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ACM.N - Q2 2022 AECOM Earnings Call

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OVERVIEW:

Co. reported 2Q22 results. Expects FY22 adjusted EPS to be $3.30-3.50.

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PRESENTATION

Operator

Good morning, and welcome to the AECOM Second Quarter 2022 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 now to turn the call over to Will Gabrielski, Senior Vice President, Finance, Treasury and Investor Relations. Please, Will, go ahead.

William Gabrielski - *AECOM - SVP of Finance & 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 undertake no obligation to update our forward-looking statements.

We use certain non-GAAP financial measures in our presentation. The appropriate GAAP reconciliations are incorporated into our presentation, which is posted to our website. References to margins and adjusted operating margins reflect the performance of the Americas and International segments. We will refer to net service revenue, or NSR, which is defined as revenue, excluding pass-through revenue. NSR and backlog growth rates are presented on a constant currency basis, unless otherwise noted. Today's remarks will focus on the continuing operations of the Professional Services business, unless otherwise noted.

During the quarter, we announced our immediate exit from Russia, and we incurred a $69 million pretax impact, which is excluded from our adjusted earnings results. The expected cash impact from our exit from Russia is approximately $10 million.

On today's call, Troy Rudd, our Chief Executive Officer, will begin with a review of our key accomplishments, strategy and growth updates and our outlook. Lara Poloni, our President, will discuss key operational successes and priorities going forward, and Gaurav Kapoor, our Chief Financial Officer, will review our financial performance and outlook in greater detail. We will conclude with a question-and-answer session.

With that, I will turn the call over to Troy. Troy?

W. Troy Rudd - *AECOM - CEO & Director*

Thank you, Will, and thank you all for joining us today. I would like to begin by expressing my deep appreciation to our professionals for their focus and commitment to their work and their clients. At AECOM, we are inspired by shared purpose of delivering a better world and prepared for the huge opportunity ahead of us as the world embarks on the long-term transformation of our infrastructure.

I'd also like to expand on the decision we made during the quarter to immediately exit our operations in Russia. We are saddened by Russia's ongoing invasion of Ukraine. This action is inconsistent with our values. As a result, we accelerated our immediate exit from this market in February. While ceasing our operations, our priority was providing our colleagues with support during this transition. This includes an emphasis on the safety, security and well-being of our teams. I want to thank our AECOM teams and their families in Romania and Poland for their tireless efforts to aid the families leaving Ukraine as a result of the invasion and all of our professionals for providing support for these humanitarian efforts.

Turning to our results. We delivered strong results on every key metric in the second quarter. In the design business, NSR increased by 5% despite high levels of Omicron-related absenteeism in January and February that has since subsided. Importantly, the U.S. government passed its fiscal 2022 Omnibus budget in March, which creates optimism around the pace of growth for our government clients in the U.S. in the second half of this year and fiscal 2023.

We also delivered a record second quarter margin of 13.8%, which remains at the top of our peer group. Our margins reflect the value we bring to our clients as well as the positive contribution of our digital, advisory and program management capabilities. Against the backdrop of rising inflation, we are consistently delivering strong profitability, which is a direct representation of the inherent attributes of our Professional Services business model and the embedded inflation protections built into our contracts.

Importantly, our growth and strong margins are translating to the bottom line. For the quarter, adjusted EBITDA increased by 10%, and adjusted EPS increased by 24%. Across the business, our end markets are strengthening, and our win rate remains at an all-time high. Our book-to-burn ratio was 1.6 and was highlighted by strength across the entire business.

Contracted backlog, one of the best leading indicators for future growth, increased by 20%, and the total backlog increased by 4%. We are realizing the benefits of our Think and Act Globally strategy which emphasizes collaboration and focuses our time and capital on the highest-returning opportunities.

I'm also pleased to report that our free cash flow in the first half of the year was one of the highest in our history. We returned nearly $300 million to shareholders through the first half of the year, which was ahead of our normal cadence, and is an accelerant to value creation.

I'm proud of our performance and what our professionals have accomplished over the past 2 years. Today, we are a highly agile professional services firm with market-leading franchises in a very well-defined and focused strategy. We're allocating resources to our largest, fastest-growing and most profitable geographies and market sectors, and we are expanding the addressable market and enhancing our client value proposition by investing in high-value digital, advisory and program management services.

Be it rising inflation, the lingering impacts of the pandemic, supply chain disruptions, war or integrating ESG into client investment decisions and planning, the pace of change is accelerating. Against this backdrop of rising macro risk and geopolitical uncertainty, the inherent advantages of our business are driving consistently strong performance.

Please turn to the next slide for a discussion of the trends across our markets. In the U.S., the outlook for the next several years is as strong as it's ever been. State and local clients have record levels of funding and are set additionally to benefit from the IIJA funds. Our U.S. Federal clients are also prioritizing investments in areas where we excel, including environment, sustainability and resilience. As a result, we expect a strong level of Federal task activity in the second half of the year and growth to persist into 2023 and beyond.

