03-Aug-2020

Jacobs Engineering Group, Inc. (J)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Alain, and I will be your conference operator today. At this time, I would like to welcome everyone to the Jacobs Fiscal Third Quarter 2020 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]

Thank you. Mr. Jonathan Doros, you may begin your conference, from Investor Relations.

Jonathan Doros

Head-Investor Relations, Jacobs Engineering Group, Inc.

Good morning and evening to all. Our earnings announcement was filed this morning and we have posted a copy of this slide presentation and our prepared remarks to our website, which we'll reference during the call.

I would like to refer you to our forward-looking statement disclaimer, which is summarized on slide 2. Certain statements contained in this presentation constitute forward-looking statements, as such as 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. Examples of forward-looking statements include, but are not limited to, statements we make concerning the potential effects of the COVID-19 pandemic on our business, financial condition and results of operations and our expectations as to our future growth, prospects, financial outlook and business strategy for fiscal 2020 or future

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fiscal years. Although such statements are based on management's current estimates and expectations, and currently available competitive, financial, and economic data, forward-looking statements are inherently uncertain, and you should not place undue reliance on such statements as actual results may differ materially.

We caution the reader that there are a variety of risks, uncertainties and other factors that could cause actual result to differ materially from what is contained, projected or implied by our forward-looking statements. Such factors include the magnitude, timing, duration and ultimate impact of the COVID-19 pandemic and any resulting economic downturn on our results, prospects and opportunities, the timeline for easing or removing shelter-in-place, stay-at-home or social distancing, travel restrictions and similar orders, measures or restrictions imposed by governments, health officials in response to the pandemic, or if such orders, measures or restrictions are re-imposed after being lifted or eased, including as a result of increases in cases of COVID-19; and the development, effectiveness and distribution of vaccines or treatments for COVID-19.

For a description of these and other risks, uncertainties and other factors that may occur that could cause actual results to differ from our forward-looking statements, see our Annual Report on Form 10-K for the year ended September 27, 2019 and our Quarterly Report on Form 10-Q for the quarter ended June 26, 2020, which we filed this evening.

We are not under any duty to update any of the forward-looking statements after the date of this presentation to conform to actual results, except as required by applicable law. During the presentation, we'll be referring to certain non-GAAP financial measures. Please refer to slide 2 on this presentation for more information on these figures.

In addition, during the presentation, we will discuss comparisons of current results to prior periods on a pro forma basis. See slide 2 for more information on the calculation of these pro forma metrics. For pro forma comparisons, current and prior periods include the results of the Wood Nuclear business which closed in March of 2019. We have provided historical pro forma results in the appendix of the investor presentation. We believe this information helps provide additional insight into the underlying results of our business when comparing current performance against prior periods.

Turning to the agenda on slide 3; speaking on today's call will be Jacobs' Chair and CEO, Steve Demetriou; President and Chief Operating Officer, Bob Pragada; and President and Chief Financial Officer, Kevin Berryman.

Steve will begin by discussing our social justice and equality action plan, and then provide an update on our response to COVID-19 and then recap our financial results and updated outlook. Bob will then review our performance by line of business and Kevin will provide some more in-depth discussion of our financial results, followed by an update on our integration and divestiture, as well as review our balance sheet and cash flow. Finally, Steve will provide a detail on our updated outlook, along with some closing remarks; then we will open the call for questions.

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

Steven J. Demetriou

Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

All right. Thank you, Jon, and thanks everyone for joining us today to discuss our third quarter business performance and strategy update. While the COVID-19 pandemic continues to occupy our time, as leaders, we must not lose sight on speaking up for what's right. Earlier today, we launched Jacob's global Action Plan for Advancing Justice and Equality which was developed in a direct response to the recent social and racial

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injustices. For the last several years, I have been pleased with Jacob's industry leading progress on building a high-performance culture, led by our focus on inclusion and diversity which we call TogetherBeyond. We believe this has been a critical success factor in driving improved performance and shareholder returns.

Today's launch of Jacobs Advancing Justice and Equality Action Plan is our next phase of this journey and builds on our TogetherBeyond strategy with the four primary pillars centered around culture building and engagement, leadership commitment and accountability, developing talent, and growing the business.

This action plan is about achieving true equality for all our employees, current and future, with a priority now on ensuring Black employees have unquestionable equal opportunity and the tools needed to advance and achieve their ultimate goals at Jacobs. I'm proud of the employee engagement and the development of this action plan, starting with the team who collaborated alongside Jacobs' board of directors and our executive leadership team to outline transparent, specific and measurable actions.

First commitment is amplifying a culture of belonging by expanding our existing Conscious Inclusion program through Bystander Intervention training with the commitment to training our 55,000-person global workforce by the end of fiscal year 2021; engaging 3,000 Jacobs leaders in meaningful dialogue on anti-racism to expand their focus on justice and equality; driving personal accountability of senior leadership for inclusion by tying individual inclusion and diversity performance plan to compensation; and adding Martin Luther King, Jr. Day as a US holiday, encouraging employees to engage in volunteer opportunities around equality and justice.

Our second commitment is to recruit, retain and advance Black employees based on merit by increasing the representation of Black employees at all levels over the next three years to proportionately reflect the overall external population. To accomplish this, we are increasing our leadership development programs to accelerate advancement for Black employees to all levels of leadership, requiring all senior leaders to sponsor and mentor at least one Black employee and ensure global reach to these efforts, and further strengthening the diversity of Jacob's board of directors, including Black representation. This has been a success area for our board over the last four years, but one that can be continually improved as board members retire and as we appoint highly talented diverse contributors.

Our third commitment is about driving structural change in the broader society. To meet this commitment, we'll donate $10 million over the next five years in support of Black educational and professional development opportunities that include two specific areas: supporting primary and secondary education programs focused on science, technology, engineering, arts and math to prepare Black students for esteemed professions; and providing financial support for scholarship, mentoring and internship opportunities at Jacobs for Black high school and college students.

In addition to that investment, we're also promoting programs with organizations committed to justice and equality through Collectively, Jacobs giving and volunteering platform, including leveraging our expertise in areas like water for at-risk urban and rural communities. And materially increasing the percent of Jacobs spend over the next five years with women and minority-owned suppliers and vendors.

To drive this action plan and our global I&D strategy, we have appointed Jeff Dingle as Vice President of TogetherBeyond. Advancing justice and equality requires strong leadership and a relentless drive to deliver on the vision, and Jeff is the right person to lead this important work and grow a culture where employees want to join, stay and thrive. Ultimately, we must create a culture in which every person can access a future of opportunities. Contributing to a structural change at Jacobs and in the broader society is about doing our part as a global leader. The time is now for us to get this right, once and for all.

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Turning to slide 5 to discuss our continued focus on keeping our people safe during the pandemic and how we're supporting clients to solve COVID-19 challenges. As we approach five months of battling the coronavirus, we remain focused on keeping our people safe first and foremost and delivering on our commitments to our clients. As the duration of the pandemic has extended, Jacobs' strong culture of caring and particularly our emphasis on employee well-being has really come to the forefront. Our teams have responded with new programs for engaging our people in supportive ways, including deep dive series on mental health resiliency.

