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ACM - Q4 2016 AECOM Earnings Call

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OVERVIEW:

Co. reported 4Q16 EPS of $0.65. Expects FY17 adjusted EPS to be $2.70-3.10.

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CORPORATE PARTICIPANTS

Will Gabrielski *AECOM - VP, IR*

Mike Burke *AECOM - Chairman & CEO*

Troy Rudd *AECOM - EVP & CFO*

Steve Kadenacy *AECOM - President*

CONFERENCE CALL PARTICIPANTS

Andrew Kaplowitz *Citigroup - Analyst*

Chad Dillard *Deutsche Bank - Analyst*

Jamie Cook *Credit Suisse - Analyst*

Steven Fisher *UBS - Analyst*

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

Anna Kaminskaya *BofA Merrill Lynch - Analyst*

Chase Jacobson *William Blair & Company - Analyst*

John Rogers *D.A. Davidson & Co. - Analyst*

Michael Dudas *Vertical Research - Analyst*

PRESENTATION

Operator

Good morning and welcome to the AECOM fourth-quarter and fiscal year-end 2016 earnings conference call. I would like to inform all participants this call is being recorded at the request of AECOM.

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(Operator Instructions) I will now 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 our press release, page 1 of our earnings presentation, and our 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 excludes the impact of acquisition 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.

I also want to point out that we have revised our backlog definition to reflect the changing nature of the work we are pursuing and winning. Our backlog now includes the proportionate value of equity method contracts. References to backlog growth and trends are on a like-for-like basis for consistent comparability. Today's discussion of organic growth represents the 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 & 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 delivered results within our guidance for fiscal 2016. Both the management services and building construction business outperformed our expectations and we achieved numerous positive strategic and financial objectives that position us well for the future. However, we are also experiencing unanticipated weakness in a few markets, which resulted in operating performance that was below our expectations. Let me take you through the details.

First, low energy prices continue to place a heavy strain on clients that are dependent on oil and gas revenues. While we have managed the cost side of our business effectively, lower demand in the market impacted our results. Second, we delivered positive growth in the Americas design business for the second half of the year, but the recovery remains choppy with uneven client spending which drove results below our expectations.

Third, we had double-digit backlog growth in our power and industrial construction businesses, but many of these wins materialized later in the year, which limited the benefit to our fiscal 2016 earnings.

Despite this volatility, we had a number of important accomplishments that reflect the strength of our diverse business. We delivered $677 million of free cash flow due to the priority we placed on driving cash collection across the enterprise. We have now paid down $1.2 billion of debt since closing the URS transaction two years ago, which gave us credibility to opportunistically refinance our bank debt during the fourth quarter.

We further advanced our design, build, finance, and operate strategy. Recent successes, such as the large contract to provide infrastructure services for Shell, validate that a growing number of clients are turning to integrated delivery for efficiency and cost savings, which is where AECOM excels.

Finally, we had record wins in the fourth quarter, driven by the greater than $1 billion contract to build the NFL Rams new stadium; successes in the Americas design market; two large O&M contracts in the oil and gas sector; and continued strength in our industrial and building construction business. As a result, our total backlog increased by 4% over the prior quarter and we are confident that the fundamentals of our business are gaining momentum as we enter fiscal 2017.

Please turn to slide 4 for a discussion of the trends across our business. Beginning with the DCS segment in the Americas, client spending has been choppy, but our competitive position is stronger than ever. Our backlog increased by 7% over the prior quarter, driven by a 1.6 book-to-burn ratio, the highest in recent history. We had successes across the transportation, water, and environment markets. Importantly, the long-term market tailwind supporting our confidence are firmly intact.

Our transportation pipeline has increased by double digits in the year, with a combination of the $300 billion FAST Act and growing state and local transportation-specific funding initiatives creating momentum. The backdrop has been further enhanced by the over $200 billion of transportation initiatives approved by voters in last week's elections, highlighted by the $120 billion Measure M in Los Angeles and numerous other significant measures including those in Seattle, Atlanta, and San Francisco.

In addition, states continued to diversify and enhance their revenue streams. New Jersey last month joined 20 other states that have recently implemented gas tax increases to support transportation investments. We are also encouraged by growing demand for integrated delivery.

Our transportation and design build pipeline has increased by more than 40% from last year and we are pursuing a nearly $20 billion alternative delivery pipeline in the water market. These trends play directly to our strengths as the leading infrastructure design firm in the US.

Turning to our international markets, performance in the Europe, Middle East, and Africa region was mixed. Revenue grew slightly, driven by continued strong performance in the UK, our largest market. While Brexit headlines continue to create some uncertainty, we delivered 3% growth for the fourth quarter and 5% for the full year. In addition, there are other encouraging indicators, including the government's recent decision to proceed with the nearly $20 billion runway expansion at Heathrow where we are pursuing opportunities.

In the Asia Pacific region, we delivered growth of nearly 10% in Hong Kong, our largest market. Our continued solid execution and leading market share resulted in steady demand for our services. Results in Southeast Asia were mixed with weaker macro trends balanced against the need to integrate the region with improved transit systems and address rapid urbanization.

And the infrastructure-driven recovery in Australia continues to build strength, which we anticipate will contribute to improved growth and profitability in fiscal 2017.

Turning to construction services, we delivered another year of double-digit revenue growth in our building construction business and continued to diversify outside of the New York Metro market. This was no more evident than in the selection of our joint venture to build the new state-of-the-art NFL Rams stadium in Los Angeles. This win not only underscores our position as a stadia construction leader, but also showcases AECOM's role as a key partner in defining skylines and urban landscapes.

We also exited the year with significant momentum in our power, industrial, and oil and gas markets. We recently broke ground on Alliant's 700 megawatt gas power plant in Wisconsin and were awarded over $700 million of oil and gas O&M contracts. These wins reflect continued market share gains as well as our clients' confidence in AECOM to take on larger and more critical assignments.

