Company Name: Jacobs Engineering
Company Ticker: JEC US
Date: 2017-11-21
Event Description: Q4 2017 Earnings Call

Market Cap: 7,813.43
Current PX: 64.86
YTD Change($): +7.86
YTD Change(%): +13.789

Bloomberg Estimates - EPS
Current Quarter: 0.776
Current Year: 3.478
Bloomberg Estimates - Sales
Current Quarter: 2601.100
Current Year: 11118.083

Q4 2017 Earnings Call

Company Participants

- Jonathan Doros
- Steven J. Demetriou
- Kevin C. Berryman

Other Participants

- Steven Michael Fisher
- Jerry Revich
- Andrew Kaplowitz
- Tahira Afzal
- Jamie L. Cook
- Michael S. Dudas
- Andrew John Wittmann
- Robert F. Norfleet
- Chad Dillard

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to the Jacobs Engineering Fourth Quarter Fiscal 2017 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

At this time, I would like to turn the conference over to Jonathan Doros, Vice President of Investor Relations. Please go ahead.

Jonathan Doros

Thank you, and good morning. Our earnings announcement was filed this morning and we have posted a copy of the slide presentation to our website, which we'll reference in our prepared remarks.

I would like to refer you to our forward-looking statement disclaimer, which is summarized on slide 2. Certain statements contained in this presentation constitute forward-looking statements as such term is defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and such statements are intended to be covered by the Safe Harbor provided by the same.

Statements made in this presentation that are not based on historical fact are forward-looking statements, including statements regarding whether and when the proposed transaction with CH2M will be consummated and anticipated benefits thereof. Although such statements are based on management's current estimates and expectations, and currently available competitive, financial, and economic data, forward-looking statements are inherently uncertain, and you should not place undue reliance on such statements as actual results may differ materially. We caution the reader that there are a variety of risks, uncertainties and other factors that could [ph] cause (01:50) actual results to differ materially from what is contained, projected or implied by our forward-looking statements. For a description of some

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of the risks, uncertainties and other factors that may occur that could cause actual results to differ from our forward-looking statements, see our Annual Report on Form 10-K for the period ended September 30, 2016, as well as other filings with the Securities and Exchange Commission, and, when filed, the Annual Report on Form 10-K for the period ended September 29, 2017, and in particular the discussions contained under Item 1, Business; Item 1A, Risk Factors; Item 3, Legal Proceedings; and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations. Neither we nor CH2M is under any duty to update any of the forward-looking statements after the date of this presentation to conform to actual results, except as required by applicable law.

Please now turn to slide 4 for a review of today's agenda. Steve will begin with a recap of our full-year results, then provide an update on our planned acquisition of CH2M, and end with a review of our fourth quarter results, including a market review about each of our line of businesses.

Kevin will then provide some in-depth discussion of our financial metrics and give an initial financial outlook that combine Jacobs plus CH2M Company, as well as update on our balance sheet and capital allocation strategy. Steve will finish with some closing remarks, and we'll open the call up for questions.

With that, I'll now pass it over to our Chairman and CEO, Steve Demetriou.

Steven J. Demetriou

All right. Thank you. Welcome to our fiscal year 2017 fourth quarter earnings call. Before discussing our financial results for the quarter, I will begin with a review of the significant strides we have made against the strategic objectives we presented at our Investor Day last December.

In fiscal 2017, we saw strong results in our Aerospace & Technology and Building & Infrastructure lines of business, which are benefiting from positive government and infrastructure dynamics, while delivering solid stable results in our Petroleum & Chemicals and Industrial businesses, where we continue to face headwinds in certain of our end markets, particularly those more exposed to commodities. Over the course of the year, we made important improvements to our company, including several strategic investments and acquisitions to support our profitable growth agenda.

Let me now recap our strategic imperatives and the progress we're making. So first, building a high-performance culture. The change to the line of business structure is clearly improving accountability, transparency and discipline across all of Jacobs. We have aligned management incentive metrics that focus on increasing profitability, driving growth, unleashing cash flow, and generating higher return on capital employed. We believe the combination of ownership and accountability of the lines of business, coupled with the right corporate level incentives is instrumental to driving long-term shareholder value.

Second, transforming the core. Our focus on operational efficiency, project delivery and sales effectiveness is clearly resonating in our results. For example, project delivery has improved with net fiscal year 2017 write-downs reduced by more than 50% year-over-year, and a measurable increase in our as-sold margin conversion. We have successfully completed the 2015 restructuring program, which unlocked our ability for Jacobs to enter the next phase of our profitable growth strategy.

Third, profitable growth. In fiscal 2017, we made great progress in executing a balanced strategy to focus on the most attractive end markets, with an optimized cost structure that will position us for long-term profitable growth. Revenue grew year-over-year in the fourth quarter, driven by a combination of organic improvement and some benefit from recent acquisitions and currency.

From a profitability standpoint, both our fiscal year 2017 gross margins and adjusted operating profit margin increased significantly, which after one year is reaching levels that position us to achieve our three-year strategic target range.

And after our August announcement of the CH2M acquisition, we immediately began implementing IMO, Integration Management Office investments and cost synergy actions during the fourth quarter in preparation for the expected closing of the acquisition. This gives us a running start as we approach the closing of this transformative and

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value-creating acquisition.

So now turning to slide 6, an update on the CH2M acquisition. With the pending merger of Jacobs and CH2M, we're combining two world-class organizations to create a global professional services leader that will deliver highly differentiated solutions for a more connected sustainable world. Since the announcement, our Joint Integration Management Office has made great progress during the planning stage and is preparing Jacobs to deliver against strategic plan commitments as well as the cost and revenue synergy initiatives that we will execute following the close.

The CH2M team delivered strong calendar third quarter results that were in line with our expectations. EBITDA for CH2M's third quarter was $99 million, including the favorable settlement with the Texas Department of Transportation for the MoPac Project and the results also reflected costs associated with our pending acquisition.

Kevin will provide more detailed on the recently reported CH2M results. We remain confident in our outlook for the CH2M acquisition, including our expectation for 15% first 12-month adjusted EPS accretion and to reach a net $150 million annual run rate cost synergies at completion of integration. Underpinning this confidence is a detailed plan, driven by a combined Jacobs-CH2M Integration Management Office. As previously stated, the major areas for cost synergies are in corporate and business unit overhead, real estate, procurement and IT. In addition, we are focused on capturing revenue synergies from expanded offerings, which are not included in our accretion assumption.

More importantly, as part of the integration planning process, I, together with the few of our business leaders, have been to dozens of CH2M and Jacobs' offices and have met with selective clients to demonstrate our priority for talent retention and our commitment to combine the best of both companies. The feedback has been extremely positive, and, in my belief, an initial step of winning the hearts and minds of the combined employee base.

Regulatories have been obtained and the CH2M shareholder meeting to vote on the transaction is scheduled for December 13. Assuming shareholders approve the deal, we expect a close around mid-December.

Turning to slide 7. Our Jacobs fourth quarter results were yet another signpost of our continued strong execution against our three-year strategic plan. Backlog growth was strong, up $1.2 billion from the third quarter and significantly up year-over-year, which still excludes the impact from approximately $850 million of previous awards that are under protest. We remain confident that most, if not all of these protested awards, will eventually be converted to our backlog.

Total Jacobs revenue grew 6% sequentially and was up modestly year-over-year, driven by strong growth in professional services. Gross margins remained strong at 17.9%, up significantly year-over-year as we continue to focus on our strategy toward higher-value projects and driving operational excellence to maintain margin through delivery.

