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ACM - Q1 2017 AECOM Earnings Call

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OVERVIEW:

Co. reported 1Q17 adjusted EPS of $0.53. Expects FY17 adjusted EPS to be $2.80-3.20.

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PRESENTATION

Operator

Good morning, and welcome to the AECOM first-quarter 2017 earnings conference call. I would like to inform all participants this call is being recorded at the request of AECOM. This broadcast is the copyrighted property of AECOM. Any rebroadcast of this information, in whole or part, without the prior written permission of AECOM is prohibited. As a reminder, AECOM is also simulcasting this presentation, with slides at the investor section at www.AECOM.com.

(Operator Instructions). I would like to turn the call over to Will Gabrielski, Vice President, Investor Relations.

Will Gabrielski - *AECOM - VP, IR*

Thank you, operator. Before reviewing our results, I would like to direct you to the Safe Harbor statement on page 1 of today's presentation. Today's discussion contains forward-looking statements about future growth and financial outcomes. Actual results may differ significantly from those projected in today's forward-looking statements due to various risks and uncertainties. Please refer to page 1 of our earnings presentation and our periodic reports filed with the SEC for more information on our risk factors.

Except as required by law, we take no obligation to update our forward-looking statements. We are using certain non-GAAP financial measures in our presentation. The appropriate GAAP financial reconciliations are incorporated into our press release, which is posted on our website.

Please note that all percentages refer to year-over-year progress, except where otherwise noted. Our discussion of financial results and guidance excludes the impact of acquisitions and integration-related expenses, financing charges, the amortization of intangible assets, and financial impacts associated with expected and actual dispositions of non-core businesses and assets, unless otherwise noted. Today's discussion of organic growth represents a year-over-year change on a constant currency basis.

Beginning today's presentation is Mike Burke, AECOM's Chairman and Chief Executive Officer. Mike?

Mike Burke - *AECOM - Chairman and CEO*

Thank you, Will. Welcome, everyone. Joining me today are Steve Kadenacy, our President and Chief Operating Officer and Troy Rudd, our Chief Financial Officer. I will begin with an overview of AECOM's results and discuss the trends across our business. Then Troy will review our financial performance in greater detail. Steve will conclude with financial guidance before turning the call over for a question-and-answer session.

Please turn to slide 3. We began fiscal 2017 with substantial momentum. Over the past two years, we have invested to build the most capable company in our industry. As a result, we are ideally positioned to capitalize on the emerging tailwinds across our core infrastructure and defense markets, where we generate two-thirds of our profits.

Our first-quarter results demonstrate this advantage. We delivered positive organic revenue growth across all three of our segments, highlighted by the Americas design business, which has now grown in three of the last four quarters. We had wins of nearly $6 billion and a 1.3 book-to-burn ratio, including a record $1.7 billion of wins in Management Services, and strong contributions across many of our markets.

We delivered positive free cash flow, which we now have done for 18 of the past 19 quarters. And, finally, our fully integrated capabilities and focused business development investments are driving results. This trend is no more evident than in the selection of our joint venture to decommission the San Onofre nuclear plant in Southern California. This contract, valued at over $1 billion, is one of the largest such projects ever undertaken in the United States. Importantly, we are drawing on the capabilities of all three of our segments, which proved to be a critical factor in this pursuit.

As a result of these accomplishments, we exited the first quarter with a record $44 billion backlog, and we are on pace with our fiscal 2017 financial guidance and the five-year financial targets we set in December.

Please turn to slide 4 for a discussion of our business and market trends.

It is truly a unique moment in our industry. A global consensus is forming on the need for substantial infrastructure investments, which is resulting in tremendous activity. This is apparent in our largest market, the Americas, where bipartisan support for infrastructure has taken center stage. This momentum began with the passage of the multiyear, $305 billion FAST Act in late 2015, which gave our clients the funding visibility to advance large projects. Numerous state and local initiatives have added to this momentum, including the record $200 billion of ballot measures passed last November.

And most recently, both President Trump and Senate Democrats have proposed substantial $1 trillion infrastructure plans, the initial details of which are very encouraging. Various sources have identified over $100 billion of prioritized projects within the president's plan. We are already pursuing opportunities on, or have existing exposure to, the vast majority of these projects.

We are also pleased that the president is emphasizing the need for private sector investment, which is key to addressing long-term market demand. In addition, early indications from the Senate Democrats' proposal are also promising. The majority of the plan's $1 trillion is concentrated in the transit and water markets, where we maintain leading share.

We are prioritizing our business development investments to capitalize on this momentum. As a result, our backlog in the Americas has increased by 4%, including an approximately 10% increase in our transportation, water, and environment markets.

Conditions are similarly strong in Canada, where Prime Minister Trudeau's ambitious $120 billion infrastructure plan is creating new opportunities. With this funding entering the market, our design revenue increased by 2%, and backlog increased by 5%.