In addition, PFAS investment is accelerating, and our leadership in assessment and destruction are leading to substantial growth opportunities. In fact, the U.S. pilot of our groundbreaking PFAS-destruction technology, DE-FLUORO (TM), is now well underway. And we are advancing our plans to commercialize this proprietary technology at scale to meet a multibillion-dollar demand opportunity.

Internationally, markets are also strong. In the U.K., revenue continues to increase, and there are several tailwinds to our business, including growing investments in rail and transportation, markets where we lead. In addition, the U.K. government's Leveling Up strategy, which includes key prosperity and equity-focused initiatives that touch on all elements of infrastructure, are creating opportunities for AECOM. In the Middle East, investments to create modern ESG-focused cities, such as NEOM and AlUla, are drawing on all of our expertise and are creating several years of visibility. In Australia, our revenue and backlog increased, and the outlook for growth across our market remains strong. At the same time, we are managing through ongoing COVID-related shutdowns in China. Though as we always do, we are remaining agile and don't expect these impacts to be material.

Please turn to the next slide. Across the business, we have built a platform that positions our professionals to innovate and deliver on 3 megatrends that will define the next several decades of investment. These are a global infrastructure investment renaissance, ESG investment, and the adaptation of infrastructure to a post-COVID world.

I'd like to discuss a few examples that bring to life how AECOM is capitalizing on these opportunities. First, we are leveraging our strength as ESG leaders to capitalize on growing demand from our clients to decarbonize and advance sustainability initiatives. Most recently, we were awarded a contract for a top-tier cruise operator to reduce emissions at their cruise terminals with alone account for a large portion of their total emissions footprint and are critical to achievement of their emissions reductions plan. We were also awarded a contract for one of the largest mine remediation projects ever in Canada. As these wins evidence, the capabilities of our nearly 50,000 industry-leading experts are creating competitive advantages in the marketplace and positioning us for strong growth.

Second, our advisory and program management business continue to create opportunities for high-value, long-duration contracts for long-standing clients. This was highlighted by our selection in the quarter for the Airside Master Plan at the Dallas-Fort Worth International Airport. We have delivered nearly $1 billion of work for this client over the past decade and are pleased to see our success translate into further growth opportunities.

Finally, our scale, experience, and global execution capabilities are leading to success on complex, mission-critical programs. This was apparent on our successful takeaway win from a competitor of the Atlantic region, Navy's NAVFAC CLEAN Environmental Action Program. We brought the capabilities of our whole company to bear to distinguish AECOM from the incumbent. Our comprehensive proposal, which also embedded our industry-leading PFAS capabilities was a critical determinant of our success and a great representation of the power of our organization when we Think and Act Globally.

In closing, our business and brand are built on nearly 50,000 of the best professionals in our industry. Despite the numerous headwinds impacting various parts of the economy, we continue to deliver for clients and to create value for our stakeholders. As a result, I am as confident as ever that our strategy, focus and discipline will allow us to continue to succeed into the future and capitalize on the opportunities ahead.

With that, I will turn the call over to Lara.

Lara Poloni - *AECOM - President*

Thanks, Troy. Please turn to the next slide. The strength of our professionals is at the heart of our success. Our leading position in numerous key end markets was reaffirmed last month when we were again ranked by ENR as the #1 transportation and facilities design firm, and we continue to hold top rankings in several key growth markets, including environment, green design, and water.

Of note, our leadership in the transportation sector positions us at the top of the market set to benefit most from increased funding. In fact, some of the most immediate and largest priorities within the IIJA will leverage our #1 position in the transportation sector, be it our leadership in a highly technical and critical discipline like tunneling or our ability to embed ESG and digital solutions in transportation design and program management.

To this point, we are taking key steps to focus our time and resources on aligning our strategy and competitive positioning to capitalize. First, we are investing in our ESG advisory practice to meet surging demand to reduce clients' greenhouse gas emissions and improve social outcomes. Infrastructure accounts for up to 50% of all emissions globally, and more than 1,500 companies have set their own net-zero commitments, creating a large need in the marketplace. By positioning with our clients early in their planning with our advisory services, we are forging key partnerships to help shape our clients' plans and manage these programs through execution.

A great example of this is our work for Network Rail in the U.K. We engaged through our advisory practice to develop and execute a strategic review, analysis and drafting of a plan to achieve net zero and sustainability objectives. From this initial scope, we expanded our role multiple times over, which demonstrates the importance of our advisory practice in creating meaningful and lasting relationships with key clients.

This is just one example of the growth opportunities in the U.K. rail sector.

Second, we are constantly challenging ourselves to push the pace of innovation. For instance, we recently developed and unveiled a proprietary IIJA-specific digital tool as part of our Digital AECOM offering. This tool was built organically by our experts in response to urgent demand from clients to best position their projects for IIJA funding. Our teams leveraged our existing PlanSpend platform and built in geospatial, machine learning, and other AI capabilities to help clients navigate the complexities of the competitive grant process for IIJA funding. Client feedback and demand have been overwhelmingly positive.