In management services over the past two years, we have repositioned the business towards growth through expanded business development efforts, which are bearing fruit. We submitted bids on an additional $10 billion of pursuits in the quarter and now have $25 billion of bids under client evaluation.

We are pursuing larger work as a prime contractor and have in over $3 billion of pipeline and pursuits with friendly foreign governments compared to only a few hundred million dollars of such projects currently in backlog. And we are focused on growing in areas where we have competitive advantages such as cyber, intelligence, critical infrastructure protection, and O&M services.

With the elections now behind us, we expect key decisions on over $20 billion of our bids in the coming year, which positions fiscal 2017 to be a transformational year for backlog growth. Further, our momentum on our DBFO vision has continued into this year with a significant number of material wins since the beginning of the fiscal year. And we are pursuing another $7 billion of projects led by our construction services segment alone that include capabilities across our three segments.

Finally, AECOM Capital continues to serve as a competitive differentiator and key enabler of our DBFO vision. We are on track to begin realizing gains on our first $200 million fund in fiscal 2017 and we are exploring opportunities to expand the size and scope of AECOM Capital into new market sectors. During the year we made our first investment in the power sector, which resulted in a $100 million EPC contract for hydroelectric power projects in Ohio.

I'd like to reemphasize how much progress we have made over the past two years and how well-positioned we are to fully capitalize on the opportunities in front of us. We are coming off a quarter with record wins. We are winning larger projects with more complexity than ever before. We are bringing more services into new markets. We are leveraging our scale and investments in people and technology to change how we deliver work for our clients and we are focused on delivering growth and value for shareholders.

I will now turn the call over to Troy to provide greater detail on our financial results.

Troy Rudd - *AECOM - EVP & CFO*

Thanks, Mike. Please turn to slide 6. Overall, our financial results fell within our guidance ranges. Fourth-quarter earnings per share was $0.65. Full-year earnings per share was $3. Free cash flow was $677 million.

We had outperformance in the management services and building construction businesses. We are also pleased with several elements of our performance, including strong cash flow, continued debt reduction, and strong backlog growth. In addition, we had better performance on tax and we favorably resolved a number of project and legal matters. However, we were disappointed that some end markets experienced softness, which more than offset these benefits.

Importantly, as Mike noted, we ended the year with nearly $43 billion of backlog and total wins of $6.3 billion in the fourth quarter, resulting in a book-to-burn ratio of 1.4.

Please turn to slide 7. DCS revenue was $1.9 billion for the fourth quarter and $7.7 billion for the year. The Americas design business returned to growth for the second half of the year and we are encouraged by the strength of our backlog, but the market recovery remains choppy and revenue declined by 3% in the fourth quarter.

The fourth-quarter operating margin declined 5.4% due to lower volume and continued investments in growth, which was evident in our 1.6 book-to-burn ratio in the Americas. For the full-year, the operating margin was 6.7%, up 40 basis points from 2015.

Please turn to slide 8. Revenue construction services was $1.6 billion for the fourth quarter and $6.5 billion for the full year. Our building construction business continued to deliver strong performance, but revenue in our energy and industrial construction business declined in the fourth quarter. Our recent wins position us for better growth in margins in fiscal 2017.

Our oil and gas business continues to be challenged by ongoing pressure on client budgets. We have broad capabilities in this market, but our exposure today is concentrated in the O&M services, where we were recently awarded two sizable long-term contracts Mike discussed earlier.

The operating margin was 1.4% and 1.5% for the fourth quarter and the full year, respectively. Excluding the negative impact from oil and gas market weakness, our full-year operating margin was 2.2%.

Please turn to slide 9. Management services revenue declined by 3% in the fourth quarter, mainly due to continued reduction in the lower margin contracts in Afghanistan. The operating margin in the fourth quarter was 10.5%. We benefited from a $27 million project incentive award and approximately $20 million of favorable project and legal resolutions.

I want to provide a bit more detail on our fiscal 2017 margin expectations for the management services segment. We anticipate margins of approximately 7%. A large number of items that benefited our fiscal 2016 margin performance are unlikely to repeat in fiscal 2017. Further, we are pursuing and winning more work as prime contractor, which results in consolidating the entire joint venture's revenue, as opposed to just recognizing our share of earnings.

Nevertheless, the profitability of our backlog and pipeline of pursuits continues to benefit from our industry-leading capabilities on mission-critical work for our clients.

Please turn to slide 10.

I am pleased to report that our strong cash flow for fiscal 2016, which included $326 million in the fourth quarter and $677 million for the full year. The strength and consistency of this cash performance allowed us to opportunistically refinance our bank debt on very favorable terms. We successfully lowered our borrowing costs, providing additional flexibility to execute our strategy.

Our fiscal 2017 interest expense guidance reflects the benefits of these lower costs and our commitment to continued cash deployment for debt reduction. While reducing our debt remains our near-term capital allocation priority, we always consider all options, keeping stockholder value creation as our top priority.

I will now turn the call over to Steve to discuss our financial guidance.

Steve Kadenacy - *AECOM - President*

Thanks, Troy. Please turn to slide 11.

Our accomplishments over the past year have established a strong foundation for fiscal 2017 and beyond. Underpinning our confidence is the continued recovery in the Americas, where our efforts to drive growth resulted in a 7% quarterly increase in our backlog for the fourth quarter. In addition, we expect another strong year of performance in the building construction business with double-digit revenue growth driven by the 15% increase in our contracted backlog in fiscal 2016.

We are also anticipating improved performance in our power, energy, and industrial construction businesses. In addition to the backlog momentum, the business is now fully integrated into our systems and going to market with the full force of our combined capabilities.

