Jacobs

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Unidentified Participant: Okay, I think we'll get started here. On the stretch run of the conference here, really pleased to have Kevin Berryman, who is the Chief Financial Officer of Jacobs with us for a broad discussion on the Professional Services space. And I think the company has a great view into a lot of what's going on in the infrastructure world and the government services world. So I think we'll get some good insight from Kevin.

Why don't we start with a broad question. You and Steve Demetriou joined about three years ago, and at that point in time you did a pretty broad strategic review of the company, identified a bunch of findings, identified a plan. Maybe if we just review what that was and then kind of get into a little bit of, like, some of the progress you made around that.

Kevin Berryman: Great, thanks, Rick. And thanks to the Morgan Stanley team for us to be able to be here back in my old stomping grounds. I grew up in Southern California, so it's great to be here, especially with a day like today. So, anyway, great to be here.

So, look, 2016 was a big year for us and Jacobs because we, as Rick suggested, went through a very, very deep dive and came up with a strategic plan. It's really the first strategic effort that had ever been done within Jacobs. And what we did is, we did a deep dive on our portfolio, we evaluated a lot of different parts of our business, came up with a three-pillar strategy, which was really important for us.

So it was about culture, it was about, kind of, transforming the core, and it was about really identifying what we wanted to be when we grew up in terms of our growth play.

I think in this space, historically, there has been a tendency to grow and do too much. And so we wanted to be focused and very clear as to what we wanted to do and what we did not want to do. And so that culture element was really about driving incremental accountability and get people excited about being part of Jacobs, which has always been a great company. And, really, what we wanted to do was take 80% of what made this company so fantastic and great over its 70-plus years of existence and then tweak a little bit on the top of that, which is about driving incremental profitable growth.

And so what we did is, through the transformation of the core, really get back to basics in terms of execution on projects, training, clarity on where we were losing money and starting to really focus on driving incremental growth.

So on the transformation of the core, we really, we created four lines of businesses, we started to execute against, within those lines of businesses, clarity on where were we going to improve our performance, where we were going to potentially not do business because we weren't getting the return profile that was appropriate, and executed against an ability to really focus on our projects and delivering what we would call (inaudible) margin.

We've made great progress over that over the last couple of years. As a matter of fact, in 2015, when I first joined the company, we effectively had the highest what we called "write-downs," which are those things where we delivered less than our (inaudible) margin. It could be just a few dollars, or it could be $100,000 or it could be $1 million. But we are seeing our portfolio seeing a lot of that. And in 2018 our expectation is our write-offs are going to be a third of what they were back in 2015. And that's an extraordinary improvement, which is really supporting an ability for us to make a margin profile that's now better than what it was back in 2015.

In addition to a very clear part of our strategy was identifying where did we want to grow and where did we not want to grow. And that was really about evaluating the portfolio and seeing where we were good and where we were not and then marrying that up with market data to understand where the growth profiles of the industries were in which we service and aligning against our growth plan, which led, ultimately, to the acquisition of CH2M, which we closed in December of 2017 at $3.3 billion, and we have since been really focused on execution of the integration of that company into ours.

We are doing really, really well on an integration-to-date basis. Our actual dynamics as it relates to attrition have, if anything improved. It certainly stayed flat versus us as two separate companies, and that's really the most important thing. You've got to make sure if you're buying talent, which is what we were doing. Then you nurture it and grow it and it becomes part of your organization and gets integrated into our company.

So that's gone really well. We had a synergy target of $150 million. We've updated that to we now expect it to be $175 million, and we're very pleased with the integration of the two companies. So if we look at where we are right now, our margin profile as it relates to what we set our targets back in 2015, we're going to be well in advance, I think, of those versus the targets that we originally established for ourselves.

So doing quite well, and as we look at where our business is right now with the combination of CH2M, we are very well positioned in government services, high-tech areas, information systems, development, information networks, cyber security. We are very well positioned in infrastructure, specifically environmental, nuclear, mostly remediation efforts, infrastructure, specifically, in transportation and, last but not least, water.

