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Q3 2019 AECOM Earnings Call

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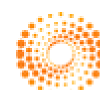

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PRESENTATION

Operator

Good morning and welcome to the AECOM Third Quarter 2019 Earnings Conference Call. I would like to inform all participants, this call is being recorded at the request of AECOM.

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As a reminder, AECOM is also simulcasting this presentation with slides at the Investors section at www.aecom.com. (Operator Instructions)

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

Will Gabrielski ***AECOM - VP 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 business 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're 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 refers to adjusted financial metrics as defined and reconciled in today's earnings press release filed with the SEC and the presentation accompanying this call. Today's call includes comments about restructuring activities that are expected to commence later this year. Today's discussion of organic growth is on a year-over-year and constant currency basis and is adjusted to exclude the impacts of noncore businesses.

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

Michael S. Burke ***AECOM - Chairman of the Board & CEO***

Thank you, Will. Welcome, everyone. Joining me today are Troy Rudd, our Chief Financial Officer; and Randy Wotring, our Chief Operating Officer.

I will begin with a discussion of AECOM's results and the trends across our business. I will also provide an update on our strategic actions that have resulted in a substantial increase in shareholder value this year. Then Troy will review our financial performance and outlook in greater detail before turning the call over for a question-and-answer session.

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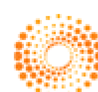

Please turn to Slide 3. We entered the year with a sharpened focus and a clear plan to maximize shareholder value and we are delighted with our progress against this plan. This progress is no more apparent than in our plan to separate the Management Services segment, the near record DCS margin resulting from the restructuring actions we executed in the first half of the year, and in our ongoing commitment to focus on our higher-margin and lower-risk professional services businesses. Importantly, we are continuing to pursue every avenue to unlock the value inherent across our enterprise, including the additional margin-enhancing restructuring actions we announced today.

Turning to our third quarter results. We delivered adjusted EBITDA of $244 million, which was ahead of our expectations. As a result, year-to-date adjusted EBITDA increased by 14% and we remain confident in delivering on our full year adjusted EBITDA guidance for 12% growth at the midpoint.

The quarter was highlighted by the highest margin in the DCS segment in the past 3 years, which is a clear indication of the success of our restructuring. To that point, our year-to-date DCS margins have increased by 100 basis points from the prior year. We continue to expect at least 110 basis point improvement for the full year with another 100 basis point increase now expected in fiscal 2020. This result validates our ongoing deep review of opportunities for margin expansion and builds on the conclusions we reached last year in consultation with Bain that resulted in our completed $225 million G&A reduction.

We delivered a fourth consecutive quarter of double-digit growth in Management Services segment, reflecting the higher returns in our business development investments, including a nearly 50% win rate over the past several years. In addition, despite the anticipated reduction of storm recovery work in the U.S. Virgin Islands, our Americas design business saw continued underlying growth.

Momentum across our markets is strong. Year-to-date wins of more than $21 billion reflect a 1.3 book-to-burn ratio, and our backlog is up 10% from the prior year. As a result, all of our segments have backlog at near record levels, which is the best indicator of our success in the marketplace and of future growth.

Free cash flow was positive but was below our expectations. We are pursuing a sizable outstanding balance for the FEMA-funded storm recovery work we executed in the U.S. Virgin Islands. We expect to collect what is owed to us and deliver on our long-term cash flow and capital allocation goals.

Please turn to Slide 4. We have made significant progress on the strategic actions we have taken and continue to take to improve our margins and drive shareholder value. In June, we announced our intent to separate the Management Services segment. We are aggressively moving forward, are ahead of schedule and have received positive reactions to date. We can't comment on specifics and we are early in the process, but we are very confident that initial steps in this process have validated our view that this is a highly valued asset. We remain confident we will unlock value for our owners.

Additionally, we are on track with our plan to simplify our business through the exit of at least 30 countries. We are also progressing well against our portfolio de-risking plans. We recently completed the sales of our Oil & Gas Production Services and International Development businesses, which further de-risked our portfolio.

And we are conducting a review of all at-risk construction exposure with the goal of having 0 at-risk, self-perform construction. Importantly, upon completion of this process, nearly all revenue will be generated from higher-returning and lower-risk businesses.

