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PRESENTATION

Operator

Greetings. Welcome to ABM Industries' Fourth Quarter 2020 Earnings Call. (Operator Instructions) Please note, this conference is being recorded.

I will now turn the conference over to Susie Kim, Vice President of Investor Relations and Treasurer. Thank you. You may begin.

Susie A. Choi - *ABM Industries Incorporated - VP of IR & Treasurer*

Thank you all for joining us this morning. With us today are Scott Salmirs, our President and Chief Executive Officer; and Earl Ellis, our new Executive Vice President and Chief Financial Officer.

We issued our press release yesterday afternoon announcing our fourth quarter and fiscal 2020 financial results. A copy of this release and an accompanying slide presentation can be found on our corporate website.

Before we begin, I would like to remind you that our call and presentation today contain predictions, estimates and other forward-looking statements. Our use of the words estimate, expect and similar expressions are intended to identify these statements. These statements represent our current judgment of what the future holds. While we believe them to be reasonable, these statements are subject to risks and uncertainties that could cause our actual results to differ materially. These factors are described in a slide that accompanies our presentation as well as in our filings with the SEC.

During the course of this call, certain non-GAAP financial information will be presented. A reconciliation of those numbers to GAAP financial measures is available at the end of the presentation and on the company's website under the Investor tab.

Before we begin, I'd like to remind everyone that Earl joined less than a month ago after the fiscal year-end. And although quickly acclimating himself to the business, should you have any questions after today's call, please follow up with Investor Relations accordingly.

I would now like to turn the call over to Scott.

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Thanks, Susie, and good morning, everyone. Thank you for joining us on today's call. And we hope you and your families are safe and healthy. It's hard to believe we're already at the close of 2020 and covering our fourth quarter results. On the other hand, we are about to discuss only the second full quarter of COVID-19's impact on our financials.

For Q4, we reported revenues of approximately $1.5 billion for the quarter. This represents a 9.9% decline versus last year and a considerable sequential improvement when comparing to our more than 15% decline in Q3. Once again, our diversified client base demonstrates the resilience of our business.

Our Technology & Manufacturing industry group grew almost 7%, and Business & Industry as well as Education posted revenue results that were only slightly down. As one would expect, our Aviation segment drove the majority of our organic decline versus last year. Technical Solutions also saw a large revenue decline and continue to see challenges in site access, which affected churn rates. Positively, the backlog of committed work in Technical Solutions is healthy, and the pipeline for '21 is robust. So all things considered, it was a good revenue story for the quarter.

From a profit perspective, there was sustained demand for higher-margin COVID-related work orders in our EnhancedClean program, particularly in Business & Industry and Technology & Manufacturing. Our financial performance was protected by our variable labor model and our ability to dynamically adjust staffing based on demand. And we continue to see profit arbitrage by efficiently managing labor as we scaled and consolidated staff during the quarter. This has been one of the key contributors of our financial performance through the pandemic. As a result of all of these factors, we grew earnings on both a GAAP and an adjusted basis versus last year. Income from continuing operations grew to $53.1 million or $0.78 per share. On an adjusted basis, we delivered $46.7 million or $0.69 per share. Adjusted EBITDA margin rose to 6.2% versus 5.6% last year.

Even more compelling, these results incorporate a noncash reserve we took for an entertainment-related project within our Technical Solutions segment. This was a unique circumstance and client and not a reflection of our broader project portfolio within Technical Solutions. This had a 120 basis point impact on our adjusted EBITDA margin as well as our earnings. So even when including this distinctive event, quarter after quarter, our performance continues to demonstrate consistent strength and execution.

In so many ways, 2020 will stand out as a pivotal year for ABM. The pandemic has created a shift in the public mindset as professional Class A janitorial services are now unquestionably viewed as an essential and nondiscretionary service. Facility owners must demonstrate that they are providing clean, healthy and safe spaces that their occupants can trust. Not only will this be required, but it will be a reflection of their brand. Our response with our EnhancedClean service gives our clients a peace of mind that comes with studied protocols and practices that keep facilities safe. And this offering creates even more distance between us and our competitors.

As a company that's been around for more than 110 years, ABM has withstood and grown during many global events, but 2020 tested us in historic ways, and I've never been more inspired by our organization. I want to take a moment to recap some of our team's accomplishments more specifically.