Turning to our Construction Services segment, revenue increased 2%, led by 9% growth in our Energy and Industrial Construction business. Our power backlog has now more than doubled since fiscal 2015, which reflects our success in reenergizing this strong franchise. This includes numerous key wins, including the more than $1 billion San Onofre nuclear contract, and three large gas power plant awards in the past year, including another win this quarter.

In our Oil and Gas Construction business, stable commodity prices are resulting in mid-teens or greater spending growth forecasts in 2017. We are encouraged by the threefold increase in our backlog over the past six months.

In addition, the president's executive actions to advance large pipeline projects and remove regulatory and permitting hurdles are creating momentum. However, market conditions today challenged our profitability in the quarter, and our focus remains on controlling costs and driving efficiencies.

Let's turn to Management Services. Revenue grew by 1%, and we are beginning to convert on our unprecedented pipeline. We entered the year with $25 billion of submitted bids. And in the first quarter, we delivered $1.7 billion of wins, a new high for our Company. These successes reflect our significant business development investments over the past two years and our continued high win rate in this market.

Importantly, we expect decisions on nearly $20 billion of bids this year, and anticipate submitting another $8 billion of bids in the second quarter alone. In addition, the Trump administration's focus on investing in defense and cyber security plays to our strengths and sets a strong foundation for growth.

Turning to Europe, Middle East, and Africa. Despite ongoing uncertainty from Brexit, we delivered 8% growth in the UK, and market indicators remain positive. The government's latest National Infrastructure and Construction Pipeline includes over $600 billion of planned transformative investments. These projects continue to prioritize integrated delivery and public-private funding models. We are ideally suited to benefit from these trends, with nearly $8 billion of integrated pursuits already in our pipeline.

We are also actively expanding our Construction Services presence in the UK. We have two projects already underway, and have several more large pursuits in our pipeline.

The Middle East market is stabilizing. We are performing well on our vast backlog of work. And projects that have been put on hold in the downturn are showing signs of returning to the market, creating better visibility.

Pivoting to Asia-Pacific, our performance remains very strong, and backlog increased by 3%. In Hong Kong, where we maintain leading market share, we are winning large pursuits, including the Hong Kong Airport's Third Runway and Concourse. In addition, the Australian market continues to recover. We delivered 7% revenue growth, the highest in several years, with contributions across the southern and northern regions.

We are making significant investments to grow our Construction Services and Management Services presence across the Asia-Pacific region. For instance, we are positioning for strong growth in the nuclear decommissioning market. We have established teams over the past two years to pursue a tremendous set of opportunities. And our success in the US nuclear market is a significant advantage as we pursue this work.

Before turning the call over to Troy, I want to put our accomplishments in perspective. We have made substantial progress on our fully integrated vision and are benefiting from our business development efforts, with a record $44 billion backlog. We have demonstrated differentiated capabilities that fully align with US policy priorities, and substantial infrastructure commitments in Canada, the UK, and elsewhere around the world; and our pipeline of integrated pursuits is stronger than ever. These achievements support our confidence in delivering sustainable growth and achieving the long-term financial targets we set in December.

Troy will now provide greater detail on our financial results.

Troy Rudd - *AECOM - EVP and CFO*

Thanks, Mike. Please turn to slide 6. Our first-quarter results set a solid foundation for fiscal 2017. We delivered $5.9 billion of wins and a 1.3 book-to-burn ratio. We generated positive cash flow, including operating cash flow that was consistent with our first quarter last year. Revenue increased by 1.4%, with all three of our segments growing organically. Adjusted earnings per share was $0.53, and matched our expectations. Our EPS included a $0.12 benefit from legal proceedings, primarily related to a legal settlement disclosed on November 23.

Please turn slide 7. DCS revenue increased by 1%. Revenue in our Americas design business increased by 2%. Our results in the UK were also strong, where revenue grew 8%. The first-quarter adjusted operating margin was 5.9%. We delivered solid underlying performance and increased business development investment compared to the prior year.

Excluding this higher spend and the expected decline in normal margin, the first-quarter margin would have increased slightly from last year.

Please turn to slide 8. Revenue in CS grew 2%. Our Building Construction business grew 3%, and is on track for another year of double-digit growth. In addition, our Energy and Industrial Construction business grew by 9%, primarily due to large wins over the past year.

The adjusted operating margin of 1.4% met our expectations. Oil and gas markets remain a headwind. However, our backlog reflects a shift to higher-margin work in the power sector, which should bode well for margins over the next several years.

Please turn to slide 9. MS revenue increased by 1%. The adjusted operating margin was 11.4%, and included approximately $35 million related to the previously mentioned legal settlement. Underlying performance was consistent with our expectations. Our margins in this segment are expected to be lumpy due to the timing of milestones and project incentives. Our long-term 7% forecast remains intact.

Please turn to slide 10. Operating cash flow was $78 million, consistent with our expectations, and the prior year. Free cash flow was $56 million, and was positive for the 18th time in the past 19 quarters. We remain on track with our full year free cash flow guidance of $600 million to $800 million. Our cash flow has traditionally been more heavily weighted to the second half of the year, and we expect the same this year.