Building on the extensive financial and strategic work our team has conducted in partnership with our Board, we also announced additional restructuring actions today that further align our overall cost structure with our more efficient and streamlined operating profile. These actions build on the success of our previous $225 million G&A reduction and are expected to significantly benefit fiscal 2020 margins and EBITDA.

As a result of our progress to date and the anticipated benefits from this plan, we are increasing our adjusted operating margin target in the DCS segment for fiscal 2020 to at least 8%, reflecting a 100 basis point increase from our fiscal 2019 expectation and a 210 basis

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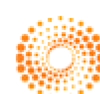

point increase from fiscal 2018. These actions further bolster our confidence in delivering continued strong earnings growth, including our expectation for adjusted EBITDA in excess of $1 billion in fiscal 2020. We will provide formal financial guidance in November with our fourth quarter results.

Please turn to Slide 5 for a discussion of our business trends. Beginning in the DCS segment in the Americas, we delivered solid results and are capitalizing on very favorable market conditions. The fiscal health of our state and local clients, which account for approximately 75% of U.S. infrastructure spending, is robust. State revenues are increasing, reflecting the late cycle nature of tax receipts and rainy day funds are at an all-time high with further increases expected in fiscal 2020. As a result, proposed state budgets for fiscal 2020 call for nearly 4% spending growth. Infrastructure investment remains popular with voters and states are prioritizing transportation projects, including proposals for another $8 billion of transportation-specific tax increases in 2020 with another 5 states set to increase gas taxes next year.

The Canadian market is also robust and execution on large projects continues to result in double-digit revenue growth led by our largest market, transportation.

Turning to our international markets, beginning in the EMEA region. We are capitalizing on a substantial set of opportunities in Saudi Arabia. The third quarter marked our strongest revenue growth in several years. We recently announced our selection for Phase 1 of the $500 billion NEOM Bay development. Wins on projects of this size, scale and ambition speak to client recognition of the strength of our capabilities as leaders in mega-city development.

The U.K. market remains pressured from lingering Brexit concerns. However, long-term infrastructure demand remains strong. Prime Minister Johnson already announced the commitment to substantial investment in national infrastructure since his appointment last month. In fact, the focus on infrastructure and the need for significant investment to support post-Brexit changes was front and center in the Prime Minister's acceptance speech, and we are well positioned to support these initiatives.

Pivoting to the Asia Pacific region. We are continuing to execute on a near record level of backlog in our largest markets led by Hong Kong and Australia. Even so, we are mindful of the geopolitical uncertainty and potential impacts to economic growth in Hong Kong. While our backlog creates a degree of certainty for us, the pace of awards is slow. We expect that demand will reaccelerate once the current issues are resolved, and we are well positioned to capitalize.

Turning to the Management Services segment. We delivered a fourth consecutive quarter of double-digit revenue growth despite tough comparisons in the prior year that benefited from the initial ramp-up in revenue from several large wins. Our backlog remains near an all-time high at nearly $19 billion, reflecting strong returns on our business development investment and superior execution by our leadership team.

In July, our performance at the Savannah River Site was rated excellent for a fifth consecutive year and our award fee was earned at more than 94%. This performance further validates our strong execution track record for our client and reinforces our confidence with the highly robust Department of Energy bid environment. In addition, after the quarter closed, we added approximately $250 million to our backlog related to our contract at the Savannah River Site that will contribute to growth in fiscal 2020.

And we continue to pursue a $30 billion pipeline of opportunities with several sizable decisions expected shortly on large DOE pursuits. Looking ahead, the defense spending outlook is strong. The President signed a bipartisan budget agreement that removes the risk of the spending caps imposed under the Budget Control Act, supports continued record defense spending and adds certainty to our outlook.

Pivoting to Construction Services. Execution in our lower-risk Building Construction business was strong. Backlog has increased by more than 50% and we have nearly 4 years of annual revenue in backlog.

For instance in New York, our largest market, strong demand for office space was evidenced by the substantial long-term leases signed by several large technology companies during the third quarter. In addition, the rezoning of 78 blocks of prime real estate in Midtown Manhattan plays to our strengths, having built approximately 60% of all buildings over 1,000 feet in New York City over the past decade.

