Company Name: Jacobs
Company Ticker: JEC US
Date: 2018-11-20
Event Description: Q4 2018 Earnings Call
Market Cap: 9,251.28
Current PX: 65.05
YTD Change($): -.91
YTD Change(%): -1.380
Bloomberg Estimates - EPS
Current Quarter: 1.207
Current Year: 5.324
Bloomberg Estimates - Sales
Current Quarter: 4070.625
Current Year: 16719.385

Q4 2018 Earnings Call

Company Participants

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

Other Participants

- Lucy Guo
- Jamie L. Cook
- Steven Fisher
- Andrew Kaplowitz
- Michael S. Dudas
- Josh Ward Sullivan
- Jerry Revich
- Anna Kaminskaya
- Tahira Afzal

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. My name is Julie and I will be your conference operator today. At this time, I would like to welcome everyone to the Jacobs to hold its Fiscal Fourth Quarter 2018 Earnings Conference Call and Webcast. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] I would now like to turn the call over to Jonathan Doros. Jonathan, you may begin.

Jonathan Doros

Good morning and afternoon to all. 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'd 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. Although such statements are based on management's current estimates and expectations, and our 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 cause actual results to differ materially from what is contained, projected, or implied by our forward-looking statements. The potential risks and uncertainties include, among others, the possibility that acquisitions of the ECR business of Jacobs by

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WorleyParsons will not close or the closing may be delayed, the ability to recognize the benefits of the ECR disposal and outcome of legal proceedings and risk of Jacobs' future performance may not achieve its estimated earnings.

For a description of these and other risks and 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 year ended September 29, 2017, and our subsequent Quarterly Report on Form 10-Q for the first quarter of 2018 when filed with the Securities and Exchange Commission, our Annual Report on Form 10-K for the year ended September 28, 2018, as well as our other filings with the SEC. We are not under any duty to update any of these forward-looking statements after the date of this presentation to conform to actual results, except as required by applicable law.

During the presentation, we will refer to certain non-GAAP financial measures. Please refer to slide 2 of this presentation for more information on these figures.

In addition, during the presentation, we will discuss our current results to Jacobs and CH2M's performance in 2017 calculated on a pro forma basis. We will also discuss pro forma financials that exclude the ECR business in light of the pending divestiture. Please see slide 2 for more information on the calculations of these pro forma metrics. We believe this information helps provide additional insight into the underlying trend of our business and comparing current performance against prior years.

Turning to the agenda, Steve will begin with a tribute to our former CEO, Noel Watson, then discuss our focus on driving a culture of inclusion and diversity, provide a recap of our fiscal year results including a market review for each line of business, and provide an update on our CH2M integration. Kevin will then provide more in-depth discussion of our financial metrics, as well as a review of our balance sheet and capital allocation strategy. Steve will then provide an updated outlook along with some closing remarks, and we'll open the call for your questions.

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

Steven J. Demetriou

Thank you. So turning to slide 4, before I discuss the results of the quarter, I'd like to honor the memory of former Jacobs' Chairman and CEO, Noel Watson, who passed away in August at the age of 82. My great mentor and friend, Noel was a larger than life leader, a man of character who brought tireless passion, perspective and wisdom to Jacobs, particularly around safety and integrity.

During his tenure as CEO, Noel steered the company's growth sevenfold from $1 billion to $7 billion in revenue with corresponding profit increases. Recruited by our Company Founder, Joe Jacobs, Noel served the firm for more than 50 years, including more than 25 years at the helm of the company. Foremost, Noel was a dedicated and loving husband, father and grandfather. He's survived by his wife, Phyllis, their two children and five grandchildren.

In honor of Noel's legacy, we've created the Noel Watson Integrity and Values Award to be presented annually to Jacobs' employees who embody the utmost standards of ethics and integrity.

Now moving to slide 5, our strong performance over the last few years has been supported by a relentless focus on culture, including safety, positive mental health, integrity, and leadership accountability. Building on this solid foundation, we are also concentrating on inclusion and diversity along with innovation to further strengthen our culture. Recently, we held our first annual inclusion week to increase the velocity of inclusion and diversity within our organization. I'm personally co-chairing our Jacobs' Women's Network and each of our senior executive leaders are sponsoring one of our other employee network groups.

Throughout the year, our PRISM Network, which represents our LGBT Plus community, participated in Pride celebrations globally. Similarly, our Harambee Network, which celebrates people of color, is actively engaged internally as well as externally with our local communities. These are but three examples of the diverse networks within our global Jacobs' family.

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We believe inclusion and diversity will be a key determinant of our success as it drives engagement and empowerment of all Jacobs' employees, creativity to solve critical challenges, and attraction and retention of the brightest talent, which together accelerates our efforts to be the employer of choice in our industry.

It is proven that companies that achieve broader levels of inclusion and diversity consistently outperform. And to demonstrate our commitment, we are instituting culture-based leadership metrics into annual executive compensation, which will include inclusion and diversity goals for each senior Jacobs' leader.

Now, let me turn to slide 6 to review our results. We delivered strong fourth quarter in total year 2018 results that exceeded expectations. Our results are a testament to our employees' disciplined focus on operational execution while delivering a successful year-one integration of CH2M, one of the most transformative acquisitions in our industry. This has translated into financial performance levels above our expectations.

Our 2018 revenue grew 9% pro forma including CH2M. Our Aerospace, Technology, Environmental and Nuclear business was a major driver of that growth with a 15% pro forma increase. And gross margin increased over 100 basis points and adjusted operating profit margins were up 60 basis points to 6%. As a result of this strong performance, our adjusted operating profit grew double digits in all three lines of business. This growth led to adjusted earnings of $4.47 per share, an increase of 38% year-over-year and above the high end of our guidance. This strong performance combined with our proactive portfolio of transformation provides us the opportunity to invest in innovation and drive continued profit and margin growth.

Now, turning to slide 7 to discuss backlog performance, our fourth quarter revenue on backlog was $27.3 billion, up 2% year-over-year on a pro forma basis, with underlying trends much stronger as large upcoming ATEN renewals of approximately $425 million are not currently in backlog. Furthermore, all lines of business contributed to a pro forma backlog growth.

Gross margin on backlog was up more than 100 basis points year-over-year on a reported basis, driven by the higher margin mix from CH2M and a continued focus on winning high-value business. Upon completion of the sale of our Energy, Chemicals and Resources business, our pro forma gross margin in backlog will further improve by more than 150 basis points from the higher margin mix of the remaining ATEN and BIAF portfolio.

Before I discuss the performance of our ATEN and BIAF businesses, I'd like to outline the significant improvement of ECR on slide 8. With the recent announced divestiture of our Energy, Chemicals and Resources business to WorleyParsons, which is expected to close in the first half of calendar year 2019, I would like to take a moment to recognize our ECR team.

I am very pleased with the team's ability to drive substantial value creation over the last few years during the recent challenging industry environment. The team successfully shifted resources to capture refining and chemical opportunities and expanded our footprint into new geographies.