Reducing our debt remains our near-term capital allocation priority. However, as always, long-term shareholder value creation is our top priority, and we will continue to consider all options.

We'll now turn the call over to Steve to discuss our financial guidance.

Steve Kadenacy - *AECOM - President and COO*

Thanks, Troy. Please turn to slide 12. We are energized by the momentum in the business and our end markets. We delivered strong wins, and exited the first quarter with record backlog. These accomplishments are a direct result of our competitive advantages, focused business development investments, and efforts to drive collaboration across the enterprise. We are on track with a number of key financial objectives we set for ourselves in fiscal 2017.

In the first quarter, we delivered growth in the Americas design market, had large wins and growth in our Construction Services segment, and we converted our record Management Services opportunities into wins. We are confident in achieving our guidance for fiscal 2017, including EPS of between $2.80 and $3.20. Our guidance continues to assume approximately $0.20 from AECOM Capital realizations at the midpoint, and a 20% tax rate.

We are working through a checklist of items to complete our first AECOM Capital realization, which may benefit our second- or third-quarter earnings, depending on how quickly this progresses. Our second-quarter EPS is tracking in line with current consensus estimates.

With that, I'll turn the call over for Q&A. Operator, we're now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Andrew Kaplowitz, Citi.

Andrew Kaplowitz - *Citigroup - Analyst*

Mike, you've talked about really transforming AECOM into more of a large project integrated focused contractor. Maybe you could -- you talked about it a little bit in the prepared remarks, but maybe you could assess your performance on that front so far. What I mean is, I know your win rates have picked up over the last couple quarters. But what is a little difficult for us is it only seems like the very beginning of a revenue growth inflection in the business.

Obviously some of the turn in the markets is -- some of the turn is markets improving. But would you say that 1Q, with the first across-the-board increase in organic growth for your segments, is really the first big sign that your strategy is working? And would you expect the revenue momentum to pick up from here?

Mike Burke - *AECOM - Chairman and CEO*

Andy, first of all, I do believe our strategy is working. And I think I cited a few examples of that. We have long believed we were putting together an organization that can bring a much wider array of services to our clients than any of our competitors. And a great example of that was the San Onofre nuclear facility, where we won that project with services from all three of our business groups: from our design group, our construction group, and our MS group. And so it's a great example of how the new combined entity has a wider array of services that allow us to differentiate us from some pretty difficult competitors.

But as far as the pipeline, a couple things: if I look at just the P3 civil integrated delivery, where we are providing both design and construction services, right now we have a pipeline of projects that we're bidding on of over $10 billion of CapEx on integrated delivery.

If I look at just the EMEA region alone, we have a pipeline of $8 billion of projects that we're bidding that have more than one of our groups involved in that bid. And so, it is clearly a differentiator in the market, and it is starting to prove out. And so, I think that will continue. But I do think, to the last part of your question, we are in early innings on this.

We are seeing the pickup in our win rate. We're seeing the pickup in organic growth. We're seeing obviously the win rate between -- in the last six months we had $12.3 billion of wins in the last two quarters, the highest number of wins we've had in the history of the Company. And we feel pretty good about the pipeline that's in front of us.

So I think, all in all, it's working quite well. And the real pickup from these wins and these market opportunities, and this market differentiation that we have will start to realize itself in FY18 and FY19.

Andrew Kaplowitz - *Citigroup - Analyst*

Okay. That's helpful, Mike. If I focus on Americas design, Americas design revenue looked like it went from down 3 last quarter to up 2 this quarter. We know you said it will still be choppy and that it eventually will move to where backlog growth is, in the mid-single digits. But was the improvement just lumpiness? Or did you actually see more activity in core design markets?

Ultimately, the question is: are you starting to see more actual revenue burn from your backlog as fiscal spend -- whether it's the FAST Act, or bond money, or state and local money starting to come through?

Mike Burke - *AECOM - Chairman and CEO*

I think it's still just a little bit choppy right now, Andy. We are seeing -- you saw in the quarter a pickup in revenue. But the markets are still just a tad bit choppy, because all the money that we're talking about isn't really making its way into the market just yet. The bond measures -- the $200 billion of bond measures that came into the market in the November ballot -- that money is not in the market yet.

We are actively and aggressively talking to our clients about how to accelerate those projects into the marketplace. And we've had great meetings very recently with the municipalities that will have that money coming to the table. But that's all forward-looking revenue opportunity.

But we feel pretty good about the number of wins and the organic growth rate, given that the real money hasn't come into the marketplace just yet. And in the Americas, to have a 1.1 book-to-burn rate in the DCS business is pretty encouraging before the real money hits -- the money from the ballot measures, the money from -- we're starting to see some FAST Act money just starting to come into the market now; and then, of course, the expected $1 trillion of money coming through either the Trump plan or the Senate Democrat plan.

