

Equities

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Defense is De-Equitizing

Alert: CACI Supports Our Leveraged Buyback Thesis

■ Industry Overview

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- **What's New** – CACI (Not Rated) announced it would be leveraging up to buy back ~15% of its float, and shares were up ~10% at mid-day on Thursday. CACI's move is line with the "Lever Up and Buyback" thesis that we outlined in a report on May 29th and the conference call we hosted last week highlighting the theme. See the bottom of this page for a link to our deep-dive and for call replay information.
- **De-Equitization is a trending defense theme** – In our view, the defense industry is increasingly likely to de-equitize given slowing industry growth, resilient cash flows, a low interest rate environment, lack of large-scale acquisition opportunities, and company managements that are targeting 10-12% annual cash returns to shareholders through a combination of dividends and share repurchases. In our view, CACI's announcement is yet one more example of this the de-equitization theme playing out.
- **CACI's leveraged buyback** – The company considers current share levels to be an "exceptional" investment value. As such, the board authorized an additional 4 million share repurchase program. This represents ~15% of its float. The company will have to raise debt to fund the buyback it expects to complete over the next few months. At current prices, 4 million shares are worth ~\$200m vs. the \$49m of cash currently on the balance sheet and FY13 (beginning July 2012) operating cash flow guidance of \$225m. The company points out that leverage likely goes from 1.25x today to ~2x after the repurchase, but notes that it has a healthy revolving credit capacity and that interest rates are low. We remind investors that the defense primes average 0.4x leverage, creating in our view significant accretion opportunities (average ~50% vs. 2012 estimates) should the industry lever up to CACI (2x) and/or Huntington Ingalls (Not Rated) (3x) levels and use the proceeds to buyback stock.
- **Leveraged buyback deep-dive** – Please see our report [Leveraged Buybacks – Why You Should Care](#) for more on this trend. We also hosted a call with two experts: Stephen Key (former Textron & ConAgra CFO) and Dr. Theo Vermaelen (INSEAD Finance professor & share repo expert). **Replay details:** US/CAN toll free: 888-203-1112. Passcode: 304-0250.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Appendix A-1

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Defense is De-Equitizing

7 June 2012

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