



AECOM | NYSE: ACM

INVESTMENT RESEARCH REPORT

"Overly-Engineered Earnings"

RECOMMENDATION: *Strong Sell*

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Spruce Point Capital is an industry recognized research activist investment firm founded in 2009

- Founded by Ben Axler, a former investment banker with 15 years experience on Wall Street
- Ranked the #1 Short-Seller in the world by [Sumzero](#) after a comprehensive study of 12,000 analyst recommendations dating back to 2008
- Five-star investment ranking from [TipRanks](#) and cracked the top 100 out of 4,759 investment professionals tracked in 2015
- **Track record of significant changes at Company level post research activism publication:**
 - Two companies have been charged with fraud and delisted from the Nasdaq to the Pink Sheets
 - Three other companies have been forced out of the public markets, privatized or acquired
 - Eight CFOs and Eight CEOs have resigned or been replaced post Spruce Point research initiation

Recent CEO Resignations Following Spruce Point Report Initiations

Spruce Point Report Date	Company	Enterprise Value at Release Date	CEO Who Resigned	CEO Announced Departure Date
4/13/16	Sabre Corp.	\$11.0 billion	Tom Klein	6/20/16
8/19/15	Caesarstone	\$1.7 billion	Yos Shiran	5/23/16
11/13/14	AMETEK Inc.	\$14.2 billion	Frank Hermance	5/4/16
12/17/15	The Intertain Group	\$1.1 billion	John Fitzgerald	2/22/16
2/10/15	Greif, Inc.	\$3.1 billion	David Fischer	10/13/15



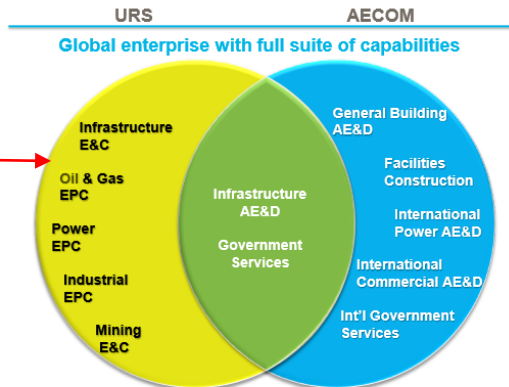
*Executive Summary:
33% – 45% Downside Risk*

AECOM Levered Up At The Top of the Oil/Gas Market To Acquire URS Corp

- AECOM (“ACM” or “the Company”) is a global engineering and construction firm based in Los Angeles, and is an enormous roll-up that came public in 2007. Bowing to pressure from an activist to maximize shareholder value, URS Corp (URS) sold itself in October 2014 to AECOM (for approx. \$5bn – a cash/stock deal which included the assumption of \$1bn in URS debt). The URS deal is the largest in AECOM’s history. AECOM’s pro forma leverage at closing of 4.4x was forecasted by the Company to decline to 2.0x by 2017 due to “strong free cash flows” – **a claim Spruce Point will put to rigorous scrutiny!**
- The URS deal was [touted as giving AECOM “heft”](#) in the oil and gas market, at exactly the wrong time! As shown by the investor presentation, URS also added exposure to the mining and industrial sectors – other areas that have shown persistent weakness since 2014
- The company predicted 25% accretion to “Cash EPS” and noted \$250m of synergies. Commenting on the deal, analyst Will Gabrielski of Stephens ([ironically now AECOM’s VP, IR](#)) said, “You couldn’t have had a better marriage of two companies that complement each other’s skill sets, scope and capabilities so well. They both have the federal government as a large customer, but there is very little overlap in what they do,” he said. “It’s a great value for both companies.”

Complementary Skill Sets

URS’s first-class franchises in key end markets create significant revenue opportunities when combined with AECOM’s end market strengths.



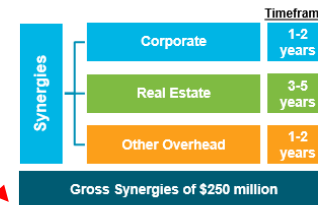
Levered up at the peak to oil, gas and metals

Significant Cost Synergies to Increase Shareholder Value

Cost savings will enhance earnings accretion; and a more-streamlined cost structure will better position the combined company to win and execute projects.

Expected to be accretive to GAAP EPS and more than 25% accretive to cash EPS⁽¹⁾ in FY 2015, excluding transaction-related costs

Heavy reliance on Cost Synergies



Read the fine print on what is considered “EPS”

(1) Defined as GAAP EPS + after-tax per share amortization of acquisition intangibles and stock-based consideration from accelerated vesting of performance shares.

Substantial Accounting Issues Plague AECOM, Proceed With Caution

- Spruce Point has been following AECOM, and has generally viewed its post-deal financial results with skepticism. Our view was fortified when on Aug 10, 2016 after reporting Q3'16 results, AECOM filed an [amended 10-K/A](#) and noted the following:

“Our management has reassessed and concluded that our internal control over financial reporting was ineffective as of September 30, 2015, due to the existence of a material weakness that existed at the end of fiscal year 2015 that is described further below. In our third quarter of fiscal year 2016, management discovered deficiencies associated with the acquisition of URS Corporation related to (a) the alignment of accounting policies specific to forward loss reserves and (b) income tax accounts.”

- **Trying to downplay this issue, AECOM stated further that:** *“These deficiencies did not have a material impact on the Company's previously reported financial results for the year ended September 30, 2015, and the Company recorded in the third quarter of fiscal year 2016 an immaterial cumulative adjustment.”*
- **Given recent disclosures, Spruce Point felt it necessary to make our analysis public with the goal of allowing investors to assess how material AECOM's accounting issues are. In our opinion, investors should be very concerned about the following issues:**
 - **[AECOM's Adjusted EPS vs. GAAP Results Are Wildly Diverging](#):** AECOM has changed its EPS definition three times since selling investors on the URS deal. Not surprisingly, each change makes the number more inflated. AECOM is now adding back “non-core operating losses” and “expected and actual asset sales” even though it told investors no divestitures were planned at deal inception. Even more alarming, in Q2'16 it booked pension curtailment gains to revenue and EPS to claim an earnings beat!
 - **[AECOM Has Incessantly Changed the URS Purchase Price Allocation](#):** Even though GAAP says that final intangible and goodwill allocation has to be completed within 12 months of closing, AECOM is still making changes 18 months later!
 - **[AECOM Appears To Have Set-up a Cookie Jar Reserve](#):** for “billings in excess of costs on uncompleted contracts” that include a margin fair value liability associated with long-term contracts acquired in connection with the acquisition of URS. AECOM has repeatedly changed its disclosure about the value of the margin liability accounted for at its inception, and continues to change its value 18 months later. **The reversal of the margin liability has allowed AECOM to book free revenue with 100% margin! We estimate this reserve has been [used to book \\$149m of revenues and \\$0.73 cents of earnings](#)!**

AECOM Concerns (cont'd)

- **Questionable Synergies:** AECOM boosted its estimate of cost savings synergies from \$250m to \$325m shortly after its CFO was rotated out of his position to become President at the end of FY Sept 2015. According to our analysis of recent industry mega deals, AECOM has promised the largest synergy targets seen in the E&C industry by a wide margin
- **Evidence of Poor Financial Planning or Worse:** We are skeptical of AECOM's synergy targets because AECOM grossly misestimated acquisition and integration costs ("A&I"), along with amortization of acquired intangibles. According to its own estimate, AECOM expected 2015 costs to be \$290m and amortization of \$250m, but actual results came in +37% and +44% above estimates, respectively. Total A&I costs are now estimated to reach a lofty \$626m! This heightens our worry that AECOM could be running regular costs through its income statement, and trying to disguise them as deal costs
- **Free Cash Flow Appears Overstated:** AECOM has shown three different definitions of Free Cash Flow! In the proxy it showed URS's free cash flow as adjusted for noncontrolling distributions, a definition we view as accurate. It currently does not remove distributions, and later changed to "capital expenditures net of asset sales." In our view, this adjustment is very aggressive and not common. Lastly, we note that AECOM includes accounts receivable financing activities, as well as excess joint venture dividends above equity earnings, as part of operating cash flow. By adjusting for these items and distributions to noncontrolling interests, **we believe free cash flow is overstated by approximately 90% in the LTM ending June 30th**
- **Plummeting Tax Rate:** AECOM noted issues with its tax accounts w/out discussing specifics. We observe that its forecasted effective tax rate fell from 32% in Dec '14 to 24% as of June '16. In the last quarter, its estimated tax rate fell by 300bps!
- **AECOM Capital Could Further Distort Earnings and Cash Flows:** Management is trying to condition investors to expect that capital fund sales should be viewed as "core" earnings and operating cash flows. It has already booked \$16m of gains in 2015, and is telling investors to expect more in the next 12 months. These irregular gains can hardly be considered "core"
- **Rising Interest Expense Revision and Debt Covenant Step-Up:** AECOM just raised its interest cost estimate by \$15m, yet has reduced its total and floating rate exposure. It says its exposure to a 1% move in rates should add \$16m of costs. We estimate rates have only moved 25bps; something doesn't add up! AECOM's credit agreement ties its interest cost to its leverage. **Did AECOM just signal that its EBITDA will be falling (leverage rising)?** Its stated 6/30/16 leverage is 4.3x and come Sept 30th, its leverage covenant drops to 4.75x - leaving AECOM very little cushion