Andrew Kaplowitz - *Citigroup - Analyst*

Okay. And Troy or Steve, just a quick follow-up on DCS margin. You talked last quarter how adjusted operating margin would improve as organic growth came back. We did see modest organic growth in the quarter, and margin was still down 60 basis points. You mentioned that the delta was increased investment and lower contribution from normal margin. But is there any reason why your margin wouldn't continue to increase here, sequentially, if organic growth continues to rise?

Steve Kadenacy - *AECOM - President and COO*

Well, we did increase sequentially, Andy. And if you back out the difference in normal profit year-over-year, and our increased BD, the core operating margins on a year-over-year basis were flat. So we do feel there's upside in the longer term as we start to get real positive organic growth. As Mike said, right now we're getting the growth three out of the four quarters, but the outer quarters in 2018 and 2019 feel better to us. And that will be incremental to our margins, no question.

Andrew Kaplowitz - *Citigroup - Analyst*

Okay. Thanks, Steve.

Operator

Andy Wittmann, Robert W. Baird and Co.

Andy Wittmann - *Robert W. Baird & Company - Analyst*

I wanted to talk a little bit about the power segment in a couple of contexts. And first off, you guys touched on the nuclear decommissioning opportunity. Obviously San Onofre is a great start on that. I'd like some of your context on what that bidding pipeline looks like, maybe number of projects or dollar amounts of projects; and what you think your win rate can be over the coming years, given that market opportunity?

Mike Burke - *AECOM - Chairman and CEO*

Let me take it in two pieces. I will talk to the nuclear piece, and Steve can talk to the domestic power, fossil fuel business. The San Onofre project was not just a $1 billion-plus project with multiple service offerings that spoke volumes to our strategy. But really what it was a stake in the ground of what we can deliver on some very, very enormous opportunities in front of us.

We are looking at a D&D market that is in excess of $200 billion. We are pursuing projects across the US. There will be another nuclear decommissioning in the state of California. We are pursuing projects in Canada; a Taiwan project we're bidding on. We have a team that has been on the ground for well over a year now in Japan to pursue the five or so decommissioning projects that will occur in Japan. And then, of course, the nuclear new build that we're now seeing sprout some roots in the UK, as well as in Canada.

So we think the San Onofre opportunity is not just a big win for us; but it gives us the credibility to take on a whole host of these other projects in a $200 billion nuclear market around the world.

Steve Kadenacy - *AECOM - President and COO*

In terms of the power projects that we've talked about ramping up, I think that's a perfect example of what Mike was talking about in his answer to Andy's question, is the revenue from those projects that we won over the last two quarters will really ramp up into 2018. If you look at the revenue we expect from 2017, it will -- 2018 will probably be 3 times on those four or five projects alone; and in 2019, probably 4 times. So these projects are large, and they ramp over time.

Andy Wittmann - *Robert W. Baird & Company - Analyst*

Can you just -- on those gas plants, I guess those are done on a fixed-price basis. I wanted to confirm that. And I also wanted to understand the risk profile with the nuclear decommissioning. Is there a contribution from that that is also fixed-price? And how do you assess those risks, not having done one in a very, very long time?

Steve Kadenacy - *AECOM - President and COO*

Well, these are fixed-price. The group that we have doing the combined cycle plants have done these. In fact, for some of the clients, they have done it for those clients, and in the same geographical area. They are not hard bid. We spend time building up the price with the client. There's no question there's -- these are riskier projects than pure design projects.

However, we approach them in a very conservative manner. It's about building in contingency and not burning revenue in advance of when you know you've hit the milestones to deliver the project on-budget.

So we're extremely conservative. There's no history on combined cycle plants in that power group that we have in Princeton of losses on these projects because of that conservative element of their management and execution. So we're fairly confident. And I think the same is true on how we're approaching the SONGS project, is we'll take a conservative approach. We will recognize revenue on a conservative approach. And we'll build contingencies in, and only release them when we hit certain milestones.

Andy Wittmann - *Robert W. Baird & Company - Analyst*

Is the whole SONGS project fixed-price? Some of it is in construction, which tends to be more fixed-pricey, if you will; and some of it is in the design group. So can you give us a breakdown of how much of that is actually at risk?

Steve Kadenacy - *AECOM - President and COO*

It's a fixed-price contract.

Andy Wittmann - *Robert W. Baird & Company - Analyst*

The whole thing? Okay. All right, great. I might circle back, but I'll leave it there for now. Thank you.

Mike Burke - *AECOM - Chairman and CEO*

Can I just add? I just want to add one comment. I think Steve addressed your question about have we done this work before; he addressed it on the combined cycle plants. In the nuclear space, there is probably no other firm that has done as much nuclear decommissioning in the United States as AECOM has in our legacy companies. The work has primarily been done for the Federal Government. But between us and Bechtel, we have dominated that entire market for decades now. So, the level of expertise that we have in high hazard waste decommissioning is second to none.

Andy Wittmann - *Robert W. Baird & Company - Analyst*

Fair point. Thank you.

Operator

Anna Kaminskaya, Bank of America.