Since March, we have been on the front lines battling a pandemic that has disrupted nearly every industry. While navigating a constantly evolving environment as we learn more about the virus, we prioritize the health and safety of our employees and our clients above all. And when it came to PPE and our global supply chain, our procurement team did not disappoint when others in our space did, as they couldn't accommodate surging demands.

Also, we partnered with large cleaning contractors to form the Cleaning Coalition of America to represent our industry, which played a critical role in restoring our country. The coalition plans to press for vaccine priority for our industry and develop a focused campaign on awareness around what differentiates best-in-class providers. At ABM, we were particularly proud of how we proactively developed our own expert-backed certified programs to answer our clients' needs with disinfection protocols such as specialized training and signage, electrostatic spraying of disinfectant and air filtration. And all of this is being supported by one of the most comprehensive marketing campaigns we've ever developed. What shouldn't be minimized is the fact that we mobilized multiple cross-functional task forces across all the critical areas of our business that elevated our adeptness and will endure long past the pandemic. These task forces led to improved operating procedures for labor management, sales and financial activities.

As an example, our approach to collections led us to generate more than $450 million in cash flow from operations and $420 million in free cash flow, both records for the firm. This translates to nearly $1 billion of liquidity, including $400 million of cash, which is an extremely powerful position to be in during still uncertain times.

As we move into 2021, our intention is to capitalize on the momentum and shift from defense to offense. Beginning with our executive team, we recently announced several appointments to further align our internal organizational structure to our business strategies.

First, I'm pleased to introduce our new CFO, Earl Ellis, on this morning's call. Earl is a seasoned finance executive joining us from Best Buy, a leading Fortune 500 provider of consumer technology products and services with 125,000 employees in North America. Earl held several executive positions across finance and most recently, he was responsible for leading enterprise capital project planning, plus transformation and procurement as well as supporting digital and technology and global real estate. During his tenure at Best Buy, Earl also spearheaded several strategic initiatives targeting labor and logistics. Earl joined less than 3 weeks ago but is quickly immersing himself in our business.

I'm also excited that René Jacobsen has been promoted to Chief Operating Officer and will lead all of our client-facing industry groups. Since joining ABM 8 years ago, René has consistently driven our operational performance and service excellence, and his leadership was unquestionably instrumental in our successful navigation of 2020. As COO, he will provide a strategic guidance for our operations and drive our financial results across all of our platforms. René will also continue to work with Sean Mahoney, our new President of Sales and Marketing. Since Sean's arrival at ABM in 2017, we've broken sales records each succeeding year, and we achieved another record in 2020 with new sales at $1.2 billion, an amazing accomplishment for any year, but especially in a year when so much of the economy was paused. With both René and Sean's leadership, our operations and sales teams proved to be a powerful combination in 2020 and will undoubtedly exceed our expectations in 2021.

Speaking of 2021, later in the year, we will be sharing our refresh business strategy, which builds on the positive changes and the acceleration we saw with our 2020 vision. At that time, we will be reviewing our technology plan and path towards a digital platform for our employees and clients. In fact, just as I discussed last quarter, some of our near-term investments are reengagements of IT projects that were put on hold due to the pandemic, like our ERP system and data management road map.

Other investments will be new given the opportunities that arose as a result of the pandemic, such as EnhancedClean and the associated build of that program. On that front, from a payback standpoint, we concluded the year with over $300 million in sales for our EnhancedClean program and COVID-related activities. And we have some really exciting sales and marketing plans lined up over the next few months to continue accelerating and differentiating ourselves in the marketplace. Of course, we will be responsible in our investment approach given how fluid the operating environment is, but we recognize that we must plan for the long term while also keeping our maniacal focus on what the near term may bring.

There is no doubt that conditions remain uncertain, particularly as we operate over the winter months. COVID cases continue to rise throughout the country, and I'm sure you've seen or experienced various stages of closures in your own communities. Unfortunately, the operating environment isn't any more predictable than it was last quarter. Clients are still generally managing for the shorter term as they react to resurgences, which caused occupancy volatility. And they don't yet have the ability to predict when the workforce at large will return. While vaccine news is encouraging, the widespread availability and use is also an unknown today, which could impact the timing of recoveries and reopenings. Therefore, our visibility remains limited. And as you would expect, we are not providing guidance for the full fiscal year in 2021. However, we are going to share our near-term expectations for the first fiscal quarter. This is the only time we anticipate guiding to such a short-term view given the uniqueness of the moment.