We think we're on the verge of a water renaissance in terms of investment profile, so we like where we are, still got work to do on the integration, got some momentum on the top line, momentum on the bottom line, and we feel pretty good about where we are. But we also wake up every day with a little queasiness in our stomach knowing that we've got to get better. And so excited about the last couple of years and, specifically, with the augmentation of our portfolio with the CH2M talent. We think we're best-in-class in terms of the talent in the world, and we feel like we're going to be able to leverage that for future successes.

Unidentified Participant: Great, appreciate that. Let's dive a little bit into that CH2M acquisition for a second. And then maybe remind the group a little bit. You talked about water, obviously, but maybe remind the group, as you walked into taking a look at CH2M and building that strategic rationale, what was the industrial strength aspect around why this was compelling?

Kevin Berryman: So when we put our strategy back together in 2016, we identified specific growth areas that we wanted to focus on. Nuclear remediation, which we had some core capabilities in. Environmental, which we had some capabilities but we knew that there was specific opportunities there. Infrastructure, specifically transportation, and water of which we also had some capabilities, but we felt the growth aspiration or the growth opportunity in that business with margins was very, very strong.

So if you looked at those four growth areas, CH2M checked all of those boxes and put us in a position, we're kind of a tier 1 player in all of those areas. And so it was very exciting when we did have the opportunity to start engaging with the CH2M organization; that it was very much aligned with our portfolio -- not a lot of overlap, as a matter of fact. So we're very, very comfortable that 1+1=3.

And if you look at this chart, ultimately, there. And we presented this in our actual third quarter earnings call. You can see that the checkmarks in terms of what we wanted and how we're being able to execute against it has been really, really strong. So we're excited about that. It's been a lot of hard work. I think what's been most exciting from our perspective is understanding the talent that we got. We thought we got great talent. We're blown away with the talent that has come into the organization with those people. And, hopefully, they are going to continue to be excited about being part of the new Jacobs. And it's been really exciting to see the teams come together and be excited about what the future looks like.

Unidentified Participant: They're very impressive, quite frankly. Bringing two businesses that are driven by human capital together is very tough. You know, sitting here working for a bank know that from past experience and that. Culturally, how do you hold the culture together? Your attrition rate has been extremely low. You've raised the synergy targets. Typically, people would look at that as being people, but it's not necessarily that here. You're keeping talent, you're driving talent, how are you doing that internally?

Kevin Berryman: So it is about a proactive stance taken on what needs to happen in integration. We announced the transaction, actually, August 1st of last year, 2017, so we're a little bit a year since then. Coming up here to the end of our fiscal year. And we integrated -- the day we announced, we already had an integration management office set up. We identified one of our top executives in the company. We pulled him out of the business. His name is Gary Mandel. And we said, Gary, your job -- and he volunteered. He actually said, "This is a great opportunity for us to ultimately drive to an integrated company that is going to be unsurpassed in its capabilities."

And so we put the integration management office in place. That was in place August 1st, the day we announced. We built in 100-person integration office. Fifty from CH2M and 50 from Jacobs. It was purposeful that it was 50 from CH and 50 from Jacobs, because what we did not want this to be was an indication that the team and the talent that we were buying, this is all about, "Hey come in and do the way we do things." CH2M in its own right was a leader in all of the areas that it was good at. And we wanted to make sure that we brought in that talent and augmented our capabilities as opposed to just kind of do it the Jacobs way.

And so you spent a lot of time communicating, you spent a lot of time really listening to the talent of that organization, and so it is a very disciplined, and one can almost call it an anal process in terms of what needs to be done in an integration. You identify the leaders that are a part of that integration, you identify the synergies, you identify who are the leaders that are going to drive those specific synergies. You make them accountable, they understand it, and you track it. And it is a very, very rigorous and disciplined process within the construct of talking with the people all the time.

The executive leadership team of Jacobs, when we were nearing the close, we spent a basic full month touring the globe and talking to the CH2M organization and its people, kitting the big offices relative to them and saying, "This is our strategy. This is how you play a role in that strategy," and they became clear, and they understood what their roles were, which is the first part of making -- getting a commitment and then an alignment and getting the people in the gut as it relates to what the opportunity is.