The situation continues to be fluid and as a global company, the variability from location to location is dramatic. Our crisis management teams continue to monitor and respond to the pandemic in our local areas and with regard to our efforts around a return to the workplace, we are demonstrating flexibility to fit the needs of our people and our clients, while accelerating our future of work strategy.

Our efforts in supporting our clients and communities in fighting COVID-19 include on the treatment side, our world-leading pharmaceutical solutions team playing a major role in the retrofit of facilities to rapidly develop COVID-19 vaccines and therapeutics. Our teams are also supporting clients of public health response strategies in US, UK, Australia and New Zealand. And from a solution standpoint, we're deploying our proprietary ion technology for contact tracing with pharmaceutical clients at large-scale facilities. We're developing scenario modeling software being used by transit clients around the globe, and digital monitoring of waste streams for COVID-19 at municipal water treatment plants.

Turning to slide 6, our business, which at its core solves highly technical scientific-based challenges across a variety of sectors, proved its resiliency in one of the most abrupt, global disruptive shocks that we have experienced. Part of our resiliency is driven by an alignment to high-value sectors of the global economy, such as national security, water infrastructure, environmental resiliency, healthcare and life sciences, Intelligent Asset Management, space exploration, and the convergence of information and operational technology. In addition to deep technical expertise, we benefit from economies of scale in both our businesses. This provides us the ability to quickly adjust to global changes in demand and manage our cost structure. More importantly, our culture fosters strong business acumen and innovative thinking to adapt rapidly to shifts in demand.

While we were certainly impacted by the pandemic during our third quarter, from a financial standpoint, we showed solid performance during the quarter with pro forma backlog up 4%, adjusted operating profit was up 3% year-over-year as we quickly transitioned to the new virtual work environment with strong productivity, while carefully managing discretionary spending. We delivered free cash flow in the quarter of $332 million and now expect reported fiscal 2020 free cash flow to approach $400 million. Overall, we witnessed better-than-expected performance in the third quarter, given the ability to proactively work with our clients to overcome physical distancing requirements.

Considering this third quarter performance and our initial view of our fourth quarter, we're raising our fiscal 2020 outlook. COVID-19 will continue to impact us in the fourth quarter and likely provide challenges into early fiscal 2021. For the full fiscal 2021, we continue to expect adjusted EBITDA growth with the potential infrastructure stimulus providing upside relative to these expectations. Finally, we continue to maintain healthy financial flexibility with ample liquidity that can be prudently deployed toward high-return opportunities.

Now, I'll turn the call over to Bob Pragada to provide more detail by line of business.

Robert Venkat Pragada

President & Chief Operating Officer, Jacobs Engineering Group, Inc.

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Thank you, Steve. And now moving on to slide 7 to review our Critical Mission Solutions performance; during the third quarter, our CMS business performed better than the COVID outlook we provided in the second quarter. Our solid third quarter results demonstrate CMS's resiliency and agility to work and perform at the highest levels for our clients. Though we will continue to be in a COVID-impacted environment through early fiscal 2021, our performance has been encouraging. The ability to recover from the shutdowns despite physical distancing occurred faster than originally anticipated, as our workforce and clients have addressed challenges and continued to execute on our contracts regardless of work location.

The underlying structural demand for our services remains strong. And as a result, total CMS backlog is now at $9.1 billion, representing a 3% year-over-year growth on a pro forma basis. While a portion of our CMS portfolio can be performed remotely, we did see some impact in our long-term enterprise contracts that involve highly technical work on client sites. Some elements of these stable and resilient contracts did experience temporary impacts from physical distancing protocols.

Let me share with you some details on the impact along with some notable wins by sector. Our US federal civilian business makes up about 35% of CMS's revenue, with the majority of the revenue coming from our NASA and DOE clients. As we've shared with you in the past, Jacobs provides broad support to NASA in its accelerated work to meet the current administration's mandate to return to the moon in 2024.

NASA must make progress towards these national goals, despite the challenges of working remotely and a reduced on-site workforce. At the end of our second quarter, we anticipated a low overall impact at NASA in the second half of fiscal year 2020. Through the third quarter, that has been the actual case, as most of our workers have transitioned well to working remotely or operating within on-site physical distancing guidelines.

Our NASA portfolio is expected to turn to full capacity as we approach the end of our fiscal year. As NASA's largest services provider, Jacobs is involved in many aspects of NASA's Artemis program to extend the frontiers of human deep space exploration, sending humans to the moon by 2024, then to Mars and beyond.

I would like to highlight a couple of achievements. A major milestone was reached in June when the solid rocket boosters arrived at the Kennedy Space Center to power NASA's Space Launch System. The Jacobs team handles final checkout and integration of all flight hardware for Artemis' mission and is currently working on the integration of this hardware. Jacobs/NASA team was also recently featured in WIRED magazine for utilizing artificial intelligence and generative design algorithms to build components for NASA's next-generation spacesuit, the first major update in decades.

Moving on to our nuclear portfolio; last quarter, we'd anticipated this business would be moderately impacted by physical distancing constraints, resulting in a decrease in on-site workforce. Despite these headwinds, due to the achievement of a few key performance milestones, several contract extension and overall business efficiencies, the nuclear portfolio performed better than expected in the third quarter.

Now, moving on to the US Intelligence Community which contributes just over 20% of CMS's revenue; our Mission IT, C5ISR and cyber businesses provide solutions to this sector. Last quarter, we had anticipated a moderate impact in Q3 from physical distancing headwinds at secured sites that would require split shifts. Based on actual results in Q3, we are now back at approximately 80% of normal operating levels and we expect all sites to be back to approximately 90% by the end of the fiscal year.

In line with our strategy to focus on higher-margin opportunities, it is important to note that we are transitioning off a lower-margin classified procurement contract, which will impact short-term revenue growth during our fourth

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quarter, but has little impact to operating profit. As a result, our unit margins will benefit. Kevin will provide further details in his remarks.

Our Mission IT business was awarded two notable contracts during the quarter both for the Department of Justice. The first is a three-year contract to modernize mission-critical applications, and the second will provide software and network DevOps support for the client's next-generation laboratory information system. Additionally, in our space ISR business, we progressed to the next phase of a highly classified space solution, further solidifying Jacobs' position as a disruptor in this high-growth, high-margin sector.

Shifting to the US Department of Defense sector, which makes up approximately 20% of CMS's revenue, we provide a wide range of mission-critical services performed at government sites or in highly secure facilities. At the end of Q2, we'd anticipated much of our work at the military test ranges and classified SCIFs to be moderately impacted by physical distancing requirements. Actual performance matched our expectations. However, these impacts were partially mitigated by our work at The Missile Defense Agency and positive performance in our cyber portfolio.

Overall, these sites are now executing at approximately 80% of normal operating levels and we expect our DOD work to ramp up to approximately 95% as we approach the end of the calendar year.