Finally, our substantial pipeline in management services creates a significant positive inflection point for backlog growth and is creating more prime contractor opportunities for AECOM. Accordingly, we are initiating fiscal 2017 adjusted EPS guidance of $2.70 to $3.10. This guidance assumes approximately $0.20 of earnings per share from AECOM capital realizations at the midpoint. We also expect full-year tax rate to be consistent with the fiscal 2016 rate at approximately 20%.

In addition, we expect the full-year share count to be approximately 159 million shares, interest expense of approximately $190 million and amortization of intangible assets of approximately $95 million. Importantly, reflecting the strength of our diverse business, we continue to project free cash flow to be within our $600 million to $800 million guidance range, which will drive additional debt reduction as we work towards achieving greater capital allocation flexibility.

With that, I would like to turn the call over for Q&A. Operator, we are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Andrew Kaplowitz, Citigroup.

Andrew Kaplowitz - *Citigroup - Analyst*

Good afternoon, guys. Steve maybe, if we step back and look at your EPS guidance, it seems that at the midpoint you were assuming a modest organic revenue decline and modestly declining margins. You did talk about MS margin of 7%. I think you recorded 12% adjusted in FY16, but if I remember a year ago you had guided to 8% margin in that MS business. So can you talk about the probability of positive performance enhancement fees in 2017?

I know you said it's not going to be like 2016, but is that sort of conservatism given the chunkiness of these types of fees?

Steve Kadenacy - *AECOM - President*

Actually MS is fairly pretty predictable in terms of planning. There's not a lot of performance -- large wins or award fees that we are anticipating in the year. They could happen, but the run rate has always been in the 7% to 8% range and we are planning for about 7%.

Mike Burke - *AECOM - Chairman & CEO*

Andy, if I can add one comment on that, one of the things that is important to note from the MS business is that we significantly ramped up our business development efforts in that space. And so we currently have an $8 billion backlog in the MS segment. We have been working now and we will be working on it through a good part of FY17, that $25 billion of bids that are currently under client evaluation.

We have invested significantly in that and all the costs of that business development activity, of course, run through the P&L. So if we even come somewhat close to our historical win rate on that $25 billion of backlog -- $25 billion of bids that are currently in evaluation, relative to our $8 billion of current backlog, it's a significant uptick. But you have to understand the impact on the margin of that enormous bid development work that's been undertaken.

Andrew Kaplowitz - *Citigroup - Analyst*

That's helpful, Mike. Mike, maybe you can talk about the state of the Americas design business. In other words, you mentioned $200 billion in state and local ballot measures that were approved. That seems like a pretty good number.

Can you give us perspective on when that kind of spend starts to hit? Obviously you have Trump out there talking and we all have our views on that, but how do you look at DCS business, specifically Americas design, as we go into 2017?

Then maybe you can also talk about the margin. I know that Steve has talked about a 7% margin in that business as a target. Margin was pretty low in 4Q; is that just underutilization?

Mike Burke - *AECOM - Chairman & CEO*

Let me take all of those. I will start with the micro and then I'll go to the macro.

So the micro relative to the margins in the quarter, the same comment that I just made about MS applies to DCS. During the quarter, we invested heavily in business development activity which produced extraordinary results. We had a 1.6 book-to-burn ratio in DCS Americas in the quarter. That's the highest we have ever had in the history of the Company in DCS Americas, and you don't go out and win that much work without significant business development activity.

So that has contributed to a lower-than-normal margin in the quarter, but that will produce higher-than-normal margins going forward. So that's on the micro.

But getting to your big question on the macro, I tell you, I don't think we have ever been more bullish on the future of infrastructure in North America than we are right now. The $200 billion of ballot measures that came through -- and we were tracking about $230 billion of ballot measures across the United States; $200 billion of them passed. Of course led by one of the largest here that we had a significant involvement in, which is the $120 billion Measure M in Los Angeles, our home city, where we have an incredibly strong position to take advantage of that spend.

But we also have seen in recent history here 20 states that have increased gas taxes. Most recently, in New Jersey; again, a state where we have a significant presence. So we are seeing a recent increase in gas taxes. We saw the $300 billion-plus FAST Act passed in the past 12 months.

We saw $200 billion of ballot measures and now, of course, the advertised $1 trillion investment by the Trump administration over the next 10 years that gives us a lot of opportunity. We are likely to see a change in direction on the Keystone Pipeline, where our environmental business will have opportunities, our oil and gas business will have opportunities; and then you are likely to see a change in overall energy policy across the country that will be a little more friendly towards capital development.

So I got to tell you, with all those together, I don't think we could be more enthusiastic about what lays in front of us.

Andrew Kaplowitz - *Citigroup - Analyst*

Okay. Thanks for that, Mike. And just a cleanup question around tax. Troy or Steve, 20% tax rate two years in a row; we shouldn't think that that structural though. Your tax rate historically has been more high 20%s, so how do we think about it for a longer-term tax guide beyond 2017?

Troy Rudd - *AECOM - EVP & CFO*

Andy, it's Troy. In the current year, we had the impact of a valuation allowance reserve in the UK, which brought the rate down to 20, so we also benefited from just having our mix of income drive our rate down.

Looking at the next year, we expect it to be about the same, driven by a mix of income again and also driven by the anticipated reversal of another valuation allowance as part of our overseas business returns to greater profitability. As we move forward, I think it's difficult to say what the future will look like, just given the recent political developments, but I think it's fair to say that the rates around the world are always progressing to be lower. And so I would see our overall rate guidance trending down based on the general trends around the world.

Andrew Kaplowitz - *Citigroup - Analyst*

Okay. Thanks, guys.

Operator

Chad Dillard, Deutsche Bank.

