LVS ADVISORY

Investment Results	2019	2020	2021	2022	2023	YTD 2024	Since Inception[1]
LVS Event-Driven (net of fees)	**7.0%**	**13.2%**	**9.1%**	**3.8%**	**6.2%**	**(1.4%)**	**43.6%**
Benchmark: High-Yield Bond Index	*13.4%*	*5.0%*	*4.0%*	*(11.4%)*	*12.5%*	1.6%	25.4%
LVS Growth (net of fees)	**-**	**61.8%**	**16.1%**	**(35.8%)**	**7.0%**	**14.7%**	**47.9%**
Benchmark: S&P 500 TR Index	-	*18.4%*	*28.7%*	*(18.1%)*	*26.3%*	10.6%	74.3%

Note: investment performance is presented net of all fees and expenses. Investment results are as of March 31, 2024.

(1) LVS Event-Driven was incepted on January 1, 2019. LVS Growth was incepted on January 1, 2020.

April 18, 2024

Dear Investors,

During the first quarter of 2024, the LVS Event-Driven Portfolio declined 1.4% and the LVS Growth Portfolio gained 14.7%, net of all fees and expenses.

The Event Driven Portfolio experienced an uncharacteristic decline due to the failure of two deals in our merger arbitrage portfolio breaking. In a normal year, we may have one or two deals in our portfolio that fail to close, causing us to lose money. In Q1, we were particularly unlucky to have two. We have taken our losses and moved on. I expect the portfolio to recover from here.

The Growth Portfolio had a much stronger start to the year and demonstrated solid outperformance vs. the S&P 500. As I noted in the Q4 2023 investor letter, I made a few tweaks to the Growth Portfolio in the back half of 2023. These changes included exiting a handful of positions that had become “serial losers” and replacing those holdings with new names that I intend to scale into over time. These adaptations have been paying off as evidenced by our improved performance over the past few quarters. Both in terms of the stocks we sold continuing to underperform and the new positions we added contributing positively. In the next section, I will discuss one of our new holdings in the strategy.

Growth Portfolio: Booz Allen Hamilton investment

We added Booz Allen Hamilton (NYSE:BAH) to the growth portfolio in October 2023. I am highlighting Booz Allen this quarter because the exercise of comparing BAH to CACI serves as an interesting example of weighing the trade-offs between “quality” and “value” when picking stocks.

Booz Allen Hamilton Investment Thesis

Booz Allen is a technology consulting firm specializing in government contracting. Founded in 1914, Booz Allen has a storied history partnering with the US Government which includes helping the US Navy prepare for World War II. These deep roots have helped engrain the Company into the fabric of Washington DC and provide a foundation for the business’ deep moat.

Not resting on its laurels, Booz Allen has relentlessly re-invested in its business by acquiring and retaining the top talent and technology in the government contracting space. This has translated into Booz Allen serving as one of the most awarded government contractors. The Company is the #1 provider of artificial intelligence to the US Federal Government with nearly 200 government AI contracts spanning defense, national security, and civil missions. Frost & Sullivan ranks Booz Allen as the most innovative company in the Global Managed Detection and Response Market. The Company is also ranked highly in broader surveys including Fortune's '*World's Most Admired Companies*' and *Glassdoor's 'Best 100 Places to Work'*.

Importantly, Booz Allen's deep moat is sustainable. There is a significant incumbency bias in government contracting, especially when it comes to IT. Contractors must understand how the legacy government IT systems function to move them forward. Given that Booz Allen has had a large hand in building many of the legacy IT systems, the Company is often the most logical choice for related contracts. This makes it extremely difficult for new entrants like Accenture Federal Services to win contracts over Booz.

Furthermore, contracts require employees to have government security clearances which take months and sometimes years to obtain. Competing firms simply do not have enough skilled labor with the appropriate clearances to take on the large contracts that Booz Allen specializes in. This is especially true in the niches of artificial intelligence and cyber security where Booz Allen has in many ways cornered the market on skilled labor with the relevant government clearances.

In many ways, Booz Allen has an unfair competitive advantage in government contracting. This is characteristic of a great business and it shows the in the numbers. Over the past five years, BAH's revenue has organically grown by 50%, its EBITDA margin has expanded from 9.5% to 11.0%, and it has converted over 100% of its earnings to free cash flow. The Company is on pace to deliver over $10 billion in annual revenue in 2024 and has a contract backlog exceeding $30 billion which provides visibility for continued growth.