This was achieved while maintaining a healthy risk posture of mainly reimbursable work and a significant reduction in write-downs driven by improved project execution. As a result, ECR drove a strong financial performance over the last two years with a 42% increase in 2018 operating profit versus 2016. And most recently, the business returned to growth with 2018 pro forma revenue up 7% and operating profit margin expanding 60 basis points versus 2017.

I'm incredibly proud of the entire ECR team's passion and commitment. They are strongly positioned for future success as they combine with WorleyParsons to create a preeminent leader in the Energy and Resources industry. While this divestiture is bittersweet, consistent with our strategy, we believe it's the right time to make this change to our portfolio, which allows Jacobs the opportunity to focus 100% on our ATEN and BIAF businesses.

Slide 9 highlights our transformed business portfolio as we move forward post the sale of ECR. This newly focused portfolio reflects a stronger sustaining revenue mix in higher value end markets aligned to growth trends where Jacobs has a leadership position, including national government priorities, sustainable infrastructure and digitally enabled solutions. We intend to leverage our full complement of differentiated capabilities across our ATEN and BIAF portfolios to drive revenue synergies. This is forming the basis of the next phase of our strategy, which we plan to

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further discuss at our upcoming Investor Day in February.

Turning to slide 10, now let me discuss the performance of Aerospace, Technology, Environmental and Nuclear, ATEN. During the quarter, our ATEN business continued to significantly outpace the growth of the market and our public, government services peers with 19% year-over-year pro forma growth. Key to this performance were a number of long-term enterprise contract wins with the U.S. government, including the Missile Defense Agency and Special Operations Command, which have created a strong base of recurring revenue.

Backlog was up 2% versus last year's combined fourth quarter, which more than offset the impact of the burn-off by a few large programs that will be re-bid soon. Together, these renewal opportunities account for approximately $425 million of annual revenue not yet reflected in our backlog.

Gross margin in backlog increased 50 basis points compared to 2017. The upside to this dynamic is that the nature of these long-term, large-scale enterprise contracts creates strong financial stability. From an end-market perspective, we are well-positioned against U.S. federal government's high priorities within the Department of Defense, Department of Energy, Intelligence Community and NASA.

Contributing to the stability of our portfolio, many of our large contracts are aligned to mission-critical areas within the federal budget and are less discretionary in nature. Furthermore, given the highly fragmented nature of the government services market, we believe that our strong technical expertise, unique localized delivery model and an industry-leading efficient cost structure will allow us to continue to gain market share over time.

During the quarter, we were awarded a contract modified by the Department of Education to deploy our Fed track and tightened cybersecurity tools across the Federal Student Aid Network Enterprise. These proprietary tools enhanced the security authorization and vulnerability management processes that secure the financial transactions and personal information of the U.S. Student Financial Aid program.

They also provide predictive cyber analytics to modernize FSA Security Operations Center and protect against threat actors seeking to infiltrate government information systems.

A five-year subcontract for the U.S. Air Force was awarded to provide software development and sustainment for the Air Force Financial Systems Office, bringing our software engineering capabilities to three core applications. We were also awarded a 10-year sole-source classified contract for continuity of senior government officials communications, which attest to the capabilities of our telecommunications, IT and cybersecurity teams.

And turning to the commercial part of our ATEN business, we continue to see strength in telecom. The business is mainly professional services such as consulting, engineering and program management of communications infrastructure development. The 5G wireless build-out provides a significant opportunity for growth over the next five years.

During the quarter, we had another key win with AT&T continuing the expansion of our geographical footprint in the United States. We are also seeing accelerating opportunities to leverage ATEN capabilities into our BIAF-client base such as smart infrastructure solutions. We believe that leveraging these technology capabilities across the rest of our portfolio will drive additional revenue synergies. So, in summary, the ATEN business had outstanding performance in fiscal 2018 and we're encouraged by the opportunities we see going forward, including continued profitable growth in fiscal 2019.

Now, on to slide 11 to discuss our Buildings, Infrastructure and Advanced Facilities line of business, BIAF, which posted yet another solid quarter of results. On a pro forma basis, BIAF backlog increased 3% year-over-year with gross margin in backlog up 70 basis points. From a macro standpoint, we continue to see a robust pipeline of global opportunities driven by the major trends of urbanization and population growth, leading to an increasing need to invest in upgrading supporting infrastructure. The results of the U.S. midterm elections were favorable for infrastructure spending and state ballot measures such as the California gas tax.

In the UK, we are aligned to well-funded multi-year programs such as the Environment Agency's TEAM2100. And we recently won Highways England's Routes to Market, a six-year program to transform England's motorways.

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Asia-Pacific demand is underpinned by strong public investment in rail and other infrastructure investments.

As outlined in our recent Water Investor Conference Call, we see multi-decade demand drivers for our water business, including in the near term being on the front end of a major water upcycle in the U.S. We recently were awarded several major water opportunities such as program management with the City of Chicago, O&M with the City of Waterbury, Connecticut, and a more than 10-year program for California WaterFix. Water is one of the areas where we are driving innovation.

As a great example, the City of Atlanta has selected Jacobs to develop the digital transformation in smart water utility action plan to define how best to align technologies to address goals such as infrastructure resilience, operational efficiency and cybersecurity.

Within transportation, aviation continues to be strong in the United States and Asia. And we recently closed the contract for design of a major terminal renovation at Baltimore/Washington International Airport. Transit and rail are strong globally. And during the quarter, we closed a significant consulting engagement with Melbourne Metro.

With regards to our built environment business, healthcare, education and federal buildings are clearly a beneficiary of the broader demand drivers. During the quarter in education, we won a program management opportunity with the Omaha Public Schools District. We're also seeing a trend unfold for more mixed use infrastructure, which is allowing for potential revenue synergies between our Buildings group and other Infrastructure teams.

Financially, our Advanced Facilities business continues to perform above our expectations, driven by our life sciences and electronics businesses with major wins during the quarter in both sectors. We had a sizable win with a U.S.-based semiconductor manufacturer. And in October, we closed a $400 million EPCM project with a confidential life sciences customer.

In summary, our BIAF line of business has shown a track record of consistent strong performance. Revenue and margins have increased from both higher value engagements improving project execution.

Before I turn the call over to Kevin, let me make a few additional comments about CH2M. We are clearly demonstrating that the CH2M acquisition has been a strategic and financially accretive use of capital. The cost synergies that underwrote our valuation are well ahead of our original plan, and our revenue synergy pipeline is gaining strong momentum. From a culture standpoint, the teams are now fully integrated and focused on delivering to our profitable growth agenda. Kevin?

Kevin C. Berryman

Thank you, Steve, and good morning and good afternoon to all. Let's move on to slide 12, where you will see a more detailed summary of our financial performance for the fourth quarter of fiscal 2018. Fourth quarter pro forma revenue grew 7% year-over-year. We have pro forma growth across all businesses with ATEN leading the way at 19%. Fourth quarter gross margins of 19% were up 130 basis points year-over-year benefiting from the higher gross margin mix from CH2M. We had another quarter of reduced G&A spend as pro forma G&A was down on an absolute basis year-over-year, and flat sequentially versus Q3, again driven by our continued success in attaining our expected CH2M cost synergies. This benefit was partially offset by higher incentive accrual true-ups in the quarter.