Terrible Risk/Reward of Owning AECOM; 33% - 45% Downside Potential

▪ Rampant Governance Concerns Raises Questions Why Anyone Would Own AECOM:

- Management Has Almost Zero Alignment with Shareholders: Since coming public in 2007, insider ownership has declined from 13.5% to a pathetic 1.1%. When thinking about the totality of our concerns, investors need to consider that management has virtually nothing at risk if AECOM doesn't perform
- Excessive CEO Comp Tied to Inflated Adj. Free Cash Flow: AECOM's CEO (also its Board Chairman) netted \$18m in comp (inc. a \$5m special performance for the URS deal (one we view as a disaster)). Management boldly tried to sell investors that it produced \$4.59 of FCF/share in 2015, +52% over the prior year. In our view, this measure is grossly inflated, and fails to account for key adjustments to remove financed receivables, excess distributions from unconsolidated subsidiaries, and distributions to noncontrolling interests. With these adjustments, we find that AECOM's 2015 normalized FCF/share was \$2.36 and declined by 9% from 2014
- AECOM's Knows How to Make News: In the past year, there've been rampant allegations of misconduct, open investigations, lawsuits and settlements on a global basis involving AECOM. To illustrate, it agreed to pay \$20.2m to resolve a US investigation into an alleged fraudulent overbilling scheme, paid \$201m to settle an Australia Toll-Road lawsuit (one of the largest settlements related to misleading and deceptive conduct in Australian history), faced a federal lawsuit related to systematically defrauding NASA, and is being investigated by the Dept. of Energy for its role in the Hanford Nuclear Reservation

▪ Trading Near 52 Week And All-Time Highs, Shares Are Fully Valued With A Terrible Risk/Reward Owning AECOM

- AECOM's Looks "Cheap" – Buyer Beware: Trading at 11x Price/16E EPS vs. peers at 14.0x, AECOM looks cheap, but in our view its Adj. EPS is fraught with overstatement. Based on our adjustments, it trades at close to 19x, a substantial premium. AECOM is levered 4.3x Debt / EBITDA leaving little room for error, but by adjusting its Debt to include its unfunded pension and sizeable operating leases and normalizing its EBITDA, true leverage is closer to 7.4x!
- Even Analysts Seem To Agree: The average price target is little more than \$35/sh and analysts' are more neutral than positive
- Meaningful Downside Potential: Given numerous accounting distortions to EPS, we believe the best way to value AECOM is on a multiple of LTM Free Cash Flow. Applying a range of 9x – 11x on \$2.10 of LTM FCF per share, we get \$19 - \$23/sh (33-45% downside)

In Our View, True Free Cash Flow Estimated 90% Lower Than Presented By AECOM

AECOM's cash flow should also be adjusted by removing net distributions to noncontrolling interests because its operating cash flow starts with consolidated net income, and needs to remove the claims held by these interests. By normalizing AECOM's free cash flow to remove financed receivables sales, excess JV dividends, and distributions to noncontrolling interests, we find substantial overstatement in AECOM's Adj. Free Cash Flow.

\$ in millions	2012	2013	2014	2015	LTM 2016
Reported Operating Cash Flow	\$433.4	\$408.6	\$360.6	\$764.4	\$729.3
<u>Less:</u> Factored Receivables	(28.0)	(64.9)	(10.9)	(108.9)	(74.9)
<u>Less:</u> AECOM Capital Sale	--	--	--	(16.4)	(10.0)
<u>Less:</u> Excess Distributions of Unconsolidated Subsidiaries (1)	(0.0)	(6.8)	(0.0)	(51.4)	(57.9)
Adj. Operating Cash Flow <i>% below reported</i>	\$405.4 -6.5%	\$336.9 -17.6%	\$349.7 -3.0%	\$587.7 -23.1%	\$586.5 -24.1%
<u>Less:</u> Gross Capex (2)	(62.9)	(52.1)	(62.9)	(90.4)	(142.0)
<u>Less:</u> Net Distributions to Noncontrolling Interests (3)	(1.3)	(18.5)	(30.3)	(144.3)	(118.7)
Spruce Point Adj. Free Cash Flow	\$341.2	\$266.3	\$256.6	\$353.0	\$325.9
AECOM Adj. Free Cash Flow <i>% Overstated</i>	\$370.5 9.6%	\$356.5 33.9%	\$297.8 16.1%	\$695.0 97%	\$619.3 90%

(1) Represents dividends in excess of equity income, which should be reclassified as an investing cash flow, not from operations

(2) Starting in 2015, AECOM started marketing its Free Cash Flow "net of disposals" which it [confirmed to the SEC](#) was \$21m

(3) For a primer on why it's appropriate to make this adjustment, see GeorgiaTech Financial Reporting & Analysis Lab Report, "[Misleading Signals From Operating Cash Flow in the Presence of Noncontrolling Interests](#)," Jan 2013. Also, consider that AECOM made this adjustment in its proxy statement to URS Corp. free cash flow



Nuts and Bolts of the Issues

URS Deal Has Failed To Meet Expectations

AECOM received initial estimates from URS, but made adjustments in June 2014 based on its independent due diligence investigation of URS. Actual URS results have underperformed even AECOM's already discounted estimates by a wide margin! AECOM said URS contributed \$8.5bn in sales vs. \$10.1bn expected

URS Management's Initial Projections

	Year Ended December 31,				
	2014E	2015E	2016E	2017E	2018E
	(in millions, except per share data)				
Revenues	\$ 10,922	\$ 11,608	\$ 12,529	\$ 13,370	\$ 14,204
Adjusted EBITDA(1)	\$ 718	\$ 733	\$ 753	\$ 785	\$ 810
Operating income	\$ 542	\$ 593	\$ 635	\$ 683	\$ 737
Earnings per share (\$/share)	\$ 3.54	\$ 4.32	\$ 4.90	\$ 5.55	\$ 6.09
Free cash flow(2)	\$ 822	\$ 426	\$ 441	\$ 465	\$ 423

AECOM's Adjusted URS Projections From Its Proxy

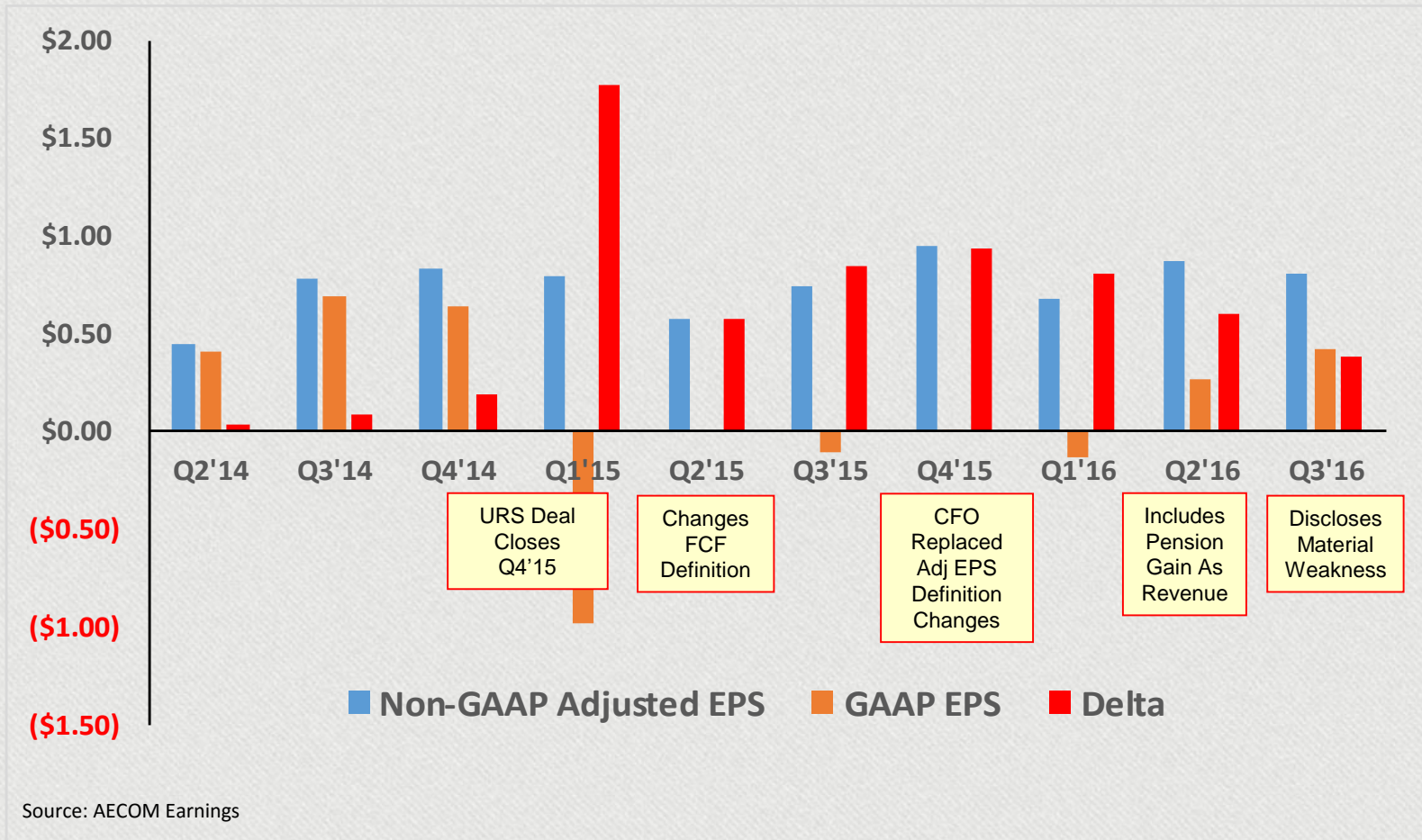
	Year Ended December 31,					
(\$ in millions)	2014E	2015E	2016E	2017E	2018E	2019E
Revenue	10,045	10,099	10,901	11,632	12,358	13,062
EBITDA(1)	631	638	655	683	705	727
EBITDA Margin	6.3%	6.3%	6.0%	5.9%	5.7%	5.6%
Free Cash Flow(2)	562	389	335	356	368	NA(3)
Net Income Attributable to URS	199	227	253	290	321	NA(3)

