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ACM - Q3 2017 AECOM Earnings Call

EVENT DATE/TIME: AUGUST 08, 2017 / 4:00PM GMT

OVERVIEW:

Co. reported 3Q17 adjusted EPS of $0.78.

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PRESENTATION

Operator

Good morning, and welcome to the AECOM Third 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 Investors section at www.aecom.com. Later, we will conduct a question-and-answer session. (Operator Instructions) I would like to turn the call over to Will Gabrielski, Vice President, Investor Relations.

Will Gabrielski - *AECOM - VP of IR*

Thank you, operator. I would like to direct your attention to the safe harbor statement on Page 1 of today's presentation. Today's discussion contains forward-looking statements about future growth and financial expectations. Actual results may differ significantly from those projected in today's forward-looking statements due to various risks and uncertainties, including the risks described in our periodic reports filed with the SEC. Except as required by law, we take no obligation to update our forward-looking statements.

We are using non-GAAP financial measures in our presentation. The appropriate GAAP financial reconciliations are incorporated into our presentation, which is posted on our website. Please note that all percentages refer to year-over-year progress, except as noted. Our discussion of earnings results and guidance excludes the impact of acquisition and integration-related expenses, onetime financing charges, the amortization of intangible assets and financial impacts associated with non-core businesses and assets, unless otherwise noted. Today's discussion of organic growth is on a year-over-year and constant-currency basis.

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

Michael S. Burke - *AECOM - Chairman & CEO*

Thank you, Will. Welcome, everyone. Joining me today are Troy Rudd, our Chief Financial Officer; and Randy Wotring, our Chief Operating Officer. Randy was appointed our Chief Operating Officer on July 1. He has led our Management Services segment for the past several years and, prior to that, served in numerous leadership roles at URS. He brings 35 years of industry experience, an established history of financial achievement and a passion for advancing our design, build, finance and operate vision. We are excited that Randy has taken an even greater role in shaping the future of our company.

I will begin with an overview of AECOM's results and discuss the trends across our business, then Troy will review our financial performance and outlook in greater detail before turning the call over for a question-and-answer session.

Please turn to slide 3. Our third quarter results included a number of accomplishments, and we advanced several key objectives. First, we generated $394 million of free cash flow, the highest ever in AECOM's history, and consistent with our track record of strong second half performance. As a result, we paid down $295 million of debt and remain on track with our targets for the year.

Second, we had $9 billion of wins, which is also a new high for our company, and a book-to-burn ratio of 1.8. Our wins include the $3.6 billion U.S. Air Force contract that was previously under an incumbent protest, and strong performance across the company. Our backlog is now over $46 billion.

Third, we delivered another quarter of positive organic growth, led by Building Construction and Power and growth in Management Services.

Finally, we closed on our first AECOM Capital realization, which generated an approximately 30% IRR and resulted in fees earned for our Construction Services segment. With our first realization now closed and an attractive growing portfolio of real estate infrastructure assets, we are establishing a strong resume as a development partner of choice.

In addition to our financial performance, I want to highlight our acquisition of Shimmick Construction, which closed on July 28. Shimmick is a leading West Coast civil infrastructure firm that is an ideal complement to our leading transportation design business. Clients are increasingly shifting to design, build and P3 models, which has made developing a leading construction platform a key priority. With Shimmick, we are now well positioned to capitalize on the more than $230 billion of approved infrastructure funding measures in our core markets. We are excited to welcome Shimmick's 1,000-plus employees to AECOM.

Please turn to Slide 4 for a discussion of our business end market trends, beginning with the Management Services segment. After 3 years of substantial investment, we entered the year with a record $50 billion pipeline of pursuits, $25 billion of bids under client evaluation and a goal of doubling our backlog. With the successful resolution of an incumbent protest at the GAO on a $3.6 billion Air Force win, we have now won nearly $7 billion of work this year, and our backlog has increased by nearly 50%. Our pipeline of pursuits remains high at over $40 billion, and we expect decisions on over $20 billion of bids over the next several quarters.

The outlook across our defense and intelligence markets remain robust. The president's 2018 DoD budget request calls for a 10% increase in spending. The 2018 National Defense Authorization Act passed with strong support in the House in July and included an even greater increase. And while the Budget Control Act remains a near-term obstacle, demand remains as strong as ever. This is true both in the U.S. and internationally, where we also have a growing pipeline. The recent U.S. and Saudi agreement and outlooks for higher global defense spending underscore the opportunity to expand our leading capabilities into new geographies.

Turning to the Construction Services segment. We delivered strong results in the third quarter, reflecting our successful strategy to diversify by end market, client type and geography. As a result of this strategy, since 2013, revenue in the Construction Services segment has increased fivefold to $7.5 billion, and backlog has increased fourfold to $18.4 billion. In addition, our business is more geographically diverse than ever. In 2013, the New York vertical construction market accounted for over 90% of our business. Today, despite continued growth in the New York market, more than 50% of our backlog is outside of New York. This diversification reflects the geographic expansion of our vertical construction business where, today, we are constructing over $5 billion of projects across California, Florida, New England and Texas, and have expanded internationally, highlighted by our selection to build Spire London, the tallest residential tower in Western Europe. In addition, we have entered and expanded our presence in new end markets. With AECOM Hunt, we are one of the leading stadia contractors in the U.S. and currently have several marquee projects underway, including new NFL stadiums in Los Angeles and Atlanta. AECOM Hunt has also enhanced our aviation practice with construction capabilities, allowing us to better participate in the $100 billion of required investment to modernize U.S. airports.