GAAP operating profit margin was 5.8% and was impacted by CH2M-related acquisition and integration cost. Our adjusted operating profit margin was 6.8% for the quarter, up 130 basis points. Operating profit as a percent of revenue was also up 40 basis points sequentially, again driven by the building momentum in cost synergies.

GAAP EPS for the quarter was a negative $0.16. Included in the GAAP figure is a $1.18 per share charge materially associated with the tax reform impact on our CH2M opening balance sheet. And this charge comes as a result of our full year-end review procedures of CH2M's historical deferred tax asset and liability position. There was another $0.18 from CH2M acquisition-related restructuring and other transaction-related expenses. And finally, another $0.10 charge resulting from the sale of our Guimar joint venture in Brazil, most of which was non-cash. This JV was previously part

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of our ECR business.

Excluding these items, fourth quarter adjusted EPS was $1.31, up 34% year-over-year. Our Q4 DSOs improved sequentially as we tightened our focus on cash collections from the uptick we saw in the first half of the year. This help support solid cash flows for the quarter, but we still certainly have more work to be done in this regard.

Turning to our bookings during the quarter, our pro forma book to bill ratio was 1.03 times for the fourth quarter period.

Let me now review our results for full year performance on slide 13. Our results clearly demonstrate our focused execution against our profitable growth strategy. Revenue increased 9% on a pro forma basis. GAAP operating profit margin was 4.3% and adjusted OP margin was 6% which is 60 basis points versus the year ago figure.

Operating profit for both Jacobs and CH2M legacy businesses grew double digits and when combined, pro forma growth was 13%. GAAP EPS was $1.28 and when excluding the same items as referenced for the quarter, adjusted EPS was $4.47, up 38% versus a year ago and above both our initial outlook as well as the high end of our current guidance. Our continued successful execution against our CH2M integration plan has certainly led us to outperform against the original accretion objectives for the acquisition.

Regarding DSOs for the year, we certainly did not meet our internal targets that we established for ourselves, but we continue to see opportunities and our focus to improve our performance going forward. Finally, for the year, our book to bill ratio was 1.04 times.

Before I turn to the next slide, we plan to file our Form 10-K in the coming days. Please note that we continue to finalize our year-end audit processes with a specific focus in the area of income taxes. As you know, this is a complex area this year given U.S. tax reform and the acquisition of CH2M.

At this point some final audit adjustments may be a possible in our final reported U.S. GAAP results that would be reflected in our Form 10-K. Notwithstanding any potential adjustments, we do not expect changes to our adjusted results at this point in time.

So regarding our LOB performance, let's turn to slide 14 and begin with ATEN. In addition to the strong top line performance that Steve already highlighted, ATEN delivered strong operating profit growth for the quarter and full year of 14% and 12% respectively. Operating profit margin for the quarter was 7.3% and 7.5% for the year when excluding the legal matter that we had discussed previously in Q2. This figure remains in line with our 7% to 8% expectation. And longer term, we continue to expect operating profit margins to improve in ATEN as we move up the value chain to higher value engagements.

Fourth quarter (sic) BIAF revenue grew 1% year-over-year on a pro forma basis. As you may recall, our revenue growth in prior quarters has been higher than our backlog growth due to the timing of backlog burn. The fourth quarter revenue growth has now corrected that differential. From a full year standpoint, pro forma revenue growth was 8% which is more indicative of the LOB's overall momentum.

On a pro forma basis, fourth quarter and annual operating profit was up 5% and 11% respectively. Operating profit margin was 8% for the quarter, up 30 basis points on a pro forma basis. For the year, operating profit margin was 7% – 7.8%, up 20 basis points on a pro forma basis.

We continue to see further room for margin expansion in BIAF from a combination of executing against our higher gross margin in backlog, strong project execution and targeting higher margin opportunities in our pipeline. In fact, based on our early wins in fiscal 2019 and the continuing progression in our pipeline, we are expecting an acceleration in gross margin and backlog by the end of the first half of the fiscal year 2019.

Lastly, our ECR fourth quarter and full year operating profit grew 19% and 23% respectively on a pro forma basis. In the fourth quarter, operating profit included a $9 million charge related to the fixed price project that we accrued in corporate expense in Q3 2018. As Steve stated, we are very pleased with the strong financial performance of our ECR business since we embarked on our strategy in 2016. In fiscal 2019, we expect our ECR businesses to be reported as

discontinued operations and assets held for sale in our financial statements.

Our non-allocated corporate overhead costs were $3 million for the quarter and benefited from a $15 million reserve – reversal of the project reserve noted earlier, $9 million of which is now reflected in ECR's operating profit. For the full year, unallocated corporate expense was $116 million and at the lower end of our expected range due to continued good performance against our synergies and lower than expected fringe-related costs. These reductions were somewhat offset by higher incentive accruals given our strong performance. In fiscal 2019, we would expect fringe-related costs to return to more normalized level and especially so in Q1 given that we are coming to an end of our medical plan calendar year and that's when medical costs tend to be at their highest level.

Now turning to the synergy numbers. Please note – on slide 15, please note that given the pending divestiture of ECR expected in the first half of calendar 2019, we will now adjust our synergy commentary to exclude any one-time costs and synergies associated with the ECR component of the CH2M integration. All following figures now exclude these impacts.

So we achieved $85 million in synergies for the year. This amount is above our previous estimate of total synergies for the year of $75 million which included ECR. Clearly, we outperformed. Going forward, we still anticipate achieving our previously increased synergy target of $175 million even without ECR. So on a like-for-like basis, we are once again raising our synergy estimate, and we expect our run rate in synergies to approach $175 million as we approach the end of our fiscal 2019. We also estimate the P&L cost to achieve these savings to be $265 million with a bit more than 60% of our P&L-related one-time costs being cash-related.

A couple of other key points. Through Q4, we have incurred $171 million of the expected $265 million in cost to achieve these synergies. These figures exclude the ECR-related one-time costs. Finally as it relates to our CH2M transaction and change in control costs, we have incurred $91 million through Q4. This figure has not materially changed versus our previously communicated figure in Q3.

Now, on to the balance sheet on slide 16, before reviewing the balance sheet, I want to provide an update on Inpex, a contingent liability we assumed as part of the CH2M acquisition relating to our project in Darwin, Australia. As you know, we have discussed this item since announcing the acquisition of CH2M.

In Q4 2018, we have updated our opening balance sheet reserves for Inpex, which remains in the early stages of arbitration. We continue to pursue our affirmative claims against the counterparty and defend ourselves. Regardless, we felt this adjustment was prudent as we further evaluated this matter over the course of this fiscal year.

Importantly, as we evaluated the CH2M transaction, we modeled a variety of potential outcomes and when including the amount of this reserve, our financial model remains materially consistent with the expected overall returns of the transaction. As a result, we do not expect that this reserve, if in fact it becomes an actual cash cost, to materially impact our original internal rate of return expectations associated with the transaction.