Adjusted earnings per share of $0.98 was at the higher end of our expectations, and Kevin will cover the components of EPS, including a bridge to GAAP EPS in his remarks. And finally, full-year free cash flow was solid, driven by continued improvement in our operational working capital.

Turning to slide 8. I'll now discuss our backlog performance in further detail. As I previously stated, backlog growth was strong and increased 6.4% sequentially and by 5.5% year-over-year despite the over $850 million in Aerospace & Technology awards still under protest and not included in these figures. It is also important to note that backlog generally includes only the initial years of large multi-year awards. For example, we have only booked $415 million in our backlog for the recent $4.6 billion award with the Missile Defense Agency.

Furthermore, the year-over-year growth in backlog was driven by higher value professional services, which grew 10.8% year-over-year, indicating a strong pipeline for future revenue growth. This more than offset a modest year-over-year decline in field services backlog.

From a line of business perspective, our higher-growth, higher-margin focused businesses are leading the way in driving profitable growth. Our Aerospace & Technology and Buildings & Infrastructure segments both posted strong growth in backlog. Aerospace & Technology was up 22% year-over-year, and for the eighth quarter in a row, Building & Infrastructure backlog grew sequentially. This strength was partially offset by Petroleum & Chemicals, which was down 3.7% year-over-year, given the continued challenged oil and gas environment. And Industrial line of business,

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which ended the fiscal year down 8.7% driven by a strong revenue burn in executing two large life sciences projects.

As I mentioned earlier, we are winning higher-value business while improving project execution. As a result, gross margin and backlog was up modestly both sequentially and year-over-year. Our Aerospace & Technology, Building & Infrastructure and Petroleum & Chemicals businesses all saw sequential improvement in gross margin and backlog with Industrial down modestly.

I'll now discuss each line of business in more detail beginning with Aerospace & Technology on slide 9. Our Aerospace & Technology business is executing well against the strategy, to expand into weapon system sustainment, become a Tier 1 nuclear provider and drive further into disruptive areas of technology.

During the quarter, we progressed our strategy with a marquee $4.6 billion win with the Missile Defense Agency. This is a major milestone for Jacobs and specifically, our Aerospace & Technology business and strengthens our position as a leading defense contractor and opens the door for expanded opportunities.

In addition, we further solidified our presence in the federal civilian IT services space with our acquisition of Blue Canopy, a leader in cyber security and data analytics. The team at Blue Canopy has an impressive resume of clients, including the United States Intelligence Community. With this acquisition, we expect to further capture adjacent opportunities and leverage the domain knowledge into our broader Jacobs Connected Enterprise initiative.

And, of course, the CH2M acquisition will add further significant strategic capabilities and growth to our A&T business, including establishing the combined company as a Tier 1 nuclear and environmental leader.

Momentum in Aerospace & Technology continues to build with our backlog increasing by over $600 million to $6.2 billion. This represents 22% year-over-year and 12% sequential growth. In addition to a few of our key wins that I previously mentioned, other major awards are long-term contracts supporting national priority programs of the U.S. government. For example, the NNSA M&O win has the potential to be a 10-year contract if all options are exercised, and the $1.2 billion rebid win with NASA is an eight-year contract.

Looking forward, our Aerospace & Technology end markets remain healthy, and we have differentiated ourselves by providing unique solutions with a delivery and cost model that positions us for continued profitable growth.

Now, on to slide 10 to discuss our Buildings & Infrastructure line of business. Our B&I line of business ended the year with another sequential quarter increase, and overall backlog grew 7.5% year-over-year. We are on track with our strategic plan to grow profitably by investing in targeted sectors such as transportation, social infrastructure, and water with leverage from our transformed global integrated delivery model.

Our end markets are robust as we see a decade of opportunities in the pipeline across all of our major focus areas, driven by factors such as urbanization, an upcoming refresh of aging infrastructure and the infusion of artificial intelligence and connectivity into infrastructure assets.

Flipping the lens on our business to a macro perspective, our key geographies of Americas, Europe, and Asia-Pacific continue to show strength despite political noise in the news. Let me provide more detail by our major focus areas. In transportation, our traditional highway business remains strong globally, and we're seeing an exciting increase in rail and aviation projects across the globe.

For example, in the UK, Network Rail's next five-year investment in railway infrastructure is due to begin in 2019. In Australia, we're seeing a major program developing that expands the reach of the local passenger rail system.

In New Zealand, government is advancing the development of their light rail system to address upcoming demands associated with the America's Cup and the APEC Summit in 2021. In the U.S., we continue to see opportunities emerge across the country both in high speed and light rail. And CH2M will further strengthen our global expertise in rail as they are the technical advisor for one of the largest and most technologically advanced high-speed rail projects in all of Asia.

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Turning to aviation, this market is robust due to continued passenger growth especially in emerging economies, aging terminals in some geographies and improved profitability among major airlines. We have demonstrated our ability to win and execute major global projects with strong sales in fiscal year 2017. This includes a major win in the fourth quarter for program management at one of the largest U.S. international airports, and we are pursuing a major opportunity for an airport expansion in Asia Pacific.

Moving to the opportunity in water, we continue to see strong demand for water services, and with our pending combination with CH2M's industry-leading water brand and capabilities and Jacobs' global operating platform, we emerge as one of the most comprehensive providers in the high-growth water sector. As identified in our strategy last year, the water market has a need for a service partner that can seamlessly and efficiently deliver water expertise globally, and we look forward to executing against that opportunity post close.

Data analytics and artificial intelligence is driving improved decision-making and increased demand across all facets of our Buildings & Infrastructure business. For example, in collaboration with key third-party partners, we are using anonymized cell phone data to conduct analytics to help one of the UK's largest cities make intelligent data-driven investment decisions that will help shape their transport solutions into the future.

And another example of how we're implementing Jacobs Connected Enterprise is in Wales, where we leverage real-time 4D virtual reality to support the upgrade program for two sections of a major highway. Our scale provides us the ability to invest in leading-edge technology that is globally transferable. As such, we are drastically improving our differentiation versus competitors that are still operating in legacy 3D environments.

In summary, our Buildings & Infrastructure business had a strong year and are well positioned for fiscal year 2018 as the planned combination of Jacobs and CH2M will result in market-leading solutions across buildings, water and transportation.

Moving to slide 11, our Industrial line of business achieved sequential backlog growth driven by life sciences wins in Ireland and in field services with improving U.S. construction. Backlog was at $2.8 billion, up $600 million from the prior quarter, but still down year-over-year due to the continued work-off from the two sizeable life sciences projects in the year-ago backlog.

However, gross margin in our Industrial backlog is up year-over-year, driven in part by improvements in the mining and specialty chemicals business. Our life sciences business remains healthy. Diversification of our project portfolio from large CapEx to small/mid CapEx projects has been particularly successful and is driving a strong base load revenue stream. Increased investment in gene/cell therapy will be a market driver over the near term. We are well positioned to capture work and have seen an uptick in life sciences projects and prospects this quarter as we focus on the U.S. West Coast, mainland Europe and in China.

Our mining and minerals market continues to recover as we see improving conditions globally. Strength in copper has led to project restarts in the study phase where we have captured work. We are optimistic many of these studies will convert to full execution with revenue gaining momentum beginning late next calendar year to position our mining business for growth in our fiscal year 2019.

During the quarter, we saw minimal impact to our field services business in the Gulf Coast from hurricane-related delays. We were fully ramped up, back up within a few weeks. And so, we do not expect to see material CapEx spend from hurricane-related damages impacting Jacobs.