Chad Dillard - *Deutsche Bank - Analyst*

Good afternoon. You have about $7 billion in construction bids, $25 billion in investments outstanding; how much of that work do you need to win to hit the 2017 earnings guidance? Can you remind us what your win rates are on both of those businesses?

And then, lastly, what percentage of your backlog that you have right now will be recognized as revenue in 2017?

Mike Burke - *AECOM - Chairman & CEO*

On the last part of the question -- Troy, do you have that number? I don't have it off the top of my head. Obviously, that's comprised of 50,000 different projects so I don't have even a rule of thumb for you on that.

Troy Rudd - *AECOM - EVP & CFO*

Again, they vary business by business. Our DCS business, given the nature of it, has something that's in the win rate of -- think about it in the 30% to 50% range. Our MS business has a win rate that is something that is a little bit lower than that, given the nature and the size of the projects. And our construction business, I don't have the number offhand, but I don't think it would look dissimilar.

Mike Burke - *AECOM - Chairman & CEO*

I think the important answer; part of that answer is how much of this do we need to win to hit our guidance in 2017? And it's important to note that these wins are long-term in nature. We don't need to win many of these to really produce the results in FY17.

For instance, in the MS sector, this $25 billion, the big chunk of those won't be decided until the May timeframe and later. So these decisions -- these are long-term projects; we are heavily investing in them. Those decisions will be made later in 2017, so those projects will start producing real revenue in 2018. And so the important part is we don't need to win even a small percentage of those projects to impact 2017.

On the construction services side, those projects -- again they are long-dated in nature and we are typically -- when we win work it doesn't produce any impact in the first year. So this is all -- we are good for fiscal 2017. What we are really banking now is incredible growth for 2018 and beyond.

Chad Dillard - *Deutsche Bank - Analyst*

Got it. And then just moving over to cash flow, can you just help us bridge your 2017 implied net income guidance of about $460 million versus the midpoint of free cash flow of about $700 million? What are you guys counting on from a working capital perspective versus any one-time items that we should be aware of this year?

Troy Rudd - *AECOM - EVP & CFO*

Not dissimilar from this past year, you can simply start with our midpoint of the EPS guide, which is about $460 million approximately of earnings. And then we have some tailwinds. We have the stock-based compensation, depreciation in the year projected to be greater than our CapEx spend, and then we also have some tax liability that's strictly non-cash.

So that all gets us to a point that puts us firmly within the range. But then we, of course, will be focused on, as we always do, managing working capital so we will be driving to a higher number. But I'd just point to the fact that consistently for the last number of years we have been able to across the business to convert the earnings into cash flow and to drive working capital improvement. And we don't see that outcome changing this year.

Chad Dillard - *Deutsche Bank - Analyst*

Great. Thanks, guys.

Operator

Jamie Cook, Credit Suisse.

Jamie Cook - *Credit Suisse - Analyst*

Good morning or good afternoon. I guess a couple quick questions, Mike. I thought it was interesting the comments you made about the level of spend that AECOM is -- related to the bids on management services as well as DCS. Is there any way you could help us clarify how much you are spending on that? Because obviously that's a headwind to earnings that we probably are under appreciating.

Then I guess my second question is -- I don't think you really ever answered Andy's question on how to think about DCS revenues and profitability for 2017, what you are assuming. Just because that business has been so choppy and as we think to 2017, I would think margins and profitability should be a little more normalized now that some of the noise is going away. So I guess I will start there.

Mike Burke - *AECOM - Chairman & CEO*

I'll let Steve answer the part on DCS guidance on margins and I will try the first part of your question, trying to quantify the spend on these.

It's difficult, Jamie, but I'll tell you generally, over the past year we spent $0.5 billion on bid and development costs. $0.5 billion, $500 million on bid and development costs and that has been increasing. It's been increasing because of the size and scale of the projects that we are pursuing.

Our profile has changed quite a bit over the past two years. We went from a smaller project company to a much larger project company where we are incurring more of the bid cost, but that also means we are going to realize a greater share of the profitability from the project. So where we have projects where we were a subcontractor -- and management service is a good example; we would've been a subcontractor to some of the big defense prime contractors -- we are now bidding these projects and pursuing them as the prime. And so we are incurring a bigger share of the business development costs and we will also realize a bigger share of the profitability as we go forward.

It's difficult for me to give you much more detail than that other than the $0.5 billion of bid development costs that we did incur during the course of the past 12 months.

Jamie Cook - *Credit Suisse - Analyst*

I guess one follow-up question and then you guys can answer the DCS modeling question. I guess, Mike, just strategically as 2017 looks to be the trough; 2018, if everything goes off like we think, you could have some real positive growth, probably that we haven't seen before.

So I guess how comfortable are you with the growth trajectory that's out here, given that we have integrated URS; you're going to be bidding on projects differently than you have in previous cycles? Is there a level of, in 2017 numbers or just longer term, investment that's needed outside of the bid and proposal costs just to ensure that we execute on these projects appropriately? Just trying to understand how you are thinking about the growth balance with risk I guess.

Mike Burke - *AECOM - Chairman & CEO*

Jamie, I think we have made the investment over the past two years. Over the past two years we have spent an incredible amount of time and effort integrating these two companies in a way that positions us for the growth that we are now starting to see. You saw incredible book-to-burn ratio in the business, incredible uptick in the number of pursuits in the MS sector, as well as the construction sector, and so we have made those investments.

We've integrated the organization; we've integrated all the IT systems. We have incurred all that cost. We've brought the organizations together that gives us a platform that is so exponentially better than it was prior to the integration.

But the past two years we have also spent a lot of time internally focused as we brought these organizations together. And during 2016 we started transitioning from an organization that was focused on integration, because we have to get that right, to an organization that is going through a transformation to bid on projects that we never thought were possible two years ago.