In line with our previous disclosures, a resolution of this matter is not expected to occur until our fiscal year 2020 at the earliest. We ended the quarter with cash of approximately $800 million and a gross debt of approximately $2.2 billion. Our gross debt level was down $194 million from our Q3 level, supported by a strong underlying cash flow from operations of $212 million. Included in our cash flow from operations during the quarter was a voluntary $50 million pension payment we proactively made to reduce our cash taxes and pension insurance fees.

Including that discretionary contribution, our underlying cash flow from operations for the quarter was more than $250 million and represented an improving cash flow trend as we progressed through our integration efforts.

Consequently, our gross debt leverage improved to 1.7 times adjusted EBITDA at the end of Q4 as calculated per the terms of our credit agreements and within the high-end of the range of our gross debt to adjusted EBITDA target of 1 to 2 times. Importantly, our net debt to adjusted EBITDA is now 1.1 times.

Turning to the right side of the slide, when considering the $2.6 billion in expected net proceeds from the sale of ECR, which, for the purposes of this slide, assumes WorleyParsons' share valuation at time of announcement, our pro forma Q4 net cash position would be approximately $1.2 billion. This clearly sets us up well to deploy capital in a manner

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that focuses on incremental value for shareholders as outlined on slide 17.

As you know, we have a track record of disciplined value-driven capital allocation, which has created strong returns for Jacobs' shareholders. As we stated when we announced the ECR transaction, our capital deployment strategy will consider organic and external growth opportunities as well as returning capital to shareholders. We'll have more details for you at our February Investor Day and as we get closer to the completion of the transaction.

Now, turning it back over to Steve for some closing thoughts.

Steven J. Demetriou

Thanks, Kevin. Turning to slide 18, we finished fiscal 2018 on a strong note and ahead of the goals we set in our three-year strategy. Our transformed portfolio has now positioned the company to accelerate its growth agenda in a more focused way. We reaffirm our previous fiscal 2019 adjusted EPS guidance in the range of $5 to $5.40, assuming a full year of ECR operations.

For Q1, consistent with our annual guidance and incorporating the seasonality of our business, we expect adjusted EPS in the range of $0.85 to $1.15, including ECR. Until we close the sale of ECR, we will continue to provide EPS guidance on a quarterly basis.

Consistent with the announced transaction, we continue to expect fiscal (sic) 2019 adjusted pro forma EBITDA, excluding ECR, on a full-year basis to be in the range of $920 million to $1 billion. We continue to work on the next phase of our strategy and we look forward to sharing this with you at our Investor Day in February.

Operator, we'll now open up the call for questions.

Q&A

Operator

We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from Lucy Guo with Cowen & Company. Lucy, your line is open.

<Q - Lucy Guo>: Thank you. Good morning, Steve and Kevin. First question is if you maybe talk about the new Jacobs segments, ATEN and BIAF, and what your early thoughts may be for the FY 2019 outlook and also if you could address the free cash conversion characteristics for the new Jacobs going forward.

<A - Steven J. Demetriou>: Good morning, Lucy. Thanks for the question. Yeah. So, we're very positive about both our lines of businesses that you mentioned, ATEN and BIAF, as we go into fiscal year 2019. ATEN, we've got a very strong sales pipeline that we're confident will drive profitable growth in both fiscal-year 2019 as well as into fiscal-year 2020 that we believe we're in all the right areas with regard to that business, long duration, recurring revenue contracts, over 90% of that business are these long-term contracts.

And also, our pipeline is significantly stronger as we enter 2019 compared to 2018. And so, whether it's Intelligence Community, defense, cyber, SOCOM, Missile Defense, we've got a rich pipeline as well as military infrastructure and, as I mentioned, some of the commercial activities around 5G, et cetera.

On BIAF, similarly we're very excited about the pipeline of our business. What's come out of the midterm elections is extremely positive for this business. And we see a very robust pipeline of opportunities in the Americas around transportation, both rail and highways. Aviation continues to be extremely strong and the U.S. Water, as a result of all the drivers of aged infrastructure, climate change, resilience is extremely strong in the U.S. And on the Advanced Facilities side in the U.S., both life sciences and electronics, we have a pretty rich pipeline of activity going forward.

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Outside of the U.S., Middle East is extremely strong almost across the board, similar to the U.S. story. We've got tremendous opportunity in aviation in the Middle East as well as Australia and India. And even in the UK, where there's Brexit uncertainty, the scope and scale of all our UK programs continues to move forward and we're penetrating broader Europe and so, we're pretty positive about the outlook for 2019 and BIAF as well.

Kevin, on the free cash flow conversion?

<A - Kevin C. Berryman>: We talked to, Lucy, when we did the announcement on the ECR transaction is that fundamentally there's two things that are going to help us going forward with kind of our new portfolio after the transaction closes.

First one is that the ECR business, while having done a great job in improving its margin profile over the last two or three years, is still the lowest-margin business that we have. The operating profit margin is in the neighborhood of a couple hundred basis points lower than the rest of the portfolio. So, clearly when that business exits, we'll have a higher-margin profile, which clearly will translate into a higher level of cash flow conversion going forward.

The second piece is that the DSOs for the ECR business tend to be higher than the rest of the business. And certainly, there are some structural issues associated with that business, obviously very competitive in nature. And consequently, as we think about our cash flow conversion, both of those items will translate into our results and – in cash flow actually improving versus where we are.

Having said all of that, unlike the numbers that we were able to put up in the back half, this is kind of a messy year on our cash flow, because we got a lot of things going on, on the integration efforts with CH2M, but the back half of the year, we're approaching $500 million of operating free cash flow in Q3, Q4, when you adjust for the onetime – you exclude the adjustment or exclude that onetime pension contribution we made.

So, we're developing into, as we progress through the integration process, a really strong picture as it relates to our cash flow dynamic going forward.

<Q - Lucy Guo>: Very helpful color. Thank you. And the follow-up question is probably on top of everyone's mind, which is your capital deployment plans maybe with a focus on ATEN and a couple of underlying context to that is, one, the budget priorities in areas such as space, intel, cyber, cloud and secondly, perhaps if you're looking for some margin-accretive transactions where you can kind of bolster to this 7% to 8% target.

<A - Steven J. Demetriou>: Yeah. So, we're going to spend some more time in February on our Investor Day outlining our strategy and I think we're going to want to wait there to kind of discuss more about how M&A fits, because, as you know, it's important for M&A to be consistent with strategy and as we finalize our next phase of that strategy, we want that to be cohesive.

But you just mentioned the federal budget. I talked about the positive nature of that on our infrastructure and we're also net positive on our Aerospace, Technology, Environmental and Nuclear business. There's a lot of talk about what's going to happen with defense spending, but we believe, based on our discussions on the Street as well, that the major focus is going to continue to be on both parties around cybersecurity, around mission – the Intelligence Community, around the SOCOM, which were a big player in missile defense, also base military infrastructure where that's a big market for us.