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

Good quarter. I wanted to start maybe on the free cash flow first. As we see the ramp-up in your organic growth, particularly shift to MS business, how does that impact your DSO? And do you see a pressure to the range between $600 million and $800 million, where you mostly get to the low end of the range, as you need to maybe reinvest into receivables?

Troy Rudd - *AECOM - EVP and CFO*

Anna, it's Troy. First, built into the plan this year we have built-in growth in the business; so our cash flow expectations for the year remain consistent with the way we had set them. With respect to the growth in the business, the DCS business will consume a little cash as it grows. But, ultimately, our Construction Services business and our Management Services business, as they grow and ramp up, consume much less cash to fuel growth. So, built into the plan this year is growth; and consistent with that growth is setting our cash flow target at the midpoint of the range.

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

Okay, great. And then can you talk in general just your strategy for AECOM Capital? We're hearing a lot about 3Ps. Private co-investment is a big part of Trump plan. How do you envision using your balance sheet maybe for some of the co-investment? Do you change your strategy how you co-invest from AECOM Capital? Can you just talk, thinking three years out, how do you participate in that opportunity?

Mike Burke - *AECOM - Chairman and CEO*

Great question. We do believe that whatever the administration's plan ultimately looks like, it will have at least one large component that will be designed to attract private sector investment into infrastructure. So, I think we feel very confident of that.

But we think the size and scale of the projects that we expect to participate in will be much larger than we would want to invest off of our balance sheet. So we are having discussions with outside capital sources that would bring money to the table. And as you could imagine, all the big pension funds, especially the non-US pension funds and the sovereign wealth funds, are very interested in putting capital to work in the US in long-dated assets, such as infrastructure, especially in today's low interest rate environment.

So the pools of capital that are available are wide and fairly large. So, we expect to be using third-party capital, but we would be deploying that capital and get paid for the deployment of that capital together with our integrated offering of design and build.

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

Got it. And then just wanted to quickly follow up on your UK exposure. The results are still pretty strong. But are you seeing any impact from Brexit on either commercial construction opportunities, or what are you seeing in terms of public spending? Any more color that you could provide, and how do you see it as a risk to your second half of 2017 or 2018 numbers?

Steve Kadenacy - *AECOM - President and COO*

Anna, this is Steve. We actually experienced growth in the UK and Ireland in the quarter. We have not felt what we anticipated would be some blowback from Brexit, so we're pleasantly surprised by that. The shift of the focus of the government into infrastructure as an offset to potential drawbacks of a Brexit is as vocal as it is here, for the Trump administration focusing on infrastructure.

The same is true in the UK government. And they have committed to investing over $377 billion in infrastructure by 2021; and in the spaces that we are highly interested in bidding in transportation, energy, utilities; things like the High Speed Rail 2, for instance. So we're experiencing the growth. And, more importantly, we see a pretty strong pipeline in the UK. Again, it's only 5% of our business, but it's a very strong market right now.

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

Great. Thank you so much.

Operator

Jamie Cook, Credit Suisse.

Jamie Cook - *Credit Suisse - Analyst*

Two questions, I guess. One, Mike, historically it was never really fair to ask you this question, because your business model is very different. But now that you have a fully integrated service offering, I feel like awards and backlog growth are going to become more important, and in particular as you are winning these larger jobs.

And so as we think about your backlog ended this quarter, I think $43 billion in change or so; it grew, I think, 2% or something like that. And you always throw out a lot of numbers of stuff you're bidding on, and they're big numbers. But is there any way you could help us think about how we think about your backlog? Like what backlog will be; or range, by the end of the year, based on just the bids outstanding you have out there and if you assume a normal win rate? Because I'm really trying to understand the inflection rate for backlog growth, just given your business model has changed so dramatically relative to when you -- years ago.

And then my second question. Obviously oil and gas, it has still been -- it's still sort of a drag on earnings, but you did talk about some of signs of life or green shoots. So can you just talk about specifically what areas, and how do we think about the operating leverage in that business as volumes come back, given you've restructured the business? Thank you.

Mike Burke - *AECOM - Chairman and CEO*

Jamie, thank you. I'll take the first half of that question, and let Steve take the oil and gas one. On backlog, you're asking how should you think about it. I think you should think about it very positively: $6.3 billion wins in Q4, almost $6 billion in Q1. Those are enormous levels of win rates that we haven't historically seen. But I don't want to try to give an estimate of what backlog would be like at the end of the year. But just to give you a few indications: in the first quarter alone, we had $1.7 billion of Management Services wins. That was a 40% hit rate. That is a very good hit rate. We tend to think about a one-in-three hit rate as normal, so we're exceeding our expectations in that for Q1.

We have another $20 billion of bids that we are -- we currently have submitted to clients that are in evaluation. The clients have a scheduled date of decision on those. About $17.5 billion of that $20 billion is expected to be decided in fiscal 2017, so that's in the next eight months. We're hopeful that our win rates will be as good as they have been historically. But difficult to predict; there's some big, big numbers in there. So it could -- the big numbers are an on-off switch either way. So hopefully they'll be in the on position when we get through that. We expect to submit another $8 billion of bids, in the second quarter alone, in Management Services.