Jacobs continues to win new, large enterprise contracts and raise its profile across the Department of Defense.

For the Air Force, Jacobs was awarded a $434 million, six-year contract with North American Aerospace Defense Command, NORAD, providing systems support and integration. Additionally, for the Navy's Kings Bay facility, we were awarded a contract to deliver our Intelligent Asset Management solution. Neither award is included in our Q3 backlog, but we recently received news that NORAD cleared the protest period and will be included in our Q4 backlog. We remain encouraged that our Kings Bay will also successfully clear protest.

Shifting now to our commercial business, this business makes up just under 10% of our CMS revenue. In telecom, we provide solutions for the build-out of 5G networks, a business that was impacted more severely than anticipated in Q3 from access limitations at some sites. We expect this business to strengthen over the next couple of quarters and return to its strong long-term demand rates thereafter.

For the automotive sector, we primarily design and operate aerodynamic wind tunnels and provide general technical services, engineering and testing of automotive engines. Anticipated delayed awards in Q3 did occur as our auto clients reevaluate their CapEx portfolios and future demand requirements. We expect a slower return to normal levels later in fiscal year 2021.

Finally, our CMS international sector makes up 15% of CMS's revenue and includes nuclear lifecycle solutions, support for UK's Ministry of Defence on its Continuous At-Sea Deterrence program, and air and land weapons programs in the UK and Australia.

Our actual Q3 impact was less than anticipated. Strong shift work execution and physical distancing practices resulted in better performance. We expect our international business to return to approximately 95% of its normalized run rate as we exit the fiscal year.

In summary, our overall sales pipeline remains robust with the next 18-month qualified new business pipeline of $30 billion with $9 billion in source selection and an increasing margin profile. We continue to see strong structural demand for our CMS services, even as impacts resulting from COVID-19 continue. Given we are

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aligned to high-priority, mission-critical areas of federal governments, we do not anticipate material impact to our outlook in the event there is a change in administration.

Moving to our People & Places Solutions business on slide 8, our P&PS business generated a strong quarter and backlog performance, up 4.3% over the same period last year and up 3.2% quarter-over-quarter, with an increased gross profit and backlog across all geographies and sectors. Our book-to bill ratio for the quarter was 1.2 times. While our pipeline remains robust across all geographies, we remain sensitive to the timing of economic recovery and government stimulus funding. Our business is well-positioned to benefit from current stimulus funding bills under review in multiple geographies around the world.

Last quarter, I spoke about the anticipated COVID-19 impact to our People & Places Solutions business from a geographic and industry sector standpoint, as well as how we have optimized our delivery amidst the pandemic. I'm pleased to say that overall we are performing better than the moderate impact scenario we expected, with most of our existing projects continuing and minimal to moderate delays in new awards. The diversity and resilience of our business and the ability to draw upon market, global, and digital connectivity to deliver lasting and relevant solutions to our customers has been the key differentiator for us.

Beginning with our Buildings and Infrastructure geographies, the Americas, including federal and environmental services business, continues to be one of our best performing and most resilient geographies with minimal impacts from COVID-19 to-date. Our federal infrastructure and water sectors continue to outperform and we are retaining some of the best talent in the industry, resulting in strong revenue growth year-over-year. Demonstrating the depth and breadth of our solutions offering, we were awarded several major projects in the portfolio spanning multiple end markets.

For example, we've been selected for the design of a $130 million drinking water pipeline for the Great Lakes Water Authority in Detroit. In Texas, we were selected for the Interstate Highway 35 Mobility program, which will improve connectivity for all forms of transit across 80 miles of I-35. And we were awarded a major follow-on contract with FEMA for continued hurricane recovery efforts in the US Virgin Islands. We anticipate continued steady performance. However, delays in stimulus funding could affect the timing of new awards in FY 2021.

In our Europe and Middle East business, recent UK government funding authorizations for environmental and water programs, including a recent award with Anglian Water Services show promise amidst continued Brexit-related slowdowns. The Anglian Water Strategic Pipelines Alliance will deliver new connective infrastructure, leveraging technology such as digital twins to drive greater efficiency and reliability. In our Middle East business, we are observing prioritized investment in water and transportation infrastructure. We remain cautiously optimistic on expectations for recovery in both of these geographies later in fiscal year 2021.

Our Asia-Pacific business performed better than anticipated. In Australia/New Zealand, we experienced material growth in the quarter and are up year-on-year on both revenue and operating profit. We converted our pipeline into several major wins in cloud computing and healthcare and are leveraging our global delivery capabilities. Southeast Asia remained steady with some project-related delays due to the pandemic and we anticipate some volatility into fiscal year 2021.

Building on our higher value solutions capability, we have been selected as program manager for the new Noida International Airport in Delhi, India. We will provide strategic planning, risk management, digital solutions and program management for this new greenfield development. We're applying our global integrated delivery model to provide leading solutions from around the world to this exciting project.

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Last quarter, we indicated that our Advanced Facilities business worldwide would likely experience positive effects from responding to the global pandemic. The demand for therapeutics and vaccine facilities is increasing, and we have drawn upon our global leadership to lock in several key wins in the quarter with several more in the pipeline. These projects tend to be shorter duration, high intensity projects, allowing us to leverage innovative and integrated delivery techniques to meet demand.

As an example, we're working with AstraZeneca to retrofit an existing fill-finish manufacturing facility to deliver a COVID-19 vaccine to the market as soon as late calendar year 2020, subject to clinical test results. We're also seeing an uptick in demand for data centers and semiconductor manufacturing due to increased cloud computing requirements. We have continued optimism for these businesses.

I will now discuss our core sectors. Global mobility restrictions are easing in several regions and we are seeing a slow recovery in all modes of transportation. Early government-lead funding has sustained many critical infrastructure projects and we are seeing continued investment in rail, including a recent award with Transport for New South Wales to transform the rail network for communities across the Greater Sydney area.

Additional global government stimulus is expected to include transportation-related funding aimed at driving economic recovery, although timing, trajectory and other key details remain uncertain. While our current business remains stable, continuing resolution and stimulus funding will drive growth opportunities.

The water market continues to be resilient with long-term demand in both upgrades to water infrastructure and utility operations and maintenance. Additionally, we continue to see ongoing growth in digital solutions including smart metering, AI, data analytics, automation, and remote operations. While market indicators suggest CapEx pressure in 2021 and recovery into 2022, as the pandemic abates and stimulus funding becomes available, we still expect to maintain growth momentum driven by solid performance with our clients and superior expertise that effectively leverages tech-enabled solutions.

The environmental sector is expected to see flat to moderate growth in 2021 with demand continuing steadily from federal and private clients, as well as stimulus related to investments in green and blue infrastructure. In addition to DOD client focus on PFAS, some states have established grant programs to address PFAS remediation. Further, we believe a focus on climate change initiatives will drive opportunities globally.

We are well-positioned for continued growth and to capitalize on these new opportunities through trusted relationships with the long-term clients; our diversity of markets in which we can apply innovative environmental solutions and strong retention of our global pool of expertise. In the built environment, which includes government facilities, healthcare, higher education, and smart cities, we are seeing demand for repurposing business space as the need for a distributed work environment and smart and sustainable buildings continues, allowing us to leverage our digital solutions.