We also recently rolled out our program management delivery system and tool kit, bringing together digital tools and technical capabilities to create a repeatable AECOM way for delivering world-class program management services. This is a critical element to our growth ambitions and will provide both a delivery benefit to AECOM while also reinforcing our value proposition for clients.

In addition, we recently entered into a partnership with Microsoft to leverage its leading cloud technology and further enhance our PlanEngage offering. PlanEngage is now being promoted by Microsoft, creating another channel from which we can deliver our innovation to the marketplace.

Finally, we are prioritizing recruiting and career development initiatives to best position AECOM to win. Our headcount increased in the second quarter, and we have an incredible platform on which careers can be built, new skills can be learned, and innovation can flourish. To expand our advantage, we are investing in new career and leadership development to expand avenues of advancement for our professionals, and we are also focused on increasing the diversity of our workforce. Diversity is an asset, especially when addressing complex challenges on a global scale. As a result, we are expanding focused campus recruiting efforts and implemented regional diversity targets to ensure we are building the strongest and most diverse workforce. With all of these initiatives well underway and producing results, we are confident that AECOM will lead the way of long-term funding growth coming to our industry.

With that, I will now turn the call over to Gaur.

Gaurav Kapoor - *AECOM - CFO*

Thanks, Lara. Please turn to the next slide. Our second quarter performance reflects the benefit of our disciplined growth strategy, the commitment of our highly talented professionals, and the strengthening trends across our largest and most profitable markets. Despite the elevated level of global uncertainty, we have delivered 5 consecutive quarters of NSR growth, continue to expand profitability and delivered another quarter of double-digit adjusted EBITDA and EPS growth.

While inflation is a headwind to many industries, the inherent attributes of our business model and contractual structures create a natural hedge against rising cost and allows us to maintain strong performance through varied environments. These advantages have resulted in strong cash flow, and we returned nearly $300 million to investors in the first half of the year. In total, we have repurchased nearly 15% of our shares outstanding since September 2020, and we are committed to deploying our consistently strong cash flow to accelerate shareholder value creation through ongoing stock repurchases and dividend payment. Our backlog and strong wins underpin our confidence in delivering on our financial commitments this year and on our 2024 financial goals.

Please turn to the next slide. Our performance in the Americas was highlighted by 4% NSR growth in the design business and a 1.6 book-to-burn across the segment. Contracted backlog increased by 24%, which supports our expectations for accelerating NSR growth. We saw an acceleration of growth in March, and with the passage of U.S. federal budget for 2022, we are confident in our growth expectations. We continue to expect IIJA funding to accelerate into fiscal 2023 and beyond, which will further benefit our industry-leading franchises. With respect to profitability, margins expanded 50 basis points from the prior year to 17.7%, which reflects growth in higher-margin areas, including advisory and program management.

Please turn to the next slide. We delivered another quarter of strong growth and profitability across the international business. NSR increased by 6%, led by growth in the U.K. and Middle East. We also had another incredibly strong quarter's wins with book-to-burn of 1.5 and double-digit backlog growth. Our wins are concentrated in our largest and most profitable markets, reflecting our leadership in growing transportation, water, ESG, and program management disciplines. Margin expanded to 8.3%, up 100 basis points from the prior year. This was the seventh consecutive quarter of sequential margin improvement. We remain committed to achieving a double-digit margin in this business and are pleased with our progress against this goal quarter-after-quarter.

Please turn to the next slide. Turning to cash flow, liquidity, and capital allocation. We delivered strong cash performance in the first half of the year with operating cash flow of $193 million and free cash flow of $145 million. This compares to a free cash outflow of $11 million in the comparable period last year. This improved phasing is consistent with our focus on delivering more balanced cash flow throughout the year. Our strong cash performance enabled us to accelerate our capital allocation strategy. Through April, we have repurchased more than $260 million of stock this fiscal year and we have made 2 dividend payments under our recently established quarterly dividend program. As a reminder, we remain committed to growing our dividend per share by a double-digit percentage annually going forward.

Please turn to the next slide. Turning to our financial outlook. We have reaffirmed all of our financial guidance metrics for fiscal 2022 and our long-term financial targets. For fiscal 2022, we continue to expect to deliver adjusted EBITDA in the range of $880 million to $920 million. At the midpoint, this would reflect 8% growth and is supported by our expectation to deliver approximately 6% organic NSR growth and at least 14.1% segment adjusted operating margin. We also continue to expect adjusted EPS for the year of between $3.30 to $3.50 or a 21% growth at the midpoint. Per share value creation enabled by accelerating NSR growth, expansion of our industry-leading margins, strong free cash flow conversion, and disciplined capital allocations remain our top priority. As a reminder, our adjusted EPS guidance only incorporates the benefit of already completed share repurchases, though we expect to continue to buy stock as part of our capital allocation program.

We also reconfirmed our free cash flow guidance for the year of between $450 million and $650 million. As we look ahead towards our fiscal 2024 targets, our strong progress to date and strengthening end markets support our expectation for an at least 19% adjusted EPS CAGR from fiscal 2021 to 2024. Built on expectations for accelerating NSR growth, a segment adjusted operating margin of at least 15% in 2024, and continued return-focused capital allocation supporting a greater than 15% ROIC.