So, we believe that the federal budget will be there for us to continue to grow our backlog, but also, as I mentioned during my remarks, our strategy in ATEN and our unique approach to going to the market were continued to be positioned to gain share in this environment going forward as well.

So, to kind of finish it off, we'll come back around capital deployment and more specifics around the topic I just mentioned, across both our BIAF and ATEN businesses.

<Q - Lucy Guo>: Really appreciate it.

<A - Jonathan Doros>: Next question, operator?

Operator

Your next question comes from Jamie Cook with Credit Suisse. Jamie, your line is open.

<Q - Jamie L. Cook>: Hi. Good morning. I guess two questions, probably more to Kevin. Kevin, I mean when you guys talked about or announced the sale of the ECR business, you had some commentary with regards to doing whatever you could to sort of offset the dilution associated with the sale. And I didn't really see much in terms of when we're thinking about the guide, how to think about that for 2019. So, any update there?

And then my second question, I appreciate the update on Ichthys and you talked about opening up the balance sheet reserve, I don't think you quantified. So, I don't know what type of color you could provide on that.

And then, also some of the partners that are finishing up the Ichthys projects are obviously having some balance sheet issues. So, how you're thinking about the potential risk to Jacobs with regards to that, in particular, Chiyoda?

<A - Kevin C. Berryman>: So, a couple things, Jamie, to respond to the questions. First one on kind of the opportunity for our go-forward elimination of stranded costs, I think the way that we're thinking about this, and we've already started the process, is that as we look to finish and execute the final transaction close and again we're expecting that to occur sometime in the first half of calendar year, by the time we are able to get to that point in time, we will have had very clear outline as it relates to what are the costs that will be going with the transaction to help support the ECR business and what costs will not. And we'll have taken actions to fundamentally, largely offset any stranded costs that remain.

And so, our view is that that's what we're going to be able to do. So, if you think about the dynamic associated with our reported results, while we're going to have a lower base versus the corporate overhead allocations, certainly the corporate allocations that are embedded into the business we assume we will be largely able to exit without really a lot of fundamental challenges associated with, let's call, the RemainCo business. So, that hopefully provides a little bit of incremental color.

As we work through that with WorleyParsons as we get to the final transition services agreement and understanding what costs we need to provide to them and how that works, we'll provide more updates, but it's a little bit too preliminary about that particular issue.

In terms of the buyback, certainly the opportunity we will continue to explore buyback on a short-term basis and take actions at minimum to offset the share creep from incentive comp that happens on an annual basis. And we will continue to evaluate the share buyback in the near term associated with that and potentially more – more to come as it relates to that as we work through the strategy update clearly.

The final thing on Inpex matter, look, I think you'll be seeing the K come out in the next day or so. And you'll see some incremental, probably, details versus what we have here, but let me make a couple comments. The total kind of purchase price accounting, the reserves that were established for the quarter incrementally versus Q3 was approximately $300 million increase, okay, not all of that is associated with Inpex, while a chunk of it is, not all of it is.

So, I'll leave it there, because we're in the midst of the arbitration process, the preliminary stages of that. So, certainly you can bookend it and say it's certainly a number that's below that incremental amount that we put on in Q4. So, hopefully that provides a little bit additional color for you.

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

<A - Jonathan Doros>: Thanks.

Operator

Your next question comes from Steven Fisher with UBS. Steven, your line is open.

<Q - Steven Fisher>: Thanks. Good morning. Kevin, you mentioned an expected – an acceleration in gross margin and backlog by mid-fiscal 2019, I think it was. What gives you that confidence? Is that based on some bookings that you already have now in backlog after we're into Q1 and how quickly could you see that translate into reported margins?

<A - Kevin C. Berryman>: Thanks, Steven. I think it's kind of two things. One, the preliminary wins that we've seen in October so far in our fiscal 2019 and the pipeline, which is transitioning from a pipeline opportunity to a win, which fundamentally is getting to the point where it might not close in October or the first quarter of this year, but certainly in the second quarter of next year. So, the developing pipeline as well as wins to-date are creating a pretty bullish view that we have, as it relates to BIAF going forward into 2019.

<Q - Steven Fisher>: Okay. And the second half of that was how quickly could that translate into the reported margins? Is that like a second half of the year?

<A - Kevin C. Berryman>: Certainly, the second half would be the expectation. If some of those larger things happen in Q1, which we're not exactly sure of the timing of what might happen, certainly could happen a little bit sooner than that, but I would say for purposes of just being conservative, I would say more second half than second quarter-related.

<Q - Steven Fisher>: Okay. And then, could you just talk about the expected trajectory of the pro forma revenue growth in ATEN? Certainly, still strong double-digits this quarter. Do you anticipate that that would moderate to the single-digit growth over the course of fiscal 2019? And if so, should we expect really the offset to be in higher margins there, maybe getting closer to the 8% of your 7% to 8% range?

<A - Kevin C. Berryman>: So a couple of things. First, as you know, the very strong double-digit revenue growth that we saw in 2018 was a ramp, was largely associated with the ramp, but the underlying business was strong as well. And so, we fundamentally believe the benefits of the large project ramp up is going to dissipate as we enter into 2019, but still the underlying businesses is strong and solid. And consequently, we're not going to see those large mid-double-digit teen kind of increases in revenue, but we do expect good revenue growth.

And so, I think the overall kind of outlook for ATEN continues to remain good solid growth, probably more in the single-digit range obviously and, of course, margin profiles continuing to improve over time. I think that's very much aligned with what our original strategy was that we outlined in 2016. And I would say, if anything, ATEN and their ability to drive innovation not only into their own portfolio but creating cross-sell opportunities with the remaining parts of our portfolio are going to be a driver to our ability to kind of grow margin profile longer term.

<Q - Steven Fisher>: Okay. Thanks very much.

<A - Kevin C. Berryman>: Welcome.

Operator

Your next question comes from Andrew Kaplowitz with Citi. Andrew, your line is open.

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

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

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

<Q - Andrew Kaplowitz>: Steve or Kevin, can you give us a little more color on what you're seeing in BIAF? Last quarter, you mentioned that sales would improve sequentially, margin will be in the 8% to 9% range. And while backlog was still up sequentially, sales were down a little. Margin was at the bottom of the range in the quarter. You mentioned UK is pretty solid for you guys, but obviously the geopolitical situation there is pretty unstable. So did you see anything that was a little weaker than you thought?

Then I think, Kevin, you also mentioned that the 8% growth you saw in FY 2018 was more representative of that business. Is that kind of what we should be thinking for 2019 sort of mid- to high-single-digit growth for BIAF?

<A - Steven J. Demetriou>: So why don't I just give a little more color on BIAF and then Kevin maybe wrap up with the trend that the question was about. So on BIAF, I think sequentially if you were talking about operating profit margin, there were a couple of dynamics in the fourth quarter that had some one-time – there was some cleanup of some past project work and that created a little noise versus last year and sequentially. And then when you look at also the strong performance in the business, there was some compensation accrual that got put in there. And when you normalize that, we had sequential profit growth and strong margin performance.