In addition, we continue to benefit from the investments we have made through AECOM Capital. As an example, this quarter, we added approximately $450 million to our backlog for 2 projects being co-developed by AECOM Capital.

We have also diversified outside of our leading building construction capabilities. Our Power business has driven more than $2 billion of wins. And our backlog has doubled over the past 3 years, highlighted by the over $1 billion San Onofre nuclear decommissioning project in California. Our Power revenue has grown by more than 40% in each of the past 2 quarters, and we expect this trend will continue.

Most recently, we closed on our acquisition of Shimmick Construction, and are now positioned to capture greater share of the substantial infrastructure spending in core West Coast markets. Significantly expanding our construction capabilities has been a key priority for the past several years, and we could not be more pleased with our progress in assembling a more complete solution for our clients.

Turning to our DCS segment beginning in the Americas. Over the past year, voters supported more than $200 billion of infrastructure ballot measures, including substantial initiatives in Los Angeles and Seattle. FAST Act funding has increased. Several states have raised gas taxes to fund transportation investment, and California signed into law over $50 billion of incremental transportation funding. Though the impact of these initiatives is expected to more meaningfully benefit our business in 2018, we are seeing many positive indicators that conditions are already improving. Headcount is growing. Labor volumes are increasing. Backlog is at new highs, and revenue growth is accelerating in our key transportation and water markets. In addition, with our enhanced civil construction capabilities and greatly expanded addressable market, we are pursuing over $10 billion of integrated civil infrastructure opportunities that will leverage our leading design and construction services. We are confident in our growth potential over the coming years.

Let's pivot to our international design markets. Despite some market challenges in the EMEA region, we are pleased to have delivered double-digit backlog growth in the U.K. In addition, we are experiencing strong growth in India, where Prime Minister Modi's support for infrastructure investment continues to gain momentum. For instance, in June, the prime minister announced a record nearly $60 billion plan to modernize railways, airports and roads, markets where our expertise positions us well. India is one of the fastest-growing markets, and we are positioned for long-term success. In addition, we are focused on expanding in the region through key investments in our CS and MS businesses and have developed a substantial pipeline of pursuits.

In the Asia Pacific region, our revenue and backlog grew in the quarter and include strong contributions from Hong Kong and Southeast Asia, where transportation investment remains robust, and we are delivering several large projects. In addition, market conditions in Australia continued to improve as the government's over $50 billion of infrastructure investment plan is leading to improved overall activity levels.

Across the company, we have made clear progress on our strategic priorities, are investing in our capabilities to expand our integrated offering, and are best positioning ourselves to capitalize on tremendous opportunities in our markets. Our record wins and cash flow this quarter serve as the greatest evidence yet that our strategy's aligned with growing market demand, and that our diverse business delivers consistent cash flow.

I will now turn the call over to Troy, who will discuss the quarter in more detail.

W. Troy Rudd - *AECOM - CFO and EVP*

Thanks, Mike. Please turn to Slide 6. Our performance this quarter reflects the benefits of our diverse business and strong culture focus on delivering cash flow. Adjusted EPS was $0.78. We drove solid results across the business, and our margins were consistent with our guidance. Our results included the first AECOM Capital realization, as contemplated in our guidance, and some outperformance on tax. Importantly, we generated a record $394 million of free cash flow, and our year-to-date free cash flow was 10% higher than the prior year.

Please turn to Slide 7. Revenue in the DCS segment decreased by 1%. We had strong performance in the Asia Pacific region and uneven performance in the EMEA region. In the Americas, I should highlight that our revenue, after excluding pass-throughs, where we don't earn a margin, increased slightly, which speaks to momentum Mike discussed earlier. Our year-to-date adjusted operating margin of 5.9% remains consistent with the guidance we provided at the start of the year. We continue to make investments in business development to position ourselves to best capitalize on the tremendous opportunities in our markets.

Please turn to Slide 8. Revenue in the Construction Services segment increased by 8%. Building Construction revenue increased by 14%, and power revenue growth accelerated due to higher activity on our large wins over the past year. The adjusted operating margin was 2.3%, which is a 100 basis point increase over the prior year and the highest level since 2015. We are benefiting from a mix shift to higher-margin work in the power market and continued strong execution. I should note that we anticipate adding approximately $1.4 billion to our fourth quarter backlog related to Shimmick, which will bring our backlog to approximately $48 billion.

Please turn to Slide 9. Revenue in Management Services segment increased by 2%. The adjusted operating margin was 9.3% and continues to reflect strong underlying business performance across our vast portfolio of projects. Importantly, following our deliberate business development investments, our backlog has increased substantially, and we're confident this momentum will continue. Our recent wins, which should begin to contribute in fiscal 2018, reflect the continued shift to larger projects in the classified sector and provides significant long-term visibility.

Please turn to Slide 10. Operating cash flow was $414 million and free cash flow was $394 million, both of which set new highs. Our year-to-date cash flow also marked a 10% improvement from the year-ago period, and this despite a $60 million outflow from a legal settlement in the second quarter. Our consistent cash performance is a key differentiator and enables a significant value-creation opportunity.