Source: AECOM [proxy statement](#)

"Since the acquisition date, URS contributed \$8.5 billion in revenue and \$219.0 million in income from operations during the twelve months ended September 30, 2015" AECOM FY 2015 [10-K](#), page 84

Alarming GAAP / Non-GAAP Disparity

AECOM has historically shown a large divergence between GAAP and Non-GAAP. While recent results appear to show some convergence (smaller delta), we will illustrate later in the presentation that cash flow is deteriorating and exhibiting YoY contraction.



Accounting rules are crystal clear that changes to intangible assets and goodwill must be completed within 12 months of the acquisition date. In the case of AECOM, which closed its URS deal Oct 2014 (within the Dec 2014 quarter), it suggests that AECOM should have finalized its allocation by Dec 2015. However, this is not the case and it is still muddling with URS' valuation 18 months later!

PricewaterhouseCoopers Acquisition Accounting Guidance

“The fair values of identifiable net assets recognised in a business combination may be based on the provisional fair values available at the time of the acquisition. The fair value of these assets and liabilities and the resulting amount of any goodwill must be finalised no later than 12 months from the acquisition date. Goodwill, as the residual, is not finally determined until the fair value exercise is complete. A change to goodwill arising from the completion of the fair value exercise is not an impairment.”

Source: [PWC guide](#), Business Combinations and Non-controlling interests, Application of the US GAAP and IFRS Standards, 2nd edition Feb 2016

Manipulation of URS Acquisition Accounting?

AECOM is still making changes to URS accounts 18 months later! Changes are shaded in orange.

URS Accounts (\$ in mm)	<u>Dec 2014</u>	<u>March 2015</u>	<u>Sept 2015</u>	<u>March 2016</u>	<u>June 2016</u>
Cash and Equivalents	\$285.2	\$284.8	\$284.9	\$284.9	\$284.9
Accounts Receivable	2,572.0	2,579.1	2,512.5	2,512.5	2,512.5
Prepaid Expenses and other	373.8	356.4	421.0	421.0	421.0
PP&E	609.2	579.9	570.9	570.9	570.9
Customer relationships, contracts and backlog	822.2	983.8	969.2	969.2	973.8
Trade Names	7.8	7.8	7.8	7.8	7.8
Goodwill	3,801.0	3,846.9	4,021.7	3,992.0	4,059.8
Other Non-Current Assets	347.1	335.2	329.8	329.8	329.8
Accounts Payable	(750.2)	(720.0)	(656.7)	(656.7)	(656.7)
Accrued Expenses and other	(1,091.4)	(1,136.0)	(1,344.8)	(1,344.8)	(1,403.7)
Billings in excess of cost; Uncompleted Contracts	(196.1)	(369.0)	(397.8)	(397.8)	(398.8)
Current Portion of LT Debt	(47.4)	(47.4)	(47.4)	(47.4)	(47.4)
Other LT liabilities	(473.7)	(433.0)	(423.3)	(393.6)	(406.1)
Pension Benefit Obligation	(402.1)	(402.1)	(406.3)	(406.3)	(406.3)
Long Term Debt	(520.2)	(520.2)	(520.2)	(520.2)	(520.2)
Noncontrolling Interest	(216.6)	(225.6)	(201.0)	(201.0)	(201.0)

The Initial URS Accounting Allocations

The initial transaction accounting had no adjustment for billings in excess of uncompleted contracts

	Historical						As of
	As of	As of					June 30, 2014
	June 30, 2014	July 4, 2014	Reclassification	Pro Forma	Notes		Pro Forma
	AECOM	URS	Adjustments (3k)	Adjustments			Combined
Assets							
CURRENT ASSETS:							
Total cash and cash equivalents	\$ 510	\$ 283	\$ —	\$ (50)	3(a)	\$	743
Net accounts receivable	2,432	2,852	—	—			5,284
Prepaid expenses and other current assets	151	198	62	—			411
Income taxes receivable	9	3	(12)	—			—
Deferred tax assets—net	20	30	(50)	—			—
TOTAL CURRENT ASSETS	3,122	3,366	—	(50)			6,438
PROPERTY AND EQUIPMENT-NET	279	592	—	29	3(b)		900
DEFERRED TAX ASSETS-NET	117	—	(117)	—			—
INVESTMENTS IN UNCONSOLIDATED JOINT VENTURES	134	244	—	272	3(b)		650
GOODWILL	1,896	3,709	—	(3,709)	3(b)		5,416
				3,520	3(b)		
INTANGIBLE ASSETS-NET	87	523	—	(523)	3(b)		1,164
				1,077	3(b)		
OTHER NON-CURRENT ASSETS	119	221	117	(22)	3(c)		523
				88	3(d)		
TOTAL ASSETS	\$ 5,754	\$ 8,655	\$ —	\$ 682			\$ 15,091
Liabilities and Stockholder's Equity							
CURRENT LIABILITIES:							
Short-term debt	28	—	—	—			28
Accounts payable	705	692	—	(4)	3(l)		1,393
Accrued expenses and other current liabilities	931	523	327	(12)	3(c)		1,711
				(58)	3(b)		
Billings in excess of costs on uncompleted contracts	352	222	—	—			574
Current portion of long-term debt	59	51	—	65	3(e)		155
Other current liabilities	—	327	(327)	—			—

Booking Free Revenue and Income!

In the second quarter after closing URS in March 2015, AECOM started disclosing in its footnote fillings that billings in excess of costs on uncompleted contracts include a margin fair value liability associated with long-term contracts acquired in connection with the acquisition of URS.

AECOM has repeatedly changed its disclosure about the value of the margin liability accounted for at its inception, and continues to change its value 18 months later!

AECOM Has Repeatedly Changed The Starting Value of the Liability

\$ in millions

Quarterly Period	<u>Version 1</u> March 2015	<u>Version 2</u> June 2015	<u>Version 3</u> Sept 15 – Mar 16	<u>Version 4</u> June 2016
Q3 June 2016	--	--		\$17.8
Q2 March 2016	--	--	\$22.8	--
Q1 Dec 2015	--	--	\$36.0	--
Q4 Sept 2015	--	--	\$51.2	--
Q3 June 2015	--	\$75.3	--	--
Q2 March 2015	\$118.7	--	--	--
Q1 Dec 2014 Balance at Inception	\$172.9	\$135.6	\$148.1	\$149.1

Source: AECOM Financials

Note: Figures post inception date reflect current balances

Cumulative EPS Benefit Estimated Up To \$0.73 Cents

Reversal of the fair value margin liability has resulted in “free” revenue and margin to AECOM of approximately \$149 million. We estimate the cumulative effect on its EPS to be approx. \$0.64 cents and AECOM stands to benefit by an additional \$0.09 cents per share from running the remaining liability of \$17.8m to maturity (1)

\$ in millions except per share amounts

Quarterly Period	Revenue and Margin Benefit	Cumulative Benefit	Diluted Shares	Effective Tax Rate	EPS Boost	Cumulative EPS Boost
Future Periods	\$17.8	\$148.9	156.0	24.0%	\$0.09	\$0.73
Q3 June 2016	5.9	131.1	156.2	12.5	0.03	0.64
Q2 March 2016	13.2	125.2	155.4	26.0	0.06	0.61
Q1 Dec 2015	15.1	112.0	154.8	25.0	0.07	0.54
Q4 Sept 2015	36.6	96.9	155.2	25.5	0.18	0.47
Q3 June 2015	6.1	60.3	151.7	26.9	0.03	0.29
Q2 March 2015	29.8	54.2	152.8	29.3	0.13	0.27
Q1 Dec 2014	24.4	24.4	141.9	25.9	0.14	0.14

Source: AECOM Financials and press releases

(1) Based on AECOM's 24% assumed effective tax rate at 156m shares outstanding for 2016

Deal Cost Forecasting #ERROR

The difference between AECOM's forecasted deal costs and amortization vs. reality came in +37% and +44% above estimates. This appears to be more than just a casual oversight!

Prior to the URS deal closing, AECOM made the following statement in its [10-K](#) (p. 56) for the year ended Sept 30, 2014

"We expect to incur approximately \$250 million of amortization of intangible assets expense and \$290 million of acquisition and integration expense in the next 12 month"

But in reality, for the year ended Sept 30, 2015 AECOM reported in its [10-K](#) (p. 35 & 84) \$398.4m and \$361.6m acquisition and integration expense and intangible amortization, respectively

"Amortization of intangible assets relating to URS was \$361.6 million during the twelve months ended September 30, 2015 since the acquisition date."