As we go into fiscal year 2019, as I mentioned, the opportunities are significant. And, in fact, a lot of wins that we discussed today came in October. And so, those wins are not yet on the backlog. When we talk about the Highways England or talk about the confidential life science or the City of Waterbury and California WaterFix, we highlighted those as recent wins, but are not on the backlog and several of those are very significant.

And the pipeline is rich when we look at what we're doing around BIAF globally. And I mentioned the strong U.S. I just want to reiterate when we look at our electronics business, significant opportunity there driven by unprecedented growth in data storage and cloud computing, autonomous vehicles, et cetera and that's coming through not only in the U.S. but in Europe and Asia Pacific, specifically in places like Korea, Japan, Taiwan and China for us.

And then, when we look at the water business, the significant opportunities in the U.S. and the funding is there. One of the positive things that came out is not just the hype around infrastructure, but specifically around the midterm elections that $40 billion of ballot measures were approved, 272 specific ones that really give us optimism around funding, around transportation and water across the United States. So, we're very bullish on the first half as far as building backlog. The question is just timing between our fiscal year first quarter and second quarter, but the wins in pipeline are there. Kevin?

<A - Kevin C. Berryman>: Yeah. I think we're feeling good about both ATEN and BIAF in terms of the growth profile for next year. The one comment I would make, and it was kind of covered in some of the remarks on the call is that we have been seeing these, for BIAF, some pretty large growth levels in the first part of the year, which was comparing to our backlog growth, which was good, solid, sustainable growth, but the growth was stronger.

I think as you look at the fourth quarter numbers, you can kind of see that we settle back to an annual number that's probably more in line with kind of the underlying momentum. So to that point, yes, we're probably back into the mid-single-digit kind of growth profile as it relates to the revenue growth. I think longer term, I think the piece that will certainly accelerate our benefit to improve our margin profile again is gross margin and backlog, which we also will assume given the earlier comments that, yeah, we're going to see an acceleration in that.

<Q - Andrew Kaplowitz>: That's helpful, guys. And then just asking you a little bit more color in ATEN backlog, in the sense you know that this is the first quarter it was down a little sequentially, obviously still up year-over-year and still good result. But last quarter you sounded confident that backlog can rise in 2019 in ATEN. Steve, I think you mentioned the $425 million of renewables will be bid out soon. So do you still have confidence in the backlog increase? And assuming that it will, should we think it's more back-end loaded or your project is more sort of piled up toward the end of fiscal 2019 or are they sort of ratable throughout the year?

<A - Steven J. Demetriou>: So just a little more color beyond what I said earlier is that specifically the pipeline, and as we dissect and analyze the pipeline, the bottom line is it's up 20% year-over-year, which is a pretty significant number and even more specifically we now have in the pipeline 17 opportunities valued at $100 million or more compared to 11 last year. So a 50% increase and larger programs and you know we have a pretty strong win rate in this business. So that gives us confidence around the ramp up of our backlog.

So a lot of that is just based on timing and also the whole rebid discussion. But we expect to be putting some of that back into our backlog as we progress through the year. So I would say as I sit here today, we just see a sequential growth going through the year. Nothing that I can point to a spike in one quarter versus the other just because we can't predict when these things will close.

<Q - Andrew Kaplowitz>: Thanks, guys.

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Operator

Your next question comes from Michael Dudas with Vertical Research. Michael, your line is open.

<Q - Michael S. Dudas>: Good morning, gentlemen. As you look at your mix of public sector versus private sector clients, maybe more primarily in BIAF, do you see any differential in growth rates or opportunities, international versus domestic? It sounds like there's a little bit more interest, excitement, as you mentioned, in Middle East and even the UK that could help lever that growth rate outside the U.S. relative to your business here?

<A - Steven J. Demetriou>: Well, it's tough to sort of pinpoint a specific answer to that, Michael. But when we look at our Advanced Facilities business, which is heavily on the commercial sector, we've got strong opportunities, as I mentioned earlier, in the U.S. and as well as in UK, Europe and some specific opportunities in Asia Pacific. But the electronics business is strong across the board. And so that gives us some pretty strong bullish outlooks as it relates to the commercial sector.

And then, I go back to the remarks I made earlier around whether it's federal, state or local funding as well as P3 funding. We just feel like we've got a strong pipeline across the board on transportation, water, environmental services et cetera. So it's – I don't think we sort of specifically differentiate growth rates just across the board. We see a strong outlook in BIAF, in all those markets.

<Q - Michael S. Dudas>: And a follow-up maybe for Kevin, as you're looking through the M&A pipeline, you have the February Investor Day, the close of the transaction sometime in the first half of calendar next year, is timing of those events, milestones impactful to what opportunities that might be ahead of you relative to capital allocation, whether it's a smaller M&A, a larger M&A or thinking about accelerating some of that to offset of the [indiscernible] (00:59:41) repurchase?

<A - Kevin C. Berryman>: Yeah. I think there's not an absolute there, obviously.

<Q - Michael S. Dudas>: Sure.

<A - Kevin C. Berryman>: And I think that we're continuing to work hard on the CH2M integration. Clearly, we've got more work to be done. We're very excited about the work that the teams have done to-date, and the profile of the margins, the profile of the cost synergies, all of the things that we were committing to at time of acquisition are going very, very well, but we can't take our eye off that ball obviously. But nonetheless, it's the strategy of as we're developing it and the update to that, it's clear that there are going to be opportunities that could become available whether it is smaller acquisitions or whatnot, and we will obviously consider those.

So, there isn't an absolute heartbreak that nothing will happen until which time that we do some of these things. The other point is that depending upon what's happening as it relates to the overall market, certainly, we will be considering share buybacks and those kinds of matters prior to our Investor Day in February.

<Q - Michael S. Dudas>: Excellent. Thank you, Kevin.

Operator

Your next question comes from Josh Sullivan with Seaport Global. Josh, your line is open.

<Q - Josh Ward Sullivan>: Hey. Good morning.

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

<Q - Josh Ward Sullivan>: Just within aerospace and defense exposure, given that the change in the House leadership here, some comments out of the current leadership about 2020 defense budget, how does Jacobs continue to move up the value chain in defense and maintain that cost leadership position? Is that dynamic a challenge to get up the chain or is an opportunity for you to gain share?

<A - Steven J. Demetriou>: Yeah. Just – again, I want to just reiterate that we see a lot of support and that even the changing government profile in the U.S. on the core programs that we're focused on going forward, intelligence, missile defense, special ops, cyber, base military infrastructure, and I think we've demonstrated that we've been expanding and gaining market share over the last couple of years with our model, which includes cost efficiency compared to other government service contractors. And so, we are continuing to believe that we're not only going to see the funding for the programs we're in, including NASA, but also that we're going to be able to continue to gain share as we go forward across the ATEN spectrum.

<Q - Josh Ward Sullivan>: Okay. And then just as you look at the two segments, what are some of the significant synergies or overlaps between the two? Do capabilities in ATEN allow you to win projects in BIAF, maybe things like cybersecurity and ATEN for something like smart cities and BIAF, or can these two segments win as stand-alone operations?