Total debt declined by $295 million in the quarter. We've now delivered $1.8 billion of free cash flow and reduced our debt by $1.4 billion since closing the URS transaction in October of 2014. Furthermore, even as we continue to reduce our debt, we're taking advantage of opportunities to expand our capabilities, including the acquisition of Shimmick Construction, which is expected to be slightly accretive to earnings.

Please turn to Slide 11. As Mike detailed, we are progressing well on the key financial and strategic objectives we set out to achieve at the beginning of the year. As such, we remain confident in reiterating our full year EPS and cash flow guidance. We expect our fourth quarter EPS to approximate current consensus. Our tax rate is now forecast to be lower than we initially anticipated. This is partially offset by higher interest expense, which now reflects the financing of the Shimmick acquisition.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Tahira Afzal from KeyBanc.

Tahira Afzal - *KeyBanc Capital Markets Inc., Research Division - MD, Associate Director of Equity Research, and Equity Research Analyst*

I guess, first question. Mike, your Chinese announcement, the JV, it was pretty interesting from the other day. And I know you talked a bit about India on this call. So can you talk a bit about what you're seeing, how you're going to leverage your new relationship with the Chinese construction element new add? And in regards to India, whether you will have to make some acquisitions or some investments to really leverage yourself there?

Michael S. Burke - *AECOM - Chairman & CEO*

Sure. Thank you, Tahira. So one of the great fortunes that we have relative to China is that we have several thousand employees in the Greater China region from Hong Kong to PRC. And we have been working with those clients around the world. And so a couple of great examples of that is Greenland, a developer out of Shanghai, which is a client of ours in China, we helped them build a project here in Los Angeles, the Metropolis project. We were just awarded the building of the London Spire, which is the tallest residential building in Western Europe. And so we're following those great relationships that we developed in China to other parts of the world, where we have a great geographic footprint. And we're continuing to expand that with many different Chinese contractors, Chinese developers and Chinese financial partners. And so we will continue to do that through our Chinese center of excellence desk and follow them around the world, wherever they're building, either core real estate assets or infrastructure assets, which they're increasingly doing around the world. With respect to India, we have been on a pretty steep growth curve in India over the years. If I go back 3 years ago when I first visited India, we had about 30 employees. We're now closer to 3,000 employees in India. There has been an enormous commitment by Prime Minister Modi's government to focus on infrastructure. Our revenues year-to-date in India are up 40% already. The profitability curve is equally as steep. And we just continue to hire as fast as we can hire in India to participate in that, not only increasing infrastructure boom, but increasing slant towards doing business with U.S.-based companies due to the enhanced economic cooperation between the Modi government and the U.S. government.

Tahira Afzal - *KeyBanc Capital Markets Inc., Research Division - MD, Associate Director of Equity Research, and Equity Research Analyst*

Got it. And I guess, as a second question, it's a relief to see your construction margins progressively improving as per your target. There's a lot of skittishness around execution on power plants understandably nowadays. Can you provide us any milestones that will help us continue to get comfortable maybe around productivity peak in terms of time line, anything that would help us to continue to get comfortable around what you're saying?

Michael S. Burke - *AECOM - Chairman & CEO*

Yes, sure. So listen, we have 3 combined cycle gas plants in our backlog today. One of those projects is 20% complete and progressing very well, and we have 2 others that we anticipate starting next year in our backlog. And so we feel pretty good about that. We've got a team with a 20-year track record of strong delivery. I don't think we've had a material write-down on any project in the power space in 15, 20 years. So we're focused on markets where we know the subcontractors very well. We understand the labor productivity. Certainly, we've seen issues among other providers related to performance guarantees. We do not provide performance guarantees greater than what the manufacturer offers, and we feel pretty good about the power projects there. We see the margins in that space are better than our typical margins. Those projects will start ramping up. The 2 that I just mentioned, they're in our backlog already, will start next fiscal year. And so you'll see a ramp-up in the revenues as well as the productivity and profitability in that sector.

Operator

Our next question comes from Alan Fleming from Citi.

Alan Matthew Fleming - *Citigroup Inc, Research Division - VP*

Mike, DCS contracted backlog, looks like it turned positive for the first time -- year-over-year for the first time in, I think, close to 2 years. So is this the inflection that you've been waiting for maybe to see that, that could finally lead to more consistent maybe low to single -- mid-single-digit growth going forward? And if not, are there any other catalysts that you're waiting for that you could get growth, particularly in that Americas DCS business, moving in the right direction?