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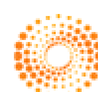

Today, nearly 90% of our revenue in the Building Construction business is in our 4 core markets, primarily New York and Los Angeles. In these markets, our execution track record is strong and our history, scale and market presence create competitive advantages. We will continue to benefit from the professional services nature of this work that provides for a low risk profile, high margins on revenue after excluding pass-through costs and generates our highest return on capital.

Please turn to Slide 6. As this quarter demonstrates, the actions we have taken to enhance profitability and reposition our portfolio towards our higher-returning and lower-risk businesses are delivering results. Today, these businesses account for approximately 90% of our total revenue. Upon completion of our strategic actions, our end state portfolio of businesses will be almost entirely comprised of our lower-risk design and construction management businesses, which provides for consistent execution, strong returns and strong cash flow.

As we will detail in our fourth quarter results and at our Investor Day in December, we will align our financial reporting with the changing nature of our portfolio. Specifically, we will continue to report revenue on a gross revenue basis, consistent with how we report today. In addition, we will report revenue on a net revenue basis or NSR, which is the self-perform component of our revenue that excludes subcontractor and other direct contractor costs. This presentation will provide a greater level of insight into business performance and is consistent with the reporting practices across our professional services peer group. We will also begin to report on and provide guidance for margins on the same basis.

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

W. Troy Rudd ***AECOM - Executive VP & CFO***

Thanks, Mike.

Please turn to Slide 8. Our third quarter results included double-digit growth in all key profitability measures, highlighted by 10% adjusted EBITDA growth and 16% adjusted EPS growth. Our year-to-date results tells a similar story with continued revenue growth, 14% adjusted EBITDA growth, more than $21 billion of wins and a $59 billion backlog. We are benefiting from the focused restructuring actions we executed in the first half of the year. Because of these actions, we are a more efficient and profitable company. This is evidenced by the 3-year high for DCS profitability and our reiterated financial guidance for the year.

Building on this momentum, today, we announced additional planned restructuring actions to further increase efficiencies and profitability by aligning our real estate portfolio with the ongoing transformation of the business. The benefit of these actions will primarily benefit fiscal 2020 results where we have increased our adjusted operating margin target in the DCS segment by 50 basis points to at least 8%. This is 210 basis points above the fiscal 2018 results. We continue to evaluate opportunities for additional margin improvement. We will provide more details on the restructuring and formal guidance ranges for fiscal 2020 in our fiscal fourth quarter earnings, consistent with our usual cadence.

Please turn to Slide 9. In the DCS segment, underlying performance was strong and the benefits of the restructuring actions we completed earlier this year led to a 130 basis point increase on the adjusted operating margin to 7.4%, which was a near record high. Our revenue was negatively impacted by the anticipated headwind from lower U.S. Virgin Islands-related storm recovery work in the quarter and a decline in the Asia Pacific region due to geopolitical uncertainty. Importantly, after accounting for the lower storm recovery work, revenue increased in the low single digits.

Our contracted backlog increased, which is the best indicator of revenue growth over the coming year. While the headwind from reduced storm recovery work in the U.S. Virgin Islands will challenge our comparisons in the fourth quarter as well, we expect underlying revenue to increase.

Please turn to Slide 10. Revenue in the MS segment increased by 10%, marking a fourth consecutive quarter of double-digit growth. The adjusted operating margin was consistent with our expectations for the year. Importantly, this business requires very little capital to grow and produces a high return on invested capital. And although peers report a higher EBITDA margin, we convert each dollar of revenue to

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cash flow at a rate consistent with our peers due to our capital-light model, which is the best measure of financial returns. Looking ahead, we remain committed to our long-term margin target of 7%, supported by continued strong funding levels in our key U.S. government clients and an increasing mix of higher-margin work from the DOE.

I should note, we removed approximately $200 million from our backlog related to the sale of a noncore business in the quarter. Adjusting for this impact, the backlog was mostly unchanged from the prior year.

Please turn to Slide 11. Organic revenue in CS declined by 9%. This result included the anticipated decline in the Power business following our decision to extract ourselves from fixed-price combined cycle gas power market. We expect to complete construction of the Alliant combined cycle power plant later this calendar year.

Revenue in Building Construction business declined against record revenue in the year ago period. However, we have strong backlog visibility into growth into 2020 as recent wins begin to contribute and our pipeline is robust.