For the first quarter, we expect GAAP EPS of $0.53 to $0.58 in earnings per diluted share or adjusted EPS of $0.60 to $0.65 per diluted share. These ranges compare to last year's $0.41 and $0.39, respectively, both considerable increases on a year-over-year basis. We also expect adjusted EBITDA margin in the range of 6.1% to 6.4%, expanding from 4.3% last year.

At this time, we believe we may have seen the bottom in revenue compression as a result of COVID-19. Sequentially, we could see similar to slightly better organic declines than what we saw in Q4. We also anticipate good demand for pandemic-related work orders and EnhancedClean to continue throughout Q1. The investments I discussed earlier should also continue into Q1, which you will see in both our segment profit and corporate lines. In general, investments will continue throughout fiscal 2021, but the magnitude and cadence will be determined by both our long-term strategy and where we see the broader recovery going. Earl will go through more detail on some of the assumptions for the quarter and year, which is obviously still dynamic. Should we have better line of sight for the full year by Q2, we would anticipate providing full year guidance at that time.

Before I turn the call over to Earl, I want to thank our team members again for their dedication to our purpose as a company, to take care of the people, spaces and places that are important to you. This purpose has never meant more than it does today. Our value to clients has risen because our teams have been the ambassadors of our brands and demonstrated the operational excellence that sets ABM apart from our competitors.

Nine months ago, we couldn't have imagined how 2020 would culminate for ABM. We not only exceeded our pre-COVID expectations but actually accelerated into our long-term EBITDA margin range of 5.5% to 6%. Our 2020 vision journey has come to a climactic transition, leading us into the next phase of growth and excellence and building on our strong foundation to propel us into the future. Next year will also mark our 50th anniversary on the New York Stock Exchange, and we look forward to celebrating this milestone in ABM's history. So while last year, was certainly a memorable one for our organization, I am now looking forward to the opportunities that lie ahead and are more excited than ever.

Now to Earl, who will cover our financial results.

Earl Ellis - *ABM Industries Incorporated - Executive VP & CFO*

Thanks for the warm welcome, Scott. I am so excited to be part of the ABM team. I recognized early on that the culture here is so special and unique. Even in just my first few weeks here, I have witnessed an exceptional drive to collaborate and execute that clearly sets ABM apart. As I spend the next several months diving into the business, I look forward to developing and sharing my perspectives on our financial strategies over future calls.

Now on to our quarterly results. Revenue for the quarter were $1.5 billion, a total decrease of approximately 9.9% compared to last year, reflecting our second full quarter of COVID-19 revenue decline, particularly in the Aviation and Technical Solutions segments. Partially offsetting this revenue decline was continued demand for higher-margin work orders that we have been providing for our clients through the pandemic, particularly within Business & Industry and Technology & Manufacturing.

GAAP income from continuing operations was $53.1 million or $0.78 per diluted share compared to $48.1 million or $0.71 last year. These results reflect the continuation of favorable claims trends related to self-insurance reserves. We saw a benefit of $21.3 million in self-insurance adjustments, of which $6.2 million was related to the current year. On an adjusted basis, income from continued operations for the quarter increased to $46.7 million or $0.69 per diluted share compared to $44.7 million or $0.66 last year.

Similar to the third quarter, our GAAP and adjusted earnings growth versus last year was driven primarily by a significant increase in higher-margin work orders as clients respond to COVID-19 as well as the continued management of direct labor to align with the demand environment for legacy services. Partially offsetting these results was a $17.6 million reserve for notes receivables for a project related to a unique family entertainment customer within the Technical Solutions segment. We are currently working with the client to resolve this issue.

In addition, operational investments in such areas as our EnhancedClean program continued, which was embedded in our operating segment result. We also reengaged certain corporate projects such as investments in IT that were previously put on hold as we prioritize business continuity during the pandemic. This amount was approximately $10 million for the quarter. On a year-over-year basis, the fourth quarter also experienced 1 less workday, which equated to approximately $6 million in labor expense savings. I'll speak about the cadence of our working days for fiscal 2021 later in the call, but the number of days in the first quarter of fiscal 2021 will be comparable at 65 days. Our overall performance during the quarter led to adjusted EBITDA of approximately $92.5 million at a margin rate of 6.2% compared to $93 million or 5.6% last year.