Michael S. Burke - *AECOM - Chairman & CEO*

Yes. There's -- clearly, the catalyst is here. And a few things to note about that, the DCS backlog. It's really a tale of 2 worlds. It's the core infrastructure, and it's the oil and gas space. Our transportation and water business, the businesses where we have the strongest footprint and we're best known for, that backlog is up 14% year-over-year. It's the environmental design business that is primarily delivered to the oil and gas space that's been a challenged market, and we think that's leveling out. But the transportation and water businesses is growing significantly. And we're just starting to see -- when you talk about catalysts, what we're starting to see is the money coming to market in the metros where they've had ballot measures over the past couple of years. And so if you look at Q4 of FY '17, our Q4 will be the first year -- first quarter that we've had significant money coming to market in those key metros, the LA metro, Seattle, Atlanta and San Francisco. By the first quarter of FY '18, we'll be at a $4 billion run rate. And that $4 billion is projects that are coming to the market in the core transportation sector, where we have the biggest footprint of anyone. That $4 billion of projects coming to the market per quarter will then increase over the next 2 years with an expectation that by the Q4 of FY '19, there will be $12 billion of projects that will come to the market that quarter. And so we've been talking about this $200 billion-plus of measures for the past year. That takes a while for it to get to the market, and it's just starting now in Q4 of FY '17 where we're seeing that come to the market. And importantly, we closed on Shimmick Construction on July 28. That gives us even more capabilities to provide civil infrastructure construction services in the core Western markets and, as I mentioned, the 4 key metro markets, 3 of the 4 are on the West Coast, Seattle, San Francisco and LA. So I think we are very well positioned to achieve outsized growth in the infrastructure market. And we laid out our longer-term objectives a year ago, and we feel even more confident about that now that we should be able to achieve 5% revenue growth over the next 5 years CAGR, 10% earnings growth, and then a combined cash flow of $3.5 billion. So the catalysts are here, and we're seeing it this quarter.

Alan Matthew Fleming - *Citigroup Inc, Research Division - VP*

Okay, that's helpful. Maybe you can talk a little bit about the uneven growth that you mentioned in the EMEA region. How much of that is weakness in the Middle East tied to low oil prices versus the U.K. seemingly maybe a little bit weaker than it has been over the last few quarters? And do you see those markets stabilizing here heading into early 2018?

Michael S. Burke - *AECOM - Chairman & CEO*

So you're exactly right. There's 2 issues there, a little uncertainty around Brexit and a little bit of oil and gas concerns. And so if I look at the Middle East market, for us, this quarter, it was down 16%. The type of work we're doing there, we're not doing oil and gas work in that market, but we are doing civil infrastructure work for countries that are -- have petrodollar-fueled economies. And so we are seeing a slowdown there. We did see countries like Qatar due to the embargoes that have slowed down a bit. But the U.K. was only down 2% in the quarter, and our backlog was up quite nicely during the quarter. So there's a little uncertainty around Brexit, but nothing to be alarmed about.

Alan Matthew Fleming - *Citigroup Inc, Research Division - VP*

Okay. And do you think those stabilize into '18, Mike?

Michael S. Burke - *AECOM - Chairman & CEO*

Oh, yes.

Operator

And our next question comes from Michael Dudas from Vertical Research.

Michael Stephan Dudas - *Vertical Research Partners, LLC - Partner*

First question, Mike, is when you look at Shimmick, can you explain a little bit about the mix of their type of business, how it differs when additive to CS, and maybe what it can do outside across the platform maybe throughout the West Coast maybe as we move into other parts of the U.S.?

Michael S. Burke - *AECOM - Chairman & CEO*

Yes. So if you look at our footprint today, we have about $7.5 billion of construction revenue today and, roughly speaking, about $400 million of civil construction. And so this doubles our civil construction capability. Shimmick is entirely focused on transit, rail, bridges and water. So core civil infrastructure, transportation and water, which are the markets that we are most bullish about. It's entirely focused in the Western U.S., the Western states, including Hawaii, and it adds that capability in probably the hottest civil infrastructure market in the country right now. And so when you couple our market dominant position on the engineering design side with Shimmick that has an incredible position, where we now have both the design and the construction capabilities that is consistent with where the market is going. If you look back since 2010, over the last 7 years, we've seen a 50% increase in the number of integrated delivery or design build procurements for transportation projects here in the United States. And so that increasing integrated delivery requires us to have both the design and the construction capability. We're seeing that accelerating dramatically. The P3 market is accelerating dramatically. We're seeing it at LaGuardia, JFK, Penn Station. We're seeing 2 projects for $3 billion being led out by LAX here under the P3 model. And so we fully expect to continue to pursue our integrated delivery strategy and have both design and construction capabilities when our clients want to buy those 2 services together.

Michael Stephan Dudas - *Vertical Research Partners, LLC - Partner*

Michael, the optimism you guys shared at the December Investor Meeting seems to be showing up here in the numbers, in the outlook into '18. How do you staff for labor on the professional side? And the Shimmick opportunity, are there others there like it that you're going to require to meet this tripling of these outlays of contracts that you mentioned in the civil side in the next 2 years?

Michael S. Burke - *AECOM - Chairman & CEO*

So first of all, on the labor side, we are hiring quite rapidly. We announced not too long ago that we have 3,000 open positions. We are on track for our hiring goals. So we obviously track those by week. And so we think there's plenty of talent out in the marketplace right now because it's been a sluggish market for a while. So we're certainly not at full labor capacity just yet. And so we're not seeing a need there. But hiring is something that we spend a lot of time on, and we're meeting our goals on that side. On the M&A side, absolutely, we are always looking to build our capabilities to achieve our vision, which is to be a full integrated provider with the ability to design, build, finance and operate these infrastructure assets. Shimmick provides us the capabilities in the civil infrastructure space, but we'll continue to look for other companies like Shimmick that can expand that platform. And we fully intend to build out a national platform with capabilities around the country. And the size of these deals are not enormous deals. And our most successful deals have been deals in this range where we've acquired, over the years, the Tishman Construction assets and Hunt Construction. If you look at just those 2 deals alone, we paid approximately $300 million in aggregate for Tishman and Hunt. And those 2 companies together will deliver over $100 million of EBITDA this year off of a $300 million purchase price. So these companies tend to grow more rapidly when they're inside our organization. When they're combined with our wide array of capabilities and our wider footprint and our bigger balance sheet, they tend to outperform their historical numbers. And so we'll continue to look for assets like that and build out our strategy.