<A - Steven J. Demetriou>: Well, clearly, we've set up this line of business structure originally in 2016 with the three lines of businesses, as we go forward, with the two lines of business, with a global focus set up as two lines of businesses because we believe that the size and scale of these global structures will position us to win in the marketplace going forward. And we still believe in that and that's the priority.

But, as we've progressed and we look at just data solutions and the whole technology and innovation spectrum, we do see a connectivity that's very important and that's the reason why we created a new Head of Technology and Innovation that individual Darren Kraabel comes from the ATEN organization was one of the senior leaders there, and his mission with our senior leadership across the company, including Terry Hagen and Bob Pragada, who run the two lines of businesses, is to drive revenue synergies. And you mentioned one of them that we think is a great opportunity is cybersecurity with the acquisitions and organic capabilities we've built and ATEN is to drive that across both ATEN and BIAF.

The whole IT enterprise management success that we've had in both ATEN and BIAF, which has been doing the same thing, we see the ability to further strengthen that. And so, whether it's organic strategies or potentially even inorganic opportunities, we see really a parallel focus of continuing to drive these two line of businesses forward with their individual strategies, but revenue synergies associated with connecting the two as you've outlined.

<Q - Josh Ward Sullivan>: Okay. Thank you.

Operator

Your next question comes from Jerry Revich with Goldman Sachs. Jerry, your line is open.

<Q - Jerry Revich>: Yes, hi. Good morning, everyone.

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

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

<Q - Jerry Revich>: Steve, I'm wondering if you could just put a finer point on timing of bid opportunities across the two remaining businesses over the course of fiscal 2019, how balanced is the large project bookings opportunity over the course of a year that you described in ATEN? And also can you comment on any major upcoming renewals or contract rollovers you have? I believe the Hartford contract is coming up. Can you just comment on any other moving pieces we should keep in mind from a re-bid standpoint as well?

<A - Steven J. Demetriou>: Yeah. From an ATEN perspective, I think the message today around re-bids is that almost across the board move to the right, which I think is a testament to our relationship and performance across the board. And as a result, we don't see – we actually see stability around that as we go into 2019, and we believe that some of the re-bid opportunities may start to progress in the second half which would then come into play for 2020.

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But, right now, I would say that it's moving to the right and we feel pretty stable profile over the next 12 months, which means we'll put some of that back on the backlog as we get confirmation on those across the next couple of quarters. Now – which then I think the exciting part is, is which pipeline of opportunity I mentioned 20% up year-over-year is really all new business opportunities. And it's all part of that expansion that we've been talking about today both market share as well as just growing in our core sectors. So, I can't give any more specifics around quarter-by-quarter timing just because the nature of the businesses is it could happen tomorrow or may take three or four more months, but we feel very confident on continuing to ramp our backlog in ATEN steadily over the next 24 months.

And then on the BIAF front, I've been very excited about what that team has been pursuing across the board as I continue to mention and some of those wins, we've already announced, but they're not in our backlog, and so that creates a near-term dynamic of backlog growth in BIAF, and there's just numerous opportunities across the built environment.

Energy distribution is becoming a nice opportunity for us and outside of the U.S., specifically, there's opportunities in Germany to distribute renewable power in post-nuclear era there that we're involved in. We're in Middle East as well around energy distribution with some significant opportunity. So that just becomes another add-on to the buildings opportunities, the life sciences, water across the globe, as well as our major transportation play and highways, rail and aviation. Aviation continues to be very strong for us. So I can't say anything other than I just expect to see it throughout the next several quarters, a nice ramp-up in backlog in BIAF as well, and we'll see how the timing is up.

<Q - Jerry Revich>: Okay. Thank you. And then separately, Kevin, just on the litigation arbitration process and Ichthys, obviously, a lot of concern in the market today, can you talk about in the worst case scenario, and obviously, you have a very strong case in your favor, but in the worst case scenario, what would the after-tax cash considerations could be, if the other side is successful? Because the stock value is down a $1 billion today, and I think the worst-case scenario on after-tax impact on Jacobs will be significantly less than that. So, maybe you could address that head on, because it's tough to get the contract structures, since they're not publicly available.

<A - Kevin C. Berryman>: Well, look, this is – we're in the early stages of this arbitration. I can tell you that we feel we've been very prudent, as it relates to the incremental reserve that we've put on the books, as it relates to this matter. So, it's hard for us to even think about something that would equate to the numbers that you're alluding to. But I think that there is, we've done a very deep diving on this issue during our diligence. We've done – been doing additional deep dives over the course of this year. And we believe that the matter at hand, and the view that we've put on to the opening balance sheet is prudent, and not aggressive from a Jacobs perspective.

So, I guess I would leave it there. Look, there is a variety of ways that the folks may be interpreting this, but I'm telling you, we view this as a prudent step to take, and we haven't been – I don't think we're underestimating the position that we have to bring to the party as it relates to this matter.

<Q - Jerry Revich>: Okay. I guess based on Jacobs' share of the project, it's tough to get to an after-tax number that would be above $400 million. Is that fair?

<A - Kevin C. Berryman>: If you look at the reserve that's been established, it's, as I've already said on this call, it's well below $300 million, and that's a pre-tax number, so...

<Q - Jerry Revich>: Okay. Thank you.

Operator

Your next question comes from Anna Kaminskaya with Bank of America Merrill Lynch. Anna, your lie open

<Q - Anna Kaminskaya>: Good morning, guys. So, maybe to wrap up the discussion on cash flow deployment, can you remind us of your return hurdles on acquisitions and the timeline for those returns? And if you do find a big strategic acquisition, would you be willing to push some of those hurdles? Kind of, how do you think about it internally? And maybe we've seen some of the companies in the [ph] indices (01:11:35) coverage and industrial

coverage moving to cash EPS, if it's, I don't know, GAAP EPS dilutive. How do you think about moving to cash EPS if it's a strategic deal? Just provide a framework as we go into your Analyst Day in February?

<A - Steven J. Demetriou>: So, thank you, Anna. Let me start here first, and then turn it over to Kevin, as we – I think the two words that are going to dominate our M&A decisions going forward are strategic and disciplined. And I think we've proven that. We don't feel under any pressure to go out and buy things. We clearly want to get through our strategy work that we have another few months to go, and we'll outline it in February.

And as we did with the CH2M acquisition, which if you recall, ticked off like six out of our eight key strategic conclusions back in 2016. That's the kind of strategic focus we're going to have going forward, whether it's small bolt-on acquisitions or whether there would be a larger acquisition that would fit. We'll see. But it's going to be clearly focused on strategic fit, and then discipline around our financial hurdles, which are all about shareholder value creation, all about accretive EPS growth and improving our return on invested capital and driving margin improvement. And it's no one specific financial metric that we can tie to, because – but we believe that anything we do organically or inorganically needs to continue to drive to the collection of financial discipline that we've been demonstrating over the last couple of years. But, Kevin, beyond that?

<A - Kevin C. Berryman>: No. I think you answered it pretty well. Our disciplined approach to this effort in driving shareholder value, especially as it relates to potential transactions that might be considered, this is a cash return team that looks at and evaluates in a disciplined manner the amount of cash that could be expended and the expected return profile associated with it.