Now for a discussion of our segment results. As a reminder, these results reflect the ongoing impact of COVID-19 on revenue. Operating profit reflects the mixed shift towards higher-margin work orders, labor modulation on legacy service demand as well as operational investments such as EnhancedClean. B&I revenues were $794.3 million, down just 1.6%. We're encouraged by the sequential top line improvement compared to a decline of 6.3% last quarter. The pandemic's negative impact on our Parking and Sports & Entertainment business continued this quarter, similar to Q3. Offsetting this COVID compression and the loss of some lower-margin business, we had consistently strong demand for higher-margin pandemic-related work orders. This led to a more favorable mix of B&I business that led to operating profit growth of more than 65% to $84.7 million, with a margin rate of 10.7%.

Another very resilient segment for us during the pandemic has been our T&M business. Revenues were $245.2 million for the quarter, up 6.7% versus last year. Operating profit grew more than 30% to $23.5 million for an operating margin of 9.6%. This segment is particularly comprised of essential service providers such as biopharma, logistics and industrial manufacturing. As a result, demand has been driven by work order and EnhancedClean work, more than offsetting any COVID-related and other account losses throughout the year.

In Education, we reported revenue of $212.2 million, reflecting the new school season and the adoption of hybrid models across our K-12 and higher education portfolios. Operating profit of $15.1 million or 7.1% margin reflects labor-related savings as a result of modified staffing at site locations during the pandemic. As many of us are likely experiencing today with our own children, there remains a great deal of variability in this segment as different cities respond to resurgences, particularly ahead of the holiday season. We continue to monitor development and partner with our clients to address both day-to-day cleaning and disinfection needs as well as longer-term budget constraints where our Technical Solutions offering can be compelling.

Aviation reported revenues of $141 million and an operating profit of $3.5 million, clearly demonstrating how the pandemic continues to have a dramatic impact on the industry. However, as discussed last quarter, our goal was to achieve a breakeven position or better by the fourth quarter. We are pleased to have closed the year in a profitable position.

And now on to Technical Solutions, which reported revenues of $123.1 million compared to $175.5 million last year. As a reminder, this segment experienced phenomenal growth last year, exceeding 25% during Q4 of fiscal '19. In addition to tougher compare, site access has been disrupted by the pandemic. Backlog remains in our healthy zone, which we've historically defined as above $150 million. We are actively monitoring our ability to churn through these projects. The operating loss of $3.6 million was driven by a reserve of notes receivables related to a single entertainment customer and associated with the client increasing credit risk resulting from the pandemic, which we continue to pursue.

Turning to cash and liquidity. During the quarter, we generated a record $198.7 million in cash flow from operations and free cash flow of $189.6 million for the quarter. This led to $457.5 million in cash flow and $419.5 million of free cash flow for the year. As a reminder, these results include $101 million in deferred U.S. payroll taxes as a result of the CARES Act, which will be due in 2021 and 2022. Even excluding this, these are records for the year. Due to our strong cash position, we ended the quarter with total debt, including standby letters of credit, of $883.4 million and a bank-adjusted leverage ratio of 2.1x. Additionally, we ended the quarter with cash and cash equivalents of $394.2 million. During the quarter, we paid our 218th consecutive quarterly cash dividend for a total distribution of approximately $12.3 million. And as stated in our earnings release, I am pleased to share that our Board of Directors approved our 219th consecutive quarterly cash dividend.

Now for a quick recap of our annual results. Total revenues were approximately $6 billion, a decrease of 7.9% versus last year. The decrease in revenues was attributable to the COVID-19 pandemic's impact on business operations, predominantly during the third and fourth quarters of this year. Our GAAP income from continuing operations for fiscal 2020 was $0.2 million. On an adjusted basis, income from continuing operations for the year was $163.5 million or $2.43 per diluted share. Adjusted EBITDA for the year increased 6.6% to $361.9 million, and we ended the fiscal year with an adjusted EBITDA margin of 6%.

Now turning to our guidance outlook. We are providing guidance for the first quarter of fiscal 2021. At this time, we expect GAAP EPS to be in a range of $0.53 to $0.58 and adjusted EPS to be in a range of $0.60 to $0.65. Adjusted EBITDA margin is anticipated to be between 6.1% to 6.4%. This guidance outlook assumes organic growth will be sequentially flat to slightly improved versus the fourth quarter of fiscal 2020. We anticipate the higher margin work orders and labor efficiencies to continue into the first quarter. And as Scott discussed extensively, we are planning to invest in fiscal 2021. The first quarter will see the same level of investments that we saw during the fourth quarter of fiscal 2020 of approximately $10 million. The first quarter will also have 1 less working day versus last year, which could lead to approximately $6 million in lower labor expense. However, we are preparing for the potential for higher payroll taxes beginning in January for SUI as well as federal taxes such as FICA.