Operator

Our next question comes from Steven Fisher from UBS.

Steven Fisher - *UBS Investment Bank, Research Division - Executive Director and Senior Analyst*

I just want to start on cash flow, if you could talk about how it compared to your expectations for the quarter. Obviously, it's pretty robust. Was there anything that was pulled forward from the fourth quarter? And were there any particularly large individual cash payments this quarter? And then any particularly large ones you're counting on for the fourth quarter?

W. Troy Rudd - *AECOM - CFO and EVP*

So Steve, this is Troy. Look, we were confident at the end of the second quarter in our ability to deliver on full year cash flow, and I think we've proved that up in the third quarter. This was really just a testament to the diverse portfolio that we have for the business model that we pursue and, frankly, the hard work and focus of all of our professionals. There's nothing significant year-to-date, other than we did have the AECOM Capital transaction that closed in the third quarter, and added a little more than $40 million to free cash flow. But we also had the other item I'd call out, which was the legal settlement in the second quarter, which was a drag, a $60 million drag on cash flow. So I don't see anything continuing to be significant that would influence cash flow other than our just hard work, collecting across our diverse portfolio in the remaining quarter of the year.

Steven Fisher - *UBS Investment Bank, Research Division - Executive Director and Senior Analyst*

But was the AECOM Capital payment the largest individual payment in the quarter from a cash inflow perspective?

W. Troy Rudd - *AECOM - CFO and EVP*

Yes.

Steven Fisher - *UBS Investment Bank, Research Division - Executive Director and Senior Analyst*

Okay. And then the second question relates to the environmental work. Can you talk about what the nature of the oil and gas-related environmental work that was really kind of the drag in the quarter in Americas' design? And is it large project-related? Is it more drilling and production related? Just I'm trying of gauge what has to happen for that to come back in the event that the catalysts that you mentioned there on the infrastructure side just still takes longer to play out.

Michael S. Burke - *AECOM - Chairman & CEO*

Yes. So most of the work in that space, well, it's a broad array of projects. I don't think I could narrow it down to big projects or small projects in the oil and gas space. But we have large master service agreements with the majors, and that the need for environmental engineering work is usually dependent on the CapEx in that space. And so when a project gets delayed, they don't need the Environmental Impact Assessment or the environmental remediation plan. And so we've seen some slowness there due to the CapEx cycle, but it is fairly tied to CapEx. The base amount that we have today, the status quo amount is -- much of it is due to ongoing regulatory requirements. And so we don't need to see anything happen one way or another to maintain the status quo of where we are today. But to see it grow again, we need CapEx to come back to the market.

Steven Fisher - *UBS Investment Bank, Research Division - Executive Director and Senior Analyst*

Okay. So no -- it sounds like you kind of flatlined it from here and no further headwinds in particular as you head into '18 on the oil and gas business?

Michael S. Burke - *AECOM - Chairman & CEO*

That's our expectation, yes.

Operator

Our next question comes from Anna Kaminskaya from BofA.

Anna Kaminskaya - *BofA Merrill Lynch, Research Division - VP*

So I just wanted to start with I know you're probably not ready to provide 2018 outlook. So there were quite a few moving parts in 2017. I know 2017 and AECOM Capital, probably some non-repeat on tax benefit. It sounds like Troy endorsed a consensus estimate for 2017. So can you just walk us a little bit through those puts and takes, just kind of how should we think about core operating base with 2017 would be as we build our models to 2018?

Michael S. Burke - *AECOM - Chairman & CEO*

So let me give you some high-level comments about how we're feeling about '18, and then Troy can talk about some of the puts and takes, so you can work from a core. So we're sitting here today with $48 billion of backlog. That feels pretty darn good. Our backlog's up 17% from a year ago, including Shimmick, 13% without the Shimmick backlog. More importantly, when you look at the buildup of that backlog, the fastest-growing components are the higher-margin segments of our business. So our Power business, higher margin, growing faster than normal. Our MS business with higher margins than average is growing faster than normal. So we're seeing all that moving in the right direction. And then the funding momentum that I mentioned earlier on the core civil infrastructure side for our DCS business feels pretty good. And so we're looking at 2018 and feeling like we're starting to get the winds at our back here on a number of fronts. And so we feel we're not ready to give guidance, obviously, for '18, but we feel pretty good about our 5-year commitment to 5% CAGR on the revenue side and 10% CAGR on the EPS side. But I'll let Troy talk about some of the puts and takes that might help your model.