With that, operator, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question comes from the line of Michael Feniger from Bank of America.

Michael J. Feniger - *BofA Securities, Research Division - Director*

Just to what you were referring to on the free cash flow, I'm curious, you reaffirmed your full year 2022 outlook, even your 2024 target, so it sounds like you have that visibility into growth. In Q1, you repurchased $200 million worth of shares. I think this quarter was only $80 million. So just with balancing out the dividend strategy, some of these internal investments and your outlook, is repurchasing still really part of that capital allocation priority list?

W. Troy Rudd - *AECOM - CEO & Director*

Yes. Michael, it's Troy. Thanks for the question. The simple answer to your question is yes, but remember what we said at the beginning of the year is that we were going to match our repurchases with cash flow during the period. And so we feel like we're a little bit ahead of where we intended on being because we had stronger cash flow in the beginning of the year. But it is clearly our intent to continue to return capital to shareholders through repurchase and through our quarterly dividend, so nothing has changed.

Michael J. Feniger - *BofA Securities, Research Division - Director*

Fair enough. And when you think about out to 2024, Troy, I mean, how does your portfolio kind of start to shift by then? I mean, do you see some of your more cyclical areas, if you would even -- if you would call that, the Construction Management, will that be slowing down by then? And the contributions from areas like environmental and water be a higher portion of your - of your portfolio, could the public customer be a bigger part of the pie there? Anything you kind of see around those verticals as we kind of move through the second half of 2022 but really into 2023 and 2024.

W. Troy Rudd - *AECOM - CEO & Director*

Okay. Yes. First, let me just start at a high level, and we think that our future is actually dominated by some pretty strong macroeconomic trends or cycles. And first, we mentioned that there is clearly a long-term investment in infrastructure that's being made. And so it's -- and we're exposed to it in all of our businesses. And whether that's Construction Management or water or environment but certainly transportation. So we're heavily exposed to what we see as a really good, long-term trend.

And in addition to that, there are some other long-term megatrends. One is just the investment in ESG. And for us, what that means is the world is valuing infrastructure, and it's doing a little bit different than it has in the past. And so you have to be prepared to adjust the output or the obligations of the infrastructure to focus on some environmental and social objectives.

And then the third thing is, clearly, there is a repositioning of investment infrastructure around the world as a result of what we've seen in supply chains. And so it's those 3 trends that give us good, long-term visibility. And again, everything is sort of lining up that way. If you look just simply in the United States, while we've had the IIJA, we actually didn't have a budget that authorized funds. Now there's a budget in place that's authorizing the funds, and it will support very strong state and local budgets. So again, when I look across the business, there's a long-winded way of saying I think all of the businesses that we're in today and around the world, they're exposed to some really good long-term trends. And we see ourselves in position to take advantage of it as we continue to progress forward.

There -- I'm going to add one more thing to that, too, because, obviously, there's a discussion of a possible slowdown or recession. But again, it's not something we certainly ever hope for, but you always have to be prepared for it. And I think we've shown in our business in the last few years that we're agile and we have the ability to react. But also, we have some really good inherent attributes in our business. And that gets to these large investment megatrends, the high-quality clients that we have, the significant long-term backlog that we have and also important that we have an asset-light business. I mean, we don't have to continue to invest heavily to fund growth unlike some other industries.

Michael, it was sort of a long answer to your question. Hopefully, it's helpful.

Michael J. Feniger - *BofA Securities, Research Division - Director*

Yes. No. That was, Troy. I guess just a follow-up and just to round out the discussion. Your Construction Management part of your portfolio, I think there is a perception that, that is viewed as more cyclical than maybe some of the other areas. I'm just curious if you could kind of comment a little bit more specifically about that area, how big of it is it for your operating profit and how cyclical do you see that in the face of a potential slowdown?

W. Troy Rudd - *AECOM - CEO & Director*

Okay. Sure. So first of all, the Construction Management business represent about maybe, say, 9% to 10% of our overall business. But even today with, again, commodity inflation and wage inflation, we're seeing that business grow its backlog, and we're seeing the pipeline continue to expand. And I think that gets to the fact that the portfolio in that business is diversified. So we're having great success in aviation, which, again, there's a long-term trend for an investment in aviation infrastructure. We're seeing significant wins and opportunities in convention centers or large meeting places. That, as a result of coming out of COVID, there is a demand for places to be together in large cities, and there seems to be a lot of competition to invest in that. We're still seeing strength in commercial and residential real estate. But to be fair, if you head into a recession, it is one place that you would see a slowdown. And then we're having success in sports, in that business. And those are really the 3 things that drive the success of that business.

But again, at the moment, you would think that we might see a slowdown because of inflation, but we're not. And that's evidenced in our growing backlog and our growing pipeline.

Operator

Our next question comes from the line of Sean Eastman from KeyBanc.