Our global healthcare crisis response team is combining multi-disciplinary expertise from across the world to provide dynamic, forward thinking, advisory and resilient solutions to a broad range of clients responding to the pandemic, as well as to those healthcare clients adapting to new healthcare service delivery models.

Summing up the quarter, the negative effects of the global pandemic on growth in our People & Places Solutions business were partially offset by solid engagements with our core clients and ongoing cost control. We continue to be proactive and agile to shifting market trends, which has resulted in a solid pipeline and allows us to continue to drive our global, market and digital connectivity strategy.

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Now, I'll turn the call over to Kevin to discuss our financial performance in more detail.

Kevin Christopher Berryman

President & Chief Financial Officer, Jacobs Engineering Group, Inc.

Thank you, Bob. I'll discuss a more detailed summary now of our financial performance for the third quarter fiscal 2020 on slide 9. Third quarter gross revenue increased 3% year-over-year, with pro forma net revenue down 4%. P&PS net revenue was flat year-over-year and CMS declined 9% on a pro forma basis. As Bob noted in his comments, the CMS decline was mainly attributed to physical distancing restrictions experienced due to COVID-19 pandemic.

Adjusted gross margin in the quarter as a percentage of net revenue was 23.5%, down 35 basis points year-over-year. As we discussed last quarter, the gross margin continues to face a headwind due to flow-through effects on the reimbursable rate of our more efficient cost structure in P&PS, positively offset by gross margin improvements in our CMS business.

The lower reimbursement rate for fixed cost is more than offset by the underlying lower level of G&A costs, thus representing positive operating profit and margin impact. This is reflected in lower G&A as a percentage of net revenue of 40 basis points year-over-year to 14.6%.

During the current quarter, our G&A also benefited from lower travel and employee-related costs associated with actions taken to offset the short-term financial headwinds from COVID-19. Now that we have increased visibility into the dynamics of operating in a COVID-19 environment, we are adjusting our operating model accordingly and expect G&A as a percentage of revenue to increase modestly in the fourth quarter.

GAAP operating profit improved substantially versus last year, driven by lower integration and divestiture-related costs, up 116% to $194 million, and included $20 million of restructuring, transaction and other charges and $24 million of other charges consisting of $23 million of amortization from acquired intangibles and $1 million of costs associated with Worley Transition Services Agreement. Adjusting for these items, adjusted operating profit was $239 million, up 3% from the prior year figure.

Our adjusted operating profit to net revenue was 8.9%, up 10 basis points year-over-year on a reported basis driven by higher CMS and P&PS margins, effectively offset by higher unallocated corporate expense. I'll discuss the underlying drivers of these costs on the next slide.

GAAP net earnings and EPS from continuing operations were $227 million and $1.73 per share, and included a $0.71 net benefit largely driven by the mark-to-market adjustments associated with our Worley equity stake, $0.11 per share of after-tax restructuring transaction and other charges as noted above, and amortization of acquired intangibles of $0.13. Excluding these items, second quarter adjusted EPS was $1.26, including a $0.05 benefit from discrete tax items. Excluding discrete tax items in both the current and year ago quarter, underlying adjusted EPS was essentially flat year-over-year.

Q3 adjusted EBITDA was $254 million or 9.5% of net revenue and was down 2% year-over-year, compared to the 3% increase in adjusted operating profit, which was primarily due to a headwind from other income due to FX and non-controlling interest.

Finally, turning to our bookings during the quarter, our pro forma book-to-bill ratio was 1.1 times for Q3, driven by the strong P&PS book-to-bill of approximately 1.2 times. CMS book-to-bill was just under 1 times and reflected the burn off from Hanford Plateau. Importantly, the CMS Q3 backlog does not include our new awards at Navy

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Kings Bay and NORAD. The pipeline dynamics within CMS remained stable with no unusual delays or project cancellations.

Within P&PS, the overall sales pipeline supports our top line growth objectives, but we are seeing changes in the underlying composition of opportunities and timing on larger awards which is reflected in our financial outlook.

Regarding our LOB performance, let's turn to slide 10. Starting with CMS, pro forma revenue declined 8.6% year-over-year during third quarter. CMS operating profit was $90 million and was up 17% year-over-year, but flat on a pro forma basis, and well above our original expectation due to the COVID-19 dynamic. CMS operating profit margin was up 80 basis points year-over-year to 7.4%, overcoming the impacts associated with the COVID-19 pandemic.

The upside versus our previous expectations were driven by a faster-than-expected transition to a virtual work environment and a return to COVID compliant onsite work environments.

In line with our expectation, we also saw meaningful year-over-year decrease in lower margin procurement revenue causing a top line headwind, and an immaterial impact on OP dollar growth given the lower margin associated with procurement-related activities, resulting in a positive impact on OP margins. Also contributing to our OP growth was a milestone-based incentive fee that was achieved during the quarter.

Please note we are still experiencing material physical distancing limitations within our nuclear remediation efforts and for some secured work environments, as onsite access continues to be less than optimal. But we expect these operations to gradually improve utilization early into fiscal 2021.

Also, in line with our CMS strategy of moving up the value stack, we expect margins to continue to improve over time as we pursue higher value opportunities. As we transition our CMS portfolio away from lower value services such as procurement, we expect some short-term headwinds to revenue growth and a positive margin impact. Long term, we continue to expect performance in line with our strategic long-term targets.

Moving to People & Places, Q3 net revenue was slightly down year-over-year. Let me provide more insight into the impacts associated with COVID-19. We and our clients swiftly moved to virtual work environments and our clients kept current projects continuing at historical burn rates. We saw continued strong underlying performance in the Americas even in the face of COVID. Net revenue increased double digits.

Our Advanced Facilities customers initially slowed the pace of some projects as they digested the macro environment. However, they quickly shifted their CapEx plans to support potential COVID vaccines and therapies in addition to their current product mix.

We continued to see headwinds in our UK business even after removing the physical distancing impact from COVID. That region's net revenue declined double digits. While we are optimistic that the UK will begin to recover later in fiscal 2021, we remain cautious on the timing of that improvement.

Operating profit was up 4%. As a percentage of net revenue, operating profit was 13% for the quarter, up over 50 basis points both year-over-year and from Q2. Our P&PS margin was supported by adjusting our cost structure by reducing discretionary spending, including travel, and also benefited from lower employee-related cost.

Our non-allocated corporate overhead costs were $41 million in the quarter, up slightly from the Q2 figures and up from $27 million in the year-ago period. A few discrete items contributed to the slightly higher costs including

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some higher-than-normal legal and IT costs. We continue to target $35 million as a run rate outlook for unallocated corporate costs.

Looking into the fourth quarter, we anticipate a total reported net revenue to be up slightly year-over-year which results in adjusted EBITDA up sequentially. This includes resuming some discretionary spend to position us for year-over-year growth in fiscal 2021 and beyond.