The adjusted operating margin was 2.6%, reflecting solid execution. Recall this business includes substantial pass-through costs in the Building Construction business that dilute the margin percentage on a gross revenue basis. Excluding these costs, margins on a net revenue basis are typically in the high teens. Upon completion of our de-risking, nearly all the revenue the CS segment is expected to be generated from our lower-risk building construction management business, where we deploy virtually no working capital and generate high returns on capital.

Please turn to Slide 12. Operating cash flow was $77 million and free cash flow was $52 million. Year-to-date free cash flow was a use of $85 million.

We continue to pursue a more than $200 million net outstanding balance for storm recovery work from our client in the U.S. Virgin Islands, which is expected to be fully funded by FEMA. We are confident in these collections, but with only 7 weeks left in the year, we cannot determine the exact precision if the collections will fall within the fiscal year.

As a result, we are now targeting free cash flow to be at the low end of our $600 million to $800 million guidance range. Recall our cash flow is typically second half weighted. And in last year's fourth quarter, we generated $500 million of free cash flow.

Our historical cash performance provides some insight into why we remain confident in the strong cash generation over time. This performance includes $2.7 billion of free cash flow generated from 2015 to 2018, including annual performance near the midpoint of the range in each of these years. As a result, we have an industry-leading cash flow yield based upon our track record of delivering on our guidance. Importantly, the highly cash generative nature of our business has not changed.

Turning to capital allocation. We will continue to allocate capital in a balanced manner, focused on maximizing shareholder returns. Our total debt declined by $81 million sequentially and by $77 million over the prior year. We have also repurchased $210 million of stock since last August under our $1 billion authorization. As we progress with the plan to separate the MS segment, we will continue to allocate our capital primarily toward debt reduction to achieve our leverage targets.

Please turn to Slide 13. With our strong year-to-date results, we are confident in reiterating our fiscal 2019 guidance for 12% adjusted EBITDA growth at the midpoint and adjusted EPS of between $2.60 and $2.90.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Andy Kaplowitz with Citi is on the line with a question.

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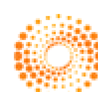

Andrew Alec Kaplowitz ***Citigroup Inc, Research Division - MD and U.S. Industrial Sector Head***

Mike, can you help us think about the additional restructuring program you announced? I know you said you'd give us more details later. But how do we think about it in the context of the past program, the $225 million G&A program. Could it be as big? And then in the release, you said that the 8% margin in DCS reflects the expected benefit from the already executed $225 million program. So does that mean that the new restructuring program could actually result in more than 8% DCS margin either over time or in FY '20?

Michael S. Burke ***AECOM - Chairman of the Board & CEO***

So thank you for the question, Andy. So first of all, based on the success we had with the execution of the $225 million reduction. You saw that we were able to execute on that fairly quickly at the beginning of the year. It has had an impact of 100 basis point improvement over the previous year. We have previously said that we expected that to be 100 basis point improvement in FY '19. And then when we had the full year run rate in FY '20, that would be another 50 basis points, right? So we were already counting on the 100 for this year, the additional 50 basis points for next year. We went through another exercise to evaluate our cost structure. And as our portfolio evolves, we took a hard look at our real estate footprint to make sure that our real estate footprint is aligned with our new business model and our expectations for the future. We also took another hard look at taking advantage of our higher utilization in our design centers and our shared services centers to continue that evolution. And the announcement that we made today is that we would expect another 50 basis point improvement. So the first round of restructuring at a full run rate would impact margins by 150 basis points. This would be another 50 basis points for a 200 basis point improvement over FY '18 margins.

Andrew Alec Kaplowitz ***Citigroup Inc, Research Division - MD and U.S. Industrial Sector Head***

All right. So let me shift gears then, Mike, and ask Troy about cash. So maybe can you give us more color into the reasons why cash has been so far below your expectations? Is it just the Virgin Islands or are there any projects that you've not been executing on as well as expected or maybe there are other projects you've had difficulty collecting cash? So just if you could give us any of the reasons or is it really just the Virgin Islands that have slipped?