W. Troy Rudd - *AECOM - CFO and EVP*

Yes. Anna, I guess, first, just an overall comment. I feel like we're on track with where we said we would be at the beginning of the year. And if you recall at the beginning of the year, we said that we would have a lower tax rate consistent with what '16 looked like. And we also said that in the midpoint of our range, we'd have 20% or $0.20 of earnings related to AECOM Capital. So when I look at where we sit today, and we have a little bit better tax rate than we had anticipated, and that's offset by some higher interest expense related to this timing of cash flow and related to the Shimmick acquisition. And AECOM Capital, we're a little bit below where we -- we're below that midpoint of $0.20. So we expect some AECOM Capital to add to the fourth quarter. But frankly, when you take all those puts and takes, tax, interest expense and where were are on AECOM Capital, we're really almost right where we expect it to be at the beginning of the year in terms of the core performance.

Anna Kaminskaya - *BofA Merrill Lynch, Research Division - VP*

I'm just trying to think, what's your normalized tax rate? What will you expect that to be for 2018? And how should I think about ACM Capital for 2018? I think you separated it as a separate segment. So just trying to figure out what are some -- again, would it be a $0.20 drop-off from AECOM Capital next year? And would it be a $0.20 drop-off from tax benefit in 2018?

W. Troy Rudd - *AECOM - CFO and EVP*

Anna, yes, sorry, it's premature to give you 2018 guidance at this point in time. But I will say, with respect to AECOM Capital, that we have a portfolio of about 16 projects. And so we do expect to continue to have AECOM Capital realizations in subsequent years, but I can't tell you more than that.

Anna Kaminskaya - *BofA Merrill Lynch, Research Division - VP*

Great. And then maybe the follow up on MS segment. It sounds like you were -- have a pretty high conviction into the backlog being doubled by the end of the year. But how should I think about that translating into kind of the segment's growth in '18, '19? I guess, there's a tendency to just maybe gross up the -- maybe overestimate growth in 2018. Kind of how will it transition into actual burn rate for the next year?

Randall A. Wotring - *AECOM - COO*

So this is Randy. Third quarter revenue was up 2%, and operating income was up 4% year-over-year. And our backlog increased 42%, and we still have $20 billion of bids under evaluation. So we've seen a ramp-up in our revenue in the MS segment over the first 3 quarters of this year, and we expect that ramp to continue into '18.

Operator

Our next question comes from Jamie Cook from Credit Suisse.

Jamie Lyn Cook - *Credit Suisse AG, Research Division - MD, Sector Head of United States Capital Goods Research, and Analyst*

I guess, a couple of questions. I guess, I was impressed when I looked at the backlog breakdown. It doesn't look like you're taking on any more fixed-price work with this level of wins. So can you sort of talk about how we should think about, understanding there's a lot coming in Management Services, like normalized new awards for AECOM over the next couple of quarters just based on what you're seeing with your fully integrated business model? And then my second question is while I understand you can't comment specifically on recent management changes, can you just say, bigger picture, has there been any changes in how AECOM is thinking about M&A, risk profile? Strategically, has there been any change in how you're thinking about things with recent management changes?

Michael S. Burke - *AECOM - Chairman & CEO*

Yes. So there's no change in how we're thinking about it. We're sticking to our strategy, which is continue to build out the fully integrated offering. The Shimmick transaction is evidence of that. The success of the civil integrated offerings, like you've seen in the power sector, are evident, and we're going to plan on sticking to that. So nothing at all to read into management changes. We've got Randy in the Chief Operating Officer role, who's got 35 years of operating experience. And we'll be deploying that experience to make sure we continue to run as effectively and efficiently as we have and continue to focus on the growth side of the equation here. I think Randy's track record in the Management Services group speaks volumes to the growth mentality we expect to be bringing to the rest of the organization. Randy was running that MS business with, and you see the track record there, a 50-plus percent hit rate during the year. We expect to double the backlog in that space. So I think he's going to bring an extraordinary growth mentality, an execution mentality to the rest of the organization. That MS business has exceeded their plan by large, large margins every year for the past 3 years. So we're really excited about Randy taking on this bigger role for the organization. With respect to -- what was the first part of that question?

Jamie Lyn Cook - *Credit Suisse AG, Research Division - MD, Sector Head of United States Capital Goods Research, and Analyst*

It's just sort of like normalized awards. I mean, like I've never seen you put up an award quarter, you know what I mean, like this one. And obviously, your business model's working. Like as you look out over the next couple of quarters, how do we think about normalized awards based on what you say?

Michael S. Burke - *AECOM - Chairman & CEO*

I -- when we had a $6 billion quarter 2 quarters ago, I think I said, "Well, that's a fantastic quarter. Let's not get too accustomed to that." And then we've put up a $9 billion quarter. And I certainly don't want to suggest that $9 billion is the new run rate, but we have an enormous pipeline of projects that we're pursuing. Our hit rates are at an all-time high, the greater than 50% hit rate in the MS business. We have $20 billion of awards in MS alone that are going to be decided in the next few quarters. We had -- we submitted another $8 billion of wins in MS this quarter alone of new bids that are under evaluation. So we have $40 billion-plus of bids under evaluation. We made a commitment to increase the amount of work that we're pursuing there. We've invested heavily over the past 2 years in business development activity. We've invested heavily in pursuing projects through AECOM Capital. This quarter alone, we have $480 million -- I'm looking at Will for confirm -- yes, $480 million of new backlog this quarter just from AECOM Capital alone. And I think with the addition of Shimmick, where we have the ability to differentiate ourselves in the marketplace with a true integrated offering, I think that will improve our hit rate going forward. So I can't give you a specific number to plug into the model on what backlog ought to be. But we have continued to execute well on that front, and it portends very well for our long-term CAGR at 5% revenue growth and 10% earnings growth.