Acquisition and integration expenses in the accompanying consolidated statements of operations comprised of the following (in millions):

	Year Ended September 30,	
	2015	2014
Severance and personnel costs	\$ 223.8	\$ 15.2
Professional services, real estate-related, and other expenses	174.6	12.1
Total	\$ 398.4	\$ 27.3

Beware of Abnormally High Costs Being Classified As Deal Related

When compared with recent multibillion dollar E&C deals, the AECOM / URS transaction is a significant outlier on every metric we've analyzed. AECOM significantly boosted the \$250m cost synergy target in Sept 2015 (to \$325m) upon the transitioning of the CFO, and while global energy markets were under extreme pressure. What's most alarming is that projected acquisition and integration costs of \$625m are unusually large, which raises the possibility that AECOM is running ordinary expenses through this account and attempting to justify them as deal costs.

\$ in millions, except per employee amounts

Ann. Date	Target / Acquirer	EV of Target	Expected Synergies (1)	Pro Forma Sales	Pro Forma Employees	Deal Costs (2)(3)	Deal Costs / Target EV	Synergies / Target EV	Synergies / PF Sales	Synergies / PF Employees
7/11/14	URS / AECOM	\$4,900	\$325	\$19,100	95,000	\$625.3	12.8%	6.6%	1.7%	\$3,421
7/30/12	Chicago Bridge / Shaw	3,400	47.5	11,493	50,000	146.4	4.3	1.4	0.4	950
6/23/14	SNC / Kentz	1,953	46.5	9,337	44,500	70.1	3.6	2.4	0.5	1,045
1/13/14	Foster Wheeler/AMEC	3,200	75.0	8,730	40,000	256.4	8.0	2.3	0.9	1,875
2/20/12	Flint / URS	1,500	12.5	11,115	57,000	16.9	1.1	0.8	0.1	219
5/28/07	Washington Group / URS	2,403	52.5	8,600	54,000	50.6	2.1	2.2	0.6	972

Source: Company financial statements and press releases

(1) Revenue and cost synergies, in some cases stated at midpoint of guidance ranges

(2) Expenses flowing through income statement, excluding financing costs.

(3) AECOM costs include 2014: \$27.3m 2015: \$398.4m and 2016E: \$200.0m

Decaying “Earnings” Quality

Below are key financial forecasts for AECOM post URS closing in Oct 2014. In our opinion, the quality of earnings has decayed and needs to be scrutinized. The company has repeatedly lowered its effective tax rate, boosted synergies substantially and increased interest expense costs, yet its FY 2016 Adj. EPS guidance this year is unchanged. We will also show how the company has made subtle definition changes to optically increase its results.

AECOM Guidance of Key Metrics

Quarter	Adj EPS	Capex	Interest Expense	Current Yr Synergies	Next Yr Synergies	Effective Tax Rate
Q3 June 2016	\$3.00-\$3.40	\$150	\$225	\$275	\$325	24%
Q2 March 2016	\$3.00-\$3.40	\$150	\$210	\$275	\$325	27
Q1 Dec 2015	\$3.00-\$3.40	\$150	\$210	\$275	\$325	28
Q4 Sept 2015 (1)	\$3.00-\$3.40	\$150	\$210	\$110	\$325	28
Q3 June 2015	\$3.05-\$3.45	\$110	\$220	\$110	\$180	30
Q2 March 2015	\$3.15-\$3.55	\$160	\$220	\$110	\$180	30
Q1 Dec 2014	\$2.75-\$3.35	\$170 (2)	\$220	\$110	\$180	30
Q4 Sept 2014	\$2.75-\$3.35	--	\$225	\$110	\$180	32

Source: AECOM press releases and conf calls

(1) On Sept 8, 2015 AECOM [appointed](#) Troy Rudd as CFO, replacing Steve Kadency. In the following period, AECOM substantially boosted its estimated synergies and capex

(2) Capex stated on a “gross” basis, changed to a “net of asset disposals” thereafter

Decaying “Free Cash Flow” Quality

AECOM has made aggressive changes to its definition of Free Cash Flow. Its most recent definition to include proceeds from asset sales is not market standard in our opinion.

In the [merger proxy](#) (p. 96), AECOM defined URS’ free cash flow as follows, a very conservative and appropriate definition in our view:

“Free cash flow is defined herein as operating cash flow less capital expenditures and non-controlling interest distributions.”

Yet, AECOM’s new discussion of free cash flow in [Q1 2015](#) used the following definition, dropping non-controlling interest distributions

“Free cash flow is defined as cash flow from operations less capital expenditures and is a non-GAAP measure”

In March 2015, AECOM [appointed](#) CEO Michael Burke to Chairman of the Board. By the next quarter in [Q2](#) May 2015, AECOM made its definition even more egregious in our opinion by including asset disposals:

“Free cash flow is defined as cash flow from operations less capital expenditures net of proceeds from disposals, and is a non-GAAP measure”

Decaying Adjusted EPS Quality...

There appears to be no limit as to how crafty AECOM can get when defining its Adjusted EPS. Also upon appointment of the new CFO, AECOM quickly added adjustments for disposals, which were never originally contemplated from the deal

On the day AECOM announced the URS acquisition, it held a conference call to discuss the transaction:

FBR Analyst: *"A lot of questions have been asked so I'll be brief. Are there any asset divestitures that could accelerate the debt paydown over the next two years that have been contemplated or maybe considered"*

ACM CFO: *"There's nothing material. We know that URS has been looking at various things, but again they're not material."*

AECOM's initial "Cash EPS" definition (now "Adjusted EPS") has been a moving target ever since sold to the Street

Deal Announcement Presentation: **"Cash EPS"** Defined as GAAP EPS + after-tax per share amortization of acquisition intangibles and stock-based consideration from accelerated vesting of performance shares


Q3'15: **"Adjusted EPS"** Defined as attributable to AECOM, excluding acquisition and integration related expenses, financing charges in interest expense, and the amortization of intangible assets.

Q4'15: **"Adjusted EPS"** Defined as attributable to AECOM, excluding acquisition and integration related expenses, financing charges in interest expense, the amortization of intangible assets, and financial impacts associated with expected dispositions of non-core businesses or assets

Q3'16: **"Adjusted EPS" (double emphasis by AECOM)** Defined as attributable to AECOM, excluding financial impacts associated with expected and actual dispositions of non-core businesses or assets, acquisition and integration related expenses, financing charges in interest expense, the amortization of intangible assets, and financial impacts associated with expected and **actual** dispositions of non-core businesses and assets"

Pension Gains As Revenues?

Spruce Point has observed dozens of accounting shenanigans over the years, but has never seen one where a company books revenue related to an accelerated pension curtailment! In Q2'16, AECOM recorded \$45m of revenue in its Management Service segment and a \$0.14 cent benefit, which appears to have required significant management judgement. AECOM disclaimed that the actual reimbursement may vary from the expectation.



AECOM reported \$0.87c of Adjusted EPS in Q2'16 vs. Street estimates of \$0.73c. Without the \$0.14c curtailment benefit, AECOM would have simply matched estimates!

AECOM made the following disclosure Q3'16 [10-Q](#), p. 17:

*“During the three months ended March 31, 2016 **the Company recorded revenue and a noncurrent asset related to the expected accelerated recovery of a pension related entitlement** from the federal government of approximately \$45 million. **The actual amount of reimbursement may vary from the Company’s expectation.**”*

Responding to Analyst Cook on the [Q2'16 Conference Call](#), CFO Rudd:

*“On the guidance, Jamie, I think, it's a good question – obviously the \$0.14 was not – **well, there was a piece of it, probably that we would have collected during the year, but that \$0.14 would have come over a long period of time, which we're now going to accelerate into FY 2016, and FY 2017.** And then, we've got the headwind from oil and gas, and if you just do the math, you kind of get to something, if you are starting from the midpoint of the range, something higher than the midpoint of the range, but when you're trying to land a company of this size, at the end of year, having some contingency in there for other unexpected items, some of which are known to us now, some of which are not known is prudent from our perspective.”*

But Wait It Can Get Worse: AECOM Capital

AECOM set up AECOM Capital in 2013 as an investment vehicle to directly invest AECOM's capital in public-private partnerships and private-sector real estate projects.

AECOM gives very few details about these projects in its SEC filings, but as we will illustrate, would like investors to view investment sales as core earnings and cash flow. In our opinion, this is an aggressive financial presentation.

- As stated in the [Q2'16 Earnings Call](#), AECOM Capital is the financing arm of its fully integrated design build finance and operate strategy and has directly invested in 14 real estate projects since 2013 as a member/partner of joint venture arrangements with other independent third parties
- AECOM Capital has committed nearly all of the \$200 million of the first fund. Management has stated this investment has resulted in over \$3.5 billion of total development value, including \$1.5 billion of construction backlog executed by the Construction Services segment. AECOM's [website](#) says the average investment size is \$10 - \$30 million
- Initial investments centered on commercial, residential and mixed-use properties in major U.S. metros led by New York and Los Angeles
- AECOM has stated that many of its investments are maturing, and going forward, earnings and cash flow from its portfolio of projects will be a more significant contributor to its financial results. AECOM is also pursuing several options to expand its capacity
- In 2015, AECOM reported the following as a line item in "Other Income"

"Our other income for the year ended September 30, 2015 increased \$16.4 million to \$19.1 million as compared to \$2.7 million for the year ended September 30, 2014. The increase in other income for the year ended September 30, 2015 was primarily due to the sale of an infrastructure fund investment."