A strong sales quarter for global field services came predominantly from placement of multiple long-term sustaining services contracts. The fourth quarter saw a high level of proposal activity, driven by maintenance demand and new client engagement, resulting in a 27% increase in backlog quarter-over-quarter.

Finally, our Petroleum & Chemicals business on slide 12. In line with our strategy, we continue to focus on downstream opportunities, along with the delivery of maintenance, turnaround and sustaining capital services. Although we closed fiscal year 2017 with revenue and backlog down $200 million year-over-year due to continued challenging industry conditions, I'm very pleased with the way our Petroleum & Chemicals backlog held up as

compared to our oil and gas industry peers who experienced significant reductions in this sector.

Also positively, our Petroleum & Chemicals gross profit and backlog increased year-over-year. Higher margins and backlog are a direct result of our continuing momentum in targeting more profitable opportunities and focusing on project delivery excellence.

Looking at the demand across our end markets, the upstream oil market rebalance efforts are showing progress as reflected in recent strengthening of crude oil prices. The chemicals market remains robust on the heels of low natural gas prices as cheap feedstocks, primarily ethane, continues to propel investments in North America and in the Middle East. Globally, the focus is largely on derivative petrochemicals.

Within refining, product exports are expected to continue from the U.S. Gulf Coast to Latin America. MARPOL regulations in 2020 are a possible windfall for heavy crude refiners. Continued CapEx for refining capacity in the Middle East and Asia is expected to continue driven by near-term economics.

Our near-term plans are to remain focused on downstream opportunities and to maintain strong project discipline to improve operating income margins. To further drive top line growth, we have made key hires to aid in our top pursuits and accelerate strategic investments in areas such as Jacobs Connected Enterprise. We have multiple projects underway to deploy solutions that collect and analyze the data from our client's critical infrastructure in order to improve their safety and efficiency. We believe that our solution offerings can drive double-digit returns on investment for our customers.

We are also hearing positive early feedback from our clients on the opportunities to leverage CH2M's strong water services as part of a combined offering post the close of the transaction. While we feel that we are coming out of the trough in energy markets, until we see several quarters of sustained improvement in pricing, we remain cautious on growth projects – prospects for fiscal year 2018. However, we feel confident in our ability to continue to stabilize backlog and to drive operating margin improvement.

Now, I'll turn the call over to Kevin.

Kevin C. Berryman

Thank you, Steve, and moving to slide 13, you will see a more detailed summary of our financial performance for the fourth quarter. Revenue in the quarter sequentially across both professional and field services grew, resulting in a combined increase of 5.5% from Q3. This marks the second quarter of sequential revenue growth and on a year-over-year basis, overall revenue is up modestly for the first time in 11 quarters.

Looking into fiscal 2018, we expect revenue, excluding any impact from CH2M, to be slightly down sequentially as Q1 represents our normal softest quarter and actually may be down year-over-year, excluding CH2M. However, we expect revenue to increase both sequentially and year-over-year as we progress from Q1 through the balance of our fiscal 2018.

Gross margins continued to be strong at 17.9%, up 150 basis points year-over-year, and GAAP operating profit margin was 4%, up 90 basis points year-over-year, and adjusted operating profit margins were 5.4%, around flat sequentially but up 30 basis points year-over-year.

While SG&A was up slightly in Q4, this was driven by business development costs, technology and strategic investments and some additional legal settlement costs. GAAP EPS was $ 0.78, a significant increase from $0.24 in the year-ago quarter, driven primarily by the closing of our successful 2015 restructuring initiative. During the quarter, we also incurred $0.09 in CH2M acquisition, professional fees, integration and related costs, as well as $0.11 of cost associated with CH2M and 2015 restructuring related activity. When excluding these costs, our adjusted EPS was $0.98 on 120.1 million shares. Both GAAP and adjusted EPS included about $0.07 from a discrete tax benefit.

For modeling purpose, I thought I'd spend a little bit of time and talk a little bit about bridging our adjusted EPS results of $0.98 to compare on a like-for-like basis with what I believe is the current consensus estimate of $0.82.

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So when you start with $0.98, one should subtract $0.07 for the discrete tax benefit, part of which is reflected within our interest expense line. One should also subtract $0.05 for the portion of CH2M costs that we guided to last quarter, which we believe is being incorporated into the current consensus estimate.

And of note, our net after-tax gain on the sale of Neste Jacobs was not significant at $0.02 to $0.03 for the quarter. This was effectively offset by certain legal settlement costs that we incurred during the quarter. Accounting for these items, our underlying results, consistent with the $0.82, effectively exceeded by about $0.03 to $0.04.

We do recognize that the current $0.09 of CH2M acquisition and integration cost is higher than the $0.05 that we originally guided to last quarter and that we now excluded the cost for purposes of our presentation, given the discrete nature of these costs.

During the quarter, we proactively determined that it was appropriate to accelerate our efforts in this regard. And as a result, more costs were recognized during the fourth quarter than we originally planned. These Q4 costs specifically relate to IMO activities, our Integration Management Office, and other costs, such as legal and other advisory fees.

The additional $0.04 of cost in the quarter do not represent an additional amount of overall cost expected with these efforts, but only an acceleration of them. In the quarter and going forward, as is customary, we will exclude these costs as well as other one-time transaction costs, such as investment banking fees, change in control costs and other advisory fees, as an adjustment to our EPS to better identify our underlying sustainable earnings, given that these normal one-time acquisition-related costs will not continue beyond our integration efforts.

In order to provide transparency, we will separately call out these costs from the $225 million in one-time costs that we have already called out and which are necessary to achieve our synergy expectations. We will provide, obviously, more detail on these costs post close.

So, now turning to our view of our fiscal full-year 2017 results on slide 14. While full fiscal year revenue declined by 8% versus the 2016 figure, our purposeful transition to higher-growth, higher-margin opportunities and improved execution delivered an increase in gross margin dollars, resulting in our gross margin percentage up over 150 basis points year-over-year, indicative of our strong execution against our strategic plan. Our increased fiscal discipline and execution led to our adjusted operating profit increasing by approximately 3% year-over-year, resulted in our adjusted EPS growing in 2017 to $3.24, an increase of approximately 5% year-over-year.

Free cash also continued to be strong with operating working capital down approximately 30% year-over-year. This resulted in our net cash position doubling to $536 million from the fourth quarter of 2016. Finally, our book-to-bill trailing for the trailing 12 months continued to improve, climbing to 1.1 times.

Looking at slide 15, let's look at the sequential trends in revenue and gross margin in more detail. As highlighted at our 2016 Investor Day, our strategic objectives included a renewed focus on improving project execution, reducing write-downs and targeting higher-margin opportunities. This has resulted in a fundamental improvement to our business, as shown by the step change in gross margin percentages post Q1 fiscal 2017, and this is particularly impressive given the continued challenging conditions in commodity and energy markets. In line with our strategic focus for profitable growth, we have now seen two consecutive quarters of sequential revenue growth in three of our four lines of business.

Moving to slide 16, operating profits for fiscal year 2017 for two of our lines of businesses were up in fiscal 2017 versus last year, and a third was near flat. Operating profit margins were up significantly for all lines of business, continuing the positive trend we saw in fiscal year 2016 across several of our businesses.

Operating profit for our A&T business was relatively flat at $203 million versus fiscal year 2016 as we continued to be impacted by lost lower margin contracts in late 2016. However and importantly, operating profit margins continue to trend higher, finishing up 90 basis points at 8.6%. If you recall, margins were up 70 basis points in fiscal year 2016 versus 2015, so we have now been able to deliver 150 basis point improvement over the last two years. And with the recent strong backlog performance, we are now poised for revenue growth in our A&T business in 2018.