Now, turning to slide 11, I would like to update you on our initiatives relative to our recent M&A and divestiture actions. Regarding the sale of ECR, to-date, we have now incurred slightly over $250 million of the approximate $230 million in related transaction, separation and restructuring costs. We expect the remaining costs to be incurred over the remainder of the year.

Turning to our acquisition of Wood's Nuclear business, as a reminder, the transaction closed on March 6. Integration continues to progress and we are on track to achieve our targeted $12 million run rate cost savings.

Finally, we expect approximately $35 million of total charges in Q4 fiscal 2020 related to the ECR separation, Wood cost to achieve synergies and other non-recurring impacts, which is in line with the approximate $150 million in P&L costs that we have projected and expected over the course of this year.

Now on to cash flow generation and the balance sheet on slide 12. During the quarter, we generated $332 million in free cash flow. Q3 cash flow was impacted by a net positive $25 million due to benefits from cash taxes, partly offset by headwinds from cash flow outflow associated with restructuring and other items.

For the full fiscal year 2020, we expect approximately $130 million of non-recurring outflows. Including these impacts, we continue to expect positive free cash flow for the remainder of fiscal 2020 with total reported free cash flow to now approach $400 million for the full year.

As anticipated, DSOs were up from Q2 2020 and up year-over-year as we expected some disruptions from COVID-19. We still see ample opportunities to lower our DSO run rate, which will be a major driver for us attaining a 1 times free cash flow conversion target longer term.

And now moving to the balance sheet. As the financial market stabilized over our fiscal third quarter, we've repaid approximately $950 million on our revolving credit facility. We still ended the quarter with cash of approximately $1 billion and a gross debt of $2.2 billion, resulting in $1.1 billion of net debt before attributing any benefits of the Worley equity. Treating the Worley equity as cash, our pro forma net debt to expected adjusted EBIT 2020 [ph] EDA (41:22) is just under 1 times, a clear indication of the strength of our balance sheet.

Regarding capital deployment, as we outlined last quarter, we paused our share purchases in March as a precautionary measure as the COVID-19 crisis escalated. Our business proved out its expected resiliency and cash generation capabilities. We will continue to be opportunistic in our share buyback activity going forward.

For modeling purposes, we would expect an average share count of $132 million (sic) [132 million] for the fourth quarter 2020 and fiscal year 2021, excluding additional share buybacks. Regarding our effective tax rate, we continue to expect an adjusted effective tax rate of 24% for the fourth quarter fiscal 2020, in line with our longer term normalized adjusted tax rate in the range of 23% to 25%.

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And finally, given our strong balance sheet and free cash flow, we remain committed to our quarterly dividend which was increased earlier this year and declared at $0.19 per share. As you know, our [ph] current (42:26) dividend level represents an increase of 12% versus year ago.

Now I'll turn it back over to Steve for our outlook and closing comments on slide 13.

Steven J. Demetriou

Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

All right. Thanks, Kevin. Now, let me review our total company outlook. Given our better-than-expected transition to a virtual work environment and the ramp up of onsite operations, we're updating our fiscal 2020 outlook. We now expect adjusted EBITDA outlook to a range of $1 billion to $1.050 billion from the $950 million to $1.050 billion.

We are also updating our fiscal 2020 adjusted EPS guidance to a range of $5.05 to $5.30, up from the $4.80 to $5.30 previous guidance. Importantly, at the midpoint of our revised EPS range, 2020 total fiscal year adjusted EPS represents year-over-year growth when excluding the impact from discrete tax items in both years.

Let me also provide some insight to the COVID-specific impact on this outlook. At the time of our second quarter earnings call, we communicated that we expected the net impact to second half fiscal 2020 earnings would be approximately $0.50 per share. However, as a result of our enhanced ability to adapt to physical distancing, we now expect a lower net impact from COVID of $0.35 per share.

Given our success in adjusting our operations to a virtual work environment, we are further evaluating opportunities to significantly improve our efficiency for new structural changes to our future work and look forward to sharing our strategy over the coming quarters. And looking into fiscal 2021, we continue to expect year-over-year adjusted EBITDA growth with the second half stronger than the first half performance.

With that, I'd like to open the call for questions. Operator, we'll now open the call.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Michael Dudas from Vertical Research.

Michael S. Dudas
Analyst, Vertical Research Partners LLC

Q

Good afternoon, gentlemen.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Good afternoon, Mike.

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

Hello, Mike.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

Hi, Michael.

Michael S. Dudas
Analyst, Vertical Research Partners LLC

Q

First question maybe for Bob. When you talked about, in your prepared remarks, looking at your P&PS business and maybe a little bit more detail on the public funded versus private funded areas, obviously, you mentioned some positive takeaways from some of the private sector and Advanced Facilities work. How concerned are you relative to what we're seeing from Washington and the time lag relative to, on the public side, getting some of those projects that are on the books start to get some revenues flowing to the bottom line. And is that part of the caution that you're looking at the fiscal year or, say, first calendar quarter fiscal 2021, moving into 2021, going forward?

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

Yeah, Michael, we're actually cautiously optimistic that something will be done. But, in any scenario, the strength of our backlog right now is sustainable and resilient. So, really, when we talk about growth, is really is the discussion around the dependence on stimulus. As far as a steady as she goes where our backlog is representative of that today. So that kind of brings a little bit of the separation of being totally and solely dependent on those that are being discussed right now and become more of a topic later in the fiscal year – next year.

Michael S. Dudas
Analyst, Vertical Research Partners LLC

Q

And when you talk about from the private sector on the Advanced Facilities, on the vaccine and such and data centers and technology side, you say it's high intensity, that could be a positive surprise impact to 2021 revenue –

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2021, 2022 revenue or booking flows and is that something that's much more real behind the scenes than maybe what we're seeing from the news flow in the marketplace because there's certainly quite a bit of that from that – in those sectors.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.
A

Yeah. And Michael, you've been with us for a long time. You know how well-positioned we are there too. So we see the short-term book and burn component of that being a real positive for us and we're sitting – I would call it we're in the early innings of what that could mean for the business, specifically, our positioning with these clients that we've had for several decades.

Michael S. Dudas
Analyst, Vertical Research Partners LLC
Q

Thanks, Bob. Appreciate it.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.
A

Yeah.

Operator: And your next question comes from Joseph DeNardi from Stifel.

Joseph William DeNardi
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Yeah. Thanks. Good afternoon. Could be Bob or Steve, I think every defense company is being asked now how sensitive their business is to defense budgets over the next few years. I want to ask you that but maybe in a slightly different way. I think a significant aspect of the CMS strategy or at least a big part of the pipeline at CMS relates to weapons and program sustainment, and that the opportunity there is mainly taking market share from OEMs. You won NORAD. It shows you guys have the capabilities to win sustainment. So can you talk about your confidence in being able to grow CMS over the next few years regardless of the top line DOD budget number? Thank you.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.
A

Yeah. So, Bob, let me start and then you add on.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.
A

Sure.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.
A

Actually, when you look at the budget, that's relatively flat overall on Department of Defense. The certain – the components of that budget, when you start to peel the onion, is actually there's several growth items that are aligned with most of our priority initiatives. You look at DOD space budget, it's up 28%, $18 billion budget, which fits right into our whole space intelligence activities coming out of the whole KeyW acquisition.

