)	2,084
As a percentage of revenues	90.8 %		90.0 %	91.1 %		90.2 %
Selling, general and administrative expenses	40	3 %	39	73	(19 %)	90
Operating income	59	(16 %)	70	122	(10 %)	136
As a percentage of revenues	5.5 %		6.4 %	5.6 %		5.9 %
Net income	$36	(3 %)	$37	$85	21 %	$70
Net cash (used in) provided by operating activities	$(35)	(252 %)	$23	$53	(9 %)	$58

Revenues. Revenues decreased $17 million for the three months ended August 4, 2017 as compared to the same period in the prior year primarily due to completion of contracts ($37 million), including the loss of an IT integration contract supporting the Department of Homeland Security (DHS) ($13 million), and other net contract declines across our portfolio ($21 million). These decreases were partially offset by higher revenue on new information technology contracts supporting the U.S. Army and federal civilian agencies ($30 million) and higher revenue on platform integration programs ($11 million).

Revenues decreased $129 million for the six months ended August 4, 2017 as compared to the same period in the prior year primarily due to one additional week in the prior year period ($88 million) and completion of contracts ($63 million), which includes the loss of an IT integration contract supporting the DHS ($27 million), and other net contract declines across our portfolio ($50 million). These decreases were partially offset by higher revenue on platform integration programs ($38 million) and new information technology contracts supporting the U.S. Army and NASA ($34 million).

Cost of Revenues. Cost of revenues decreased $7 million for the three months ended August 4, 2017 as compared to the same period in the prior year primarily due to a decrease in revenue volume ($15 million). Cost of revenues as a percentage of revenues increased from 90.0% in the prior year quarter to 90.8% primarily due to lower net favorable changes in estimates on contracts accounted for under the percentage-of-completion method ($6 million), lower profit on re-competed supply chain management contracts and higher severance expense ($2 million). Lower net favorable changes in estimates were largely driven by prior year write-ups on programs supporting federal civilian agencies.

Cost of revenues decreased $98 million for the six months ended August 4, 2017 as compared to the same period in the prior year primarily due to a decrease in revenue volume ($117 million). Cost of revenues as a percentage of revenues increased from 90.2% in the prior year period to 91.1% primarily due to higher net unfavorable changes in estimates on contracts accounted for under the percentage-of-completion method ($17 million), lower profit on supply chain management contracts ($3 million), and higher severance expense ($2 million). Higher net unfavorable changes in estimates were largely driven by increased costs to meet testing and mission requirements necessary to complete the Engineering, Manufacturing and Development (EMD) phase of the platform integration programs supporting the U.S. Marine Corps combined with prior year write-ups on programs supporting federal civilian agencies.

Cost of revenues also decreased due to an update to our fiscal 2018 Disclosure Statements that we prepare in accordance with U.S. government Cost Accounting Standards. We classify indirect costs as cost of revenues or selling, general and administrative expenses (SG&A) in the same manner as such costs are defined in our Disclosure Statements. The update resulted in certain types of costs that had previously been included in cost of revenues to be included in SG&A ($3 million and $5 million for the three and six months ended August 4, 2017, respectively); however, total operating costs were not affected by this change.

Selling, General and Administrative Expenses. SG&A increased $1 million for the three months ended August 4, 2017 as compared to the same period in the prior year due to National Capital Region facilities consolidation expense ($1 million) and updates to our disclosure statements ($3 million). These drivers were partially offset by the absence of acquisition and integration costs in the current year ($3 million).

SG&A decreased $17 million for the six months ended August 4, 2017 as compared to the same period in the prior year primarily due to the absence of acquisition and integration costs in the current year ($10 million), the reversal of a vacancy reserve for a facility in the National Capital Region that we now intend to occupy (net of higher facilities consolidation expense) ($6 million) and lower amortization of intangible assets ($3 million). These decreases were partially offset by updates to our Disclosure Statements ($5 million).

Operating Income. Operating income as a percentage of revenues decreased to 5.5% for the three months ended August 4, 2017 from 6.4% in the comparable prior year period primarily due to lower net favorable changes in estimates on contracts accounted for under the percentage-of-completion method, lower profitability on supply chain management contracts and higher severance and facility expense.

Operating income as a percentage of revenues decreased to 5.6% for the six months ended August 4, 2017 from 5.9% in the comparable prior year period primarily due to higher net unfavorable changes in estimates on contracts accounted for under the percentage-of-completion method and lower profitability on supply chain management contracts, partially offset by lower SG&A expenses.