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Operating profit for our B&I business increased almost 11% to $193 million versus our fiscal year 2016, a 14 basis-point improvement in margin to 7.9%. For comparison, we saw 190 basis-point improvement in fiscal 2016 versus 2015 or approximately 200 basis points improvements over the past two years.

Meanwhile, our Industrial line of business operating profit increased nearly 42% to $115 million, represent a significant increase of 130 basis points to 4.2%. A material part of this improvement was from the elimination of costs related to litigation settlement and customer bankruptcy costs that did not repeat in fiscal 2017 versus the 2016 figures.

Lastly, our P&C business, Petroleum & Chemicals, saw a 10% increase in operating profit in fiscal 2017 to $114 million as challenged energy markets continued to weigh on this line of business. Margins, however, continued to improve and were up nearly 80 basis points to 4.6% in fiscal year 2017 versus the prior year. This is a continuation of the 60 basis-point improvement we saw last year.

Lastly, our non-allocated corporate overhead increased $21 million year-over-year due to strategic investments in IT systems and incentive compensation.

Now, let me turn to slide 17 to briefly discuss CH2M's third quarter results, though, of course, we look forward to providing more detail on CH2M post closing. CH2M revenue of $1.2 billion includes a negative impact from the deconsolidation of the Chalk River JV and a positive impact from a MoPac settlement. Excluding both, revenue would have increased 3% year-over-year. From a profitability standpoint, both items were included in the GAAP operating margins of 6.7% that were reported by CH2M. These two items positively impacted operating margins by 70 basis points.

And let me provide a bit more detail on the MoPac settlement and its impact on CH2M's third quarter results. During the quarter, the company recognized $32 million of incremental revenue from an agreed-upon settlement with the Texas Department of Transportation, which was partially offset by $21 million of additional costs. As a consequence, on a net basis, there was an $11 million benefit to operating income in the quarter related to MoPac.

All in all, the performance in the quarter certainly underscores our continued confidence in the solid outlook for the CH2M portfolio of business. As a result, we continue to be confident in our previously announced accretion expectations for the first 12 months post-close. Because our fiscal 2018 results, however, will now only include nine months of CH2M results, we estimate that approximately two-thirds of that accretion benefit will be seen in the first nine months, or approximately $0.30 to $0.35 versus our guidance for Jacobs as a standalone entity. Of course, we will provide additional insight post-close and during our fiscal Q2 earnings call.

So let me comment on slide 18 on the first final quarter of our successful 2015 restructuring program. Our final recurring annual savings are $289 million, and the cost to achieve these savings was $444 million. Importantly, our cash restructuring cost that were included in our cost to achieve those benefits resulted in the cash payback of roughly one year versus the cash expenses.

Moving to CH2M related and expected synergies; we continue to estimate that $150 million of net synergies will be realized after completion of our integration efforts with a cost to achieve these synergies of $225 million.

You will also note that consistent with our acceleration of activities in our integration management office efforts, Jacobs also proactively took actions in anticipation of a successful completion of the CH2M closing. As a result, there were $13.5 million in fourth quarter restructuring costs to begin to drive synergies in our fiscal year 2018.

Before turning the call back to Steve to discuss our outlook, I would like to provide a framework as to how to think about post-CH2M balance sheet and capital allocation strategy for the company. Again, we anticipate a net debt position of approximately $1.9 billion immediately following the close, including a new $1.5 billion three-year term loan. Additionally, we'll have $900 million of liquidity capacity existing on our revolving credit facility.

And moving to capital allocation going forward, our short-term cash deployment will continue to be focused on paying down our planned larger debt position. However, we continue to have buyback authorization available as a capital return tool and $252 million remains on that outstanding authorization. We will plan to execute against repurchases in an opportunistic manner and are prepared to support our share price should there be any dislocation due to post-CH2M

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close market dynamics.

And as of this point in time, there is no change to our current dividend program. Finally, while we continue to evaluate strategic acquisitions and divestitures, our continued and primary focus will be to reduce debt in the short-term.

So now, let me turn it back over to Steve for some closing thoughts.

Steven J. Demetriou

All right. Thank you, Kevin. In summary, we're delivering against our three-year strategy to transform Jacobs. I'm excited to see that accountability and operational discipline has become ingrained in our culture. This has resulted in stronger commercial and project execution, with record backlog and profitability. We're tracking well for a successful integration with CH2M that we believe will drive sustainable, profitable growth and shareholder value.

Our standalone Jacobs outlook is for adjusted earnings per share guidance in range of $3.25 to $3.60. Assuming a mid-December close, we estimate approximately an additional $0.30 to $0.35 of adjusted EPS for fiscal year 2018 from the CH2M acquisition, and we are reiterating our CH2M expectations for 15% adjusted EPS accretion in the first 12 months following the close.

With that, I'd like to thank you for listening, and we'll now open up for questions.

Q&A

Operator

Thank you. We will now begin the question-and-answer session. [Operator Instructions] And your first question will be from Steven Fisher of UBS. Please go ahead.

<Q - Steven Michael Fisher>: Thanks. Good morning. Historically, it made sense to look at Jacobs' operating margins rather than the gross margins because there are often changes in the professional services mix versus field services, which you guys are experiencing now obviously. I mean, do you agree with that perspective on how to look at it? And what's the expectation embedded in guidance for operating margins for 2018? It sounded like maybe from your comments that some of the margin growth, at least at the gross margin level, is moderating. I'm not sure if that would be the case at the operating margin level as well.

<A - Kevin C. Berryman>: So Steve, thanks for the question. A couple of comments. Look, I do believe we're focused on driving the, let's call it the gross profit level of the company, which is translating into improved margins. And we think that that will continue to happen regardless of the mix of professional services versus field services.

As you know, field services is a lower margin business and consequently to the extent that we do see that growing as a percent, which could happen given the mix that we have right now and backlog is largely professional services and that is an opportunity for us to start to accelerate growth longer-term in field services, because we have the opportunity to execute some of that professional services and transform it into field services business in longer-term.

But we really are focused on the return elements associated with it, and gross profit dollars and gross margin dollars, we expect, will continue to improve, not at the rate that we saw in 2017. We obviously ramped up significantly in the year, and so I would say there is a moderating impact in 2018 versus some of the improvement we saw in 2017.

And I think that that's just a prudent perspective to take at this particular point in time. We still are very excited about the margin profile and I think that that looks good for the future of the company.

<Q - Steven Michael Fisher>: Okay. So just to be clear, the 5.4% adjusted operating margin, it sounds like you expect some modest improvement in that in 2018.

<A - Kevin C. Berryman>: Yes.

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<Q - Steven Michael Fisher>: Okay. Thanks.

<A - Steven J. Demetriou>: Go ahead. Steve, I was going to add to Kevin's comment that I think we've got to look at both equally. The gross margin, especially by line of business, really gives us a good indication of our commercial strategies, our focus on higher-value business. But at the end of the day, operating profit margin, EBITDA margin are equally we're intensely focused on, and we clearly believe that there is opportunity to further strengthen operating profit margin as part of what we laid out in our three-year strategy. And so we're going to continue to develop strategies and plans that seek to drive increases in operating profit margin.

<Q - Steven Michael Fisher>: Okay. That's helpful. And, Kevin, thanks for the bridge there on the quarter. Maybe you can just give us a sense for the framework around what things you're going to be including and excluding from earnings, adjusted earnings as we close CH2M.