With respect to interest, based on our operating expectations for the first quarter and our current cash position, we do not anticipate an increase in borrowings compared to the fourth quarter. Therefore, sequentially, interest expense should decrease slightly due to the continuing amortization of our term loan. The tax rate for the quarter is anticipated to be approximately 30%. This rate excludes discrete tax items such as the work opportunity tax credit and the tax impact of stock-based compensation awards, the total impact of which we currently expect will be under $1 million in Q1.

As it relates to fiscal 2021, as illustrated in today's presentation, there will be 1 less working day in the new fiscal year, 1 less day in Q1, 1 more day in Q2, 1 less day in Q3 and flat to last year in Q4. With respect to cash flow, we assume government-related benefits in the U.K. and U.S. such as the CARES Act will not recur. This should be considered when ascertaining free cash flow for the new fiscal year. However, we drove higher free cash flow as a result of sharper operational practices in response to the pandemic, and we intend to continue to uphold these standards and disciplines.

Lastly, related to taxes. In fiscal '20, our full year impact for the Work Opportunity Tax Credit was $4 million, reflecting the pandemic's impact on traditional higher-end practices. Currently, WOTC is expected to expire on December 31 of this calendar year. However, we are actively monitoring Congress for related actions, including an extension on WOTC.

Before I turn the call over to the operator, I'd like to reiterate my excitement about being part of the ABM team. On the heels of such strong results for 2020, I look forward to sharing more with you over the coming quarters.

Operator, we are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Andrew Wittmann with Baird.

Andrew John Wittmann - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I guess my question -- my first question here has to do with the margins, and they are obviously very good. You guys have continued to positively surprise here over the quarters. And so I wanted to dig into that, particularly on the gross margin expansion, I guess.

I was hoping that you could give us some sense about how much of the gross margin expansion that you're posting is purely from the mix of having so much more tag revenue and less parking revenue, things of that nature, so mix benefit, from what seems like you guys have actively really managed your labor pool against the base business to drive efficiencies there. So I know that might be a hard question to quantify, but I thought I would try and see what you could tell us so we can understand kind of some of the moving pieces inside of it.

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Yes. Sure, Andy. And good to hear you. Look, a majority of the margin increase did come from pandemic-related work orders and also our EnhancedClean and then also our labor management. It's probably about 50-50 in terms of contribution. And so it's been a really good story for us. And I think the better story is that we're continuing to see momentum into the first quarter, which is reflected in the quarterly guidance. And we wish we could give full year guidance to give you a better sense of it, but it is really still early on.

But I will tell you, Andy, the one thing that has changed, I think if you were to look maybe a couple of months ago, you would think that this was -- with the vaccine coming, it would be more of a binary event. And is this all going to be over in October, right? And I think what we're starting to learn now that this isn't a quarter-by-quarter event. There's going to be a rollout of these vaccines. There's going to be some supply chain issues. And we've even seen that. From all the polls I've seen, at least 50% of the population is either going to take the vaccine. So we think this is going to be a longer-term story than something that, again, is going to be feeling like more binary.

And then you think about kind of the office environment, and you're going to have some people that are taking the vaccine, some people that aren't taking the vaccine. So there's still going to be people wearing masks. There's still going to be a need to disinfect because I'm not sure they've even figured out whether or not if you've been vaccinated, you can still transmit it, right? And then the question is how long does the vaccine last? So there's so many uncertainties there. So whereas, again, I think earlier in the year, we thought this could be maybe a quarterly story. I'm not sure. It's not a longer-term yearly story right now. So -- and we're seeing the heightened awareness. So I don't think the momentum is going to change anytime soon.

Andrew John Wittmann - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Yes, I wanted to dig in on that. I'm glad you kind of went that direction, Scott, because as -- I mean you obviously had to de-scope with your customers, obviously not occupying so much space. And it feels like, and I guess you just said that basically, as they've de-scoped. You've managed your labor probably even better and that's afforded you some margin improvement.

I guess the question -- the addendum to that is as we do reopen at whatever pace that is, and you do have to re-layer in labor as your customers are more occupied and need more services, do you expect that you'll be able to retain some of this margin? All of this margin? Or do you feel like you'll have to progressively give some of the profit margin back to your customers? I was just wondering how you see that playing out.