- **Bear in mind, AECOM reports total asset of \$13.8 billion, yet its capital commitment is \$200m.** Yet, on the next slide, we illustrate that AECOM wants investors' to view this as "core" earnings, and operating cash flows!

ACM Capital Viewed As Core Earnings and Going Through Operating Cash Flow

AECOM Q4'15 Conference Call

Chase A. Jacobson - William Blair & Co. LLC: ***"First question, can you give any more color as it relates to the monetization of the AECOM Capital Investments? I know you're probably not going to give us a size. But how is that recorded? And as we go forward, are those going to be regular like every quarter, or is it going to be once or twice a year? Is there any color you can give there?"***

Michael S. Burke - Chairman & Chief Executive Officer: *"Sure. We don't want to give guidance on a sub-segment level, but we – in those transactions, it will be difficult to project by quarter or even by year, but **we fully expect that we will have a couple of monetizations per year for the foreseeable future**. We have 14 individual investments that we are in process with right now within AECOM Capital. We have a much longer pipeline of potential investments beyond that. And so we will have monetizations this year. But given that we are in the midst of negotiating some of those monetizations, we don't want to get too specific on it, but **it will be a regular part of our business going forward**. The objective is to invest in these projects, deliver the design service and construction revenue along with it. And then when the project is complete, we want to recycle the capital and do it all over again. **So it will be a regular part of business and it will be a part of our core earnings**"*

AECOM Q2'16 Conference Call – CFO Does Not Dispel The Statement That Investment Gains Are Operating Cash Flows

Jeffrey Y. Volshteyn - JPMorgan Securities LLC: *Thank you for taking my question. I wanted to ask on free cash flow side of things. So, year-to-date, you're probably at around \$160 million, which leaves if I use the midpoint of your guidance about \$540 million for the second half of the year. **Can you help us think through what might be coming through AECOM Capital, what might be coming through operating free cash flow, and how does it work with CapEx, which seems to be kind of ramping up towards the year-end as well?***

W. Troy Rudd - Chief Financial Officer & Executive Vice President: *Hey, Jeff, this is Troy Rudd. I guess, first of all, we're right on track with where we expected to be in the first half of the year. If you look historically the business produces about 20% of its cash flow in the first half of the year and 80% in the back half of the year. This is a couple of data points. In the first half of the year, we spend a little more than \$100 million on variable comp and some tax related to our equity programs that we don't have in the second half of the year. So that's the sort of the most significant item that influences the timing of the cash flow beyond what we see in just the normal run rate and earnings in our business. Our business does ramp up in the second half of the year and that also influences cash flow. So, where we sit today, we have great confidence in our ability to hit that full year guidance number.*

In Our Opinion, Operating Cash Flow Is Inflated By Financed Receivables

AECOM sells accounts receivables in a financial arrangement to institutions. The company includes these asset sales as part of operating cash flow. In Spruce Point's opinion, we do not view these arrangements as true operating cash flows, and are better viewed as financing cash flows, or as investment cash flows since they pertain to asset sales. As a best practices, many companies adjusted out financing receivables for presentation purposes (e.g. [IBM](#))

ACM reported \$108.9m of receivable sales in 2015. URS contributed \$2,512m of receivables upon deal closing, while ACM's receivable balance was \$2,655m at 9/30/14. Thus, while ACM's total receivables grew 94%, its receivable sales grew from \$10.9m in 2014 to \$108.9m in 2015, representing a ~900% increase!

\$ in millions

	2012	2013	2014	2015	YTD 2016
Reported Operating Cash Flow	\$433.4	\$408.6	\$360.6	\$764.4	\$451.3
Less: Factored Receivables	(28.0)	(64.9)	(10.9)	(108.9)	(65.3)
<i>% YoY Growth</i>	--	132%	-83%	899%	34%
Adjusted Operating Cash Flow	\$405.4	\$343.7	\$349.7	\$655.5	\$386.0

Source: AECOM Financials and press releases

Note: Spruce Point tried to identify the governing document for the receivables sales program, but it does not appear that AECOM filed them with the SEC. The first mention of the sales came in its FY 2012 [earnings release](#)

In Our Opinion, Operating Cash Flow Also Inflated By Excess JV Dividends

We recently exposed Sabre Corp for inflating its operating cash flow by ~\$15m by running JV dividends in excess of earnings as operating cash flows. Not surprisingly, Sabre recently cut its free cash flow estimate from \$400m to \$375m, but blamed higher capex needs! (1) Sabre's CEO also abruptly resigned. (2) Accounting practices dictate that excess distribution above earnings should be viewed as returns of capital, and treated as investment cash flows (3). AECOM's Cash Flow Statement clearly shows excess JV distributions running through operating cash flows.

AECOM Consolidated Statement of Cash Flows (in thousands)	Fiscal Year Ended		
	September 30, 2015	September 30, 2014	September 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss) income	\$ (71,233)	\$ 232,764	\$ 243,196
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	599,265	95,394	94,406
Equity in earnings of unconsolidated joint ventures	(106,245)	(57,924)	(24,319)
Distribution of earnings from unconsolidated joint ventures	157,616	23,839	31,159
Non-cash stock compensation	85,852	34,438	32,611
Prepayment penalty on unsecured senior notes	55,639	—	—
Excess tax benefit from share-based payment	(3,642)	(748)	(1,754)
Foreign currency translation	(19,632)	(20,794)	(16,061)
Write-off of debt issuance costs	8,997	—	—
Deferred income tax expense (benefit)	(53,034)	27,155	(7,210)
Other	(18,248)	1,460	1,821

Source: AECOM [10-K](#)

(1) Sabre reduces free cash flow estimate, [Aug 2, 2016](#)

(2) Sabre CEO transition, [June 20, 106](#)

(3) ASC 230-10-45-12 as noted in [E&Y's Statement of Cash Flows guide, June 2015](#)

In Our View, Free Cash Flow Also Inflated By Not Removing Noncontrolling Interest

AECOM's cash flow should also be adjusted by removing net distributions to noncontrolling interests because its operating cash flow starts with consolidated net income, and needs to remove the claims held by these interests. By normalizing AECOM's free cash flow to remove financed receivables sales, excess JV dividends, and distributions to noncontrolling interests, we find substantial overstatement in AECOM's Adj. Free Cash Flow.

\$ in millions	2012	2013	2014	2015	LTM 2016
Reported Operating Cash Flow	\$433.4	\$408.6	\$360.6	\$764.4	\$729.3
<u>Less:</u> Factored Receivables	(28.0)	(64.9)	(10.9)	(108.9)	(74.9)
<u>Less:</u> AECOM Capital Sale	--	--	--	(16.4)	(10.0)
<u>Less:</u> Excess Distributions of Unconsolidated Subsidiaries (1)	(0.0)	(6.8)	(0.0)	(51.4)	(57.9)
Adj. Operating Cash Flow <i>% below reported</i>	\$405.4 -6.5%	\$336.9 -17.6%	\$349.7 -3.0%	\$587.7 -23.1%	\$586.5 -24.1%
<u>Less:</u> Gross Capex (2)	(62.9)	(52.1)	(62.9)	(90.4)	(142.0)
<u>Less:</u> Net Distributions to Noncontrolling Interests (3)	(1.3)	(18.5)	(30.3)	(144.3)	(118.7)
Spruce Point Adj. Free Cash Flow	\$341.2	\$266.3	\$256.6	\$353.0	\$325.9
AECOM Adj. Free Cash Flow <i>% Overstated</i>	\$370.5 9.6%	\$356.5 33.9%	\$297.8 16.1%	\$695.0 97%	\$619.3 90%

(1) Represents dividends in excess of equity income, which should be reclassified as an investing cash flow, not from operations

(2) Starting in 2015, AECOM started marketing its Free Cash Flow "net of disposals" which it [confirmed to the SEC](#) was \$21m

(3) For a primer on why it's appropriate to make this adjustment, see GeorgiaTech Financial Reporting & Analysis Lab Report, "[Misleading Signals From Operating Cash Flow in the Presence of Noncontrolling Interests](#)," Jan 2013. Also, consider that AECOM made this adjustment in its proxy statement to URS Corp. free cash flow



Foreshadowing Problems: *Interest Expense Rising Now?*

With just 1 quarter left in its FY 2016, AECOM boosted its interest expense forecast by \$15 million in Q3'16. Yet, both its outstanding floating debt exposure has declined and interest rates haven't budged much. Bofa Prime Rate and 3M Libor are up approx. 25bps. AECOM said recently a 1% increase in rates would cause its interest expense to rise by \$16m. Something is not adding up! AECOM's credit agreement ties interest rate pricing to leverage – has it just signaled to investors that its deleveraging target won't be met?