And I don't think people or companies do that enough. And when you do that, you've got to speak truth, and you've got to be straight, but they start to understand what the role is, and they don't make up anything because human nature is newness, unknown as you kind of go to the dark side in terms of what the implications are for everyone personally. And you over-communicate to ultimately try and get to a place where people understand that this is an opportunity, longer term, coming into a larger organization. So we spent a lot of time doing that.

Unidentified Participant: Well, let's dig a little deeper into the segments. So Government Services, growing faster than the peers out there and, quite frankly, I'm not sure the investment community always sees just how big the business is on a relative basis versus maybe what people considered your traditional peers are, quite frankly, against pure play Government Services players. What's driving the growth there in the outperformance?

Kevin Berryman: Yes, so we have aerospace, technology, environmental, and nuclear. Up on the slide you can see that. It is one of our highest-performing organizations, a good margin profile, and it is basically a Government Services business, about 85% Government Services. Very high-tech oriented in terms of information systems work, cyber security work, a lot of work with three-letter agencies in the government. And I don't think the investment community really yet fully understands this business, because it has been part of a big kind of conglomerate Jacobs, and so if you think about what this business looks like, it's 7% to 8% in terms of operating profit margins, very high technology oriented. We're winning new businesses. We just won a $4.7 billion contract, missile defense system contract, where we are in an information systems capability supporting the government.

And so this is a business that is targeted towards areas of the government where there is going to be spending, high profile expenditures, and you can see that the margin profile and what the expectations of this business are strong longer term.

We feel like there's three strategic pieces of the work that they do, which really exemplifies our ability to build this business to a bigger business and a more profitable business longer term.

The first one is that we have a very good cost profile in our ATEN business. And it affords us the ability to have good margins even if there is a competitive bidding process, which, for some of these contracts they are very competitive. And so we have a very good cost profile. We have probably best-in-class, if you understand the Government

Services business called CPAR scores where the government rates you in terms of the work that you do and how good you are doing or how well you are doing. That is off-the-charts good, strong, probably top-tier against our competitors.

And the third one is we've structured our ability for this business to be very nimble, very agile, to be able to customize the offerings to the government. And really understanding what the mission is for the client, whoever it might be, whatever part of the government it is, and adopting and customizing our offering, which facilitates their ability to be facile and reach their objectives.

You take those three together, and we're starting to gain share in terms of the Government Services field. So we're excited about that.

The next one is probably BIAF, biggest business, the highest-margin business that we have. It has a very large state and local piece as well as federal piece. And if you think about our business there, it is water, it's transportation, and within infrastructure transportation, excuse me. And then on top of that, we have environmental capabilities as well.

So if you look at this business, where we are very strong in this business is in the Northwest, in California, in Texas, in Georgia, and in Florida and also in the Northeast. And if you take those areas, that's where monies are available for the local municipalities and state local governments are spending money. And, consequently, we think there is a robust growth environment for this part of our business.

We all hear about infrastructure. We know investments are going to be required. There has always been the discussion about the Trump Trillion or 2 trillion or whatever the investment profile is. We believe, even without those incremental monies that may or may not come to fruition that we're well positioned in those particular parts of the United States and well-positioned to be able to take advantage of it.

We also think that our water profile is really near-best in class, and we think we're on the verge of a renaissance in water investment that is coming forth. And we're getting to a point where some of our municipalities and the customers that we're working with, they're going to have to start spending money, but they're not going to be able to have drinkable water for their constituents, which, obviously, is not going to work.

We're actually going to do a water call. I think it's on Monday, John, is that correct? Where we're going to be talking about our capabilities in water. I welcome you to participate in that. You get a good sense of the opportunities facing us in water.

In addition to the US, which is the bulk of our business, we're also strong in the UK, we're strong in Australia, and what we're really excited about is a new joint venture that we've formed with Saudi Aramco and the Sovereign Wealth Fund of the country to be able to be the PMCM partner for Saudi Arabia, Saudi Aramco, to help drive the infrastructure buildout of that kingdom.