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Cybersecurity is up 5%. The hypersonics, which we're a growing player with our missile defense work, a recent Air Force win, some work that we do for NASA around that area, a whole host of classified programs where the budgets are up. And then you even look at like PFAS where they added $180 million where we're in the mix there. So, environmental, Department of Defense across our CMS, we actually feel pretty positive from a budget standpoint even when you look at the headline of a flat Department of Defense budget.

Joseph William DeNardi
Analyst, Stifel, Nicolaus & Co., Inc.

Q

That's helpful.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

Steve, maybe one to – sorry.

Joseph William DeNardi
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Oh, go ahead.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

And just to – Joe, the other part of that question is around – and the strategy around gaining that market share really then comes from technology hubs that we have within the overall company. And differentiating our position around what would traditionally been a people seats kind of business around sustainment; so a technology-enabled solution in order to take that market share.

Joseph William DeNardi
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah, that's helpful. Kevin, you mentioned in your prepared remarks that transitioning to a higher margin work at the CMS will represent a revenue headwind near-term. What's that the message there? How material is that? When does the headwind kind of end? And is there may be a specific portion of CMS that you kind of want of let run off? Any color there would be helpful. Thank you.

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

Yes. So, yes, there is a few contracts that we've had which are going to be running off over the course of the first part of 2021 specifically. That doesn't that mean that we're not going to be able to show some growth. And especially, I would focus the commentary more on bottom line as opposed to top line relative to that dynamic, Joe.

So I think that the margin profile that we've been talking about, we do believe we're going to start to see some fundamental benefits of that in a more material manner as we enter into 2021. And so while the revenue could face some flattish kind of pressure over the short term, I think ultimately we're going to be in a position where as these new kind of projects and programs come into play with the associated ramp up in revenue and margin associated with those, you'll start to see that really play out in a nice way as we progress through 2021.

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Joseph William DeNardi
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Got it. Thank you.

Operator: And your next question comes from the line of Jim (sic) [Jamie] Cook from Credit Suisse.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Good morning, everyone. I've never been called Jim. But, anyway, I hope you guys are well. I guess a couple of questions. One, at your Analyst Day in 2019, I think you talked about sort of a $7 to $8 earnings power potential for the company. Understanding that's not in the cards for 2021, can you just give us sort of your updated view on is there a bridge to get there past 2021 and what would have to happen for you guys to get there?

And then I guess my second question, obviously, the cash flow in the quarter was positive. Kevin, can you just help us understand where you think DSOs can go sort of over the next sort of 12 to 18 months? And just how you're thinking about cash flow opportunities to improve cash flow conversion more consistently? Thank you.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

So, first of all, Jamie, let me start – yeah, I'll take the first one, Kevin, and then why don't you build on it?

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

Yeah.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

So, Jamie, with regard to the 2019 strategy, I really think the best answer is the fundamentals of that strategy are solid and, if anything, have been strengthened as we continue to diversify the company and bring innovative solutions. And it's just, as you suggested, it's just moved to the right. And obviously, funding's going to play a key component on some elements of it. But we're very confident that that's, again, just a matter of timing and that we're going to see the growth.

But when you look at our Critical Mission Solutions business and our People & Places Solutions, I just look at that 2019 strategy that led to that $7 to $8 outlook and feel very confident that that's still out there for us in the near term. And as we progress into giving some guidance for 2021 and I'm sure we'll also kind of give some update overall on the timing of that question.

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

So let me...

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Kevin?

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Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.
A

...I'll make some comments to Steve's comment. Just reminding, Jamie, and I think you're already sensitized to it. The $7 to $8 was a potential earnings – earnings potential, which assumed that we would fully utilize the strength of our balance sheet in some manner, shape or form. And I think that, clearly, as I just communicated, the strength of the balance sheet is as robust as it ever has been. And consequently, those opportunities to utilize capital longer term or to fundamentally increase our growth potential is certainly there.

So I would just make that comment and that it's going to be conditioned upon the utilization of the balance sheet. I think, clearly, COVID has required us to step back and reflect and make sure we're taking care of business and we'll continue to do that, but I think that, clearly, longer term, no change, I would say versus our ability to get to those kind of figures over the period of time that we will be talking about as we think about over the next year or two or thereabouts.

The other point I would say on the DSOs, look, COVID is putting some challenges in place for us as it relates to the DSOs. So, if you go and you think about where we progressed or not over the course of 2021, we have had some challenges in the 2020 periods. And I think that we're just going to have to continue to focus on that. Get back to it. Certainly, there could be some pockets of disruption in areas where it would be tough to get back at those until there is greater visibility in terms of some of the underlying sectors of which we're supporting. But we do believe we have that ability.

And so, a couple, three days adds up to some pretty significant figures in terms of our improvements in cash flow, and we would expect that as we get through COVID. I'm not going to say exactly when that will be and when our customers are back kind of without being impacted by some of the dynamics. Certainly, we feel like we're going to be able to get those numbers down at those levels – by those levels and then some longer term to help us get to the conversion numbers that we would like.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC
Q

Thank you very much. I appreciate the color.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.
A

Yeah.

Operator: And your next question comes from the line of Josh Sullivan from The Benchmark.

Josh Sullivan
Analyst, The Benchmark Co. LLC
Q

Good afternoon.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.
A

Hey, Josh.

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Josh Sullivan
Analyst, The Benchmark Co. LLC

Q

On the defense contracting environment, you mentioned you've adjusted your G&A. How has the defense customer responded to that? Are they accepting COVID pass-throughs? And then also curious if those increased costs plus additional remote working has had any impact on the government's perspective on low cost technically acceptable bids versus the more value-added technology-enabled approaches you guys are starting to put forward?

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Bob, do you want to...?

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

Sure. So, I think that I'll answer the second part first, Josh. Is that we do see the value-added and the differentiated solution is being accepted by our government client as a differentiated solution. That the kind of – the natural, if you look, at what happed during the last dislocation or the global financial crisis, there was a trend more towards typically acceptable low bid. We haven't seen that yet.

So, I think that kind of plays to where we sit in the value trajectory. First part on some of the stimulus – well, when I say stimulus, some of the continuing efforts to keep our people going on critical efforts. I think that's a testament, again, to our portfolio. If you look at each sector that we're serving, it's not everybody that's in the defense contracting community received the CARES 3610 type of compensation. We did just because of how critical our services are with our government client. So we like our positioning of where we sit in the defense focus areas right now.

Josh Sullivan
Analyst, The Benchmark Co. LLC

Q

And then you guys also have a very unique perspective of the global infrastructure environment. I was curious if you could just give us a sense of what the typical cost of designing in and securing against COVID is for the customer versus maybe that same project was without COVID productions a year ago.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

Steve, do you want me to go ahead and address that one?