So, we have -- and you've heard Steve and Troy talking about it -- about some of the margin pressure that we've experienced, because we are investing heavily in business development right now; because when the fire is hot, you strike. And right now there's a lot of opportunity, and the new size and scale of our organization allows us to qualify for more opportunities than we ever have.

And so, we feel really good about the opportunities in front of us. We feel good about our execution in chasing these bids. And I'm just talking about the Management Services, but it rolls out throughout the rest of the organization. And I have no reason to believe that we won't continue on a pretty good trajectory.

Jamie Cook - *Credit Suisse - Analyst*

Okay, thanks.

Steve Kadenacy - *AECOM - President and COO*

Jamie, on oil and gas, we're very much in still a cost containment mode with oil and gas. Any green shoots that we saw were mostly on the operations and maintenance side. And we had some wins up there in Q4 in the Calgary, Alberta, area. And we've done a good job of managing that business to where it's not a drag. It's also a very small piece of our business now. Excluding environmental, the oil and gas business is only 3% of our business. So we will continue to manage it.

It's an element of our portfolio that we want to have exposure to when things come back, which inevitably they will; and the when is the question. So, we're poised to take advantage of it when it comes. But in the meantime, we're managing it to where it's not a significant drag on us.

Jamie Cook - *Credit Suisse - Analyst*

All righty. Thanks, I'll get back in queue.

Operator

Steven Fisher, UBS.

Steven Fisher - *UBS - Analyst*

Troy, I think you mentioned that the Management Services margins would be lumpy, but that the 7% remains a long-term target. But I thought 7% was the target for 2017. How are you thinking about that margin, then, for the year, and how much more variability could there be this year? Is there more likely upside or just sort of neutral at 7%?

Steve Kadenacy - *AECOM - President and COO*

Steve, this is Steve. There's a lot of moving pieces in there, because when we win a project, depending on whether we prime or not will dictate whether it comes in on the equity line or on a fully consolidated basis. So that long-term 7% is our outlook for assuming more of a prime position on wins and fewer award fees, which are difficult to predict. And if there are award fees, or if we happen to have more earnings come in on the equity line, that would be to the upside.

Steven Fisher - *UBS - Analyst*

Okay. But 7%, then, is still your base case for the year?

Steve Kadenacy - *AECOM - President and COO*

Correct.

Steven Fisher - *UBS - Analyst*

Okay. Can you talk about what you are seeing that the state and local level in the US, from a transportation perspective and budget perspective, and how things vary regionally? I'm just curious how, from your perspective, what mix of states have growing budgets versus those where it's more sluggish. Or do you think it doesn't really matter because in the overall picture, like you said, Mike, you've got FAST Act starting to come through, and maybe you got the bigger picture of what's going to happen from a stimulus perspective. Just trying to understand what's really going on at the individual state level and how it all adds up.

Mike Burke - *AECOM - Chairman and CEO*

It's widely varied. I think you correctly point out it is widely varied across the country. There are some municipalities that are flush with cash, and many or most that are not. But so we focus on the money, and follow the money. And you look at some of the cities that have had these ballot measures, like Los Angeles, that had Ballot Measure M in November. You look at places like Seattle that are flush with cash because the taxpayers have voted in specific tax measures wholly dedicated to transportation infrastructure. So it's widely varied, and we strategically attack those markets that we think have the best opportunity.

And given our wide footprint across the country, we can be real opportunistic in pursuing those opportunities. So, Colorado is good, Denver in particular; Los Angeles, Texas, Seattle, New York, Atlanta. So the big cities are spending the most money and have the biggest tax base.

Steven Fisher - *UBS - Analyst*

But just to clarify that, do you have people working that are in the weaker budget states? Are they working on projects that are outside of their territories? Is there sufficient work out there to keep up that type of utilization and allocation?

Steve Kadenacy - *AECOM - President and COO*

On an increasing basis, Steve, we share work around not just the country, but the world. So we will soak up utilization in Centers of Excellence where we can. So we don't have -- we don't carry significant portions of people in slow areas unless it's a Center of Excellence.

So the answer to your question is yes; they are working on other things. The Riyadh Metro, for instance, is being delivered in probably three or four different offices around the world. And the same is true -- just pure US infrastructure being delivered around the US.

Steven Fisher - *UBS - Analyst*

Great. Thank you.

Operator

Michael Dudas, Vertical Research.

Michael Dudas - *Vertical Research - Analyst*

Mike, when looking at your private sector clients in your portfolio, do you get the sense that they are still in a wait-and-see mode relative to their business investing decisions because of uncertainty with the administration; and maybe still the little -- somewhat tepidness of the US GDP that we've witnessed over the last 6 to 12 months?

Mike Burke - *AECOM - Chairman and CEO*

No. Especially in the industrial sector, the manufacturing sector -- based on the activities over the past few weeks on easing regulations, and a push for more manufacturing in the US, we are seeing a much more bullish opportunity for building assets in the US.