Detractors would point out that Booz Allen has experienced growth during a period of above average fiscal spending growth and that defense contractors are "over-earning" due to active wars in Eastern Europe and the Middle East. I agree that a potential cut to the federal budget is the key risk to Booz Allen's business today.

However, Booz Allen is levered to mission critical programs within the defense budget which won't be cut including managed IT services, cyber security, and artificial intelligence where funding is expected to increase. Booz Allen is purely a services provider and does not sell physical products that are currently being procured to fund today's wars. In fact, if the wars were to end tomorrow, Booz could actually see funding free up for the programs it works on. Finally, in an environment where the government is forced to reduce budgets, the government would need to lean into technology programs administered by Booz Allen to become more efficient.

Booz Allen Hamilton vs. CACI

One of the interesting quirks of the government contractor industry is that it is extremely difficult to distinguish between otherwise very similar companies. One reason is that contractors are limited in what they can disclose in their financial reports.

I have been intrigued by CACI International (NYSE:CACI) which on paper appears to be a Booz Allen clone at a cheaper valuation. The key question in my research of Booz Allen was whether it was worth owning Booz Allen Hamilton over CACI.

	Booz Allen Hamilton	**CACI International**
Market Cap	$18.7 billion	$8.2 billion
2024E Revenue Growth	14.5%	10.4%
TEV / 2024E EBIT	21.0x	16.2x
Price / 2024E Earnings	26.6x	18.1x

Source: S&P Capital IQ as of 4/12/2024.

I spent several months conducting field interviews with industry experts to help better understand Booz Allen and how it compares to competitors like CACI. I concluded that there are key differences between the two companies that favor Booz Allen.

Capabilities

A consistent theme in our research was that Booz Allen Hamilton has proprietary best-in-class technology that it brings to government customers. But importantly, Booz Allen leverages its deep familiarity with the various stakeholders in the government to fit the technology to meet the needs of government contracts.

One former Booz Allen employee noted the following:

> *"So one of the strategies that Booz Allen constantly uses when bidding on government work is the fact that they've been around for 100-plus years. They know a majority of the clients. They've worked for a majority of the government. They generally have a lot deeper reach than most companies. And so they take that and use that as a cornerstone of their bid and not only attack the skills necessary for project success upfront.*
>
> *And because they've been around for a long time**, they have proactive R&D to help address these innovation-type projects.** And so landing those two large national defense projects, they're able to go in and capture all of the O&M and traditional type work. And then in the future**, as they settle in maybe six months to a year in the project, they'll find areas to improve and start pitching innovation to the client**.*
>
> *…With that proactive R&D arm that I mentioned**, they tend to be one year, 1.5 years, two years ahead of most of our competitors**. And so they're able to very much make a more compelling case to get that high end work with the higher margins than a lot of the other companies."*

By contrast, CACI International tends to focus on hiring former high-ranking government officials to win contracts. CACI will still bring in best-in-class technology but the organization is less tech savvy and the technology is less novel.

One former Leidos (a competitor) executive noted:

> *"**There's a joke in the industry that CACI should stand for colonels and commanders because that's who they hire**. Now, what that also does is it creates a bit of a cloistered environment for CACI. They bring in*

> *technologies that they've used while they were out in the field. As far as being able to bring things in from industry, the outside world,* ***it's relatively difficult for someone who, say, has spent their entire life working in Silicon Valley to go work for CACI. There's a culture gap there.****"*

Finally, several industry experts noted that Booz Allen has the strongest internal technology for organizing contracts and proposals. This has helped Booz be more strategic about which contracts they bid for and their bidding strategy. It has contributed to BAH commanding a high win rate in the industry.

A former CACI employee noted:

> *"Booz Allen Hamilton has, by far, one of the best proposal management systems in the business. They can find any section of any proposal that they've ever written anywhere in the company.*
>
> *CACI does not have that.* ***Booz Allen can tell you about a particular subcontractor they've used, how many times they've used them, what is their expertise, how they performed, good or bad, rates, everything. And that's a key piece of strategic information.****"*

Growth Strategy

CACI and Booz Allen have completely different growth strategies. CACI is a serial acquirer, relying on M&A to drive growth. Acquisition-driven growth can work wonders for a talented management team with a sharp playbook on how to extract value from each deal. However, inorganic growth tends to be lower quality than organic growth because the acquisition pipeline is less predictable and deals often don't succeed due to cultural issues or difficulties during integration.