And so I am incredibly confident, which I think was your question; was how confident am I that 2018 will be a big uptick in growth for us. I am incredibly confident of that and I am incredibly confident of 2017 as we just gave you direction on it.

Jamie Cook - *Credit Suisse - Analyst*

Okay, thanks. Then just a follow-up on 2017 DCS revenues and margins, thanks.

Mike Burke - *AECOM - Chairman & CEO*

Steve will take that.

Steve Kadenacy - *AECOM - President*

I think the DCS Americas for 2017 will kind of mirror what Mike just said. You look at our backlog in 2016 is up 6% year over year, and if I interpret the question is when will that actually materialize in terms of gross revenue organic growth?

We are planning for something less than that and we intend to ramp into that 6% growth as we go forward. And there's no indication, best that we can tell, that we won't continue to see that kind of backlog grow throughout the year. Because as Mike said, we are seeing the playing field in the pipeline of opportunities up significantly relative to what we've seen in the past six years, quite frankly.

And that's true for MS and CS as well, particularly outside the building construction space where we haven't seen the growth in power and industrial, for instance. We are now seeing that growth and you have seen that backlog change significantly.

If I go back to a couple questions where the win rate was the question: what do we need to win. We just need to win our fair share at our normal run rate and our backlog in MS will transform during the year, will continue to grow at organic 6%, 7% on Americas DCS. And CS will continue to grow as well.

Jamie Cook - *Credit Suisse - Analyst*

Sorry, DCS margins?

Steve Kadenacy - *AECOM - President*

Well, the margins will improve as that organic growth comes back. You can't look quarter by quarter, so we were up slightly quarter over quarter, down year over year, but we didn't take our foot off the pedal in terms of investing in the business development because we see the opportunities.

Jamie Cook - *Credit Suisse - Analyst*

Okay, thanks. I'll get back in queue.

Operator

Tahira Afzal, KeyBanc Capital Markets.

Unidentified Participant

This is Sean on for Tahira today. Just to continue on a similar topic that Jamie was wondering about, just looking at margins in backlog. Could you comment on sort of where the margins are in backlog at this point versus maybe this time last year, so we can kind of get better sense for how margins are looking outside of these investments and some of these timing nuances?

Steve Kadenacy - *AECOM - President*

Margin and backlog are looking strong. It varies by business line, but if you go within each segment, within each market sector, the backlog that we are winning is no different.

Our mix from that standpoint is up, particularly in CS, where we are winning more in the power and industrial sector, which has a higher margin than building construction. And DCS continues to win in the higher-margin businesses as well. And of course, the synergies that we have seen brought to -- are going to fall to the bottom line as we grow the top line.

Unidentified Participant

Okay, thanks. Then in terms of the larger power and industrial projects that you guys called out as having a more pushed-out timeline than you had previously thought. Could you just comment on how those projects ramp up through fiscal 17 and what the average duration of those projects is?

Steve Kadenacy - *AECOM - President*

Those projects can be anywhere from a two- to four-year build. They will ramp up within 2016; within 2017 they are probably improving into the second half.

Unidentified Participant

Okay, thanks. Then just one last one from me. I was just curious what you guys are thinking about in guidance in terms of some of the more challenged markets like oil and gas and the Middle East, for example.

Mike Burke - *AECOM - Chairman & CEO*

We have muted expectations for oil and gas as a whole; however, we did have, as we mentioned earlier, some big wins in the O&M side of oil and gas in Q4 so that feels pretty good. Then as I mentioned earlier, that if we see some of these regulatory changes on the Keystone Pipeline and others, we could see a resurgence in capital expenditures in the oil and gas sector in 2017 and forward.

Unidentified Participant

Okay. Thanks, guys; appreciate it.

Operator

Steven Fisher, UBS.

Steven Fisher - *UBS - Analyst*

Thanks, good morning. Can you -- just to continue the discussion on the organic growth, you can just give us a sense for what you have assumed for the overall organic growth for the Company in 2017? Is it positive year over year?

Troy Rudd - *AECOM - EVP & CFO*

Yes.

Steven Fisher - *UBS - Analyst*

At the midpoint it's positive growth year over year?

Troy Rudd - *AECOM - EVP & CFO*

Yes, correct.

Steven Fisher - *UBS - Analyst*

Okay. Then I guess in terms of your -- how granular is your understanding of what drove the weakness in the Americas design? I guess maybe at kind of the key project levels that you have in your prospect sites or in your backlog. And what's the confidence that you'll see that accelerate into fiscal 2017?

Steve Kadenacy - *AECOM - President*

There's nothing at the granular level that we would need to call out. It's not a result of a project having a hit during the quarter or anything like that. It was merely volume driven. You can't expect volume quarter over quarter or every three months to be completely predictable.

And then we did change -- even though we weren't seeing the volume side from a spending standpoint, we were seeing it in the pipeline and we dedicated ourselves to winning those projects as is indicated by the 1.6 book-to-burn in the quarter. So when you are spending on a robust pipeline and the current quarter volume is not high, you're going to see that impact on the margin.

Steven Fisher - *UBS - Analyst*

Okay. How do you think the year is going to play out in terms of the number and timing of AECOM Capital realizations embedded in that $0.20 a share?

Mike Burke - *AECOM - Chairman & CEO*

We don't have a specific date on the calendar for when that will sell, other than in FY 2017. We are positioned quite well for that sale, as we've talked about before. We expect it to sell sometime in FY 2017, but we don't have a date yet.

Steven Fisher - *UBS - Analyst*

So is it just one project at this point?

Mike Burke - *AECOM - Chairman & CEO*

It's one large project and two smaller transactions.

Steven Fisher - *UBS - Analyst*

Okay, great. Just lastly, can you just clarify again the 7% margins. You talked about business development costs, but have all those all been expended in fiscal 2016 as those bids are now in with the customer? Or is there still more of a drag from those costs in fiscal 2017 or is that just sort of the normal 7% to 8%, like you said, without assumed any incentive fees or anything in fiscal 2017?