Just kind of wondering how wide the gap is going to be between GAAP earnings and adjusted and make sure we're kind of consistently including and excluding things. And along those lines, what's in the $0.30 to $0.35 that you have assumed already for fiscal 2018?

<A - Kevin C. Berryman>: $0.30 to $0.35 accretion...

<Q - Steven Michael Fisher>: Yes.

<A - Kevin C. Berryman>: ...we have not included one-time cost associated with the transaction. So what we're separating is, let's call it, the discrete. We will separate and call out the discrete costs, whether they're investment banking fees, change in control costs, other advisory fees, IMO-related activities which will continue for the time being into the balance of not, necessarily the full year of 2018, but certainly a big chunk of it, as they are driving the integration efforts. So it's really we're separating the discrete costs versus what we considered to be the sustainable kind of margin profile that the business will be able to deliver once we're complete with the acquisition.

The numbers especially when you include the one-time change in control costs are pretty significant. Those numbers are kind of adjusting as we speak, so I don't really want to quote a number yet because I'll probably be wrong as we're working through the integration. But at the end of the day, they're somewhat sizeable and will be another chunk on top of the $225 million. I will tell you, though, that those numbers were always embedded into our valuation. There is no change versus what our original expectations were.

So they are kind of probably the biggest piece will come in our Q2 probably or Q1, late Q1. It depends on ultimately what the timing and how that works. But I think that, ultimately, it's going to be – the biggest chunk of change will be coming in Q1, Q2 and then it will ramp down to a – slide down to a normal kind of IMO-related activity related costs. So big numbers in Q1 and Q2.

<Q - Steven Michael Fisher>: And that excludes amortization to $0.30 to $0.35?

<A - Kevin C. Berryman>: Yes. Yes.

<Q - Steven Michael Fisher>: Okay. All right. I'll turn it over. Thanks.

<A - Kevin C. Berryman>: No. I'm sorry, it includes...

<A - Steven J. Demetriou>: It includes.

<A - Kevin C. Berryman>: It includes the incremental amortization. I'm sorry.

<Q - Steven Michael Fisher>: Okay. Thank you.

<A - Kevin C. Berryman>: So that's a reported EPS accretion number – adjusted reported EPS number.

<Q - Steven Michael Fisher>: Okay. Great. Thanks.

<A - Kevin C. Berryman>: Okay.

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Operator

The next question will come from Jerry Revich of Goldman Sachs. Please go ahead.

<Q - Jerry Revich>: Hi. Good morning, everyone. I'm wondering if you can talk about a little bit more what you're seeing in mining in terms of the types of commodities and whether it's expansion versus greenfields where you're seeing a pickup in bidding activity. And if you could, Steve, just frame for us where the business is in the cycles and the major acquisition [ph] do (45:58) just a pro forma because it's my understanding that backlog is still near historical lows, and hopefully you folks have a good runway in front of you as we think about what this business looked like in the last cycle.

<A - Steven J. Demetriou>: Yeah. So we're in the very early phases of what we would call a modest uptick. So, as I mentioned, we're now seeing studies come back up. So, as projects from the past got shut down because of what was going on with commodity pricing, it's going to take time for these studies to get complete.

We're one of the leaders in helping our clients with these studies. And as I mentioned before, we hope that these will convert to EPCM projects or other services late in our fiscal year 2018 and really help us for positioning for backlog growth and driving profit growth beginning in 2019.

The focus for us is copper and iron ore, and we're seeing activity in both. A lot of activity in Australia, in South America specifically, and a few other parts of the world, but especially in those two areas. And where we're seeing most of the activity is really replenishing capacity as mine lives come closer to end. We're just seeing a lot of strategic capacity projects which are more replacement capacity, which gives our clients probably the near-term highest return. So it's all about the projects that give them the shortest payback.

So, as far as the big long-term strategic capacity growth expansions, we're really not seeing a heavy activity on that yet. And so, until we see more sustained pricing and even further pricing improvement, we see that most of the efforts will be on these sort of very – very focused on near-term return on investment, capacity replenishment upgrade, as well as some sustaining capital-type projects.

<Q - Jerry Revich>: And, Steve, in your prepared remarks, you spoke about really strong momentum in your Infrastructure business. Can you talk about what backlog growth would look like just for Infrastructure, excluding Buildings, and what's the opportunity set as you look at 2018 and bid activity compared to what bid activity looked like for 2017 a year ago? Can you just frame that for us?

<A - Steven J. Demetriou>: We're still bullish that we should keep the momentum going on the backlog trend that we've seen in our Building & Infrastructure over the last two years. There's always the timing element, so I'm not going to get it down to the quarters. But I would say that, as we go through 2018 fiscal year, we're clearly expecting to see solid backlog growth in our Global Building & Infrastructure business. The North America market remains extremely strong even though there's still a lot of uncertainty on the whole federal government infrastructure support bill and tax bill, et cetera.

The demand is there. The economy is strong. We're strongest in West Coast, Texas. Florida, for example, robust activity across all sectors of infrastructure. And you add on top of that a lot of our geographic growth initiatives that are playing out. We announced our Middle East joint venture several quarters ago. We continue to get a lot of positive momentum there that will take some time, but will eventually contribute to our backlog. And so we're pretty excited about it, but it'll play out in sort of different phases across the year, but we definitely are optimistic and confident that we'll see backlog growth in Building & Infrastructure in 2018.

<Q - Jerry Revich>: Thank you.

Operator

The next question will come from Andrew Kaplowitz of Citigroup. Please go ahead.

<Q - Andrew Kaplowitz>: Good morning, guys.

<A - Kevin C. Berryman>: Good morning.

<Q - Andrew Kaplowitz>: Steve or Kevin, backlog growth has really been accelerating in A&T. Is it a function – you talked about getting away from those rebid losses a couple of years ago. Is it a function of easier comparisons, is it an accelerating market, or is it really just all share gain for Jacobs at this point? And can you maintain – I mean, you now have double-digit backlog growth in that segment. How should we look at backlog growth in 2018? Can you maintain double-digit backlog growth going forward? And can you just tell us how much the acquisition was in backlog in the quarter in A&T?

<A - Steven J. Demetriou>: Yeah. So, the Aerospace & Technology backlog growth is – we just got to say, it's been super impressive. And there's a lot behind it, but I will say the first thing that's driving it is the strategy. Terry Hagen and his team put together a strategy a year-and-a-half ago that was very focused on the things that we talked about and in a very stable government service spending environment. And so yes, we are executing on that strategy, we're winning share, but we're winning share against non-traditional competitors that we've competed against in the past, which means we're widening our scope, we're expanding into sectors that we haven't participated before.

And so as we completed the rebid cycle, we talked about really focusing heavily on new business. And so it's getting stronger in the intelligence community. It's getting into this weapon sustainment area, becoming a stronger defense contractor, moving into DOE and other elements of the government. And it's leveraging these small but very strategic acquisitions around Van Dyke and Blue Canopy, which is strengthening our whole Jacobs Connected Enterprise, getting us into more – the ability to move into cyber security and some of the growing pieces of the large government sector spending.

So we're very pleased with probably – I would say, we're exceeding the pace of execution against the A&T strategy. And as we move into 2018, again, it's like Building & Infrastructure. It's going to be lumpy, the backlog. A lot of it depends on some of these protested wins coming off and from protest to moving into our backlog and it could happen in the upcoming quarter or could take a few more quarters. And that will drive some of the backlog growth, but we're also working on several exciting initiatives that we hope will play out. So, again, all in all, we see backlog growth in 2018 fiscal year and we'll just look forward to continue to demonstrate that.