Alexander David Dwyer - *KeyBanc Capital Markets Inc., Research Division - Associate*

This is Alex on for Sean this morning. So first, just taking a look at the intact segment-level margin guide, it implies that the year-over-year margin expansion trends kind of flatten out in the second half of the year compared to what we've seen over the past 2 years. I just want to get your thoughts on why this would makes sense if it's seasonality or tough comps or if there's just general conservatism baked into this given the economic uncertainty this year?

W. Troy Rudd - *AECOM - CEO & Director*

Yes. I'm going to let Gaur answer -- take that question.

Gaurav Kapoor - *AECOM - CFO*

Alex, thanks for the question. So one thing I would say is you're right. Our first half margins have been very strong and consistent with plan. In fact, if you look at our international business, it's a little bit ahead of plan, and that gives us so much confidence going into the second half, but we typically see a little bit of seasonality. But where we sit today, we could not be happier where our margins are, not because we lead our industry in that category. But if you look at what's happened in the first half comparing to some of our peers where they have seen margin contraction, our teams, our professionals continue to deliver year-after-year, quarter-after-quarter of margin growth consistent and ahead of expectations. And this is why we're making significant investments in the business in the various opportunities we have. '22 is one of the biggest investment years we've had at AECOM over a long period of time. So irregardless of what the macroeconomic headwind may be, let it be inflation or another variant or geopolitical issues, logistical issues, as Troy articulated earlier, we continue to deliver on margin targets. And that's why not only are we very confident in our 2022 target of 14.1% plus but 2024 targets of 15% plus and our long-term ambition of 17% that we feel very confident as time passes by because of how our teams are delivering and leading the industry.

Alexander David Dwyer - *KeyBanc Capital Markets Inc., Research Division - Associate*

That was very helpful. And secondly, does the momentum we've seen in the backlog reflect any tailwinds from the IIJA yet? And if not, do you have any updated thoughts on when you think incremental funding will start to be visible in the bookings?

W. Troy Rudd - *AECOM - CEO & Director*

Sure. The answer is we have seen some impact, but it is not material at this point. What we are seeing is a lot of work going on with our clients to position for IIJA funding, and that really means it's not just working with federal clients but working with state and local clients as they work through that. So at a high level, what we would expect is a lot of activity with our clients, positioning for that funding followed by a very strong award season in the second half of this year and heading into '23. And then we would expect to see the impact of those awards impact our business in '23 and beyond and for a long period of time.

Operator

Our next question comes from the line of Andy Wittmann from Baird.

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

I just had a question on the comments about absenteeism impact of the quarter, Troy. Could you, or Gaur, or either one of you. Could you just talk about how much of an impact that was? And against expectations for accelerating growth through the year, this quarter and the first half of the year, obviously, not just seasonally strong this quarter, but not seeing a lot of inflection yet. So maybe, Gaur, if you could decompose a little bit about the differences between the relative growth rates in Construction Management versus the underlying Americas design business would be helpful in us understanding and assessing the net service revenue growth in the quarter.

Gaurav Kapoor - *AECOM - CFO*

Yes, absolutely, Andy. Two parts of the question. I'll take your first part as to what was the impact of the Omicron variant. And Andy, I'd like to start by saying, consistent with the question Alex had, irregardless of the macroeconomic headwind that comes through, one thing we're very proud of is our teams are nimble irregardless of what it is to continue to deliver to our targets and not using anything as an excuse. And a lot of it is by design, right? We have an enterprise today that takes advantage of our scale. So if there is labor pressures or varying pressures in a particular region, we're going to use our ECC to drive growth. And we're going to utilize our skills in program management and advisory services to continue to deliver on the growth expectations. But if you were to just isolate Omicron, which, again, we're not using that as an excuse, we've beaten on every single metric. It had approximately, I would say, 100 basis points of impact in the current quarter.

And second part of your question, the real NSR growth quarter-over-quarter. If you look at our design business, our design business delivered 5% compared to 4% last quarter. Our Construction Management business had a negative growth. It was minus 4% in the quarter, which was expected. if you would recall, specifically in the second quarter of last year, there was a lot of pent-up demand for COVID-related work as a lot of people were coming back to work. So that came through in the second quarter of last year. Going forward, we expect Construction Management business to be positive on back of the significant backlog wins we've had and continued pipeline expansion.

Operator

Our next question comes from the line of Sabahat Khan from RBC Capital Markets.

Sabahat Khan - *RBC Capital Markets, Research Division - Analyst*

Great. Just I guess a question on the International segment and particularly the Europe side. On the U.S., the IIJA is expected to be a lift to infrastructure spend over the next few years. But I guess how are you thinking about the European green deal or that the U.K. leveling-up agenda that you talked about? Is that over the -- through to 2024 plan? Is that expected to be a material lift versus run rate spend? Or is that just replacing maybe some of the old spend? How are you baking that into your kind of 3-year outlook?

W. Troy Rudd - *AECOM - CEO & Director*

Saba, it's Troy. Look, we have -- I would describe it as we have that baked into our long-term outlook. We have seen a significant investment in Europe and outside of the United States into infrastructure for a long period of time. And these, again, these are just the plans in place, like leveling up, that will continue to provide investment in transportation infrastructure, in particular, for rail where we're very strong. So I wouldn't call this out as being something incremental, but we think about this as, these are the long-term programs that provide us great long-term visibility and the opportunity to grow the business.