When it comes to the private sector, oil and gas clients, the executive orders in the past week around Dakota Access and the Keystone Pipeline are giving people whole new levels of confidence on the oil and gas space. And so, generally it feels like there's a much more bullish approach in the private sector over the past couple months than there was previously.

Michael Dudas - *Vertical Research - Analyst*

That's great to hear. And I assume once the commerce and transportation secretaries get up and running fully, we'll probably see some more visibility and headlines regarding overall investment going forward?

Mike Burke - *AECOM - Chairman and CEO*

That's clearly our expectations. And we are expecting to participate in the formation of some infrastructure policies that will be helpful to the industry as a whole. And we expect to have a voice at the table as those new infrastructure policies and plans are both developed as well as implemented.

Michael Dudas - *Vertical Research - Analyst*

Excellent. My final question, for Mike or Steve: as you look at AECOM Capital going forward -- I know you addressed this in response to a question on how you're looking for outside sources. But is there a level of AECOM balance sheet capacity, or as a company itself that you're, over the next

3 to 5 years, might be invested from the shareholder base of AECOM relative to outside investment? Is there a relative range of a number? Is it large, small?

Mike Burke - *AECOM - Chairman and CEO*

It would be relatively small, recognizing that we have realizations that are now coming through. You will see over the course of the next couple of years, the investments that we made three years ago, now we are expecting to flip those assets. And we will have cash coming in that we will reinvest. So, it will be a small amount from the balance sheet on a net basis. But on a gross basis, of course, as money comes in, we would then want to recycle some of that money into new investment opportunities. So you shouldn't expect to see a significant new total amount on the balance sheet.

Michael Dudas - *Vertical Research - Analyst*

That makes a lot of sense. Excellent. Thank you, Michael. Thanks.

Operator

Tahira Afzal, KeyBanc Capital Markets.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

The first question is: given your backlog profile, which seems to have a lot of visibility and it seems pretty exciting; opportunities that you could be booking. Are you at a point where you feel comfortable or encouraged about accruing earnings next year, even though you have, like, $0.32 this year, that can be considered one-time in a sense? Or is it too early to say?

Steve Kadenacy - *AECOM - President and COO*

I think it's too early to give 2018 guidance, but we're certainly more bullish on our revenue growth into 2018 and 2019. And we have the broader guidance that we gave at Investor Day, of course, which forecasted about 5% growth.

Mike Burke - *AECOM - Chairman and CEO*

5% revenue growth and 10% EPS growth over the next five years.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

Got it. And just a clarification, does that include -- should we be looking optically at your current guidance, or should we scrape out a couple of the things, like the $0.12 we saw?

Steve Kadenacy - *AECOM - President and COO*

The midpoint of the range would be $2.90, Tahira. So there's ups and downs on both sides of that, obviously, but that's our best analysis right now.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

Okay. Well, that's good enough. And a second question is [there] will just be a lot of what's coming with the new administration seems to be pretty positive for your businesses. Any comments on the labor side of the equation?

Mike, is it net neutral? Or could there be some slow issues in terms of your labor, given what's happening?

Mike Burke - *AECOM - Chairman and CEO*

We're not concerned about labor shortage, if that's what you are referring to. We will have -- these projects will, first of all, take a while for the administration to lay out a plan and get it through Congress. So we're six months away from that happening. And then we -- as you probably saw, AECOM produced the report of the 40 most important projects for the previous administration that was handed over to the new administration, of the big infrastructure projects that we thought were the kind of projects that the administration should be focused on.

So, those projects will roll out slowly over time, and start building into 2018 and 2019. So we will have plenty of time to build up our labor force to meet that demand. So that is something we're not overly concerned about.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

Got it. Okay, thank you very much.

Operator

Brent Thielman, D.A. Davidson.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Just on the Management Services segment, I don't get the sense you are seeing any shift in timing of decisions on these bids. But was hoping to get some perspective, particularly for the federal agency work you're after. Are most of these opportunities relatively detached from any initiatives that might come with the new administration?

Mike Burke - *AECOM - Chairman and CEO*

I'm not sure -- I don't know what you mean by relatively detached. The baseline defense spending budgets are in the $550 billion range. I don't think there's any expectation that defense spending is going to decrease in the current administration. I think most people are expecting that it's going to increase, if anything. So, that is something we're not overly concerned about.

On the other area of focus for us is Department of Homeland Security, cyber security, anti-terrorism type initiatives. They are all of the areas that we have a presence in; we've been providing that work for quite some time. We expect to see growth in that area based on the pronouncements of the current administration. So, I think we're in the sweet spot there.

We are not exposed in foreign contingency ops outside the US. That's almost a non-existent part of our business nowadays. We're not expecting to see growth in boots-on-the-ground activity outside the US. So I think we're very well positioned for the current budgets, as well as our expectations of priorities for the new administration.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Okay. So for the bids you've got out there, was just trying to get a sense if there's less urgency among some of these agencies as they digest what Trump intends to do? Or is it business as usual?