W. Troy Rudd ***AECOM - Executive VP & CFO***

Yes. So Andy, let me give you a headline and then some detail. I guess, first, the headline is putting aside the U.S. Virgin Islands, what we're experiencing is we're experiencing issues with the timing of some of the collection on some projects, but not the collectibility on those projects. So we clearly have a second half weighted cash flow historically, and we expected the same this year. So beyond the U.S. Virgin Islands, which we had expected to collect a little in Q3 and some in Q4, we've had some projects in Q3 that those collections moved into Q4 and we've already collected on a number of those items.

And with respect to the U.S. Virgin Islands itself, the reason that we downgraded our view on where we'd end up in the range is because with, as I said, with 7 weeks to go, we've actually experienced the bureaucracy with our customer and with FEMA in getting those invoices and those collections made, we've actually seen the bureaucracy getting worse, not better. So that has changed our expectations. But again, I just highlight that our view is, it's an issue of timing. It's certainly not collectibility on any projects or execution.

Andrew Alec Kaplowitz ***Citigroup Inc, Research Division - MD and U.S. Industrial Sector Head***

And Troy, to that comment of you've already collected some of the cash, do you have visibility like you did last year toward collecting? We understand a couple of hundred million of Virgin Islands could slip. But the $500 million that you need besides that, do you already have the visibility you need to collect that cash here in Q4?

W. Troy Rudd ***AECOM - Executive VP & CFO***

Yes, Andy. We've got a pathway to do that in Q4.

Operator

Jamie Cook with Crédit Suisse is on the line with a question.

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

I guess a couple of questions, one, Mike, back to the improvement in the DCS margins of at least 8%. Before, you sort of talked about broad 2020 EBITDA guidance of above $1 billion. So I'm just trying to figure out, does that mean we can add an additional $0.25 or

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whatever to what we were expecting on 2020 estimates? So I'm just trying to think of it, is that a guidance range relative to the bigger picture 2020 EBITDA target? And then my second question just back on the cash flow again, Troy, if the couple hundred million from the Virgin Islands slips into 2020, do we view that as additive to 2020 free cash flow, so you should be at least at the high end of your free cash flow guidance range of $800 million? And then last, Mike, for you also, just an update on where we are on the construction divestiture?

Michael S. Burke ***AECOM - Chairman of the Board & CEO***

Great. Thanks, Jamie. So why don't I let Troy answer the first 2 parts on cash flow and guidance and then I'll answer the question -- I'll come back and answer the question on CS.

W. Troy Rudd ***AECOM - Executive VP & CFO***

Yes. So Jamie, yes, Jamie in terms of the 2020 guidance, again, as we said, it's too early in the process to give formal guidance. We'll do that when we get to Q4 earnings. But in terms of the DCS margin improvement, we do see that being additive to our guidance in fiscal '20.

And with respect to cash flow, the answer is yes. We gave guidance that was over a 3-year period. And so to the extent there is some cash that moves into the following year, I would see that being additive or moving us to the higher end of the range in the following year.

Michael S. Burke ***AECOM - Chairman of the Board & CEO***

Yes. Just to underscore that, Jamie, we still feel very good about our overall long-range cash flow. We had 5 years in a row now of incredible industry-leading cash flow. We don't see that changing at all. And anything that does move from Q4 into Q1 next year, it's just a timing difference if we have it, so no change there.

With respect to CS, as we have said, we have a clear goal to be out of the at-risk, self-perform construction business by the end of this calendar year. We are in the market. We are actively engaged with discussions with potential buyers for the civil and power business there. And that continues to progress and we'll update you as soon as we have something to announce on that front. But I think the important part is that by the end of this calendar year, we fully expect to be entirely out of the at-risk, self-perform business. We will have a professional services business of a high margin, certainly on an NSR basis, a high margin construction management business, a low risk business and a changed portfolio going into calendar '20.

Operator

Tahira Afzal with KeyBanc Capital is on the line with a question.

Sean D. Eastman ***KeyBanc Capital Markets Inc., Research Division - Associate***

This is Sean on for Tahira today. So for me, just drilling in on the DCS margin target for FY '20, how would you characterize the dependence on the overall macro economy holding out to hit that target versus kind of what you've already got locked in, in backlog and locked in with the cost savings through these last 2 programs?