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Keep going.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

Yeah. So, Josh, I'd say that with our clients, we don't go after a lot of newer clients. So, if you look at the major public agencies that we do work for, whether it'd be in the US on state DOTs or big water agencies, UK, Australia, these are clients that we have larger framework agreements with pre-established commercial arrangements.

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And so, going back to Michael Dudas' first question, what we've seen is a use of that platform, that framework agreements that were already in place, so any type of pricing pressures we haven't seen as far as the clients having to spend more dollars in order to get that work done. I think those vehicles are helping the client as well because that cost to procurement, though we talk about it from a supply chain standpoint, having those agreements in place has helped the client as well.

Josh Sullivan
Analyst, The Benchmark Co. LLC

Q

Got it. Thank you for the time.

Operator: And your next question comes from the line of Andy Kaplowitz from Citi.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Good afternoon, guys.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Hey, Andy.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

Hi, Andy.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

So we talked a lot about the interruption from physical distancing, but maybe not as much about the positive impacts that the pandemic could have on Jacobs. We talked about life science potential, but could you talk about how your customers are reacting to the potential for reassuring and bolstering supply chains in general and how Jacobs could be involved there? And then how work from home could potentially lower longer-term costs for Jacobs in terms of maybe the potential to lower physical real estate costs as you go into FY 2021?

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Yeah. So let me start. As far as the pandemic and the impact on our business, it's pretty widespread and there's a lot of opportunities there. Bob talked a lot about the life sciences side. When you look at the whole future of work, and I'll come back to sort of the Jacobs opportunity, but the demand opportunity now that's out there for what we would say we're in the whole supply chain of the digitization – massive change in the economy around digitization as our industry leading position around semiconductor or the mission-critical data centers that are accelerating and the whole race for 5G. All three of those areas, we're a critical player in. And we've clearly seen the fact with more virtual work, more streaming and online gaming, et cetera, that whole drive is going to increase the need for semiconductor capacity, data center capacity, and 5G is another big example around our whole Advanced Facilities business.

As it relates to Jacobs, we've commented that we had been working on a future of work strategy over the next several years prior to COVID-19. Our ability to rapidly shift to 85-plus percent of our employees and maintain

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strong productivity and be able to demonstrate that we not only can deliver projects, but win business in that area is accelerating now our work around looking at what we can do starting as early as 2021. And so, we have a team looking at that. That's where we commented we'll be updating over the next several quarters of what that looks like, what the timing is. But we're very excited about that next phase in our transformation journey around accelerating future of work.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Thanks for that. And then...

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

So we would...

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

...see if there's – I'm sorry, does someone want to say something?

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

Yeah, I was just going to say we would plan to give an update on those efforts as we close out the fiscal 2020 year and what the potential implications would be for 2021.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, Kevin. And there's an obvious follow-up there just in terms of revenue visibility, I know Michael asked the question, let me ask it in a different way. As you sit here today, you mentioned pro forma backlog growth is up 4%, you obviously had strong book-to-bill in both segments. There's some question of whether P&PS needs help from stimulus or new infrastructure bill, but you've got this Advanced Facilities stuff that we just talked about. So, can you talk about your confidence in revenue growth in 2021? Obviously, you seem confident in EBITDA and EPS growth, but in revenue growth in both segments.

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

Steve, you want me to...

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Yeah. Kevin, go ahead. Yeah. Yeah.

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

Yeah, I think our belief is that absent any substantive stimulus that comes into play – and this is not only the US, but there are other regions around the globe, in the UK and Australia specifically, where we would be watching those areas closely. Look, I think we have a portfolio that's stable and has the ability to continue to build capabilities and deliver solutions to our clients.

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I think that as we think about that dynamic, we could see some growth in 2021, absent. But I think ultimately, our belief is that stimulus, there will be something as it relates to that and that probably results in the back half of 2021 being that much more stronger than the beginning parts of it. But I think that clearly, the resiliency of our portfolio would – we would suggest that we have the ability to grow in 2021.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Thanks for that.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

Andy, if I could just add one more to the reshoring comment because it's an important one and it goes to what Kevin and Steve are saying. I'd look at it from this dynamic, all of our larger – and those are, we call them core, clients that we've been with for decades, they're going through – clearly, there's a headline news on reshoring. But think about it from a two-step process. All of these clients are also looking at their product portfolio mix, and them looking at the reshoring aspect of that supply chain from the learnings of now countries being blocked during the pandemic. And so, I would kind of characterize that as early innings, but with probably some optimism that that's going to be real as these two parallel efforts are going on at the same time.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you, Bob.

Operator: And your next question is from Gautam Khanna from Cowen.

Gautam Khanna
Analyst, Cowen Inc.

Q

Hey, thanks. Good afternoon, guys.

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

Good afternoon.

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

Good afternoon.

Gautam Khanna
Analyst, Cowen Inc.

Q

Just wanted to follow up on some of the earlier questions. Specifically thinking about revenue growth next year at CMS, you called out the transition on the one contract. Maybe if you could just quantify what the known headwinds are into next year. And then if you could also maybe calibrate us on recompetes, what percentage of sales are up for recompetes in 2021 – or between now and the end of 2021, and what percentage of revenues therefore are vulnerable in 2021 to recompetes? Thank you.

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Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Let me start, Kevin, and then maybe you can give whatever guidance you want on the quantification of revenue. But 2021 is going to be a fairly light year, almost down to one or two recompetes. So, it's a very immaterial effect for us in 2021. And so, from a revenue standpoint, we don't see risk around that. In fact, we're excited about some initiatives that others are looking at the recompetes that we're hopefully going to gain some share on. But, Kevin, do you want to talk about the revenue question?

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

Yeah, for sure. There's basically two things that are out there. We've had fairly large procurement revenue in 2020 which has actually dampened our margin profile. We've talked about that over the course of this fiscal year. That will be transitioning off the books over the course of the first half of 2021. And then, of course, depending upon how Hanford plays out, the Hanford Plateau project obviously will be off the books over the course of 2021. That assumes that the current protest dynamic doesn't change any material direction there.

So, those are numbers that will be plus $500 million certainly over the course of the full year, and we'll see how that plays out. I think what I would suggest to you is the strength of the pipeline in our minds overcomes that number and, ultimately, starts to drive incremental profitability because the procurement and the Hanford Plateau are obviously lower parts of our margin profile. So, that goes away, pipeline comes in, replaces it and margin goes up all at the same time, resulting in good operating profit growth.

Gautam Khanna
Analyst, Cowen Inc.

Q

That's very helpful. And I was hoping maybe you can actually quantify the higher procurement sort of pass-through stuff this year, how much is non-recurring. And then relatedly, bookings in the September quarter obviously off to a good start. Maybe can you give us a sense for what – just based on when the adjudications lie, how the bookings outlook at CMS looks to next September, December quarters, kind of what you're expecting as potentials in terms of book-to-bill.

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

So, let me...