Mike Burke - *AECOM - Chairman & CEO*

Let me put it this way; it depends on which group you are talking about. If you are talking about (multiple speakers) --

Steven Fisher - *UBS - Analyst*

Management services.

Mike Burke - *AECOM - Chairman & CEO*

-- management services group, the lion's share of the money spent on that was spent in 2016. However, there is ongoing work that needs to be done on those bids because the clients are coming back to you with additional requests for information.

But we will continue to invest in growing the business every single year. It's not like we turn off the spigot on investing in BD, but the big ramp up and spend was in 2016. To the extent we see more opportunities, we are not going to slow down on chasing them.

Steven Fisher - *UBS - Analyst*

Okay, thank you.

Operator

Andrew Wittmann, Robert W. Baird.

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

Great, thanks. Troy, you mentioned that the year is going to benefit from a valuation allowance. I guess the 20% you mentioned is for this year; compares to something, what, like 27% or 28%? So is the guidance benefiting from the valuation allowance to the tune of like $0.30-ish? Is that the right number to be thinking about?

Troy Rudd - *AECOM - EVP & CFO*

Yes, that's right.

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

Okay. And just as that relates certainly this is -- the fact that your cash tax has been under your GAAP tax is an important point. You commented earlier in the conversation that 2017 is another year where the 6% to 8% makes a lot of sense.

All else equal, assuming no growth going forward from that, that's a level of cash flow that's like 1.5 times your net income if you strip out the gain, which would be some return of capital and some operating cash flow. But you are well over 1 times free cash flow, which has been the commitment from the Company to deliver cash flow and net income.

So how do we think beyond this level? How sustainable are these exceptionally high levels of cash flow versus the net income that you're reporting? Can you just give us some thoughts on that longer term?

Troy Rudd - *AECOM - EVP & CFO*

One thing to keep in mind again is there are some non-cash items -- as I said, stock-based comp and depreciation beyond CapEx -- which contribute to that cash performance. We expect in the long term our cash to be equal to our net income, so that would be a long-term guide. But for 2017, again we will be consistent, somewhere between the $600 million to $800 million range.

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

Got you. Then just -- I don't know; maybe, Mike, can you talk about DCS with the margins? I understand the big costs were up. Maybe give us some context for how much that was a factor in the margins on a year-over-year basis.

And then maybe just talk a little bit about that all-important utilization metric that you guys talk about with --. I guess the reason why I'm asking is with organic growth decelerating again there in DCS, do you need to be looking at some level of adjustment to spruce up those margins, all else equal?

Mike Burke - *AECOM - Chairman & CEO*

Well, I'll let Steve jump into the more detail on that, but just let me be clear. We do not -- if your question is do we need to improve our utilization and cut back headcount, absolutely not. In fact, we need to grow that headcount significantly.

When you have a 1.6 book-to-burn ratio in the quarter and you're looking at a market in front of us with $200 billion of bond measures, gas taxes increasing, FAST Act moving into play, and a $1 trillion investment in infrastructure, we need to hire more people, certainly not cut back on our cost structure, as it relates to the revenue-producing people in the organization.

Steve Kadenacy - *AECOM - President*

I think that's right. Our margin in DCS year over year is up 40 basis points. We're pretty happy with how we've structured that business. We have a firm foundation to grow it. We're having good execution. We are not having project blows; it's highly predictable.

You are looking at a volume issue in one quarter and I know it's tempting to read into one quarter's results, but if you look at it on a broader basis that business is performing pretty well.

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

That's good context. Thank you very much.

Operator

Anna Kaminskaya, Bank of America Merrill Lynch.

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

Morning, guys. First, I just wanted to follow-up on the CS segment. Just sequentially revenue declined and I thought historically it was supposed to be seasonally stronger quarter. So how much of that is just oil and gas, ongoing oil and gas weakness, or how much of that is just commercial construction maybe decelerating?

And if you could just remind us how big is oil and gas business within that segment for this year and also kind of how should we think about potential risk of commercial construction slowing down? Are you seeing it in your pipeline of projects?

Mike Burke - *AECOM - Chairman & CEO*

First of all, the commercial construction, what we call our building construction group, had its second year of double-digit organic growth in FY 2016. The commercial construction is not coming off, so the commercial construction is a little different than it was going back a couple years ago.

We have diversified away from the high-rise construction and we are moving into a whole host of different types of construction. As you heard us mention the NFL Rams stadium; that's a $2.5 billion project for a 50/50 joint venture on it. So we are seeing a lot more opportunities on that side.

The big drop off, as you pointed out, Anna, is the oil and gas business. That business is down 40%. And --

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

For the year or for the quarter?

Mike Burke - *AECOM - Chairman & CEO*

For the year, for the year. Clearly, that market dropped off, but we are starting to see growth opportunities in the energy side of it. You heard us last quarter talk about the $1 billion of wins. Those wins happened in FY 2016 and they will start to ramp up in 2017, so you'll start to see the growth coming back to that business in FY 2017.

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

Is it fair that you are losing money and oil and gas for fiscal year 2016?

Mike Burke - *AECOM - Chairman & CEO*

No, it's not fair to say. We did not lose money in oil and gas in (multiple speakers).

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

Okay, so it's more like breakeven or --?

Mike Burke - *AECOM - Chairman & CEO*

Closer to breakeven.

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

And then just I'm trying to make sure I understand your methodology for the new awards disclosure with the change to backlog. So the over $6 billion of awards, does it include some equity awards as well as part of a JV?

How does it compare to how you previously reported new wins and also kind of book to burn, how you previously reported? Is it apples to apples or is there some benefit from I guess the fact that you've changed the methodology?