Net Income. Net income for the three months ended August 4, 2017 decreased $1 million as compared to the same period in the prior year primarily due to lower operating income partially offset by lower income tax expense as a result of the adoption of ASU 2016-09, Improvements to Employee Share-Based Payment Accounting ($4 million). Based on the required adoption of the new standard we recognized the excess tax benefits related to employee share-based payments as a reduction to income tax expense rather than as previously recorded to additional paid in capital in equity. Net income was also positively impacted by lower interest expense as a result of the refinancing of our debt in the third quarter of the prior fiscal year.

Net income for the six months ended August 4, 2017 increased $15 million as compared to the same period in the prior year primarily due to lower income tax expense as a result of the adoption of ASU 2016-09, Improvements to Employee Share-Based Payment Accounting ($20 million) and lower interest expense, both partially offset by lower operating income.

Net Cash Provided by Operating Activities. Net cash provided by operating activities was $53 million for the six months ended August 4, 2017, a decrease of $5 million as compared to the same period in the prior year. The decrease in operating cash flows over the prior year period was due to reduced customer collections ($68 million) primarily caused by a government payment system issue ($45 million), partially offset by payments for an extra week of payroll in the prior year period ($30 million), excess tax benefits for stock based compensation in the current year ($20 million) and prior year working capital investments in U.S. Marine Corps platform integration and IT services programs ($16 million).

Non-GAAP Measures

Internal revenue growth (contraction), earnings before interest, taxes, depreciation and amortization (EBITDA), and adjusted EBITDA are non-GAAP financial measures. While we believe that these non-GAAP financial measures may be useful in evaluating our financial information, they should be considered as supplemental in nature and not as a substitute for financial information prepared in accordance with GAAP. Reconciliations, definitions, and how we believe these measures are useful to management and investors are provided below. Other companies may define similar measures differently.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

Internal Revenue Growth. Internal revenue growth (or internal revenue contraction if negative) is utilized to evaluate revenue growth after the completion of acquisitions and other adjustments identified as impacting year over year comparability. Internal revenue growth is calculated by comparing our reported revenues for the current year to the reported revenues for the prior year comparable period adjusted to include any pre-acquisition historical revenues of acquired businesses. We adjust current and prior year revenue to exclude the impact of revenue performed by our former parent company, Leidos Holdings, Inc. ("former Parent") since revenues on pre-separation joint work are recorded equal to cost and are expected to decline over time (See Note 8 of the notes to the condensed and consolidated financial statements for information regarding our separation from former Parent). For fiscal 2017, a 53-week fiscal year, we have also adjusted revenue to exclude the estimated impact of the additional week in order to facilitate comparison to the current year period. We estimate the revenue impact of the additional week by dividing first quarter fiscal 2017 revenues by the number of days in the first quarter of fiscal 2017 and multiplying that amount by the number of additional days in the first quarter of fiscal 2017. We believe that adjusting prior year revenues to reflect the impact of the additional week improves comparability since differences in the number of days generally have a direct impact on the amount of revenues earned in our business during the respective periods.

We believe internal revenue growth provides management and investors with useful information in assessing trends on how successful the Company has been at growing revenues of our base business and of the businesses we acquire.

Internal revenue growth is calculated as follows:

	Three Months Ended	Six Months Ended
	August 4, 2017	
	(in millions)	
Prior year period's revenues, as reported	$1,095	$2,310
Prior year period's revenues performed by former Parent	(2)	(6)
Estimated impact of 53rd week	-	(88)
Revenues of acquired business for the pre-acquisition prior year period	-	-
Prior year period's revenues, as adjusted	1,093	2,216
Current year revenues, as reported	1,078	2,181
Internal revenue growth (contraction)	$(15)	$(35)
Internal revenue growth (contraction) percentage	(1.4%)	(1.6%)

Internal revenue contraction for the three and six months ended August 4, 2017 was primarily due to completion of contracts, including the loss of an IT integration contract supporting DHS, and other net contract declines across our portfolio.

EBITDA and Adjusted EBITDA. The performance measure EBITDA is calculated by taking net income excluding interest expense, provision for income taxes, and depreciation and amortization. Adjusted EBITDA is calculated by taking EBITDA and excluding acquisition and integration costs. Adjusted EBITDA is a performance measure that excludes acquisition and integration costs that we do not consider to be indicative of our ongoing operating performance as they relate to the Company's significant acquisition of Scitor.