And, you know, the Prince's vision 2030, which talks about trying to take the Saudi Arabia economy and not be so beholden to oil and to build out the capabilities of that country. So we're in the very early stages of that. If anything were in investment mode right now, but we're excited about what that will afford us long term as well.

The last business is our ECR business. It's actually the business that used to be the biggest part of our business, historically speaking. It now represents probably less or around 20% of our profit. It's a business that we have really done a lot of work in terms of transforming the coal to the strategy. We shrunk that business over the last three years. Some of it purposeful, some of it not so much because of the challenges in the oil and gas business. But if we look at our business right now, it's maybe 50% of the size it once was. And as we shrunk that business, our margin profile actually improved.

And so as we sit here today, we're focused against where we can make money, where we're excited about it, and now it's, for the first time since I've been in the company, we're poised to score that business as well.

As I think about where we have been and where we are now in terms of transformation of our capability set on margin profile as well as the augmentation with the CH2M acquisition, we're looking at all three of our LOBs being able to see some growth and building off of a margin profile that's better than it ever has been in the history of the company.

Unidentified Participant: Great. I want to come back to the infrastructure, to a question on that in a second, but just on ECR for a second here, are you seeing accelerated CapEx in the commodity cycle? Are you seeing that customer field more strength to drive this business? I think the answer is yes based on your comments, but you talked about shrinking about the business but now being poised. Maybe talk a little bit about the macro environment you see here?

Kevin Berryman: Yes, we've kind of reframed our ECR business from what it was four or five years ago. We had a big chunk of upstream business at that particular point in time. Probably, number two -- or -- that was the second-largest part of our business, refining was the largest, and then chemical was a little bit smaller piece. We've now flipped that where, actually, the chemical -- petrochemical piece of our ECR business is largest. Refining still in the mix, but our upstream business is very, very small right now. Purposeful in terms of going after the businesses where we felt we could make better margins.

And so as we think about that kind of picture, we do believe there's opportunities in petrochemicals specifically. We see complexes being planned and built. We do see there being, oh, a pretty intense competitive environment right now. We're going after some of these projects, and we're going to be thoughtful and disciplined as it relates to that. We do see it building, over time, and I think in the early stages of the development and the build of that business, everyone is craving for business, very aggressively going after it. We're going to be disciplined because we think the margin profile might be a little bit better in the next year or so, and that would be our expectations when we really start to see a big build in our business.

Still be able to grow in the short term but maybe a little less fast but with good margins and then, probably, as we go through the course of 2019, we'll start to see some incremental backlog really build.

Unidentified Participant: Okay. And just come back to the infrastructure for a second. Maybe you can reinforce for the audience just the scope of work that you're focused on around that. Because what I see is, particularly with the CH deal, is a lot of front-end design work, consulting work where there's this margin opportunity on the forefront for the company, and it's really taking the strength of that acquisition forward.

Kevin Berryman: Yes, if you look at this business itself, we are -- one thing I want to impress upon the audience is that we are not a big, lump sum project player. If you look at all of the, kind of, let's call it construction risk that many of our peers get involved with, we have very, very little of that. And when we do that work, it's kind of what we would call progressive lump sum work, where we do the preliminary design and engineering. And we've been working on something, maybe even doing the consulting front end work three years before something happens about understanding where we are.

By the time we get to, and if we are going to do any construction work, we know exactly what we're getting into. And so it's a negotiated lump sum contract as opposed to a bid lump sum. We don't do bid lump sum. And if you look at that, it represents less than 5% of our annual revenue. So it's not a big part of our business.

But, to your point, we do a lot of engineering, a lot of design, a lot of consulting, a lot of plan work, a lot of evaluation where it's really front end strategic evaluation, which ends up having higher margin work. And then that translates into our ability, longer term, to do design-build work or, you know, additional project program management kind of activities.

We've done, for example, a lot of the work that we've done in the UK led the company to be the program manager for the London Olympics, for example, which is, obviously, huge project work. But we're the kind of consulting project program management party that's involved in doing that as opposed to, kind of, the construction.