And so, to Steve's point, we have a view as it relates to how we're going to want to drive our business going forward. And there are certainly some opportunities that we believe are out there, but we don't feel we have to do it. And consequently, we will be very disciplined when we execute and determine what the implications for our portfolio is, what the value creation opportunity is, and that ultimately will translate to an incremental return from a cash flow basis.

<Q - Anna Kaminskaya>: That's helpful. And then...

<A - Kevin C. Berryman>: Just – go ahead.

<Q - Anna Kaminskaya>: No, no, no. I'll let you finish. Apologies.

<A - Kevin C. Berryman>: No. I was just going to say – you also asked the question about the cash EPS. Certainly, there is noise in our figures right now as it relates to the CH2M acquisition, and the amortization, and then what happens when we divest. And certainly, we'll provide an update as it relates to it at our Investor Day coming in February. So certainly, there are some benefits associated with that, because it gives greater clarity on that underlying cash flow, which I was fundamentally just talking about.

<Q - Anna Kaminskaya>: Great. And maybe just given what's happening in the market and at new Jacobs, have you thought internally about what the company will look like in the next downturn, what levers you have to pull, what kind of margin profile can we see, let's say, if there is a downturn tomorrow?

<A - Kevin C. Berryman>: Well, look, as we talked about the ECR sale, which again is going to be scheduled for the close – first half of the calendar year 2019. There is a greater degree of volatility associated with that. And we fundamentally believe that our remaining businesses are poised against long-term secular needs both for the U.S. government and governments across the world, as well as the infrastructure needs across the globe as well. So, we fundamentally believe there's an underlying positive kind of secular trend that we should be able to benefit from.

So, we don't see that at this particular point in time in terms of there being a very large, kind of, change as it relates to the go-forward momentum behind each of these businesses that we are talking to. So, certainly, the secular trends that we've seen in the past especially when you talk about the commodity side of our business will be eliminated. And consequently, we believe that there's a greater stability associated with our business.

And when you combine that with the innovation efforts that are going to be embedded into our portfolio, which are already happening and which will continue to be accelerated given our focus on it, that further will provide an ability to

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mitigate versus any kind of overall slowdowns relative to specific businesses or industries in which we are serving. So, we're very robust as it relates to that.

<Q - Anna Kaminskaya>: I appreciate your thoughts.

Operator

[Operator Instructions] Your next question comes from Tahira Afzal with KeyBanc. Tahira, your line is open.

<Q - Tahira Afzal>: Thanks. Hi, folks. I apologize. I got disconnected. So, I apologize if I'm asking questions that might have been asked before. Kevin, just in terms of quarterly cadence of EPS, you've been very helpful in the past. Is there more of a back-end loaded profile going forward? Is it kind of spread equally amongst the quarters? Anything would help.

<A - Kevin C. Berryman>: Yes. Thanks for the question. Clearly, we provided some preliminary guidance for the Q1 figures. You will note that if you take that number and multiply it by four, it doesn't get to the $5 to $5.40 that we provided as guidance. There's a couple of things I think that are important to note. First one is, the kind of cadence of EPS over the course of our year, the lowest quarter in the year is our first quarter. That's driven by a couple of things. Certainly, it's driven by the kind of holiday period where we tend to have a little bit lower revenue burns associated with what's going on. Clearly, the winter aspects associated with our first quarter, the October to December time period also impacts that. So, that is one thing. So, the seasonality of Q1 is always a lower number and we tend to basically see when you look at a number which is Q1 versus kind of how we've ended the previous quarter, where typically, we can range from 15% down to maybe even as high as 20%, 25% down sequentially versus our fourth quarter.

So know that our guidance for the first quarter has that embedded into it and the other thing which I alluded to on our call, was we saw some really good performance through the last half of our fiscal 2018 relative to our fringe rate performance. And that's really driven by our actuarial teams and they do the full analysis and we've seen really good performance on medical, on workers' comp and in insurance claims and all of those things which has been really positive. We're not assuming that that continues to the rate that is, so you take those two things combined and effectively that translates into a more muted Q1 figure.

The other point that I would make consistent with 2018 is our ramp in synergies continues. And so at the end of the year, the synergies are larger than at the beginning of the year. And as we saw this year, clearly the margin profile was changing over the course of the year where the margins continually got bigger on a sequential basis and our Q4 numbers of 6.8% for the quarter were clearly an indication of that, and we would expect a similar dynamic, maybe not as pronounced in 2019 because of the large successes we had in synergies in 2018. So clearly, yes. Just like last year, our back end is stronger than our front end. And clearly Q1 is seasonably the lowest EPS quarter for the year.

<Q - Tahira Afzal>: Got it, Kevin. And a quick follow-up to that. And if I look at the margins you've guided to that embedded in backlog clearly higher. Can you give us an idea of how much of the savings going forward you are baking into them? If it only reflects really the type of efficiency gains and productivity gains you've gotten to date?

<A - Kevin C. Berryman>: No, I'm not quite sure I followed the total question but let me rephrase and make sure I understand. Are you suggesting that whether or not we're assuming that our productivity gains are included into our gross margin and backlog, is that what you're suggesting?

<Q - Tahira Afzal>: Yes. If not, I assume they're incremental as you realize them next year?

<A - Kevin C. Berryman>: Well, look, I think our backlog gross margin expectations include both, right? So to the extent...

<Q - Tahira Afzal>: Got it.

<A - Kevin C. Berryman>: ...that we are bidding on projects and we have a clear understanding of what our cost structures are, which creates some level of productivity that we have been able to realize plus in fact perhaps an

incremental margin profile associated with our innovation or the project itself, both of those are embedded to that gross margin kind of expectation going forward.

Now, having said that, more to come as it relates to our continuing opportunities on the integration of the CH2M portfolio, and I would say the one thing that remains out there is our continuing investment in our system environment which is not yet really done. We started that process to integrate the two companies together on a single ERP platform. That is really hard work. As you know some pluses and minuses and that's a hard thing to work through when you got the moving pieces we have as an organization. But we would feel like that will start to generate some incremental benefit as we go over the course of the year as well. And certainly as we go into 2020, we'll have an ERP suite of applications which is going to be much better than it is today.

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

<A - Kevin C. Berryman>: Welcome.

Operator

We have no further questions at this time.

Steven J. Demetriou

Thank you. So as I said when we announced our portfolio transformation, we're building a stronger Jacobs that presents a compelling proposition for our employees, clients, investors and superior value for our shareholders. We believe this transformation creates inspiring opportunities for employees while driving a high performance culture that reflects accountability and inclusion, bringing together diverse people, capabilities and perspectives. And amidst the conversion and acceleration of significant global challenges, we're capturing attractive long-term growth opportunities and uniquely positioned to compete and win.

So thank you very much and we look forward to seeing all of you at our Investor Day in February.

Kevin C. Berryman

Thank you.

Operator

This concludes today's conference call. Thank you for your participation and you may now disconnect.

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