<A - Kevin C. Berryman>: Andy, perhaps another comment just in terms of augmenting Steve's comment on lumpiness in A&T, we do actually have one large rebid that's coming up in 2019. So effectively what that means is as we approach 2019, the backlog will start to see some pressure just because we haven't gone through the rebid process yet. And we expect that we'll be successful in that rebid, but that will now be a trail and a headwind on the backlog just because as we get to the end of the bid, there's really going to be no backlog and then it will get replenished when the rebid occurs. So there is some stuff going on there that's really the only thing of note. I think it's important to suggest. So I agree with Steve's comment that there can be some lumpiness because we're starting to see that headwind occur and then it really is dictated by when the other wins and the protests kind of come to fruition.

<Q - Andrew Kaplowitz>: But, Kevin, just to be clear, you think you can still grow backlog from here in A&T even with that headwind in 2018?

<A - Kevin C. Berryman>: Yes.

<Q - Andrew Kaplowitz>: Is that fair?

<A - Kevin C. Berryman>: Yes.

<Q - Andrew Kaplowitz>: Okay.

<A - Kevin C. Berryman>: Our comment is more about the lumpiness of it.

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<Q - Andrew Kaplowitz>: Understand. And then, Kevin, maybe if I could ask you about CH2M in the sense that even if I exclude the MoPac adjustment in the quarter, $88 million of adjusted EBITDA seems pretty high. When you look at the history of CH2 seasonally is probably a pretty strong quarter. But maybe if you could comment on – they've been sort of working on restructuring and improvement, just as you guys have. So it would seem like a pretty good quarter from them. And then if there's any color you could give us on the other legacy liability that CH2 has as well?

<A - Kevin C. Berryman>: So, look, I would just reemphasize everything that we said about the CH2M portfolio of businesses. They have gone through a lot of efforts over the last couple, three years to reposition their portfolio, handle and address some of the legacy issues that we're talking about, taken restructuring and positioned themselves to be a higher-margin business, all of which we really diligenced in a material manner over the course of the time that we were able to spend with the company. So, yes, they are coming out of some of the issues that they have relative to legacy in a much stronger spot than when they were before, so clearly an improved portfolio. So I would just reemphasize that.

As it relates to the other issue, legacy issue, no real new news. That will continue to meander its way through the process. We've said that that's a long-term issue. We understand what the potential issues are. So, no real new news to say on that front. I will say that MoPac is coming out and in a manner that is, if anything, a little bit better than we would have expected. So we're happy about how the team has been executing against that.

<Q - Andrew Kaplowitz>: Thank you, Kevin.

Operator

The next question will come from Tahira Afzal of KeyBanc Capital Markets. Please go ahead.

<Q - Tahira Afzal>: Hi. Good morning, guys.

<A - Kevin C. Berryman>: Good morning.

<A - Steven J. Demetriou>: Hi, Tahira.

<Q - Tahira Afzal>: Hi. So, first question, and maybe this is more for Kevin. Kevin, it seems like you've included in the suggested adjusted EPS accretion. Maybe it seems that there's more than $1 per annum in amortization costs that you're including in there. Would that be kind of correct?

<A - Kevin C. Berryman>: No. No. In terms of – no.

<Q - Tahira Afzal>: Okay.

<A - Kevin C. Berryman>: No. A $1 would be sizable in addition to – into their already existing depreciation and amortization. So I'm not sure how you got to that number, but it would not be $1.

<Q - Tahira Afzal>: It wouldn't be that high. So would you [indiscernible] (57:38)

<A - Kevin C. Berryman>: Remember – Tahira, maybe I can help you. If you remember, we said 25% on a cash accretion basis. So if you take the difference between those two numbers, you're going to get more accurate as it relates to 15% versus 25% number.

<Q - Tahira Afzal>: Perfect. Okay. And, Kevin, if you're looking at how that amortization dissipates, is it a very gradual effect so we shouldn't assume [indiscernible] (58:05) your adjusted EPS beyond fiscal year 2018?

<A - Kevin C. Berryman>: Say again? I'm sorry. I missed the...

<A - Steven J. Demetriou>: Is it a gradual effect or is it – the amortization...

<Q - Tahira Afzal>: Does it sort of – I guess I'm just wondering [ph] if that (58:18) wears off.

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<A - Kevin C. Berryman>: Yeah. No, look, we will have an opening balance sheet that incorporates our views of the revised balance sheet, which will incorporate goodwill, it will incorporate the value of intangible assets, and those intangible assets will begin to amortize immediately. So it will basically happen over the course of 2018 as soon as we close.

There is a process that we will go through over the course of 2018, where we will look to finalize exactly what the numbers are. Once we get the company and we have the figures and we're able to do the detailed analysis, there may be some adjustments that are ultimately embedded into that opening balance sheet. But that will be done within the first year, and we'll have the revised figures kind of going forward by the end of our fiscal 2018.

<Q - Tahira Afzal>: Got it. Okay. And, Steve, just on this NEOM City, I'm sure you've been following all the news and headline news there. It seems to play a lot into all the strengths and all the initiatives that you're trying to build within Jacobs on the technology integrated side. Any thoughts around whether this could be a pretty big opportunity for yourself or whether it's going to really take away from some of the other areas there that Saudis have been spending?

<A - Steven J. Demetriou>: Definitely it's right in the heart of what we're doing with regard to our joint venture there, and so it's exciting to see that unfold. I was out in Saudi Arabia a couple of weeks ago and talking to some of the NEOM executives and it was – I'm thrilled to see that the head of that is my former colleague when I was in the aluminum business.

So Klaus Kleinfeld is leading that and he and I had worked together in the past. So we were excited to be a big part of that as that unfolds. The question is, again, like anything with regard to that major initiative, is how quickly will it ramp up in funding and a lot of it is probably going to be driven by unleashing some of the cash from Aramco with their IPO and redirecting some of that to drive that growth, but pretty exciting stuff.

<Q - Tahira Afzal>: Got it. Thank you very much.

Operator

The next question will come from Jamie Cook of Credit Suisse. Please go ahead.

<Q - Jamie L. Cook>: Hi. Good morning. I guess two questions. One, Kevin, on the organic growth, I think you said for the year, Jacobs is expected to be down year-over-year. I guess I'm just surprised given the backlog growth that you've seen this year as well as some of the comps that you have in the first half of the year. So if you could just give some color on how you're thinking about that and how we think about the high end versus sort of the low end in that versus your longer-term targets to grow 2% to 4% on the organic business?

And then my second question is on just the P&C margins, it's the only business that's not hitting your target margins at this point. So what we need to see to get those margins up, is it just volume, so any color there? Thank you.

<A - Kevin C. Berryman>: So the comments about the revenue – Jamie, thanks for the question – really is only as it relates to Q1.

<Q - Jamie L. Cook>: Okay.

<A - Kevin C. Berryman>: So I think it's ramping up and we do expect to see growth for the year, organic growth, excluding the impact of the CH2M acquisition. So we do expect that for the course of the balance of 2018. So clearly, it's a Q1 comment only.

<Q - Jamie L. Cook>: Okay.

<A - Kevin C. Berryman>: So that's the first point. Second point on Petroleum & Chemicals, look, we're not going to – look, we're excited, actually, about the margin profile of Petroleum & Chemicals because of some of the challenges that we've seen in the market. And so they have, in a very, very tough environment, actually improved their operating profit margins over the last couple of years and have more than overcome a pretty significant fall in revenue, which a

lot of folks have had to experience in this business.