Sabahat Khan - *RBC Capital Markets, Research Division - Analyst*

Okay. Great. And then, I guess just within the IIJA outlook, I think you're indicating that probably more of that will start to come through in 2023. I guess can you maybe talk about where the discussions are right now? Is there -- we've heard some of the money that has not been allocated but has been starting to be discussed. Can you talk about how you were talking to your clients about it right now? What stage of planning they're at? And which areas do you think the first kind of leg of spending probably comes through, even if it is in 2023, kind of which end markets are you probably expecting to see the initial benefits?

W. Troy Rudd - *AECOM - CEO & Director*

Sure. So I'm going to answer that in reverse order. First of all, we really see the opportunity across all of our end markets here in the United States or all of our business lines in the U.S. Clearly, everyone is talking about the money that's coming into transportation. There's also a significant money being invested that we will see in our water business. And then as a result of those projects, they also include the capabilities that are in our B&P business. And then a part of all of that, whether it's the permitting part of the process or it's money that's in the IIJA that's going to go to remediation or curing the environment, there's a huge opportunity for that. And I already made mention of our PFAS technology. We think that with the funding and some long-term regulatory changes that we expect in the U.S. from the EPA, that, that also provides a significant long-term benefit to the business. So again, it's very broad-based for us, our participation in it.

But in terms of the client dialogue, there are a lot of clients that have built their long-term plans and ambitions about how they're going to invest in infrastructure, and those conversations have been going on for a long time. Right now, the conversations are working to fill in the funding gap, the expectation that part of that money comes through the Federal Government and through this budget. And so that dialogue is going on to provide that additional incremental funding so that those budgets can be rounded, out and they begin the projects. But also, there's a lot of new money that's coming to the market. We're -- again, these are new programs and new processes. And so we're spending a lot of time actually having conversations with our customers about how they access that money. And that was really one of the important things we did during the quarter was we actually built a tool to make ourselves a little bit more user-friendly and expedite that process with clients. So we talked about our IIJA tool, Lara did in our prepared remarks. And so that's an important tool that allows those conversations to pick up momentum and along with our professionals, allows our clients to sort out how they quickly access that money to accelerate their programs. But again, as I said, we don't see that having any significant impact on our business until we get to 2023 in terms of generating revenue.

Sabahat Khan - *RBC Capital Markets, Research Division - Analyst*

Okay. If I could just squeeze in one more just quickly on the -- just the International segment. I guess FX is being talked about as a bit of a headwind. Can you maybe talk about how that affected the quarter and then just maybe how you're thinking about for the rest of the year? Obviously, you reiterated guidance but just thinking how you're taking into account the FX headwind meeting?

W. Troy Rudd - *AECOM - CEO & Director*

Yes. I'll let Gaur take that one.

Gaurav Kapoor - *AECOM - CFO*

Saba, thanks for that question. It is built into our guidance that we have reconfirmed. So any little positives or negatives, as I've said before, we're not going to make any exceptions for it. Our focus is to deliver on the results, commitments that we have made, which we're doing for the first half and have full confidence to do in the second half of the year.

Operator

Our next question comes from the line of Andy Kaplowitz from Citigroup.

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

Troy, you've mentioned the embedded inflation protection you have in your contracts. Maybe you could give us a little more color around that. And given all the demand that it seems like you're seeing, how can -- or are you adjusting your pricing of your contracts to adjust for inflation?

W. Troy Rudd - *AECOM - CEO & Director*

Sure. I'm going to answer that in 2 parts. I guess, first of all, in terms of our business, we have mechanisms that are already embedded in our clients, which give us the ability to pass along the cost to them, and that represents a significant portion of our contracts. And the second thing is, is that we have -- we do have fixed price work, and sometimes it adds escalations in it. But if they're not significant enough to reflect that, they do sometimes have a short turnover. So as they turn over, we just adjust the pricing, and so the market accepts those adjustments in additional labor costs.

But really, the proof here is in the pudding. The fact is that it's not affecting our business because you see our margins continuing to improve. And typically, if we couldn't pass the inflation costs along to our customers, given that labor is the largest component of the cost in our business, there would be proof. In fact, we're not able to do that because our margins are increasing, and at the same time, we're investing to grow the business through those margins. We're able to prove, in fact, that is true.

But the second answer to the question is our customers also have the experience of inflation in their costs. And at the moment, what we're not seeing is we're not seeing that influence either in governments or in our private customer base, their investment decisions. And part of that gets to the fact that even though there has been inflation, the revenue side of the equation for them when they look at the long term has actually improved beyond the additional cost. Now I don't know if that's going to hold true for a long period of time. But today, that holds true, and that's why we still see our pipeline growing even in this highly inflationary environment.

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

Troy, Gaur, can I ask a quick follow-up to that? Just in terms of Q2, if you look at the Americas, the margins were flattish sequentially. Did you up your investment costs? Or is it costing more to hire new people or train new people, when you look at the Americas business?