W. Troy Rudd ***AECOM - Executive VP & CFO***

Sean, it's Troy. Look, I think that when you look at our '20 guidance in terms of margins, we're not building in an expectation of significant growth into that. Now clearly the market conditions that we're seeing support growth in that business. And based on the backlog that we have at the end of the third quarter, we certainly see contracted backlog being up. So that indicates growth in that business. But really through the restructuring actions that we've taken and that we're going to take, we see the confidence in that 8% margin guide.

Sean D. Eastman ***KeyBanc Capital Markets Inc., Research Division - Associate***

All right. That's really helpful. And then MS prospects-wise sounds like there's some bigger DOE contract decisions being made in kind of the coming months. I'd just like to get an update on AECOM's competitive positioning in the DOE realm, considering we do hear several other companies talk about wanting to be bigger in that space so an update there would be great.

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Randall A. Wotring ***AECOM - COO***

Sure. This is Randy. Look, in this quarter, we saw the Savannah River contract extended. And as Mike said, subsequent to the quarter end, we received another $250 million incremental funding on that contract. It will go back into competition sometime in the future. Other than that, the next contract up for award is the Central Plateau contract at Hanford. We expect that award announcement to be in the near term. I mean, can be made at any time over the next 3 to 4 weeks. There's another contract at Hanford, the tank ops. It will probably be delayed.

But look, the best indicator of our success in the future, in my opinion as I've stated previously, is the performance we have on existing contracts. All of our contracts within DOE are rated very highly. And just as Mike mentioned in his prepared remarks, our last award fee score at Savannah River was over 94%. So we continue to perform in an outstanding manner on all of our DOE contracts. And we remain very bullish on our bidding activities and the future here. We've been in this market for over 50 years and have consistently been a top performer. So we're very bullish on the future.

Operator

Andy Wittmann with Baird is on the line with a question.

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

I just wanted to clarify and maybe just get a little bit of context on the precise impact of the U.S. Virgin Islands revenue. You mentioned that the core business was up despite that. So can you just tell us what the U.S. VI year-over-year headwind was so we can get a better sense of that underlying business?

W. Troy Rudd ***AECOM - Executive VP & CFO***

Yes. It was about 2%, Andy, in terms of revenue was the headwind.

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

Got it. And that should be fairly similar in fourth quarter? And I think that compare stays relatively difficult through the second quarter of next year, but I guess I wanted to confirm that with you.

W. Troy Rudd ***AECOM - Executive VP & CFO***

Yes. It's something similar. It will be 200 to 250 basis points in the fourth quarter, I think, is the headwind from that.

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

Got it. And then the next year as well that we should be thinking about that?

W. Troy Rudd ***AECOM - Executive VP & CFO***

In the next year, absolutely, in the first half of the year next year in the first quarter and second quarter, we'll again have the same headwind, yes.

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

Okay. Great.

W. Troy Rudd ***AECOM - Executive VP & CFO***

I was just going to add one thing to it, too. But as we do look forward. Again, even absent that, we do see the opportunity for growth in that business into '20.

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

Certainly. Okay. And then just on this next wave of restructuring in DCS as you're looking at your cost structure there. Obviously, we can do the math in terms of how much cost you're expecting to come out of the P&L. Do you expect the relationship between the cost to achieve that 50 basis points to be somewhat consistent with this first wave? In other words, the ratio of cost to achieve to cost savings? And do you expect it to be primarily cash or noncash in nature?

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W. Troy Rudd ***AECOM - Executive VP & CFO***

Yes, Andy. Again as we said, again, I'll headline a couple of details. First is, yes, we see it actually having a slightly larger cost and the reason is this relates to real estate. So the return is not quite as significant. But with respect to real estate, there's a fairly nonsignificant, noncash component. But at this point in time, it's too early for me to give guidance on that detail.

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

Yes, totally understand. That's helpful and I'll leave it there.

Operator

Chad Dillard with Deutsche Bank is on the line with a question.

Chad Dillard ***Deutsche Bank AG, Research Division - Research Associate***

So just want to spend some time on the MS segment and just understand just the revenue ramp for the projects at least that you have in your backlog right now. How are you thinking about how long it takes to actually hit the full run rate? And then also just on the margin side, I know you guys recommitted to the 7% margins. And just wanted to understand whether it's the case that it's kind of needing to kind of ramp up the business and you'll actually get there or is there more -- anything else that you need to do to hit that target?