We believe that EBITDA and adjusted EBITDA provide management and investors with useful information in assessing trends in our ongoing operating performance and may provide greater visibility in understanding the long-term financial performance of the Company.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

EBITDA and adjusted EBITDA for the periods presented were calculated as follows:

	Three Months Ended		Six Months Ended	
	August 4, 2017	August 5, 2016	August 4, 2017	August 5, 2016
			(in millions)	
Net income	$36	$ 37	$85	$ 70
Interest expense	10	12	21	26
Provision for income taxes	13	21	16	40
Depreciation and amortization	11	12	21	27
EBITDA	70	82	143	163
EBITDA as a percentage of revenues	6.5%	7.5 %	6.6 %	7.1 %
Acquisition and integration costs	-	3	-	10
Depreciation included in acquisition and integration costs	-	-	-	(2)
Adjusted EBITDA	$70	$ 85	$143	$ 171
Adjusted EBITDA as a percentage of revenues	6.5%	7.8 %	6.6 %	7.4 %

Adjusted EBITDA for the three months ended August 4, 2017 decreased to 6.5% of revenues from 7.8% of revenues for the prior year due primarily to lower net favorable changes in estimates on contracts accounted for under the percentage-of-completion method, lower profitability on supply chain management contracts and higher severance and facility expense. Lower net favorable changes in estimates were largely driven by prior year write-ups on programs supporting federal civilian agencies.

Adjusted EBITDA for the six months ended August 4, 2017 decreased to 6.6% of revenues from 7.4% of revenues for the prior year due to higher net unfavorable changes in estimates on contracts accounted for under the percentage-of-completion method and lower profitability on supply chain management contracts. Higher net unfavorable changes in estimates were largely driven by increased costs to meet testing and mission requirements necessary to complete the Engineering, Manufacturing and Development (EMD) phase of the platform integration programs supporting the U.S. Marine Corps combined with prior year write-ups on programs supporting federal civilian agencies. These drivers were partially offset by the reversal of a vacancy reserve for a facility in the National Capital Region that we now intend to occupy (net of higher facilities consolidation expense).

Other Key Performance Measures

In addition to the financial measures described above, we believe that bookings and backlog are useful measures for management and investors to evaluate our potential future revenues. We also consider measures such as contract types and cost of revenues mix to be useful for management and investors to evaluate our operating income and performance.

Net Bookings and Backlog. Net bookings represent the estimated amount of revenues to be earned in the future from funded and negotiated unfunded contract awards that were received during the period, net of adjustments to estimates on previously awarded contracts. We calculate net bookings as the period’s ending backlog plus the period’s revenues less the prior period’s ending backlog and initial backlog obtained through acquisitions.

Backlog represents the estimated amount of future revenues to be recognized under negotiated contracts as work is performed. We do not include in backlog estimates of revenues to be derived from IDIQ contracts, but rather record backlog and bookings when task orders are awarded on these contracts. Given that much of our revenue is derived from IDIQ contract task orders that renew annually, bookings on these contracts tend to refresh annually as the task orders are renewed. Additionally, we do not include in backlog contract awards that are under protest until the protest is resolved in our favor.

We segregate our backlog into two categories as follows:

- Funded Backlog. Funded backlog for contracts with government agencies primarily represents estimated amounts of revenue to be earned in the future from contracts for which funding is appropriated less revenues previously recognized on these contracts. It does not include the unfunded portion of contracts in which funding is incrementally appropriated or authorized on a quarterly or annual basis by the U.S. government and other customers even though the contract may call for performance over a number of years. Funded backlog for contracts with non-government customers represents the estimated value of contracts, which may cover multiple future years, under which we are obligated to perform, less revenue previously recognized on these contracts.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

- Negotiated Unfunded Backlog. Negotiated unfunded backlog represents estimated amounts of revenue to be earned in the future from negotiated contracts for which funding has not been appropriated or otherwise authorized and from unexercised priced contract options. Negotiated unfunded backlog does not include any estimate of future potential task orders expected to be awarded under IDIQ, GSA schedules or other master agreement contract vehicles.

We expect to recognize revenue from a substantial portion of our funded backlog within the next twelve months. However, the U.S. government can adjust the scope of services of or cancel contracts at any time. Similarly, certain contracts with commercial customers include provisions that allow the customer to cancel prior to contract completion. Most of our contracts have cancellation terms that would permit us to recover all or a portion of our incurred costs and fees (contract profit) for work performed.

The estimated value of our total backlog as of the dates presented was:

	August 4, 2017	February 3, 2017
	(in millions)	
Funded backlog	$1,805	$ 1,811
Negotiated unfunded backlog	7,436	6,209
Total backlog	$9,241	$ 8,020

We had net bookings worth an estimated $2.1 billion and $3.4 billion during the three and six months ended August 4, 2017, respectively. Total backlog at the end of the second quarter has increased compared to total backlog at prior year end due to several large awards received during the period, including IT services contracts from the Environmental Protection Agency and U.S. Central Command, and a virtual systems contract from the U.S. Army.