And if you look at our business across that, it's really strong on water, it's really strong in transportation, specifically, aviation and rail. Our capabilities that we have. I apologize in advance that we're doing the LaGuardia work. Any of you guys fly through LaGuardia know of which I speak. We are involved in LAX as well. So we're doing a lot of work around the globe as it relates to the refurbishing of airports. And airports and, kind of, some of the transportations are becoming strategic competitive assets that the countries and/or states are using to try and attract and infrastructure build around it. So we see there being big opportunities in that business long term.

Unidentified Participant: Great. Great, let's turn to financial performance for a second. So it looks like the end market driver is positive. You guys are executing. Clearly, the integration is going well, upsizing synergies. You're at a leverage profile for the business, which I think you've communicated works for you guys and now the company is generating cash. So what do you think about capital allocation, going forward? Is that dividend share repurchases? More M&A? Maybe talk to the audience a little bit about that.

Kevin Berryman: Yes, we've kind of said for the last -- since we did the transaction on CH2M, that we were going to be delivering because we did add some leverage onto the balance sheet. We felt that, given our cash flow dynamics, we would soon delever to numbers that were going to be appropriate. We, actually, are pretty close to being there, but I would say for the next six months at least, we're going to continue to drive the integration and be focused, priority 1, 2, 3, 4, 5 and 6 is still going to be driving the integration to make sure that we don't lose traction on the preliminary successes we've had on the integration.

Once we get through that, we certainly believe the cash flow dynamics of the company, because there's really no fundamental need for large CapEx numbers. We believe there's working capital opportunities to improve our accounts receivable, over time; that we will have a healthy balance sheet as well as a healthy cash flow.

We believe external growth opportunities will be part of the mix, going forward, and we have a dividend, and we have an existing share buyback authorization that we really haven't been doing much with because we wanted to delever. I think we're probably six months away from being able to really start to effect incremental activities in those areas to ensure that we prove to the investment community that this acquisition was an unheralded success.

We'll point to the deleveraging, we'll point to the growth profile, we'll point to the margin profile, we'll point to the synergies, which you will see in the P&L And then we're back at it in terms of being able to fundamentally transform the growth profile, going forward, in terms of a further evaluation of where we are on a portfolio basis and continue to drive a profitable growth agenda, going forward.

Unidentified Participant: Maybe I'll finish with one broader question around the positioning in the business today. When I sit back and look at the positioning post-CH deal, I see a pretty diversified professional services firm grounded in a lot of human capital talent, a lot of technical capabilities, technology capabilities. Yet you still, oftentimes, get lumped into this broad E&C category, which is a grab bag of different types of business models. So maybe talk a little bit about your thoughts around that, and then get to, kind of, what metrics you're pushing towards that really differentiate you versus that bucket of peers that aren't necessarily really peers?

Kevin Berryman: I think that our aspirations as a company are to become a more value-added, innovation-based company. And I think about some of the work that we do right now -- let's call it in the E&C space -- and I don't want to take anything away from our competitors because they're good, strong competitors. But we believe that we have technology today that can start to transform our delivery of the value that we provide to our customers.

And I think about what we call Jacobs connected enterprise, which is actually taking a lot of our capabilities in some of the higher-tech areas in aerospace technology, environmental, nuclear, and those technologies specifically that we're doing for cyber security work for the US government are directly relatable to our private sector clients. And what we've done is create a SWAT team within the context of the Jacobs connected enterprise, which is now taking that subject matter expert and then marrying up with our domain knowledge in whatever -- whether it's infrastructure or whether it's oil and gas, or whether it's pharma or whether it's semiconductors or whatever. And those are directly related capabilities, which I believe allows us, over time, to take the technology plays in some of our more sophisticated, kind of, high-tech, software-related areas and now do the same kind of work for our clients, which starts to change our margin profile longer term.