Troy Rudd - *AECOM - EVP & CFO*

Anna, it's Troy. First of all, just think about the perfect example, which is the Rams win; so we have a win that is in an unconsolidated joint venture. We are now reporting our proportionate share of that win in our backlog.

And in the results that we are reporting, we are reporting it on apples-to-apples basis. We have the proportionate share of backlog in the prior period as well, so you're seeing an apples-to-apples comparison and it is up quarter over quarter.

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

Then just finally, just going back to your cash position; I don't know if you can update us on how much of that is internationally and is there any tax reform? Does it provide an opportunity for you to bring some of the cash back or how do you think about cash utilization? Or do you need over $600 million on your books?

Troy Rudd - *AECOM - EVP & CFO*

About 25% of our cash is typically outside of the United States. I would say that it's a little premature to predict what the outcome might be, but if there is some favorable impact of some US tax legislation, it would be to our benefit.

We typically deploy cash to run the business, but we don't need to deploy 25% of the cash outside the United States. There's also -- again, I think this feeds into what Mike has been talking about, which is the repatriation opportunity would help us, but more significantly it would help our clients and would increase the cash available for infrastructure spend in the US. So I think that's the greater opportunity.

Anna Kaminskaya - *BofA Merrill Lynch - Analyst*

Great, thank you very much.

Operator

Chase Jacobson, William Blair.

Chase Jacobson - *William Blair & Company - Analyst*

Good afternoon or good morning to you. Just given the consistency and the robustness of the cash flow over the last couple years and your expectations going forward, are you changing at all what you think the appropriate debt level is for the business? And is there any -- I know that debt reduction is the top priority, but is anything else moving up the list beyond that?

Mike Burke - *AECOM - Chairman & CEO*

Chase, as we've said all along, we look at all of the levers for capital deployment across the entire spectrum. Today, as it was yesterday, still our number one priority is debt pay down, but we are always constantly looking at opportunities for investment in organic growth, for investment in smaller scale M&As that give us some expertise that we might need in niche markets. But right now the number one priority is debt pay down.

Chase Jacobson - *William Blair & Company - Analyst*

Okay. And is there a change in what you view the appropriate debt level to be or --?

Mike Burke - *AECOM - Chairman & CEO*

No, no. Right now we are continuing to deploy our capital to pay down debt, so we will continue to do that. We don't have any change in our views of what the ideal debt level is. We are comfortable with our debt level is right now and we would be happy for it to continue to decline as we deploy that cash to pay down that debt.

Chase Jacobson - *William Blair & Company - Analyst*

Then just another question on the bid pipeline. I appreciate all the color that you've given so far and the win rates and everything. I'm trying to get a sense into the visibility into that.

I guess maybe we can just focus on the MS business. So $25 billion; you talked about most of it likely to be awarded in the second half of your fiscal year. Can you give us any color, even from a high level, as it relates to the mix of that in terms of size of opportunity, competitive intensity? Are those opportunities funded yet? Any color as to that would be really helpful, thank you.

Mike Burke - *AECOM - Chairman & CEO*

A few things. First of all, it is -- almost all of it is domestic versus related to contingency ops or war effort outside the US. Now there are some components that are the base ops stuff outside the US, but the vast majority of it is domestic. So we feel good about that, especially in light of the incoming administration's focus on retracting the horns from the battlefield and focusing it more domestically. So that's good.

Secondly, the opportunities that we are pursuing are in our sweet spot of Department of Energy and Department of Defense so it's two of the agencies that we have broad and deep experience within. Our win rates should be at the normal rates that we've experienced over the course of the past few years.

I'll tell you a couple things. This is just more generally -- part of it is MS and part of it is the other part of the organization -- we haven't talked about is the momentum of wins from FY16 into FY17. I can tell you today that here we are five or so weeks into our fiscal year of 2017 and we have had an increase in our win rate in that first five weeks.

Just in that first five weeks we've had $3.3 billion of wins in the last five weeks alone across the organization; not just MS, across the organization. So an incredible ramp up in wins again in just five weeks here. So you are seeing a ramp up from 2016 to 2017. So I feel pretty confident.

To try and give you a sense exactly what the win rate will be on that $25 billion, I can't; but I can tell you we are positioned better than we have ever been. The depth and breadth of our capabilities from the combined organization of URS and AECOM is second to none. Our win rates have been very strong and they are both within agencies that we have broad and deep experience within and a great track record.

Chase Jacobson - *William Blair & Company - Analyst*

Okay, we can follow up. Thank you.

Operator

John Rogers, D.A. Davidson.

John Rogers - *D.A. Davidson & Co. - Analyst*

Good morning. Just a couple of follow-up things. First of all on the AECOM capital. When the sale of the one project was pushed out of fiscal 2016, I guess I was under the impression that you expected that transaction to close in the current quarter. But that's not the case anymore?

Mike Burke - *AECOM - Chairman & CEO*

No, that will not close in Q1.

John Rogers - *D.A. Davidson & Co. - Analyst*

Okay. And, Mike, there was a whole set of these -- I thought -- projects that were ready to monetize over the course of the year. Has the market just been pushed out a little or are you just reassessing --?

Mike Burke - *AECOM - Chairman & CEO*

No, let me give you a little more color on that. I will give you two examples. The one that we talked about pushing it out, we own half the project and our partner owns half the project. That's our typical structure.

Under the agreement, we had the ability to sell half of our interest. Our partner didn't want to sell, but we could've sold half. When you're going into the market and you're trying to sell half of a 40-story building, you have a limited group of buyers compared to when you want to sell 100% of it.

Our rights under the agreement allow us to force a 100% sale, but only after we have had three consecutive months of greater than 90% occupancy and we have given our partner the right of first offer. So we could've sold half of it.