Sept 2015: "For the year ended September 30, 2015, our weighted average floating rate borrowings were \$3,001.9 million, or \$2,476.9 million excluding borrowings with effective fixed interest rates due to interest rate swap agreements. If short term floating interest rates had increased or decreased by 0.125%, our interest expense for the year ended September 30, 2015 would have increased or decreased by \$3.1 million. Our average effective interest rate on our total debt, including the effects of the interest rate swap agreements, during the year ended September 30, 2015 was 4.2%"

Dec 2015: "For the three months ended December 31, 2015, our weighted average floating rate borrowings were \$2,778.4 million, or \$2,178.4 million excluding borrowings with effective fixed interest rates due to interest rate swap agreements. If short term floating interest rates had increased or decreased by 0.125%, our interest expense for the three months ended December 31, 2015 would have increased or decreased by \$0.7 million"

March 2016: "For the six months ended March 31, 2016, our weighted average floating rate borrowings were \$2,759.9 million, or \$2,159.9 million excluding borrowings with effective fixed interest rates due to interest rate swap agreements. A 1.00% **increase** in such interest rates would increase total interest expense under our Credit Agreement for the six months ended March 31, 2016 by \$10.8 million, including the effect of our interest rate swap"

June 2016: "For the nine months ended June 30, 2016, our weighted average floating rate borrowings were \$2,739.2 million, or \$2,139.2 million excluding borrowings with effective fixed interest rates due to interest rate swap agreements. A 1.00% increase in such interest rates would increase total interest expense under our Credit Agreement for the nine months ended June 30, 2016 by \$16.0 million, including the effect of our interest rate swaps. Our average effective interest rate on our total debt, including the effects of the interest rate swap agreements, during the nine months ended June 30, 2016 and 2015 was 4.3% and 4.2%, respectively."

Looming Goodwill and Intangible Asset Writedown?

AECOM has to test its goodwill impairment on an annual basis, in this case by Sept 30th coinciding with the end of its fiscal year. 45% of assets are goodwill and intangibles. Based on management's downbeat assessment this quarter, it should take a hard look at the valuation of these assets.

	June 30, 2016 (Unaudited)	September 30, 2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 508,766	\$ 543,016
Cash in consolidated joint ventures	19,231	140,877
Total cash and cash equivalents	27,997	683,893
Accounts receivable—net	20,393	4,841,450
Prepaid expenses and other current assets	52,582	388,982
Income taxes receivable	70,923	81,161
Deferred tax assets—net	—	250,599
TOTAL CURRENT ASSETS	6,171,895	6,246,085
PROPERTY AND EQUIPMENT—NET	624,545	699,322
DEFERRED TAX ASSETS—NET	110,133	—
INVESTMENTS IN UNCONSOLIDATED JOINT VENTURES	341,967	321,625
GOODWILL	5,831,409	5,820,692
INTANGIBLE ASSETS—NET	493,249	659,438
OTHER NON-CURRENT ASSETS	305,129	267,136
TOTAL ASSETS	\$ 13,878,327	\$ 14,014,298

Q3 Conf Call, August 2016: "In oil and gas, revenue declined by 44% due to the Fort McMurray fires and general market weakness. We're optimistic for a return to growth in this business, and we've continued to reduce overhead costs to better position us for an upturn in activity"

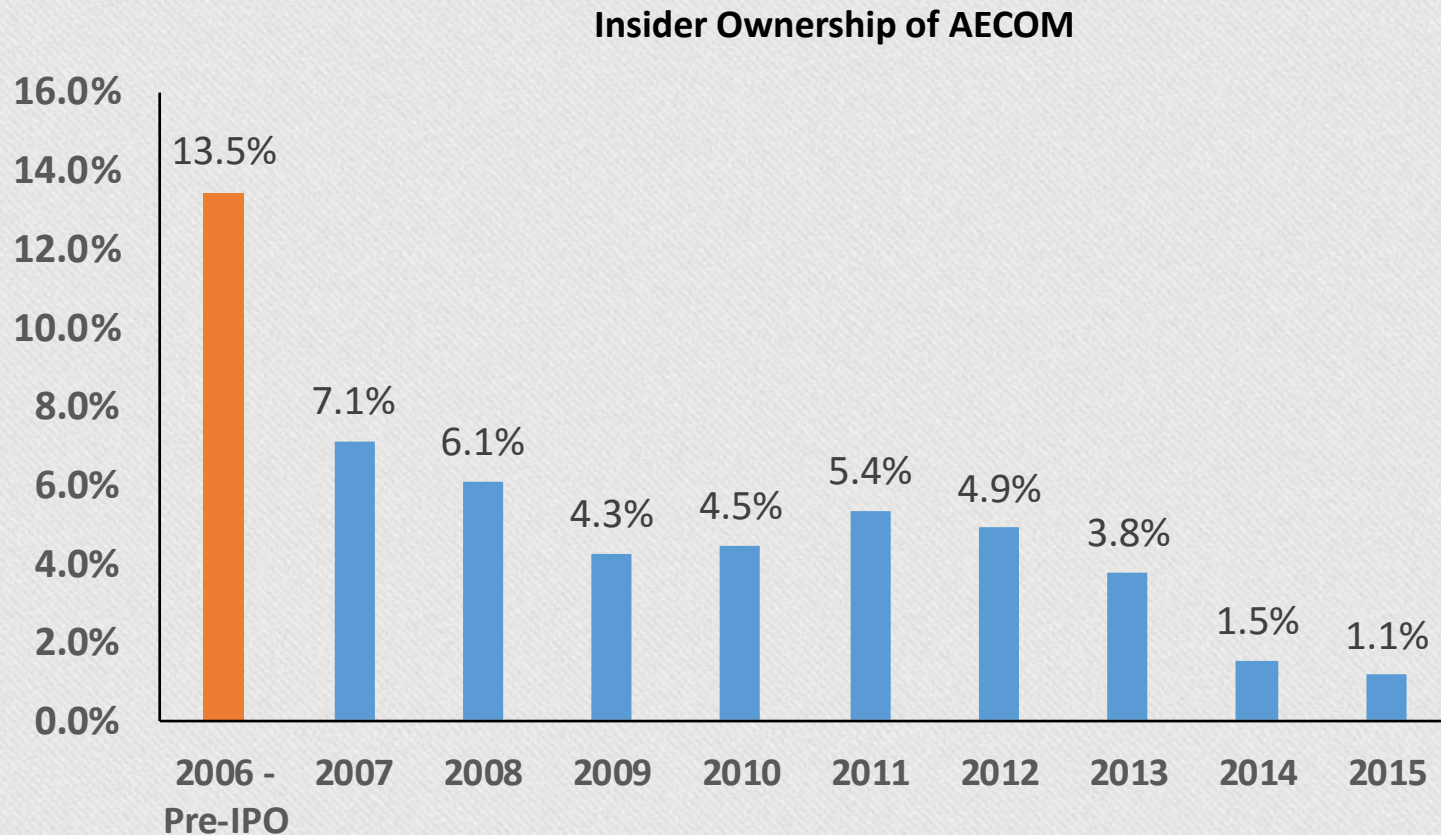
Source: AECOM [proxy statement](#)



Shareholder Governance Concerns

Management Has Little Incentive To Act For Shareholders Best Interests

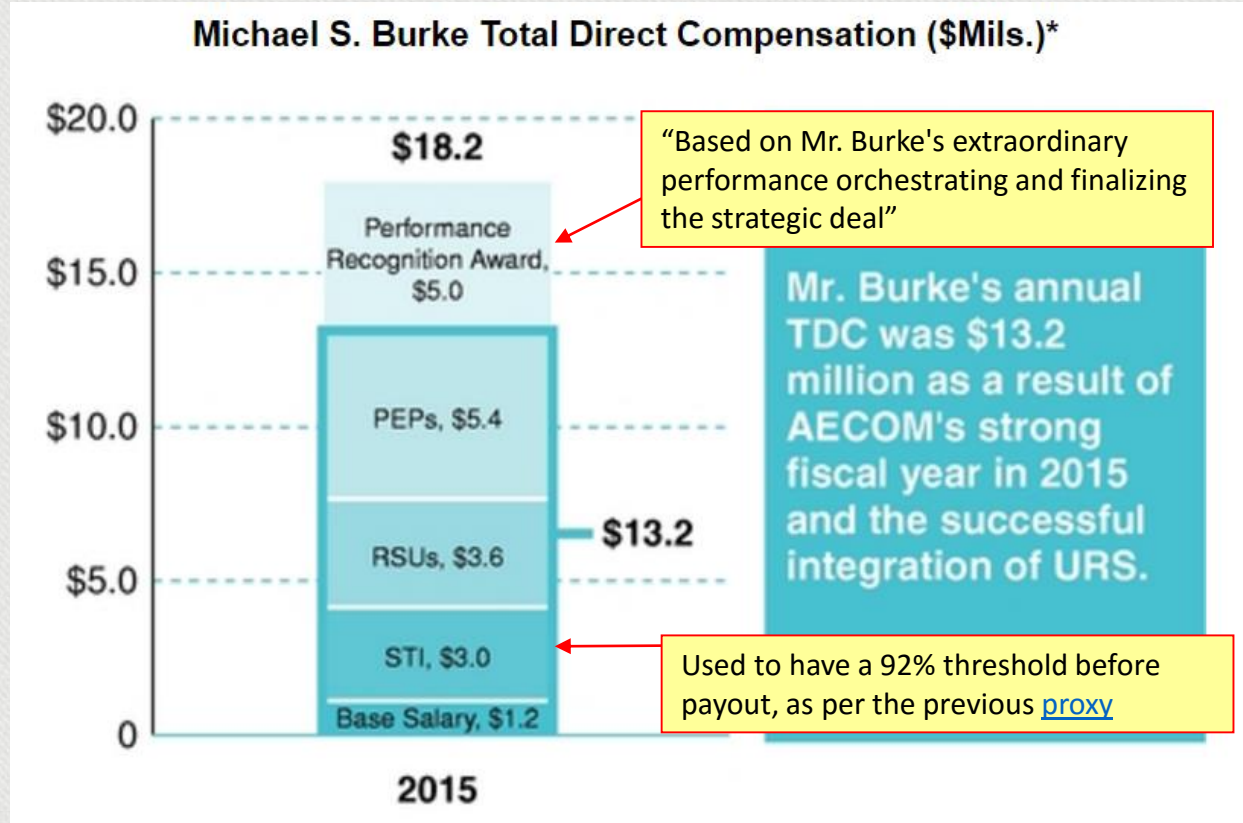
**Ownership by insiders has rapidly decayed post AECOM's IPO
The linkage between management and public shareholders seems broken**



Source: AECOM proxy statements and [initial IPO prospectus](#)

Material Weaknesses and Accounting Problems, But The CEO Still Gets Paid!