And while we've got to convince our customers that that works, because I think many parts of our business, they kind of do the same thing that they've done for the last 50 years. But the technology that is available right now, and the work that we're doing right now, is directly going to be able to leverage our, I think, business longer term. Where if you think for the gross margin number of 20%, which is what our company is right now, some of the work that we're going to be able to do, we should be able to have a 10 percentage point margin. Or a 20 percentage point margin improvement in the gross margin just because we're bringing those technologies in and overlaying cyber security data analytics into how we're designing, delivering, perhaps constructing in terms of our clients on the private sector side.

So longer term that's what we're thinking about. And so I think the next phase of our strategy is how do we start to differentiate ourselves? Because we believe that

technology, even though there are people out there that can do that work, they don't have the domain knowledge that we have. We are in a refinery, we are in a petrochemical plant, we are in a pharma plant, and we've been there for 50 years because we're managing the maintenance and the sustaining capital work.

The domain knowledge married up with that, I think put us in a unique competitive position to drive a very different delivery that we might want to be able to provide. And I think the value proposition of that is going to be much different than, kind of, what our business has been historically.

Unidentified Participant: Does that point to different metrics then, over time? You mentioned gross margin --

Kevin Berryman: Yes.

Unidentified Participant: -- that there's a point to more owned internal technology that you're leveraging? It sounds like the answer is yes.

Kevin Berryman: Yes, yes. That will be our strategy. Look, we have to convince ourselves, part of the challenge is our people themselves, got to know that we can deliver something that is higher than a 20%. And we've got to convince our clients. But I will tell you, the kind of discussions that I have when I meet with our customers, and you're tending to deal with C-Suite kind of individuals, the time that they lean forward the most is when we talk about the technology offerings that we think we can start to provide.

And so we've just got to continue to work that angle and really get the kind of discussions, which allow for our customers to become a much better operator. And if they can see us being able to provide services and capabilities that allow them to improve their yield coming out of factories or thinking that way, that's pretty important for them.

Unidentified Participant: Great. Maybe we have time for a few questions from the group.

Kevin Berryman: One up here in the front.

Unidentified Audience Member: I had two questions. I noticed in your chart on aerospace, the ATEN, that you listed work for AT&T on 5G networks. I found that interesting that was in that group and not in the infrastructure. But I'm curious, very much like what you're involved with -- how and what you're involved in on 5G for them and, also, particularly what timeframe that might -- that work you expect that to progress on?

And then a separate question on the infrastructure when you talked a lot about rail. And I wonder, especially being here in California where they've looked extensively at hyperlink and MUSC (ph) designs and things like that. I'm curious to know what a -- it seems that you're talking more about traditional high-speed rail, but are you involved in any of those hyperlink projects or is there anything happening there that your company will be doing?

Kevin Berryman: Yes, look, I think the first question on the telecom kind of question -- we are involved in the build-out of the infrastructure around it. The technology play is also oriented around some of the work we do for US government. So telecommunications, the management of telecommunication networks for the US government is a big part of our business. So there's a connection there relative to that.

Unidentified Audience Member: (inaudible).

Kevin Berryman: Yes. Yes. And so that's the reason it's there. And I think that it's not the biggest part of our business, but we do believe there's capabilities to build out that longer term. Our customers in that are AT&T and so on and so forth. So that is a business that we see as an opportunity, but it's not the biggest part of our business.

The second point, remind me?

Unidentified Audience Member: (inaudible).

Kevin Berryman: Well, building out infrastructure, specifically, okay? Now, in terms of the rail piece, we are involved in high-speed rail. We will get involved as we think it's appropriate relative to -- you mentioned the MUSC, you know, hyperlink and that kind of stuff. I'm not aware of, specifically, what we might be doing in those areas. I don't know that we're involved in, necessarily, some of that stuff, but we're very involved. And I would say the buildout across the globe as it relates to what I would say is the rail, whether it's high speed or it's activities within the metropolitan buildout of transportation. And it's a big opportunity specifically as it relates to building technology into that. Because that's the work that is really our bread-and-butter stuff.

Unidentified Participant: Other questions? Okay. Thanks for listening. Thanks, Kevin, for joining us today and look forward to continued great performance out of the company.

Kevin Berryman: Good, thank you very much. I appreciate everyone's time and attention.