Gaurav Kapoor - *AECOM - CFO*

Yes. No, good question, Andy. If you recall, when we put the plan for it beginning of this year, our margins included significant investment in practically every single business of ours and our people. And as you see, our utilization is very consistent with our plan, and we're marching along exactly where we thought we were in Americas.

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

Okay. And then, Troy, I know you're sticking with your guidance of 6% NSR growth for the year, but would hold your growth back from starting to rise significantly toward your contracted backlog growth? I think in Americas, you said 24% up. Usually, the funding needs to be in place, but it's in place. Is it because this contracted backlog mostly is for '23? Or should you now start to really see the uptick in your NSR revenue?

W. Troy Rudd - *AECOM - CEO & Director*

Yes. Well, I think we've already seen the uptick in our NSR revenue for the -- again, sort of slowly building for the last 5 quarters. But again, we don't -- everyone living with the impression all of a sudden we're going to be growing at 24%, along in line with our contracted backlog. The fact of the matter is, is when you grow your backlog significantly like that, it's usually large, chunky programs that have a longer life.

So what this means is we believe we're still going to grow around that same rate, but what we do is we believe that this gives us much more visibility into the future and certainty to achieving that outcome. And with, again, as we look longer term, with the additional funding coming into the market as a result of the budget authorizations around the IIJA, we see that, as we look forward, there should be some more opportunity to grow. But as we said in the past, there is a limiting factor and the limiting factor is capacity for us in our industry, and that's why we've been investing in our people. We added net headcount during the quarter. We're investing in our capability centers to create capacity for the future. And again, we're also focusing on making digital investments to think -- to change the way that we can deliver things to create capacity. So while we're investing deliberately and winning and are winning, we're also deliberately investing to increase the capacity of the business for the future.

Operator

Our next question comes from the line of Michael Dudas from Vertical Research.

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

Troy, you guys generated a pretty healthy book-to-bill -- book-to-burn ratios of this quarter. Maybe you can touch a little bit about like where there are certain areas, certain end markets, international, domestic, that impacted that? And how is your program management business aiding that trend? And certainly, I think, going forward, on a mix basis with margin -- upward margin pressure because of the mix of your business improving on such - those good orders as come in?

W. Troy Rudd - *AECOM - CEO & Director*

Yes. So Mike, we're -- we're seeing success across the business, success across international markets, and we're also seeing it here domestically in the U.S. But we're also seeing this as a trend. We had -- again, we said 1.6x this quarter book-to-burn globally. It was about the same internationally as it was in the U.S., a little higher in the U.S. But if you recall, last quarter, our book-to-burn in our Americas business was 1.4x. And so we -- again, we're just -- we're seeing this be -- I would characterize it as a trend, and it is across the entire business.

And I think fairly, you're right to ask the question and point out that program management is an important part of that. Our program management business in the first half of this year has had very strong double-digit growth. We are winning these big projects that we think are important to us at a very high win rate in what we've defined as being important to win. And we're seeing, again, backlog growth higher than the average program management business as well. So it is a significant contributor to the business across the world.

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

And my follow-up is maybe for Gaur. I think in your primary remarks, you talked -- you've consistently talked about investing in the business and still generating very good margins and margin outlook. Did you indicate that maybe this -- as you put out this plan through '24, was this the, I won't say, peak, but was it the strongest year of this type of investment? Is it going to be at the similar levels as we look forward? Or because the markets are changing, opportunities change that type of investment will continue into '23?

Gaurav Kapoor - *AECOM - CFO*

Yes. Mike, we will always be focused on investing in the business and keeping our eye to the future, and that's because we have a lot of confidence in what we're delivering and the commitments that we have made today for fiscal year '22, including our 2024 plan. And that's where you've heard us say before, we're not going to be penny wise and pound foolish. We're not just satisfied with delivering 14.1% end of this year. We're not just satisfied delivering 15% plus by 2024. Our focus is to transform this industry where we're going to be delivering 17-plus margins in the long term. And we're putting those building blocks together by investing in the business, in the enterprise, and most importantly, in our people to do that.

Operator

Our next question comes from the line of Jamie Cook from Credit Suisse.

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

Nice quarter. I guess just one follow-up question given it's late. Your earnings in the first half of the year would imply we're trending to the high end of the range, and you haven't narrowed your guidance. Just any color around that with only 2 quarters left.

Gaurav Kapoor - *AECOM - CFO*

Jamie, this is Gaurav. I'll take that question. Thank you for the comments. The team continues to deliver in a pretty challenging environment with all the macroeconomic headwinds we're talking about. And one would argue today the environment may be sometimes more unstable than it ever has been. But irregardless, our teams are putting together a track record. Our professionals are putting forth the effort to deliver quarter-after-quarter. So that gives us a lot of confidence given what we've delivered 6 months to date. And I'll remind you, consistent with prior year, we're going to continue to be prudently conservative given the environment we're operating in.

Operator

Our next question comes from the line of Steven Fisher from UBS.