Contract Types. Our earnings and profitability may vary materially depending on changes in the proportionate amount of revenues derived from each type of contract. For a discussion of the types of contracts under which we generate revenues, see “Contract Types” in Part I of the most recently filed Annual Report on Form 10-K. The following table summarizes revenues by contract type as a percentage of revenues for the periods presented:

	Six Months Ended	
	August 4, 2017	August 5, 2016
Cost reimbursement	44 %	41 %
Time and materials (T&M)	29 %	30 %
Firm-fixed price (FFP)	27 %	29 %
Total	100%	100 %

Revenues from cost reimbursement type contracts increased for the six months ended August 4, 2017 compared to the prior year comparable period primarily due to two cost reimbursable federal civilian agency awards, an IT system integration award for the U.S. Army, and higher technology refresh activity on an existing program.

Cost of Revenues Mix. We generate revenues by providing a customized mix of services to our customers. The profit generated from our service contracts is affected by the proportion of cost of revenues incurred from the efforts of our employees (which we refer to below as labor-related cost of revenues), the efforts of our subcontractors and the cost of materials used in the performance of our service obligations under our contracts. Contracts performed with a higher proportion of SAIC labor are generally more profitable. The following table presents changes in cost mix for the periods presented:

	Three Months Ended		Six Months Ended	
	August 4, 2017	August 5, 2016	August 4, 2017	August 5, 2016
	(as a % of total cost of revenues)			
Labor-related cost of revenues	48 %	49 %	48 %	49 %
Subcontractor-related cost of revenues	33 %	34 %	34 %	34 %
Supply chain materials-related cost of revenues	12 %	11 %	12 %	12 %
Other materials-related cost of revenues	7 %	6 %	6 %	5 %

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

Cost of revenues mix for the three and six months ended August 4, 2017 was consistent with the respective prior year periods.

Liquidity and Capital Resources

As a services provider, our business generally requires minimal infrastructure investment. We expect to fund our ongoing working capital, commitments and any other discretionary investments with cash on hand, future operating cash flows and, if needed, additional borrowings under our $200 million Revolving Credit Facility.

We anticipate that our future cash needs will be for working capital, capital expenditures, and contractual and other commitments. We consider various financial measures when we develop and update our cash deployment strategy, which include evaluating cash provided by operating activities, free cash flow and financial leverage. When our cash generation enables us to exceed our target average minimum cash balance of $150 million, we intend to deploy excess cash through dividends, share repurchases, debt prepayments or strategic acquisitions.

Our ability to fund these needs will depend, in part, on our ability to generate cash in the future, which depends on our future financial results. Our future results are subject to general economic, financial, competitive, legislative and regulatory factors that may be outside of our direct control. Although we believe that the financing arrangements in place will permit us to finance our operations on acceptable terms and conditions for at least the next year, our future access to, and the availability of financing on acceptable terms and conditions will be impacted by many factors (including our credit rating, capital market liquidity and overall economic conditions). Therefore, we cannot ensure that such financing will be available to us on acceptable terms or that such financing will be available at all. Nevertheless, we believe that our existing cash on hand, generation of future operating cash flows, and access to bank financing and capital markets will provide adequate resources to meet our short-term liquidity and long-term capital needs.

Historical Cash Flow Trends

The following table summarizes our cash flows:

	Six Months Ended	
	August 4, 2017	August 5, 2016
	(in millions)	
Net cash provided by operating activities	$53	$58
Net cash used in investing activities	(7)	(8)
Net cash used in financing activities	(116)	(133)
Net decrease in cash, cash equivalents and restricted cash	$(70)	$(83)

Net Cash Provided by Operating Activities. Refer to “Results of Operations” above for a discussion of the changes in cash provided by operating activities between the six months ended August 4, 2017 and the comparable prior year period.

Net Cash Used in Investing Activities. Cash used in investing activities for the six months ended August 4, 2017 is consistent with the prior year due to similar capital expenditures for property, plant, and equipment.

Net Cash Used in Financing Activities. Cash used in financing activities for the six months ended August 4, 2017 decreased compared to the prior year period primarily due to proceeds from borrowings on our revolver in the current period and lower principal payments on borrowings, partially offset by increases in stock repurchased and retired or withheld for taxes on equity awards.