Operator

Our next question comes from Brent Thielman from D. A. Davidson

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Brent Edward Thielman - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Mike, when you consider the opportunities to come on the West Coast and heavy civil infrastructure, is Shimmick in the sweet spot in terms of the size of projects you want to go after from an integrated perspective? Or is this sort of just the beginning of something to build on and maybe add to it and go after even larger projects with that integrated approach?

Michael S. Burke - *AECOM - Chairman & CEO*

Well, clearly, the size of the projects that Shimmick has been working on are very sizable. They are punching well above their weight already. With our balance sheet and our capabilities, I think it will be even more successful. But you look at some of their projects, whether it's the Honolulu Rapid Transit Project, that's an $875 million project. You look at the Bay Area Rapid Transit, where they're working on the new water pumping system for BART, it's a $0.25 billion project. So they are in the sweet spot of the type of projects that we want to go after. If I look at the other top 5 projects, they range anywhere from $150 million to $900 million, and that's a good sweet spot to be in. But they are limited to the West Coast right now. And so our objective is going to be to take that combined integrated offering capability and supplement it with other capabilities around the country, so that we can create a national platform for integrated delivery.

Brent Edward Thielman - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Okay. And then when you think about the infrastructure funding initiatives that have been put in place and kind of some of the lag this year in terms of getting those projects kind of off and running, based on kind of what you're seeing develop now plus kind of this pent-up activity, I mean, are you more optimistic about kind of the step-up into fiscal 2018 for this sector? Do you maintain a little more caution and how quickly this stuff can move forward? Just curious on your thoughts there.

Michael S. Burke - *AECOM - Chairman & CEO*

Yes. I definitely feel much better than I have. And I think there's always been this hesitancy. "Well, are we really going to get an infrastructure bill out of Washington?" And I think the point to recognize there is 77% of the core infrastructure funding for transportation and water, 77% is delivered from state and municipal governments, not from the federal government. So if the federal government comes along with something, that will be a great additional catalyst, but it's not as important as the state level, where we're seeing 20-some states increase their fuel's tax to focus on transportation. And there's $200 billion-plus of individual state and city measures that have come about in the past year. So if you look at those, again, LA, Seattle, Atlanta and San Francisco, in Q2 of this year, there were 0 projects that were procured from those monies in the market. 0. Then you look at Q3, the quarter we just ended, it was a couple of hundred million. And as I mentioned earlier, by Q1 of FY '18, we expect in just those 4 markets alone, from these tax measures, $4 billion of projects will be procured in the marketplace. And we'll stay on that $4 billion per quarter run rate for a few quarters, ramping up to $12 billion being procured by the fourth quarter of '19. And so we schedule all these out. We have a schedule that shows us when we expect the projects to be procured in the marketplace because we're developing our bid strategies, obviously, 2 years in advance on these. But if you look at that schedule of procurements in just those 4 markets, it's going from almost 0 in Q2 to $12 billion just in the fourth quarter of '19 alone. So I think that gives you a sense for what we're positioning for.

Operator

Our next question comes from Chad Dillard from Deutsche Bank.

Charles Albert Edward Dillard - *Deutsche Bank AG, Research Division - Senior Research Analyst*

So is there a way to help us understand the margin profile in DCS Americas versus the rest of the segment? In the past, you've mentioned that the sub business has been -- had some tremendous operating leverage. So once the EMEA and oil and gas emancipate, it might be helpful to understand just where the margins could go once we get past those issues. And then, also, if my math is right, business development expenses are running around like $500 million to $600 million per quarter in DCS. Do you expect to be able to keep that run rate, just given that you see a lot of opportunities ahead? Or do you expect that number to increase going forward?

W. Troy Rudd - *AECOM - CFO and EVP*

So Chad, this is Troy. I guess, first of all, just on the amount of -- the absolute amount of bid dollars that you're talking about, that number is -- that's way too high. That would be more like an annual number than a quarterly number. And then with respect to continuing to invest in business development, just given the market opportunities in front of us, we will continue to invest to pursue what we think is a great market opportunity, especially in North America, and we'll continue to do that globally. Again, there's a balance to be found there, but between balanced earnings and pursuit of -- investing in new project opportunities. So -- but we're going to continue to do that. So I wouldn't see us shrinking our business development budgets, but in fact maintaining it or perhaps increasing it. And with respect to the margin profile of the DCS business, our guidance that we gave was 6% at the beginning of the year. As we moved through the first 3 quarters of the year and into the fourth quarter, we expect to be in line with that guidance. And as we see that business to grow and put some of the issues you described behind us, that we expect operating leverage to improve. And we see an improvement in overall margin, but giving guidance beyond '17 would be -- just it'd be premature to do that at this point.

Charles Albert Edward Dillard - *Deutsche Bank AG, Research Division - Senior Research Analyst*

Fair enough. And then just moving over to Shimmick. Can you just flesh out the revenue opportunities? I mean, how much can AECOM grow revenues in this business in over the next 3 to 5 years? And I mean, I don't know if you are able to give any 2018 earnings contribution yet?