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Well, look, the book to – Kevin, maybe I'll start. Just building on Kevin's pipeline comment and what Bob talked about earlier on protests. So, we're getting off to a fast start, first and foremost, because some things we want in the third quarter are not on the books yet as it relates to our book-to-bill and our bookings and backlog. And so that, when you look at – first of all, when you look at those two initiatives, the Navy Kings Bay and the NORAD wins, you'd put that into – with everything else we won in the third quarter and the book-to-bill is strong in Critical Mission Solutions.

Our pipeline is at a record high, significant increase from where it was a year ago, when we look at our current CMS pipeline of $30 billion. And when you look at the margin in that pipeline, it's exciting. And the things we've just recently announced are all margin enhancement, along of course with the Wood acquisition and KeyW acquisition as those continue to ramp up.

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So, as Kevin said, that you put all that together, this is for us a great transition that we're going through that's consistent with our strategy that we outlined of growing the business, but enhancing the margins at the same time. And we feel confident that that's playing out now as we get into 2021 and beyond. And so, Kevin or Bob, anything to add to that?

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.
A

No. I think, Steve, I think the first quarter will look solid. And as far as that hovering at 1 or above is very much within reach, we've got a nice pipeline.

Gautam Khanna
Analyst, Cowen Inc.
Q

Thank you, guys.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.
A

Thank you.

Operator: And our next question is from Steven Fisher from UBS.

Steven Fisher
Analyst, UBS Securities LLC
Q

Great. Thanks, guys. So, you've talked a few months ago about EBITDA growing in 2021 and you've reiterated it here today. I'm just curious how the drivers of that growth changed in the last few months or so. To what extent maybe is it more margin-driven now rather than revenue, inorganic versus organic or any particular programs that may be driving it now that were different than you were thinking a few months ago?

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.
A

Well, let me just qualitatively say that some things that sort of help us make that comment about growth next year are the two recent acquisitions we made, KeyW and Wood are clearly going to contribute to some of that growth next year. We've been doing very well on the KeyW acquisition around the cyber side and the Mission IT side. As we've talked about this great opportunity we have on space intelligence has moved to the right a bit where it underperformed this year. But everything is still standing there with regard to the great opportunity and we have two specific initiatives that we're moving through and we expect to drive growth next year around that whole space intelligence side of KeyW along with the other two businesses. So, we're very positive about that business.

Wood Nuclear combination with Jacobs, we're going to see the majority of the synergies next year around the cost synergies as well as some revenue synergies. So, those two businesses are going to contribute. We're going to have kind of some balancing things going on, on the cost side as we resume some discretionary spending that we temporarily halted. But at the same time, we have some initiatives underway where we're going to see some productivity and efficiency coming in with some of the things that we've initially talked about with future of work, et cetera.

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And then the rest of it is really driven by just a continuation of what we've talked about of being aligned to the secular trends that are moving in the right direction, national security, water infrastructure, water still is – we're very bullish on, environmental resiliency, of course, the whole healthcare and life sciences. We've been talking a lot about the Intelligent Asset Management side on Critical Mission Solutions that the three Navy wins over the last 12 to 18 months, margin enhancement, profit growth and then, of course, this whole race to the Artemis 2024 space exploration side of things. And add on top of that the digital initiatives that we're working across both businesses are really the drivers of what we're talking about.

Steven Fisher
Analyst, UBS Securities LLC

Q

Okay. And then maybe, Kevin, curious what's the shape of how that 4% decline in pro forma revenues trends over the next handful of quarters. Should we assume that that kind of remains negative through the fiscal first quarter of next year? And then it starts to turn positive or is that more like a second half of 2021? Any thoughts on kind of the shape of that recovery?

Kevin Christopher Berryman
President & Chief Financial Officer, Jacobs Engineering Group, Inc.

A

We're probably not going to give you specifics relative to it, but I do think certainly we're facing a more muted short-term dynamic versus longer-term, consistent with the comments that we've made. So, probably not going to give you a lot of incremental color, but certainly we're going to be more muted in the short term. Certainly, I would say as it relates to the Q4 numbers, certainly we're going to be thinking about that relative to the numbers. And so, maybe I'll leave it there and then we'll play out and give you more perspectives as we enter into 2021 after we finish up Q4 and have another three months under our belt relative to the COVID-19 pandemic.

Steven Fisher
Analyst, UBS Securities LLC

Q

Fair enough. Thanks a lot.

Operator: And your last question comes from Michael Feniger from Bank of America.

Michael Feniger
Analyst, BofA Securities, Inc.

Q

Yeah. Thanks, guys, for squeezing me in. I know you said you expect some federal support on the P&PS side. But before we get to November elections, there is a FAST Act expiring at the end of September, the recent Republican stimulus polls really lack aid for the state and local municipalities. So, I'm just curious, what is kind of the base assumption here? Can you guys grow if there is a CR, one-year extension maybe and they just kind of punt to November? Maybe you could just flesh out your exposure by states and what you're seeing there. Are some states struggling more than others? Are they accessing rainy day funds? Clarity around that will be helpful.

Steven J. Demetriou
Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

A

Yeah. Bob, why don't you pick that up?

Robert Venkat Pragada
President & Chief Operating Officer, Jacobs Engineering Group, Inc.

A

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Yeah. Yeah. Sure. The short answer, Michael, is, is that we're going to be solid. As far as tangible anticipated growth pre-pandemic, clearly, we're kind of in a new norm now. But when I say solid and when I'm saying solid, I'm talking about, Michael, in the event that there isn't agreement and we're moving towards an election. And it goes back to my earlier comment around the strength of our backlog and programs that have already not only been approved, but also funded and are part of current state budgets that we don't see any reallocation going on there. So, that's in the event. Now, the FAST Act line item, though you mentioned it's not in the Republican proposal, it is in the Democratic as well as it could be a negotiating tool as well. But I think it's too early to make an assessment on that.

As far as areas that give us that confidence, if you look at what kind of are our main centers of really strong presence, these are household names that do have surpluses as it pertains to certain – I'm speaking mostly on the transportation side even with revenues coming down from a user fees perspective, California, Texas, Southeast United States. And so, those programs that were in our backlog and continue to be awarded were staying very close to our clients and those are going to continue. How fast and how much they grow, we're still in the middle of that right now.

Operator: And I'll now turn the call over to your CEO for closing remarks.

Steven J. Demetriou

Chairman & Chief Executive Officer, Jacobs Engineering Group, Inc.

All right. So, thanks, everyone. Look, the past five months as the pandemic increased in intensity, we kept our focus on our people. The culture of caring that we talked about is part of our DNA. Today's launch of our Action Plan for Advancing Justice and Equality is our next phase. It's our call to action and direct response to the recent social and racial injustices, and actions that go beyond words and rhetoric, and actions we hope others will do the same.

As we look at our business, these last two quarters have proven the resiliency of our company to stay the course, drive results in times of uncertainty. The diversity of our end markets, the strong foundation, the strong global teams have all held firm. And looking forward, the highly recurring nature of our work provides us some good visibility into our business opportunities and we expect to grow EBITDA in 2021. Thank you and good luck.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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