Contractual Obligations

During the second quarter of fiscal 2018, we contracted for approximately $50 million of long-lead time materials from various vendors that will be necessary to complete the low-rate initial production (LRIP) phase of our Assault Amphibious Vehicle contract with the United States Marine Corps. As of August 4, 2017, we had not yet been awarded the LRIP phase, however, we believe it is probable that we will receive the award. In order to meet our anticipated commitments for the LRIP phase, and to maximize volume discounts with our vendors, we committed to purchasing these materials. If we do not receive the award for the LRIP phase we may not be able to recover all of the costs associated with these orders, which would adversely affect our future profitability. Subsequent to the end of the second quarter, we received a partial award which reduced our commitment on the portion of the LRIP phase not yet awarded to approximately $30 million.

Other than this update, there have been no material changes to our contractual obligations as reported in our most recently filed Annual Report on Form 10-K.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our condensed and consolidated financial statements, which are prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies, as well as the reported amounts of revenues, expenses, gains and losses during the reporting periods. Management evaluates these estimates and assumptions on an ongoing basis. Our estimates and assumptions have been prepared on the basis of the most current reasonably available information and, in some cases, are our basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Estimates and assumptions may change in the future as more current information is available.

Management believes that our critical accounting policies are those that are both material to the presentation of our financial condition and results of operations and require management's most difficult, subjective and complex judgments. Typically, the circumstances that make these judgments difficult, subjective and complex have to do with making estimates about the effect of matters that are inherently uncertain. There have been no changes to our existing critical accounting policies during the six months ended August 4, 2017 from those disclosed in our most recently filed Annual Report on Form 10-K.

Recently Issued But Not Yet Adopted Accounting Pronouncements

For information on recently issued but not yet adopted accounting pronouncements, see Note 1 of the notes to the condensed and consolidated financial statements contained within this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to our Market Risks from those discussed in our most recently filed Annual Report on Form 10-K.

Item 4. Controls and Procedures

Our management, with the participation of our principal executive officer (our Chief Executive Officer) and principal financial officer (our Chief Financial Officer), has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) and have concluded that as of August 4, 2017 these controls and procedures were operating and effective.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the quarterly period covered by this report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

We have provided information about legal proceedings in which we are involved in our fiscal 2017 Annual Report on Form 10-K, and we have provided an update to this information in Note 8 of the notes to the condensed and consolidated financial statements contained within this report.

In addition to the described legal proceedings, we are routinely subject to investigations and reviews relating to compliance with various laws and regulations. Additional information regarding such investigations and reviews is included in our fiscal 2017 Annual Report on Form 10-K, and we have also updated this information in Note 8 of the notes to the condensed and consolidated financial statements contained within this report, under the heading “Government Investigations, Audits and Reviews.”

Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed in our most recently filed Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of Equity Securities. We may repurchase shares on the open market in accordance with established repurchase plans. Whether repurchases are made and the timing and amount of repurchases depend on a variety of factors including market conditions, our capital position, internal cash generation and other factors. We also repurchase shares in connection with stock option and stock award activities to satisfy tax withholding obligations.

The following table presents repurchases of our common stock during the three months ended August 4, 2017:

Period (1)	Total Number of Shares (or Units) Purchased (2)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or

				Programs (3)
May 6, 2017 - June 9, 2017	200,472	$ 74.86	194,269	4,086,390
June 10, 2017 - July 7, 2017	148,477	71.03	145,568	3,940,822
July 8, 2017 - August 4, 2017	170,881	71.07	170,593	3,770,229
Total	519,830	$ 72.52	510,430	

(1) Date ranges represent our fiscal periods during the current quarter. Our fiscal quarters typically consist of one five-week period and two four-week periods.

(2) Includes shares purchased on surrender by stockholders of previously owned shares to satisfy minimum statutory tax withholding obligations related to stock option exercises and vesting of stock awards in addition to shares purchased under our publicly announced plans or programs.

(3) On December 15, 2016 the number of additional shares of our common stock that may be repurchased under our existing repurchase program previously announced in October 2013 was increased by approximately 3.3 million shares, bringing the total authorized shares to be repurchased under the program to approximately 11.8 million shares. As of August 4, 2017, we have repurchased approximately 8.1 million shares of common stock under the program.

Item 3. Defaults Upon Senior Securities

No information is required in response to this item.

Item 4. Mine Safety Disclosures

No information is required in response to this item.

Item 5. Other Information

No information is required in response to this item.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

Item 6. Exhibits

Exhibit Number	Description of Exhibit
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive Data File.

Table of Contents

SCIENCE APPLICATIONS INTERNATIONAL CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: September 7, 2017

Science Applications International Corporation

/s/ Charles A. Mathis

Charles A. Mathis

Executive Vice President and Chief Financial Officer