Spruce Point believes AECOM's CEO compensation is excessive in relation to the poorly timed acquisition of URS, its newly disclosed accounting issues, and its overly aggressive accounting methods designed to portray AECOM in a better light than reality would dictate. Furthermore, we question the Board's characterization of his performance as "extraordinary" and worthy of a \$5m Performance Recognition Award.



CEO Highly Incentivized on “Adjusted” Free Cash Flow Metrics

AECOM’s CEO has an enormous incentive to present free cash flow in the most positive light given both his long and short-term bonuses are tied to this metric. As defined in the proxy, free cash flow does not adjust for factoring receivables, excess JV and noncontrolling interest distributions. It also gives credit for asset disposals through “net capital expenditures.”

CEO TDC (Michael S. Burke)					(\$mls.) 2015
Base Salary Mr. Burke's salary increased to compensate for his expanded scope of responsibilities resulting from his election to Chairman of the Board of AECOM and overseeing a company that has doubled in size since the previous year.					\$1.2
STI Award For fiscal year 2015, Mr. Burke's bonus target was 150% of base salary. The financial performance metrics, performance targets and the Company's actual performance for fiscal year 2015 were as follows:					\$3.0
Financial Performance Metric	Weight	Target	Actual	Earned Percentage	
Adjusted Earnings Per Share	35%	\$3.00 - \$3.10	\$3.08	100%	
Operating Cash Flow Per Share	35%	\$3.83 - \$3.93	\$5.05	200%	
With respect to the qualitative component of the STI award, the Committee took into account Mr. Burke's fiscal year 2015 accomplishments, the highlights of which include:					
<ul style="list-style-type: none"> Led the transformational acquisition and integration of URS, the largest acquisition in the industry's history, which doubled the size of the Company; Realized \$110 million in synergy savings from the URS acquisition, and increased the total synergy savings target from \$250 million to \$325 million; Drove 76% growth in adjusted net income attributable to AECOM, and 14% adjusted EPS growth; Delivered 133% growth in free cash flow and 52% free cash flow growth per share; Achieved \$18.7 billion in new wins; Reduced \$721 million of debt since closing the URS deal on October 17, 2014; Expanded construction services and management services to new geographies; Continued execution of integrated delivery strategy; and Implemented key strategic enablers. 					
LTI Award The Committee believed that Mr. Burke's LTI award for fiscal year 2015 was commensurate with his larger role in the Company as the Chairman of the Board and his increased scope of responsibility overseeing the Company, which doubled in revenue and employees when it acquired URS Corporation. This equity grant was divided into a target amount of 166,616 PEP performance units (60% of total grant value) and 111,077 RSUs (40% of total grant value).					\$9.0
<ul style="list-style-type: none"> The PEP performance units have a three-year vesting period with two one-year performance periods. Performance criteria are adjusted EPS and free cash flow per share, each with a 50% weighting in determining overall payout criteria. Payouts may range from 0% to 200% of target based on actual performance achieved over the performance period. 					
Sub-Total (Annual Compensation)					\$13.2
Performance Recognition Award					\$5.0
<ul style="list-style-type: none"> Based on Mr. Burke's extraordinary performance orchestrating and finalizing the strategic \$5.2-billion acquisition and integration of URS Corporation, Mr. Burke was granted a one-time, special recognition restricted stock unit award with an aggregate grant date fair value of \$5 million. This one-time award will vest, in equal installments, in November 2017, November 2018 and November 2019. The Committee established a back-loaded, 5-year vesting period to help ensure retention throughout the critical acquisition integration period and to align the vesting with long-term value creation. 					
Total*					\$18.2

FCF Per Share: Fiction vs. Reality

AECOM presents the chart on the left to investors in its Proxy Statement showing a +52% increase in FCF per share, and uses it to justify outlandish compensation to management. In our opinion, the reality is not as rosy. When adjusting for numerous accounting distortions, we find its FCF actually fell by 5%.

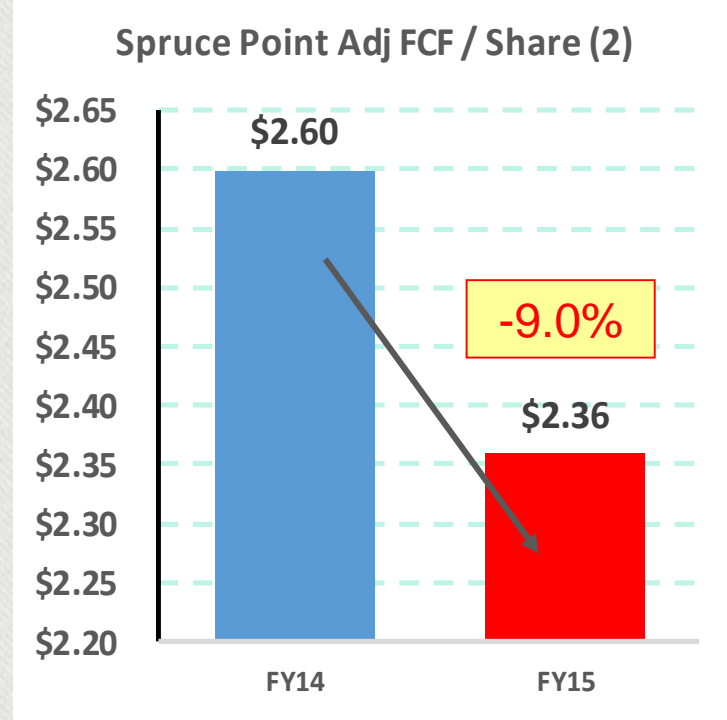
AECOM Fiction



(2) Defined as cash from operations less capital expenditures net of proceeds from disposals, and is a non-GAAP measure

Source: AECOM [proxy statement](#)

Spruce Point Reality



(2) Defined as cash from operations less gross capital expenditures, less accounts receivable financing, less excess distributions of unconsolidated subsidiaries, less net distributions to noncontrolling interests less AECOM Capital sale. Based on diluted shares of 98.7m and 149.6m in 2014/15

Should allegations of misconduct be an acceptable part of AECOM's business and rewarded by shareholders?

AECOM discloses Hanford investigations in SEC filing

August 12, 2015: "AECOM stockholders had a rocky ride Wednesday after the company disclosed government investigations and litigation it is involved in at the Hanford nuclear reservation in a filing with the Securities and Exchange Commission."

Source: [Tri-City Herald](#)

NASA vehicles maintenance contractors in federal fraud lawsuit

September 2, 2015: "The complaint accuses URS Federal Services Inc of Maryland, owned by the global management services firm AECOM Technology Corp, and its subcontractor, Yang Enterprises of Florida, of systematically defrauding the government between 2009 and 2015 by filing more than 1,000 claims for undocumented and unreasonable early replacement of car tires."

Source: [Reuters](#)

AECOM Unit Pays \$201 Million to Settle Australia Toll-Road Lawsuit

September 21, 2015: "AECOM's settlement is one of the largest related to misleading and deceptive conduct in Australian corporate history. The landmark settlement ends a costly saga for the firm, which received only a few million dollars in fees for its forecasting work almost a decade ago but was held accountable when the project went bankrupt."

Source: [Wall St. Journal](#)

Tishman Construction to pay \$20 million to settle overbilling probe

December 10, 2015: "The settlement with Tishman, a unit of Aecom and one of the largest construction companies in New York City, will resolve charges that it improperly billed clients on projects including One World Trade Center and the Plaza Hotel.."

Source: [Reuters](#) and [Dept. of Justice](#)



Valuation Opinion Isn't Pretty

AECOM is Fully Valued; Limited Upside

Analysts are mixed on AECOM, but not as outright negative as they should be given the plethora of issues we've highlighted. We do not see a compelling risk/reward for being long AECOM at current prices and the market seems to agree given the average price target is \$35.44 – implying little upside

Analyst	Recommendation	Price Target
UBS	Buy	\$40
D.A. Davidson	Neutral	\$38
KeyBanc	Overweight	\$38
Alembic Global	Overweight	\$38
Baird	Hold	\$36
Credit Suisse	Outperform	\$36
William Blair	Marketperform	\$33
Canaccord	Hold	\$33
Macquarie	Neutral	\$27
	Average Price Target % upside	\$35.44 1%

Source: Bloomberg
Upside based on \$35.10 ACM stock price

Decaying Adjusted EPS Quality...