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

Great. Just you were talking to Andy Kaplowitz about the growth rate of total NSR for the rest of the year. Curious if you could give a little bit more comment on the design piece of that. Was that an acceleration in the quarter? It sounds like it may have even accelerated a little bit more as the quarter went on. So I guess I'm curious with your overall NSR looking to be about steady, I think you said, in the second half, but I guess your Construction Management should be turning from negative to positive. What does that imply about the design piece? If you could just give a little more color on the design NSR for the rest of the year.

W. Troy Rudd - *AECOM - CEO & Director*

Sure, Steve. So first of all, for the balance of the year, we still hold the expectation of having NSR growth of 6% for the business. And it's difficult for us to differentiate that because we really view the whole business as a professional services business. But nevertheless, that implies for a design business that we continue to see accelerating growth through the year. Our growth in the second quarter for the design business was a little bit better than the first quarter, and that has been a continuing trend for the last 5 quarters. So that -- again, without getting into a whole bunch of detail about what happened intra-quarter, there were some things that impacted growth in the quarter. But I look at this as having a successful growth -- successfully grown the design business in the quarter, even in the absence of some things that -- some headwinds that happened during the quarter like Omicron.

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

Okay. Fair enough. And then maybe can you just give us an update on some of the progress of your core margin initiatives? There's been some real estate alignments. There was then your centers of excellence and design, some of your back-office processing. What are some of the digital initiatives? Can you talk about what stands out in the first half that you accomplished and what we can expect in the second half, please?

W. Troy Rudd - *AECOM - CEO & Director*

Sure. I'll let Gaur take that question.

Gaurav Kapoor - *AECOM - CFO*

Sure. In specific to the various initiatives we have underway, as you just mentioned, real estate is a continual process through the year. It's consistent with our expectations. We're executing to it. We expect to complete whatever we had projected in the second half of the year. Now just to put it into context, we had approximately $30 million of restructuring expense related to various initiatives that have double expense, real estate being one of them. Total, we have incurred $7 million year-to-date, and it will accelerate into second half of the year in Q3 and Q4. This also includes us continuing to take advantage of what we call our scale, scale for our benefit. This is our global capability center. So as Troy and Lara have discussed, the market ramps up, the demand for our services ramp up. We're able to take advantage now of this global capability center, irregardless of where the demand may be coming from, to position our labor force, our scale, to deliver it.

And lastly, also looking at our support functions, we continue to look for the most efficient way to deliver the services to our professionals through our support functions. And that includes taking some repeatable tasks that we can put into our captive centers and deliver them not only efficiently but more effectively than we have. So all of those things continue to trend very positively.

And last is our flexible work arrangements, that, given the challenges that we face, is one of the key reasons why you see our growth continuing to accelerate in our design business. And we expect that to provide benefit to us going forward as well.

Operator

Our next question comes from the line of Adam Thalhimer from Thompson, Davis.

Adam Robert Thalhimer - *Thompson, Davis & Company, Inc., Research Division - Director of Research*

First, I wanted to ask about the IIJA. What's your current thinking on how much incremental funding could come from that?

W. Troy Rudd - *AECOM - CEO & Director*

Well, again, I would think about it in this way, over the next 5 years, that you can kind of -- again, it's uneven because it happens in different places. It comes throughout our business. But through our client base, sort of thinking about as an increase of about 10% in quarter funding year-over-year-over-year for our customer base. That's probably the way to think about it with a rule of thumb.

Adam Robert Thalhimer - *Thompson, Davis & Company, Inc., Research Division - Director of Research*

So kind of a compounding 10%?

W. Troy Rudd - *AECOM - CEO & Director*

Yes. I mean, again, yes. I mean, there are obviously other factors that -- you can say that right, like state and local government spending expanding budgets. But again, our state and local governments, right now, they have surpluses, and so there's possibly an opportunity for that even to expand. But it's hard -- again, hard for me to say. If you look out 5 years, that's what's going to happen. What we can tell you is with the IIJA, approximately, it's -- think about it as 10% in terms of expanding funding for our customers.

Adam Robert Thalhimer - *Thompson, Davis & Company, Inc., Research Division - Director of Research*

Great. And then just real quick on AECOM Capital. What's the high-level thought on that as a capital allocation priority going forward?

W. Troy Rudd - *AECOM - CEO & Director*

Yes. Again, we still have a business. It certainly has some great people with some great projects, and it's contributing to our success. But the most important element of that is we're using third-party capital to deploy in those projects, not our own capital. But it's sort of -- it's part of the fabric of our business and many times the offering and the discussions that we have with clients.

Operator

We currently have no further questions. I will hand over back to Troy Rudd for any final remarks.

W. Troy Rudd - *AECOM - CEO & Director*

Great. Thank you, and thank you, operator. Look, I just want to thank our teams for their contributions over this past quarter. It's the team's effort and diligence that has delivered our strong results for the quarter and has positioned us well for the future. So thank you, and thank you, everyone, for joining the call today.

Operator

This concludes today's call. Thank you so much for joining. You may now disconnect your line.