Michael S. Burke - *AECOM - Chairman & CEO*

I don't think we're prepared to give '18 contribution yet. But we have $12 billion of projects in the civil infrastructure pipeline that we're evaluating. And so there's an enormous amount there. And Shimmick is well positioned on the West Coast to do that. I don't think we're going to be able to rapidly expand it on to the East Coast without adding on another platform to do that. But just based on the numbers that I mentioned earlier, the $4 billion a quarter starting in FY '18 ramping up to $12 billion a quarter by the end of '19, there's a -- I don't want to say there's unlimited opportunities, but there's more opportunities than we've ever seen in this space.

Operator

Our last question comes from Andrew Wittmann from Baird.

Andrew John Wittmann - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Troy, I guess, I wanted to make sure I was understanding the income statement correctly, particularly around the nuances of joint venture accounting. It looks like there was a pretty significant increase in noncontrolling interest in the quarter. Oftentimes, those come out of the MS segment. And given that there's like a $20 million step-up from what I'd call an average rate over the last couple of quarters, I want to confirm that there was, in fact, maybe an incentive fee or something paid in MS. And I just want to relate that back to MS and -- because on the consolidated results, the margin profile's quite high. Should we be normalizing for that if there was an incentive fee? Or can you just take us through how the accounting on that worked in the quarter?

W. Troy Rudd - *AECOM - CFO and EVP*

Yes, you're absolutely right. In the Management Services business this quarter, they did outperform against some award fees and some milestone payments, and it was in joint ventures that we control. So it does come through our operating margin, but we do share that with the partners in those joint ventures. If you were to normalize for NCI, we would be right in line with the 7% guidance we gave for Management Services. And there's nothing in there that is not atypical. That's just continued performance against milestones and awards.

Andrew John Wittmann - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, great. That's helpful. And then I was just wondering if you can -- for the DCS margins, I was wondering if you could quantify the year-over-year headwind that you may have had from increased business development costs, since that was called out explicitly as one of the drivers.

W. Troy Rudd - *AECOM - CFO and EVP*

Yes. Think about it as 30 basis points of margin.

Andrew John Wittmann - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

To the segment or to the company?

W. Troy Rudd - *AECOM - CFO and EVP*

To the segment. Yes, to the segment, not the company. To the segment.

Andrew John Wittmann - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Got it. And then, I guess, Mike, my last question is on the backlog, and obviously up a lot sequentially. Does that speak more to the duration and the visibility that you have with this backlog? Or does that speak to an impending kind of revenue ramp that you expect to be hitting more significantly into '18? I guess, your thoughts on that would be helpful. Because a lot of it is in the federal business, and those 2 tend to be longer-duration, high-profit contract.

Michael S. Burke - *AECOM - Chairman & CEO*

Yes. Clearly, we are -- well, first of all, we're really happy about not having $47 billion of backlog, to say the least. But they are -- we are creating longer tenured contracts, which is great. We love the longer visibility nature of these contracts. We're not prepared to give revenue guidance for '18. But I'll just reiterate what I said earlier, we feel good about our 5-year commitments to a 5% revenue growth CAGR and a 10% earnings growth CAGR. But the addition to the backlog, we are very happy with our progress there, and we're equally happy about the projects in the pipeline that we are pursuing. And if we can continue to hit anywhere near the hit rates and capture rates that we've experienced this year, it all looks really good.

Andrew John Wittmann - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I do have a last, last question, if you'll afford me. I guess, Troy, on the tax benefit to the quarter, is it fair math to take like the 28% kind of normalized rate that you guys have talked about, plus the 15.5% that you said was the effective adjusted tax rate for the quarter to calculate the EPS impact? Or was there anything else in there that we should be aware of?

W. Troy Rudd - *AECOM - CFO and EVP*

There's -- I guess, if you take this factor, there's nothing else in the quarter that you need to be aware of. And in terms of a normalized rate, I don't think we have a pinpoint that we've used for normalized rate. But our rate has typically been in the 26% to 28% range. But I'd suggest, just to get into the details of your model, and then give Will a call.

Operator

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

Michael S. Burke - *AECOM - Chairman & CEO*

Great. Thank you, operator. In closing here, I'd just like to reemphasize a few of the key themes that hopefully you've taken away from today. First of all, we're delighted with delivering a record $394 million of free cash flow, which really underscores the consistent cash flow performance that we've had over many years now that enables us to continue our debt reduction plan and keeps us on-path with the targets that we set out for the year. Second, I can't emphasize enough the record $9 billion of wins in the quarter and exiting the quarter with, including Shimmick, $48 billion of backlog. And then third, I want to emphasize the diverse foundation. We have been focused for several years now on building a very diverse foundation, diverse across geographies, diverse across service lines, diverse across end markets and sectors. And we've made a number of investments to continue that diversity. And this is now our third consecutive quarter of positive organic revenue growth, and we see that continuing to head in the right direction. And then finally, we closed on our very first AECOM Capital property for sale in the quarter. And that was a project from buying the ground, developing the asset, building the asset, leasing up the asset and turn around and selling it, and it really underscores the significant potential of our financing arm of our DBFO vision.

So with that, I want to thank you all again for attending our call, and I look forward to talking to you again next quarter in our November earnings call. Thank you, and have a great day.

Operator

Thank you. Ladies and gentlemen, this concludes this call. Thank you for participating. You may now disconnect.