So to your point, I think it really is, we've now reset the bar on our cost structure and when that business does ultimately start to see some momentum in growth, you'll see some improvements in margin. And the business is continuing to target higher margin works, so we would expect that that will continue to evolve over time as well.

<Q - Jamie L. Cook>: Okay. Thank you. I'll get back in queue.

Operator

The next question will come from Michael Dudas of Vertical Research. Please go ahead.

<Q - Michael S. Dudas>: Good morning , Steve, Kevin, Jon.

<A - Steven J. Demetriou>: Good morning.

<A - Kevin C. Berryman>: Good morning, Mike.

<Q - Michael S. Dudas>: Steve, I was impressed with your comments in your prepared remarks relative to the loss-making write-downs – or the write-downs on projects down 50%, I think, you said year-over-year relative to what you presented at your Investor Day last December. Where do we stand on towards getting to zero?

And as you look at the – as you have an indication from what CH2M Hill is going through with your negotiations and discussing all the offices, is there a similar idea relative to CH2 where we can see that type of positive performance once they get under the Jacobs umbrella?

<A - Steven J. Demetriou>: Yeah. Mike, thanks for the comment on that. And, we're extremely pleased with the progress. We still have a lot more work to do because there's a couple of different metrics we're driving. One is the write-downs, but the other is holding onto the as-sold margin all the way through projects and that's kind of a broader, bigger opportunity for us that is – we're still in the early stages. So we think that – kind of going back to my comment around operating profit margin improvement over the next several years, one of the reasons we're confident is we're just going to stay relentlessly focused on upgrading our tools and our discipline and standardization across the company to improve project delivery, program delivery excellence and drive operating profit improvement because of that especially on the margin side.

CH2M, a couple of years ago, launched a very similar transformation effort. That's one of the things that excites us as we got into the due diligence and now into the integration process that we both have had a very common path forward over the last couple of years and really refocusing the company on discipline, accountability, really looking at tools and project delivery excellence. And so, I think that we're just going to pick up on that immediately upon close. We've actually been working it during this planning stage and yes, we do see significant opportunities on their side as well.

And really, I don't want to say we're going to bring Jacobs' processes to make them better. I think what we're really going to do is take the best of both sides and accelerate, further accelerate and stretch ourselves to do even better than we thought we could do on our own by putting the power of the two companies' transformation processes together.

<Q - Michael S. Dudas>: I'm assuming that the IMO team has the organization ready to hit day one to run forward as a combined company. Any thought about the changing and maybe new business opportunities within some of the enhanced processes or enhance the markets that CH2, especially on the water transportation side that can maybe lift more in the backlog or order opportunities as we – as they get their – get it set for 2018?

<A - Steven J. Demetriou>: Yes. So first of all, on your comment, I've been involved with a lot of acquisitions, including some major ones, and I am – this is easy for me to say because I'm running the company, but this is the most impressive integration process that I've experienced and I've seen across M&A and going in other markets.

And a lot of it is lessons learned from not only what Jacobs and CH2M have done in the past, good and bad, but also the industry and also, just broader M&A. We've got a great external consultant helping us. We've got tremendous

leadership on both sides led by Gary Mandel on Jacobs side and Lisa Glatch and so – on the CH2M side, both senior executives, that are plucked out of the day-to-day business to invest in this integration process, which, I think, very few companies would do that and it's clearly paying dividends for us to, what we believe, will get us off to a very fast start on integration because of all the work that we've been doing since August. And the team is extensive with members of both companies on a variety of sub-teams in this whole Integration Management Office.

As far as the revenue synergies, which you talk about, we've defined the $150 million of cost synergies. But what really excites us is the growth opportunity. And there are numerous examples of where we can put the power of two companies together. But what CH2M really brings for us that will accelerate our ability to grow that we couldn't do on our own is really their innovation, technology, culture, climate change initiatives going on across all of our markets but especially in Buildings & Infrastructure and the likes of some of our Industrial markets, will be huge for us.

Taking their water and environmental leadership positions across our global platform in a much bigger way into mining and oil and gas, chemicals, and when you think of oil prices improving, one of the eventual beneficiaries is going to be upstream, and even though upstream is not a core market for us, our integrated energy clients that will be doing upstream projects will demand significant water services. And that's where we are already hearing exciting feedback from a lot of our major clients on the fact that we'll have the CH2M industry-leading water capabilities and environmental capabilities. And so, those are a couple of examples which clearly we're going to be driving for future backlog growth and revenue synergies.

<Q - Michael S. Dudas>: Excellent. Just one quick one, final one from me. Kevin, any seasonality of the CH2 business relative to Jacobs? Is it similar in cadence or is there any [indiscernible] (01:09:09) delays, et cetera, relative to timing, whether it's from cash flow or from business standpoint?

<A - Kevin C. Berryman>: Look, I think, ultimately, probably the only thing to say is that their Q4 is more like our Q1 just because that tends to be a quarter where there's a lot of holidays. So, other than that, I really wouldn't venture to guess any or give you any guidance until we get our hands on this and really dig in and understand it. But I would make that comment now and give you more color later on.

<Q - Michael S. Dudas>: Well, enjoy the upcoming holidays, guys. Thank you.

<A - Steven J. Demetriou>: You too, thank you.

<A - Kevin C. Berryman>: Thanks.

Operator

The next question will be from Andy Wittmann of Robert W. Baird. Please go ahead.

<Q - Andrew John Wittmann>: Great. Thanks. Kevin, just to start off with some cleaning questions here. In the guide for 2018, is there any gains or discrete tax items that we should be aware of? And I don't think you gave the tax rate that's underlying that core fiscal 2018 guidance. I think maybe that'll be helpful to get us in the right direction.

<A - Kevin C. Berryman>: Yeah. Look, Andy, we continue to target a low-30s kind of tax rate, which I think is pretty much where we ended up pretty close in this year, not exactly, but close to it. So we're pretty much in the low-30s, low end of the 30s.

<Q - Andrew John Wittmann>: Great. And no items that are notable in the guidance?

<A - Kevin C. Berryman>: Yeah. No, look, there are probably – who knows what ends up happening. We'll always have puts and takes as it relates to that, but we've considered this to be a normal operating level of taxes.

<Q - Andrew John Wittmann>: Great. And then just on the SG&A, I guess, adjusted SG&A year-over-year is up $32 million, about 120 basis point difference. You mentioned in the comments business development, legal, IT. I think you also mentioned later incentive compensation. Can you maybe just help us understand which one of those – which of

those costs were more material in the year-over-year delta in SG&A cost just so that we can get a sense of how much of this is likely to stick around and embedded in that 2018 guidance?

<A - Kevin C. Berryman>: So, if you remember, we had $30 million of strategic investments that occurred in 2017. But on top of that, our incentive comp is higher as well plus the other items that I talked about. So, certainly, some of that was offset by the savings associated with our restructuring, obviously. But we still feel like as we go into 2018 and we're transitioning to a growth environment that we'll have continued investments in business development cost to help drive the growth agenda going forward because it's clear that momentum is gaining. And so, there will be incremental investments that we're talking about in 2018.

So, I think that the incentive comp is a good number for this year, and so it is certainly, probably along with the strategic investments, the two biggest pieces where we were seeing investments in 2018 – excuse me, 2017.

<Q - Andrew John Wittmann>: Yeah. Thank you. That's helpful. Can you just help us with the backlog contribution, the revenue contribution from Blue Canopy in the quarter as well?

