AECOM (ACM)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

| Price ($) (5/21/20): | 35.63 |
| 52WK H-L ($) : | 52 - 22 |
| Market Cap (mil): | 5,726 |
| Shares Out (mil): | 160.7 |
| Float (mil): | 156.9 |
| Avg. Daily Vol (mil): | 2.52 |
| Dividend ($) : | 0.00 |
| Yield (%): | 0.0 |

Rating: Outperform

Suitability: Average Risk

Price Target ($) :
- Q1: 42
- Q2: 5%
- Q3: 10%
- Q4: 37.6%
- Total: (5.4)%

Outperform Average Risk
- FY Sep: 0.56A, 0.69A, 0.72A, 0.80A, 2.75A
- FY P/E: 13.0x, 16.7x, 11.5x
- EPS (Cal): 2.68A, 2.41E, 3.21E
- P/E (Cal): 13.3x, 14.8x, 11.1x

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L-Term Rev. Gr Rate Est: 5%

L-Term EPS Gr Rate Est: 10%

Debt/Cap: 37.6%

ROE: (5.4)%

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Company Description

AECOM is a ~$13 billion gross revenue global provider of engineering, architectural, design and program/construction management services to government and commercial clients around the world. According to Engineering News-Record, AECOM is the second largest design firm in the world.

Revenue Profile

GEOGRAPHY

FUNDING SOURCE

END MARKET

Source: Company reports, F2019

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Revenue Profile

Competition

The global E&C industry is highly fragmented with AECOM competing with many global, national and regional publicly traded and privately held firms. Market "share" and competition sets varying considerably by geography and end market.

Quick Summary

- E&C value opportunity. For years we’ve advocated AECOM simply to do what they’re doing today and we like ACM’s new professional services-focused business model, which eschews risk and is designed to generate more predictable/stable results.

ACM’s balance sheet is also well-equipped to weather current conditions, with the MS sale proceeds in January helping to reduce net debt leverage to just 1.2x, well below 2.5x target. Additional portfolio actions also remain possible (the company is in various stages of negotiation to divest all or portions of its remaining fixed-cost at-risk construction work in the oil & gas, power, and civil markets) with expected collections and other working capital releases expected to drive very strong FCF through year-end. Against
this backdrop, shares screen attractively, with ACM potentially offering a balance sheet with zero net debt over the next couple quarters, with optionality to pursue buybacks and other deployment vehicles once market conditions settle. We also still don’t fully rule out the possibility of a WSP merger returning to the table, particularly given the recovery in WSP stock (the likely main currency of a deal) and without a permanent AECOM CEO at the helm.

- **Recent results.** All key metrics (net revenue, EBITDA, EPS, backlog) as well as F2020 guidance (which came in ahead of the recently falling consensus) were better-than-expected in F2Q20 with solid progress against restructuring initiatives (margins +200 bps YOY) and portfolio actions (asset sales/organic wind-downs). Positively, EBITDA trended ahead of plan through April, despite COVID disruption, with enough visibility to maintain guidance, only modestly lower. MS sale proceeds coupled with very strong expected near-term FCF provide a balance sheet well-equipped to play offense, with backlog (at a record, including near-record quarterly awards) and continued restructuring-led margin benefit offering a portfolio set to drive continued growth. Buybacks, CEO transition, and significant near-term FCF are catalysts; state/local budget health key risk, absent federal bail-out.

**Investment Thesis**

**The call:** We believe AECOM offers better relative exposure to US infrastructure investment at an attractive basis. While acknowledging uneven organic growth history and the macroeconomic uncertainties that exist today, we focus on better relative opportunity inside AECOM's core design business supported by steady backlog gains and better relative industry fundamentals. The company's recent simplification through selling its government services business should enhance operational focus and has left its balance sheet overcapitalized. The risk profile is declining and returns are improving after significant restructuring actions in F2019 and into F2020 and the overall quality of the franchise is improved against good market fundamentals. Reports of ACM being an acquisition target by WSP Global offer a newer angle though COVID disruption has (at a minimum) shifted any potential timeline.

**Broad service portfolio and international mix offers diversification and long-term growth opportunities.** AECOM is the second-largest global design firm in the world with leading positions throughout its end markets, particularly within transportation and environmental services. Indeed, from a thematic perspective, few companies can match ACM's exposure to infrastructure investment. Long-term infrastructure needs stemming from growing population in emerging markets and aging infrastructure in developed markets should result in significant demand for AECOM's services. A long economic recovery continues to bolster tax coffers, the source of funding which looks as good as it has in at least a decade.

**Value creation driven by cash generation.** Management's long-term financial outlook contemplates a 5%+ organic revenue CAGR and 10%+ EPS CAGR. Over the long term FCF and net income should be equivalent. Today's earnings growth is benefiting from a series of margin enhancing strategic actions which is supplementing strong fundamental margin underpinnings. ACM's balance sheet contains new optionality with leverage well below 2.0-2.5x target. That capacity likely is returned to shareholders, as the board has essentially sworn off acquisitions.

**Risks & Caveats**

**Highly competitive industry.** The global engineering and design industry is highly competitive and AECOM competes with many global, national and regional firms. Competition may limit AECOM's ability to bid successfully for new contract awards and may also impact AECOM's overall profitability.

**Economic sensitivity.** Despite AECOM's diverse service offering and geographic presence, the company is not immune from a downturn in the global economy. The inability of state and local governments or private developers to secure adequate access to capital, or a prolonged pullback in private investment, may result in project delays and/or cancellations.

**Acquisition integration risk and an increasing project risk profile.** AECOM has historically pursued an aggressive acquisition strategy, topped off with the $6 billion acquisition of URS in 2014. Integration efforts have not always been smooth and invite the potential for operational distraction. More recent acquisitions (e.g., Hunt, Shimmick) pushed ACM's project mix further down the risk spectrum, though management has recently begun to reduce portfolio exposure here. We expect M&A will no longer be a meaningful aspect of the AECOM investment story.

**Supplemental Information**

**AECOM Valuation Chart**

<table>
<thead>
<tr>
<th>F3Q19 Multiples</th>
<th>Forward P/E</th>
<th>Forward EV/EBITDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical Range (10-yr)</td>
<td>6x-26x</td>
<td>5x-16x</td>
</tr>
<tr>
<td>Historical Average (10-yr)</td>
<td>12.2x</td>
<td>9.0x</td>
</tr>
<tr>
<td>$42 Price Target:</td>
<td>12.7x</td>
<td>7.9x</td>
</tr>
</tbody>
</table>

Source: Baird Research
Appendix - Important Disclosures and Analyst Certification

Approved on 22 May 2020 14:25EDT/ Published on 22 May 2020 14:30EDT.

Rating and Price Target History for: AECOM (ACM) as of 05-21-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of ACM.

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