Almost 30% of AECOM's 2016 Adj. EPS guidance is made up of questionable adjustments.

FY16 GAAP EPS Guidance based on Adjusted EPS Guidance

	<u>Fiscal Year End 2016</u>
Implied GAAP EPS Guidance	\$ 0.91 to \$ 1.31
Adjusted EPS Excludes:	
Amortization of intangible assets	\$1.35
Acquisition and integration-related expenses	\$1.28
YTD non-core operating losses	\$0.17
YTD loss on disposal activity	\$0.27
Tax effect of the above items*	(\$0.99)
Adjusted EPS Guidance (Non-GAAP)	<u><u>\$ 3.00 to \$ 3.40</u></u>

\$425m of costs already booked from 2014-15; another \$200m in 2016 seems excessive!

Aggressive presentation to pretend like forecasted losses never existed!

*The adjusted tax expense differs from the GAAP tax expense based on the deductibility and tax rate applied to each of the adjustments.

Normalizing AECOM's "Earnings"

Ascertaining AECOM's true "earnings" is a difficult exercise given its multitude of accounting issues. In our opinion, AECOM's 2016 Adj. EPS range of \$3.00 - \$3.40 per share cannot be taken seriously. We have normalized the results to adjust for aggressive adjustments.

Line Item To Bridge EPS	Value	Comment
AECOM's 2016 GAAP EPS Range	\$0.91 - \$1.31	A starting point, although even ACM acknowledges control weaknesses
<u>Add</u>: Amortization of Intangibles	\$1.35 (\$0.92 after tax)	32% effective tax rate
<u>Add</u>: Acq. and Integration Costs	\$1.28	ACM has made excessive addbacks already; we give no credit
<u>Add</u>: YTD Non-Core Operating Losses	\$0.17	Cannot pretend like they don't exist
<u>Add</u>: YTD Loss on Disposal	\$0.27 (\$0.18 after tax)	32% effective tax rate
<u>Less</u>: Pension Curtailment Gain	(\$0.14)	Questionable pull forward in Q2'16 subject to uncertainty
<u>Less</u>: Reserve Reversal	(\$0.25)	Questionable margin liability reversal mgmt. keeps changing assumptions
Spruce Point Adjusted 2016 EPS	\$1.62 - \$2.02	
AECOM's Promoted Adj. 2016 EPS <i>Spruce Point Discount</i>	\$3.00 - \$3.40 40 - 46%	

Buyer Beware: If It Looks Cheap, There is Usually A Reason...

On inflated Wall St. estimates, AECOM is trading at just close to 11x P/E (which looks very cheap) and 8.7x EV/EBITDA (a modest premium to peers). However, on our adjusted figures it trades closer to 19x and 12.5x and is significantly leveraged! On Street estimates, Debt/EBITDA will be approximately 4.0x by year end. However, we haircut its EBITDA and include sizeable pension and operating lease obligations to estimate its true leverage at 7.4x. (1)

\$ in millions, except per share figures

Company Name (Ticker)	Stock Price	% of	Ent. Value	'16E-'17E		Price /	P/E			Enterprise Value				Debt /	
	8/15/2016	52-wk High		Revenue	EPS	LTM FCF				EBITDA	FCF	Sales	2016E	Dividend	
				Growth	Growth	per share (2)	2016E	2017E	2016E	2017E	LTM	2016E	2017E	EBITDA	Yield
Fluor (FLR)	\$52.02	93%	\$7,039	0.5%	2.6%	15.1x	15.3x	14.9x	6.9x	6.8x	14.7x	0.4x	0.4x	1.7x	1.6%
Jacobs Engineering (JEC)	\$54.25	97%	\$6,457	1.6%	6.8%	13.9x	17.5x	16.4x	10.0x	8.9x	13.6x	0.6x	0.6x	0.8x	0.0%
SNC-Lavalin (SNC.TO)	\$43.53	97%	\$6,400	2.5%	14.3%	NM	20.7x	18.1x	12.7x	11.3x	NM	1.0x	0.9x	1.4x	1.8%
Quanta (PWR)	\$25.38	94%	\$3,904	4.6%	27.7%	9.5x	16.4x	12.8x	7.2x	6.1x	10.1x	0.5x	0.5x	0.8x	0.0%
Amec Foster Wheeler (AMFW)	\$6.60	50%	\$4,002	-3.3%	1.5%	9.4x	9.7x	9.6x	9.1x	8.9x	14.7x	0.6x	0.6x	4.6x	6.1%
Chicago Bridge & Iron (CBI)	\$34.04	64%	\$5,248	-1.1%	-3.5%	10.8x	7.0x	7.3x	5.4x	5.8x	16.1x	0.5x	0.5x	2.4x	0.8%
KBR Inc. (KBR)	\$15.64	78%	\$1,475	-4.2%	-4.5%	17.0x	11.8x	12.3x	1.9x	5.0x	11.3x	0.3x	0.4x	0.1x	2.0%
			Max	4.6%	27.7%	17.0x	20.7x	18.1x	12.7x	11.3x	16.1x	1.0x	0.9x	4.6x	6.1%
			Average	0.1%	6.4%	12.6x	14.1x	13.1x	7.6x	7.6x	13.4x	0.5x	0.5x	1.7x	1.8%
			Min	-4.2%	-4.5%	9.4x	7.0x	7.3x	1.9x	5.0x	10.1x	0.3x	0.4x	0.1x	0.0%
AECOM - Street Estimates	\$35.10	97%	\$9,300	3.2%	4.4%	8.8x	10.8x	10.5x	8.7x	8.4x	15.0x	0.5x	0.5x	4.0x	0.0%
AECOM - Spruce Point Adjusted	\$35.10	97%	\$9,300	--	--	16.7x	19.2x	--	12.4x	--	28.5x	0.5x	--	7.4x	0.0%

Wall St. research, Company financials, Bloomberg, and Spruce Point estimates

- (1) We adjust debt to include AECOM's reported unfunded pension liabilities of \$499m and operating leases of ~\$1.4 billion as of 9/30/15. Street estimated 2016 EBITDA reduced by \$200m of integration costs, \$45m pension curtailment gain, \$52m margin liability reversal, and \$27m of non-core losses
- (2) Defined as LTM operating cash flow – gross capital expenditures – Excess JV dividends above earnings – factored receivables - noncontrolling interest distributions

AECOM Leverage Covenant: *No Room For Error*

Leverage covenant becoming more restrictive at a time when AECOM can least afford it.

■ **AECOM's recent 10-Q Gives its Current Leverage Ratio, But Remains Quiet on its Covenant Level**

*"Under the Credit Agreement, the Company is subject to a maximum consolidated leverage ratio and minimum interest coverage ratio at the end of each fiscal quarter beginning with the quarter ended on March 31, 2015. **The Company's Consolidated Leverage Ratio was 4.3 at June 30, 2016.** As of June 30, 2016, the Company was in compliance with the covenants of the Credit Agreement."*

■ **Warning: AECOM's Leverage Ratio Covenant Becomes More Restrictive Sept 30th. It's Dangerously Close To This Covenant At A Time When Its Financial Control Problems Are Becoming More Evident**

Consolidated Leverage Ratio. Permit the Consolidated Leverage Ratio as of the end of any fiscal quarter of the Company set forth below to be greater than the ratio set forth below opposite such period, beginning with the First Test Date:

Four Fiscal Quarters Ending	Maximum Consolidated Leverage Ratio
First Test Date through June 30, 2015	5.50 to 1.00
September 30, 2015 and December 31, 2015	5.25 to 1.00
March 31, 2016 and June 30, 2016	5.00 to 1.00
September 30, 2016 and December 31, 2016	4.75 to 1.00
March 31, 2017 and June 30, 2017	4.50 to 1.00
September 30, 2017 and December 31, 2017	4.25 to 1.00
March 31, 2018 and June 30, 2018	4.00 to 1.00
September 30, 2018 through and including June 30, 2019	3.75 to 1.00
Each fiscal quarter thereafter	3.50 to 1.00

Source: AECOM [credit agreement](#) dated Oct 17, 2014

Price Target Implies 33% to 45% Downside

We prefer to value AECOM on its Adjusted Free Cash Flow basis given the numerous distortions inherent in its income statement and EPS presentation.
AECOM deserves to trade at or below the low end of industry peers.

Price / 2016E Adjusted EPS	
Peer Multiple Range	12.0x – 16.0x
AECOM Discounted Multiple Range	10.0x – 12.0x
Spruce Point 2016E Adjusted EPS Range	\$1.71 – \$2.11
Implied AECOM Price Target	\$17.10 – \$25.30
% Downside	-27% to -50%

Price / LTM Adjusted Free Cash Flow Per Share	
Peer Multiple Range	10.0x – 15.0x
AECOM Discounted Multiple Range	9.0x – 11.0x
Spruce Point Adjusted LTM FCF per Share	\$2.10
Implied AECOM Price Target	\$18.90 – \$23.10
% Downside	-33% to -45%