A former CACI employee noted:

> *"****CACI's primary growth strategy has been around acquisition****. And certainly, in my time there, I know that in their history,* ***they've acquired well over 60 companies*** *by now, some small, some large. And during that acquisition process, you're picking up all the nuts and bolts within a given acquisition.*
>
> *I would also say that* ***they have acquired a number of organizations that, over time, they have failed to either integrate well into the company.*** *They have failed to maintain the unique culture, dynamics or environment that allowed those companies prior to acquisition to succeed."*

By contrast, Booz Allen has built a culture around fostering organic growth. This is evidenced by the internal tools described above which assist the company in more effectively organizing its bidding processes. Furthermore, the Company has developed an organizational framework called VoLT designed to foster a culture of innovation and decentralized decision-making.

A former Booz Allen employee noted:

> *"****Booz Allen has empowered those frontline leaders to be more business developers****. And so the thought process there is that by implementing VoLT, growth can be achieved at a much faster clip because you really just increased your bandwidth of business developers."*

Later in the conversation, the same expert noted:

> *"**Booz Allen is really trying to get more of a foothold and provide a lot of thought leadership** on how governments can really incorporate AI and ML, **so that when the government realizes there's a lot of potential with AI in this particular space, they can put out an RFP for that**."*

Booz Allen also uses M&A to drive growth, but the company uses an extremely disciplined approach to identify the right acquisition partners in areas where there is a capability gap. Booz typically has worked with targets in some capacity as either a prime or a sub-contractor so that there is greater understanding and trust in the quality of the team and technology they are buying.

A former Booz Allen employee noted:

> *"Booz Allen is excellent with M&A targets. **Typically, when they select a company as target, it's only after they have decided on the market, decided on a long-term strategy, decided on the capability**. There's all kinds of things that go into that company.*
>
> *And so what Booz Allen was trying to do when I left was identify a niche company to give them some really high-speed, sexy cyber capabilities. To my knowledge, they have not identified one yet, and they have not moved towards purchasing, but **there's a lot of research that goes into those acquisitions**."*

<u>Culture</u>

By most accounts, CACI is a good company to work for, and most industry experts we spoke to were complementary to CACI's culture. However, some cultural issues may have been created by the volume of acquisitions CACI has completed. This has resulted in a number of restructuring events and a focus on rationalizing the financial merits of transactions in the years following a deal.

A former CACI employee noted:

> *"I stayed through a numerous number of cycles of reorganizations, **CACI has a real penchant for reorganizing**, in some way, shape or form every fiscal year. **In a 6.5-year period, I had 6 supervisors, 6 different supervisors.** And being that we were a product group**, they didn't quite know where to put us."***

Another former CACI employee noted:

> *"I mean **they very much are focused on quarterly results**. You live and die by your forecasts, you live and die by your indirect versus direct billability. I know many organizations -- during my time there, we were squeezed from an 85% billability rate to a 97% billability rate. And I mean **that's aggressive, and it just means sacrificing a lot of elements that contribute to sales, business development and growth**."*

By contrast, most people familiar with Booz Allen were quick to describe a collaborative culture where innovation and employee development were prioritized. Booz Allen is culturally similar to the leading commercial consulting companies such as Accenture which provides employees with opportunities for internal promotion and skill training. I was also surprised to learn that Booz Allen has much lower employee turnover than other large service companies. Employees typically stay for at least 5 years and it is not uncommon for people to stay at the company for their whole career.

A former Booz Allen employee noted:

> *"When I started at Booz Allen,* ***we had a huge AI machine learning lab****, and we're trying to see how we could incorporate AI and machine learning for the federal projects for the federal government.* ***We were encouraged to work on these things or be a part of that thing after your project dies. I think it's just a culture of innovation*** *which encourages a lot of employees and encourages an employee like me to work for Booz Allen because you can be creative, you can think boldly, and I think that's very important."*
>
> *I know people I recruited were attracted to Booz Allen, the key area is innovation. There's a culture of innovation. Booz Allen, they've really invested in AI work and they were ahead of their time."*

Another Booz Allen employee noted:

> *"**I think a lot of employees stay at Booz Allen**. If I look at my career progression, the longest I've been with any company has been with Booz Allen. I was with them for seven and a half years. You do tend to stay A) because it's very, very difficult to get clearances it's expensive, somebody has to sponsor you, you've got to have a project where you're going to be sponsored on to get clearance, and it takes time."*