<A - Kevin C. Berryman>: We didn't disclose that. But, look, the vast majority of the increase in backlog was associated with the new wins that we've discussed. So, keeping that in mind, if you think about, Andy, the fact that we actually don't include the full $4.6 billion in our backlog, we only kind of take the first couple of years, as Steve outlined, those are big numbers there. And so consequently, if you add that, it's even a smaller piece. So it was not a material part of the increase at all.

<Q - Andrew John Wittmann>: Okay. We'll leave it there. Thank you.

<A - Kevin C. Berryman>: Thanks.

Operator

The next question will come from Rob Norfleet of Alembic Global Advisors. Please go ahead.

<Q - Robert F. Norfleet>: Good morning. Just a quick question on the P&C segment. I know the focus right now is obviously on downstream with some of the refinery turnaround work. And obviously, we're seeing some strength in chemicals. But can you discuss a little bit in terms of what prospects at least you're seeing in upstream? I mean, I think some of your competitors decided that FEED work has been picking up and that some of these deferred projects seem like they're at least coming back a little bit, but if you could provide a little color around that. And, I guess, secondly to that, can you grow P&C backlog with upstream still being in a very challenged position or do you need that business to start seeing an increase in order rates for overall backlog to improve?

<A - Steven J. Demetriou>: Yeah. Thanks, Rob. I'll go in reverse that we do expect to see backlog growth in 2018 versus 2017. Again, timing will depend on when some of these wins happen, but we're pretty confident on that. And it will be driven primarily by what I said in my opening remarks around downstream. Petrochemicals, we're well positioned on some interesting opportunities across the globe and also around maintenance turnaround activities.

We are seeing as the market is getting better profitability, they're starting to address things that were delayed. So things like maintenance and even turnarounds that have been pushed off from 2017, we now are seeing a lot of those accelerate in 2018 as they're getting more confident in the overall market. So, that's what gives us confidence in backlog growth going forward.

As far as upstream goes, we are not depending on upstream in our backlog when I talk about backlog growth. I would say, for us, that's upside. And as I mentioned before, upstream strength will help us in several areas. Most of our big integrated clients have held back even some downstream investments because of the pressure on upstream.

And so, therefore, as that – as their overall profitability includes when upstream improvement occurs, they're going to spread that capital across wherever they're making their best return on investments, and some of that will still come from some of these big strategic refining and downstream chemical projects.

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We are strong in the Middle East, first and foremost, and Aramco has announced a 10% increase in their CapEx for 2018. We're one of the leading players there. We do participate on the upstream side. We're in the mix for some very interesting projects that we hope to announce soon. And so that should be one of the areas that you would see us benefit on the upstream side.

And we continue to see some interesting prospects in the U.S. Gulf Coast. We have a strong position in Louisiana offshore platform work. Some of that activity is starting to pick up. And so Calgary is another area where we're seeing some renewed strength. We're seeing global opportunities that we can execute out of Calgary in our upstream group. So we are starting to see some activity, but it's not the major driver for what I'm talking about when I – I'm confident about backlog growth in 2018 in P&C.

<Q - Robert F. Norfleet>: Great. That's helpful. Just a quick question for Kevin. Post the closure of the deal, your pro forma leverage ratio is going to be around 1.9 times. Given the free cash flow generation between you and CH2M, clearly, you're going to be able to repay debt, as you mentioned, fairly quickly. I guess, I just wanted to understand what is your optimal or target leverage ratio. Because again, it seems like you can pretty quickly retire some of the debt here, and certainly you have a lot of balance sheet capability.

<A - Kevin C. Berryman>: Yeah. Look, we've talked about this in the past, Rob. We've targeted this 1 times to 2 times EBITDA number and we're not too far above that. The other item that we will likely be thinking about over the course of the next month or two as we approach the close is locking in some longer-term money, which then ties back into a more stable, let's say, efficient balance sheet where we're having some long-term money locking in at the lower rates that we see today. So, 1 times to 2 times is the short answer and probably looking to execute shortly after close to lock in some long-term money as well.

<Q - Robert F. Norfleet>: Great. I appreciate it and congrats on a great quarter.

<A - Kevin C. Berryman>: Thank you.

Operator

The next question.

<A - Kevin C. Berryman>: Denise, let's make this the last one.

Operator

Certainly. The last question, then, will come from Chad Dillard of Deutsche Bank. Please go ahead.

<Q - Chad Dillard>: Hi. Good morning, guys.

<A - Steven J. Demetriou>: Good morning.

<A - Kevin C. Berryman>: Hi, Chad.

<Q - Chad Dillard>: So, given you've seen such a ramp in your A&T backlog, can you help us think – with thinking about how quickly this backlog should be converted into revenue versus history? I mean, it seems like your contracts are getting a little bit longer. So, I just wanted to make sure that we're correct on that.

And then, just going back to the $850 million under protest. Can you just talk about how chunky that is? I mean, is that one or two projects? And, I mean, how should we think about the timing in terms of whether a good majority of that will potentially get booked in the first quarter, assuming you're successful on the protest?

<A - Steven J. Demetriou>: Right. So, good question on the conversion, and it ranges, depending upon the project, but I'd say some of them get converted within a couple of months, two to three months. Others will take up to six months to

really get going and starting to generate profitability for us.

With regard to the backlog that's being protested, there's several projects, the largest one being the SOCOM project that was announced. But there's several that are over $100 million, so it's not overly dependent on one, but clearly that one I just mentioned is the largest. And so we're focused on every one, but I'd say there's quite a handful, Kevin...

<A - Kevin C. Berryman>: Yes. Yes.

<A - Steven J. Demetriou>: ...of these protested projects.

<Q - Chad Dillard>: Got it. And then switching over to the B&I segment, can you speak to where this business is in terms of utilization today, and just given that you have a pretty healthy backlog, where you expect that to go as we look towards 2018 and just how to think about the margin comps over a year-over-year basis?

<A - Steven J. Demetriou>: Yeah. So, what we love about the B&I business is it's very diverse. And so the things that we see, backlog growth opportunity, aviation continues to be strong across the globe. And we're in the mix of many of the projects. We just won a major one in the U.S. that we haven't formally announced yet but is clearly helping our backlog. But we – so aviation is one. The whole transportation sector for us, rail, highways, as we take on the CH2M acquisition, we'll broaden that, obviously, with water capability, ports and marines and many other parts of the business.

And then the building side, we continue to see strength across the globe in our building sector in the U.S., the government sector on the building side. K-12 is doing well for us. And data center opportunities are pretty robust. So it's pretty widespread. And then the geographic expansion for us is something that we still believe is untapped opportunity for us, where we're still very heavily focused in the U.S., UK, Australia. By the way, Australia continues to be extremely positive for us. A lot of the key projects we've been working on look like they're going to get funded and hopefully, we'll have a winning streak in that area that will continue.

But geographic expansion into the Middle East, we're looking at parts of Africa, our overall Asia Pacific strategy is still in its early strategic days, and other geographic expansion opportunities. So we're not overly dependent on one area and we're excited about the prospects.

<Q - Chad Dillard>: Clear. Thank you, guys.

<A - Steven J. Demetriou>: Okay.

Operator

And Mr. Demetriou, would you like to offer some closing comments at this time?

Steven J. Demetriou

I just want to take everyone in the investment community for listening to the quarterly call today. Happy holidays and look forward to talking to you soon. Take care.

Operator

Thank you. Ladies and gentlemen, the conference has concluded. Thank you for attending today's presentation. You may now disconnect your lines.

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