Randall A. Wotring ***AECOM - COO***

Chad, this is Randy. Let me talk about the revenue ramp. Again, we've seen revenue at double-digit growth the last 4 quarters. That will slow down. We believe that will slow down. But again, the pipeline remains very large. So the comps get tougher, but we see opportunities to continue to grow this business. We have a pipeline of $30 billion and our bidding activity remains high. Our win rates remain really healthy. And from that standpoint, we see this business continuing to grow, albeit it may be at a lower rate given the comps that we see going forward. In addition, we see a higher content of DOE-type bids in the next 18 months to 2 years. So I'll let Troy talk about the margins.

W. Troy Rudd ***AECOM - Executive VP & CFO***

Yes, Chad. Our margins are really driven by the mix of business. And the mix of business, if you recall in the past, we won a significant amount of work at the Department of Defense, so with that client. And as you heard from Randy, in the fourth quarter, we had another award that's DOE award, and there are a number of DOE awards coming in the future. So as we see a change in our backlog as a result of an increase in percentage of total backlog related to the DOE client, we see that improvement in margin over time.

But I also want to make another point, which is that in terms of looking at our margins, I also think it's important to look at the actual cash flow cash conversion. Because when we look at the amount of cash that our Management Services business produces as a percentage of its revenues, it actually equalizes for the impact when compared to our peers. Because our peers, a lot of our peers have very capital-intensive businesses. Ours is a very capital-light business. And when you look at the percentage of cash to revenues in the business, we see that, in fact, our business may look at 6% and 7% margins to be lower, but in fact, it is right in line with all of those peers.

Chad Dillard ***Deutsche Bank AG, Research Division - Research Associate***

That's helpful. And just another question on AECOM Capital. I think you guys called out about $13 million of EBITDA for this year, but just wanted to get a sense for how you're seeing the monetization pipeline as we go into 2020? Do you see, I guess, the ability to actually capture a similar level of realization? And then just on the Construction Services side, I noticed that the equity in earnings saw like a pretty nice healthy bump up to $20 million. Just wanted to get some clarity on kind of how sustainable that is.

Michael S. Burke ***AECOM - Chairman of the Board & CEO***

So with respect to, I don't want to start to give subcomponent guidance for next year on AECOM Capital, but just a quick update there. We expect to complete the external fundraising process by the end of this quarter. We would expect then to be using almost entirely outside capital to fund that activity. And so the restructuring there to hone our focus has been successful. The realization of gains will not

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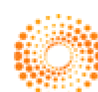

be dissimilar from what we recently experienced. So you should expect that to be somewhat constant, but we'll give more guidance on that come the November earnings call when we give the full year guidance for 2020. And then the second part of your question was about CS. What...

Chad Dillard *Deutsche Bank AG, Research Division - Research Associate*

Yes. So I just noticed that there's a nice little pop in the equity in earnings, up $20 million. Just want to kind of understand like how sustainable that was and what drove that?

W. Troy Rudd *AECOM - Executive VP & CFO*

Yes. Andy, I wouldn't look at that as being a sustainable pop. Again, within our CS segment, we have a number of projects that we consolidate and a number of projects that are in joint ventures. And it just happened in the quarter related to project execution that we actually saw the impact of that coming through our EJV line or through joint ventures.

Operator

(Operator Instructions) Michael Dudas with Vertical Research is on the line with a question.

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

Mike, I wanted to delve into your prepared remarks regarding the MS spin and how you're seeing that? What's given you more confidence? What's some of the feedback that you refer to? And since the announcement, have you received indication of interest from other parties about different structures to monetize or get the value out of that business?

Michael S. Burke *AECOM - Chairman of the Board & CEO*

Yes. So Mike, thanks for that question. We initiated this process with the belief that the MS business held considerable value which a separation would unlock. We feel even more confident about that belief today than we did before the announcement. And I really can't comment on the specifics because we're early in the process. But we're just very confident based on the initial steps in the process and our initial dialogues that have validated this view that it's a highly valued asset and there's no question that we're on the right path here. So I'll leave it at that, Mike, as you could understand I don't want to comment too much about the specifics given where we are in that process.

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

Totally understand. And timing is similar to what you talked about back in June, like within a quarter or so range?