Another Booz Allen employee noted:

> *"**Booz Allen was pretty serious about ethics**. We had very diligent ethics training in a periodic manner. Every six months or so, we had to pass that certificate to continue employment at Booz Allen. And then this didn't just stop from training,* ***they followed those ethics and then created values around ethics so that people are rewarded behaving ethically*** *and then the other way around if they don't behave ethically."*

Management Turnover

Building upon the comments from the former employees on culture, Booz Allen has done an exceptional job of retaining employees for the long term. This is evident at the senior management level where the median executive has been in the job for over 10 years. This compares to CACI where the median executive has only held their senior role for approximately 4 years.

CACI International

(Years of Service)	Executive Tenure	Tenure at Company
CEO	4	11
CFO	1	1
Division President	23	40
COO	2	8
Division President	4	6
Division President	3	3
General Counsel	9	6
Median	**4**	**6**

Booz Allen Hamilton

(Years of Service)	Executive Tenure	Tenure at Company
CEO	23	30
CFO	11	20
COO	13	17
Division President	18	34
General Sounsel	9	9
Median	**13**	**20**

Low management turnover can be a strong signal of a company with a good culture. Culture can be a competitive advantage if there is a combination of strong internal training, incentives to rise within an organization, and a deep bench of talent intimately familiar with the company's products and customers. I believe culture is a competitive advantage at Booz Allen given the company's long track record of industry-leading performance. This makes particular sense in a human-capital-oriented business like IT services where consistently having the best consultants, analysts, and programmers is what drives client outcomes and builds brand equity over time.

Financial Performance

Bringing it all together, let's take a look at how the qualitative insights relate to the quantitative outcomes.

In terms of capital allocation, Booz Allen has returned two-thirds of its capital to shareholders in the form of buybacks and dividends. Booz Allen doesn't require much capital reinvestment evidenced by the $75 million per year in capex. The company has opportunistically made acquisitions. On the contrary, CACI has allocated most of its capital towards inorganic growth and has only returned 22% of capital to shareholders.

Last 10 Years Cumulative Capital Allocated

Booz Allen Hamilton

Capex	$755	11%
M&A	$1,659	24%
Buybacks	$1,712	25%
Dividends	$2,686	39%
Total	$6,812	100%

CACI International

Capex	$553	9%
M&A	$4,242	69%
Buybacks	$1,351	22%
Dividends	$0	0%
Total	$6,145	100%

The table below shows the outcome of these decisions. CACI has grown its top line at a faster rate; however, Booz Allen has had higher organic growth. Booz Allen has grown earnings per share at a faster rate driven by a reduction in shares outstanding. Booz Allen's more disciplined investment focus has resulted in a much higher return on invested capital. The net result of all this is that Booz Allen has demonstrated a much higher return for shareholders.

	BAH	CACI
10 Year Revenue CAGR	6.8%	7.6%
10 Year EPS CAGR	15.6%	14.2%
Return on Invested Capital	16.0%	8.8%
10 Year Stock Total Return	697%	419%

"Quality" vs. "Value"

After threading the needle between qualitative and quantitative analysis, we decided to invest in Booz Allen's stock over CACI's. Booz Allen deserves to trade a higher valuation multiple because it has superior technology capabilities, a more robust organic growth strategy, a cultural advantage, is more disciplined in its capital allocation, and generously rewards shareholders with buybacks and dividends. These characteristics should allow Booz Allen's stock to continue outperforming CACI over the long run.

Until next time

Although I am not providing an extended commentary for the Event Driven Portfolio this quarter, I am working on an exciting research project in the power generation industry that I plan to share next letter. As always, clients and prospective investors are welcome to reach out with any additional questions.

Best regards,

Luis V. Sanchez CFA

ABOUT LVS ADVISORY

LVS Advisory is a boutique investment firm focused on providing active investment management services for individuals, families, and institutions. The LVS Event-Driven Portfolio is an absolute return strategy focused on capital preservation. The LVS Growth Portfolio is a global equity strategy focused on capital appreciation. Luis V. Sanchez CFA is the Founder and Managing Partner of LVS Advisory. Luis is a licensed Investment Adviser Representative and a CFA Charterholder. LVS Advisory is a Registered Investment Adviser based in Central Florida.

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