Mike Burke - *AECOM - Chairman and CEO*

No, I think it's business as usual, or plus to that.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Okay, okay. And then within Construction Services, it certainly looks like energy industrial portion saw a nice acceleration, particularly compared to buildings -- the buildings group. Assuming that trend continues, does that mix shift begin to benefit segment margins in a more material away over the course of the next few quarters? Or is it more so into 2018 and beyond?

Steve Kadenacy - *AECOM - President and COO*

Absolutely, from a pure margin standpoint; although our Building Construction margins are low, it is highly accretive from a return on invested capital standpoint. Because our building construction requires so little capital, if any. But on a pure margin basis, the power wins tend to run in the 6s versus the low single digits for Building Construction.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Okay. And then lastly, just again for construction services, could you provide what the headwind was from oil and gas for the quarter?

Steve Kadenacy - *AECOM - President and COO*

They were down from a revenue standpoint in the low double digits, but I'm not sure exactly what the overall impact was. I haven't quantified that. I'm sure Will can update you.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Okay, thank you.

Operator

Chad Dillard, Deutsche Bank.

Chad Dillard - *Deutsche Bank - Analyst*

How do I think about when AECOM could see the benefits from the $200 billion in infrastructure ballot initiatives? I look back to the time it took between the FAST Act and AECOM seeing a positive impact, and it's basically been about a year. Is that the right way to think about it? Is that what you and your customer conversations are centered around, or it could be shorter?

Mike Burke - *AECOM - Chairman and CEO*

That's a minimum. I, think first of all, before I jump onto that, let me just make sure I underscore: the momentum that we have right now, the two biggest quarter of wins in the history of the Company, are pre-ballot measure funding, pre-Trump funding, or any new infrastructure bill funding. So we have momentum going into it, but the administration -- the Secretary of Transportation was just confirmed last week. I think it would be a surprise to see anything that gets through Congress on an infrastructure bill until the fall. So we've got at least six months before we have a bill. Then it needs to be implemented, and the money needs to get to the marketplace; so a year, at a minimum. That would be fast for the money to hit the market.

But the good news is, in the meantime, we have the FAST Act that's rolling out and is now starting to get into the market. We have had very good discussions with some of these municipalities -- like the city of Los Angeles that passed their big $120 billion program -- of how to accelerate the implementation of those initiatives. So that's all happening along the way, and so you are stacking building blocks here.

You are stacking the building blocks from the FAST Act to the ballot measures, then to the Trump plan. And all these things will build up to a very solid 2018, 2019, 2020. Which is why we feel so confident in at least 5% organic growth over the next five years in revenue that will produce at least 10% growth in earnings per share over that five-year period of time, and produce in excess of $3.5 billion of free cash flow over that same five-year period of time.

Chad Dillard - *Deutsche Bank - Analyst*

Got it. And then just switching over to DCS, how should we think about the business development margin headwinds over the next 12 months or so? Will it be in line with what you experienced during the quarter? I'm basically trying to combine that line of thinking with you seeing a greater mix of America's DCS business and whether you can actually exit 2017 at a 7% run rate. And then just really quickly, if I can squeeze one more in. Of the $20 billion of MS work that you're bidding, how much is prime?

Steve Kadenacy - *AECOM - President and COO*

So on the DCS piece, the 7% is probably an aggressive target. I believe we guided into the low 6 range, which we think is achievable. There could be some upside to that. The BD spend headwind in there, I'd say would be relatively consistent with Q1. We have a team dedicated to winning work, either in full or part of their day jobs. And we don't expect to increase or decrease that substantially through the course of the year. And that is up from prior year, so I think the run rate that you're seeing is consistent.

In terms of the prime bids that we are shifting into the prime position within MS, it's probably 60% to 70% of our pipeline is in the prime position.

Chad Dillard - *Deutsche Bank - Analyst*

Great. Thank you very much.

Operator

We have no further questions at this time.

Mike Burke - *AECOM - Chairman and CEO*

Okay. So in closing, if I could just reiterate what we've been talking about. We feel like we have a real solid start to the year with the level of wins, with organic growth in all three of our segments; our cash flow phasing is consistent with our expectations. And we're quite energized by what we have in front of us: the FAST Act, the ballot measures, the new infrastructure plan that we expect to come out of Washington, and expectations of growth in the DoD sector. And we are continuing to invest, as you heard Steve and Troy say earlier.

We will continue to invest in BD. We believe it's a great opportunity to build our backlog up for the future. And when the opportunities are there, we're going to invest, as we have been, in some of these big opportunities. We will continue to invest in AECOM Capital, and we will continue to invest in collaboration across our organization.

As we talked about earlier, the number of new integrated bids, where we are selling more than one service to the same client, is the realization of the strategy that we laid out a few years ago. So, we're encouraged by what we're seeing, and we're as optimistic about the future as we've ever been.

So over the second quarter here, we'll be out on the road meeting with investors during the quarter. And we'll look forward to speaking to you again on our Q2 call. Thank you, and have a great day.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.