Michael S. Burke *AECOM - Chairman of the Board & CEO*

Yes. We are moving ahead of schedule right now, let's say that.

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

Excellent. And follow-up is on the CS business. You called out New York, Los Angeles boom there. I'm assuming there'll be some more sports arenas built especially out in California that you have opportunities with. We're watching tape and seeing the concern about the economy, concern about market, et cetera. Do you have any indication from some of your -- the key developers or the folks that there's been some pause, concern? Are we really late in the game on the non-res big construction in these core markets or is still there enough hope and visibility, especially with maybe funding costs coming down that we continue to see this market expand for you guys for the next several years?

Michael S. Burke *AECOM - Chairman of the Board & CEO*

Yes. Mike, this market still seems to have legs in front of us. We have -- first of all, that business has about 4 years of backlog right now. So there's plenty of backlog to keep us busy for the next 4 years. But having said that, the wins that we have seen, our total backlog in CS is up 34%. And so the backlog continues to grow. I think there's just a number of other really interesting areas we are seeing growth in. And you mentioned the sports arena where we are a leader in that marketplace, continues to be a robust market. You've heard us mention in the past the aviation market where there's an expectation over the next several years for $100 billion of investment in airports in the U.S. alone, which we are a strong player in that space.

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But even in the core nonresidential building market, the JPMorgan headquarter building on Park Avenue in New York, of course, that's a very large project. But what's significant about that is the rezoning of that entire section of Midtown Manhattan to allow for additional high-rise buildings. And we're seeing a lot of demand in New York City. We're seeing a lot of technology companies taking up significant amounts of space in New York City. So that market still seems to have quite a bit of legs. So the important part is we continue to win work. We have about $10 billion of decisions that we are waiting on that we expect to be made in the next 6 months for construction management work.

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

So you're telling me, it's still going to be difficult to get around Midtown Manhattan for the next several years, is that what you're saying, Mike?

Michael S. Burke ***AECOM - Chairman of the Board & CEO***

That's correct.

Operator

We have no further questions at this time. I will now turn the call back over to Mike Burke for closing comments.

Michael S. Burke ***AECOM - Chairman of the Board & CEO***

Okay. Thank you, operator.

So before concluding the call today, I just want to put our third quarter accomplishments in the right perspective and emphasize a few points that we've made throughout the discussion today and throughout the Q&A session.

It was 2 years ago that we began a very deliberate process to transform this business to best position us for long-term success and maximize shareholder value based upon a number of changes that we were seeing in the marketplace. And you saw that commitment back in 2017 with our capital allocation policy where we are focused on returning capital to our shareholders through both debt reduction and our stock repurchases under the $1 billion share authorization.

We then moved into a further effort with a deep analysis of our cost structure in consultation with Bain and our Board of Directors, which resulted in the $225 million restructuring plan that we completed earlier this year and the additional incremental restructuring that we announced today.

We then embarked on a path to de-risk our portfolio. And that started in early part of 2018 with the decision to extract ourselves from the combined cycle gas power business, so that we could focus on the higher-returning and lower-risk businesses. We announced that we were exiting more than 30 countries. We announced the sale of noncore assets where we believe the risk wasn't commensurate with the rewards. And we announced our intent to fully extract ourselves from the self-perform, at-risk construction business. And we are well on our way on all of those fronts.

Our third quarter and our year-to-date results really provide the strongest evidence that these strategic actions are creating real value for investors. We've delivered 14% adjusted EBITDA growth in the first half of the year, the highest margin that we've seen in several years in our DCS business. And we continue to benefit from near record backlog levels.

So as we continue to evaluate additional avenues for further unlocking the value inherent in the organization, we announced back in June the separation of our Management Services business to unlock that value. And we'll continue to pursue every strategic opportunity in front of us to do that. But we remain incredibly confident in our ability to position this company to provide incredible growth opportunities for our employees that deliver great value for our clients and of course, to drive long-term value for our investors. So we are delighted with the progress that our leadership team has made and all of our employees to transform this business over the past 2 years. And I think you're seeing the tracks in the snow this quarter, once again, down that path.

So thank you again for joining us today. And with that, I look forward to the next discussion. Thank you.

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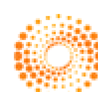

Operator

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

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