We believe there is opening it up to a much wider group of potential buyers when we get past 90% occupancy for three consecutive months, which we now have done. We are 95%-plus occupied for -- that three-month period will expire just in a couple weeks here and so that will allow us to tap into a much broader group of potential buyers. When you have a broader group of buyers, it tends to drive up price.

So we are not in a rush to sell it if we believe that we could open it up to that broader group, so that is on that asset. The other very large asset that we have we have sold; it was a project that had office condo and residential condo. That project is just capping out right now.

We have sold 95%-plus of all of the condos in that building already. We have had 100% return on our basis in that project and anything that happens from here, the sale of the retail and all of the associated assets, will produce the profits from that. So we have had a 100% return of our basis in that project already.

Again, it's a wild success, but you get your basis back first on those type of projects. Hopefully, that's helpful.

John Rogers - *D.A. Davidson & Co. - Analyst*

No, that helps. Then a couple of other just quick things. In terms of the -- I'm just thinking about the timing of the benefits from increased infrastructure spend. Have you seen a material impact yet from the FAST Act?

Mike Burke - *AECOM - Chairman & CEO*

No, we have not seen a material impact in terms of producing revenue, but what we are seeing is a significant increase in the amount of activity around projects that we are starting to bid on. Not unlike the rest of our competitors. Our peer group has had the same experience in --.

Through FY 2016 it's not producing revenue just yet, but that's -- these are long-term projects that take a while to get started up and so I think you'll see a slow ramp on that type of activity.

John Rogers - *D.A. Davidson & Co. - Analyst*

Okay. Then, lastly, the potential for changes -- I know it's speculation, but environmental regulations. Does that help your power business?

Steve Kadenacy - *AECOM - President*

Certainly on the air quality side we have a strong resume in terms of providing retrofits for coal-fired. There's obviously more gas projects as well.

Mike Burke - *AECOM - Chairman & CEO*

I think the increase in environmental work will have a bigger impact if you start seeing changes in shale gas opportunities and pipeline opportunities. We do a lot of environmental permitting work in that space.

John Rogers - *D.A. Davidson & Co. - Analyst*

Thank you, I just wanted a little color. Appreciate it.

Operator

Michael Dudas, Vertical Research.

Michael Dudas - *Vertical Research - Analyst*

Hello, everybody. Two questions from me. First, maybe to expand on what you generally talk about on AECOM Capital. What do we expect to see over the next year or two there? You said there would be some interesting things going on.

Is that set up -- given all the private money that's required for all this infrastructure, can that be a much more powerful driver of business flow and eventually earnings for the Company in the next three to five years?

Mike Burke - *AECOM - Chairman & CEO*

Michael, that's certainly our expectation. We started off investing in real estate development projects. We expanded it this past year into hydroelectric. It was our first project on the Muskingum River in Ohio, developing low-head hydro projects, where we're design, build, financing, and operating those assets.

We are bidding on P3 projects right now which we see increasing, and certainly our incoming administration is talking a lot about bringing the public sector and the private sector together to create a mechanism that will increase the flow of private money into infrastructure that would present a lot of opportunity for us. We are currently bidding on more P3 projects than we ever have in the history of the Company.

So we do expect that AECOM Capital will continue to be an increasingly important part of our organization; again, consistent with our vision of being able to offer the fully integrated offering to our clients to be able to design, build, finance, and operate infrastructure assets. And capital is a big part of it.

Now we don't expect to be funding these projects entirely off of our balance sheet. We expect to be bringing external capital to these projects and facilitating the flow of capital. But we've got our upcoming analyst day on December 13 in New York City and during that meeting we will have an opportunity to give you a lot more detail on the long-term outlook for not just AECOM Capital, but for the entirety of the business.

Michael Dudas - *Vertical Research - Analyst*

Excellent. Thank you, Michael. Just one quick follow-up on -- congrats on Measure M. Is there anything we should look for? Is that something that is going to start to kick into gear in the next 12 to 18 months, something sooner? What kind of maybe news flow could we see from that pretty enormous outlook?

Mike Burke - *AECOM - Chairman & CEO*

We are just trying to start to think about how we go about that. We have -- the city of Los Angeles has reached out to us and asked us to start giving some thought to ways to accelerate the expenditure of that money and we are in the process of doing that right now. But that is something that will start to -- we will be working on over the course of this year, but you're not going to see revenue growth in 2017 from that. That will be an 2018 and forward opportunity for us; but we are really excited about it given the size and scale of that.

It's the largest infrastructure program in the history of the United States, $120 billion in Los Angeles alone. It's great to see that kind of infrastructure in our hometown, where we have the best capabilities and the best relationships among any of our competitors.

Michael Dudas - *Vertical Research - Analyst*

Excellent, Michael. Thank you.

Operator

Thank you. This concludes the question-and-answer session. I will now turn the call back over to Mike Burke for closing remarks.

Mike Burke - *AECOM - Chairman & CEO*

Great. Thank you, operator, and thank you, everyone for participating today. As you've heard -- obviously you've heard us say a number of times today we feel more bullish about the future than we ever have. We feel that we have spent the past two years putting together two great companies from our sector and building a foundation that is second to none that can capitalize on these new growth opportunities.

We've been doing that for the past two years and now we feel that we also have some external wins at our back at the federal level, at the state level, at the municipal level, as well as internationally. We didn't get a chance to talk about the big infrastructure expenditures that are expected in Canada and across the UK, but we feel better about the markets than we have in quite some time. Obviously, we feel really good about the foundation that we've built here at AECOM to capitalize on those opportunities that are now in front of us.

We do look forward to the analyst day on December 13 and giving you a lot more detailed insight into what we are seeing in the market today and what our prospects for the future might hold. Thank you again and we will see you in December. Goodbye now.

Operator

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