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Sure. So look, I think the labor efficiencies that we're getting now -- because remember, offices are 10% occupied, right? And think of this, it's 10% occupied, but yet our revenues are only 10% down, you could make a case why aren't they 90% down, right? So I think as we restaff, we'll lose some of that labor arbitrage. Our goal is to maintain some of it, but we're certainly not going to maintain all of it. That wouldn't be sensible. So I think we're going to capture permanently some of that labor arbitrage.

And then from the COVID-related activities, I think we're going to retain a fair amount of that just because of the awareness. And the flip side to all this, Andy, is that as we reoccupy it's going to turn into a revenue story, right? Because people are going to be back. And so I think we'll start seeing growth again. And we're thinking that's probably more of a back half story.

For us, it's always been about momentum. We just want confidence and momentum. So I think the vaccine is going to start doing that. So whereas you may see a little trail down in margin from the labor efficiency, you'll see revenue go up.

Andrew John Wittmann - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

That makes sense. If you will, for me, just one last question. I wanted to ask about some of the investments. I think you said the word investments a few times on the conference call. That does seem pretty material here. And I just wanted to make sure that we're all understanding this correctly.

I think when you -- when fiscal 2020 started before the pandemic, so pre-pandemic guidance, you guys were talking about putting in an incremental like $20 million, mostly related to IT initiatives and digitization process things, if I'm not mistaken, pretty sure that's correct. But now we heard here in this quarter that it was $10 million up just for this quarter and that there's another $10 million for next quarter. So that's $20 million already, and it feels like the run rate of investments obviously, therefore, is a lot larger than you thought about at a year ago at this time.

So I guess, first of all, can you validate that? And then the second thing is, what else are customers and shareholders going to be benefiting from? How else is that going to be seen in your results, so that we know that you're getting a good return on these incremental investments?

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Yes. That's a great question. So I think let's go back where you started. Pre-pandemic, we were talking about the ERP, right? That was the big deal for us. And we did say that we were going to pause that because we were -- obviously, it was a liquidity event, right, the pandemic. So as we started getting strong from a liquidity standpoint and our results, we said we got to go back at this again. But I think the pandemic changed so much, and it caused us to rethink our longer-term tech road map. And with a remote workforce with -- at ABM and with clients being remote, we said we have to rethink that. So we're going through this what we would call an exploration phase of how do we move forward? How do we create this digital platform? How do we look at how we're going to interact with clients? And how do we look at how we're going to interact with our workforce from a workforce management standpoint?

So all that is underway. And that's the investments that you're really seeing when you talk about that $20 million, the $10 million and the $10 million. And it's all going to be founded on the ERP system as the first leg of this thing, right? Because you need to have your data. You need to have a good financial system. So I think as the year unfolds, we'll have a better story of how much we're spending, how much will be capitalized versus OpEx. So we'll be thinking about that. And so we'll give you more color as it goes on, as the strategy framework shapes up. But I think the backdrop to all this is we're going to be prudent. We are still in the middle of pandemic. So even with these investments, Andy, if things get squishy in the economy with resurgences, we could always pull those back. Was that helpful?

Andrew John Wittmann - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

It is. Happy New Year. Happy holidays to everyone.

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Same to you.

Operator

Our next question is from Sean Eastman with KeyBanc Capital Markets.

Sean D. Eastman - *KeyBanc Capital Markets Inc., Research Division - Senior Equity Research Analyst*

Earl, welcome. Welcome.

Earl Ellis - *ABM Industries Incorporated - Executive VP & CFO*

Thank you, Sean.

Sean D. Eastman - *KeyBanc Capital Markets Inc., Research Division - Senior Equity Research Analyst*

I want -- I wanted to go back to just the sustainability of margins. I'm just trying to understand this transition from shorter-term planning, work order dynamic to EnhancedClean uptake. What has been sort of the margin impact from moving over to that more permanent contract structure within EnhancedClean? And maybe you could just comment on the uptake on EnhancedClean since inception there.

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

That's great. And I'm glad you asked that actually because we can clarify that. So when you think of pandemic-related activities, which -- and just think large-scale disinfecting spaces, right? And I think we've talked about this before, it's basically the types of chemicals that we were using in pantries and in bathrooms is now being used in general office space to disinfect, right? And there's 2 ways that clients are going about it. They're either hiring us based on a work-order basis, which, again, just to make it real simple, they talk to us on a Monday and say, "Hey, Thursday night, can you come and disinfect? And could you bring 2 more people to take care of high-touch services." So that's one way.

And then the other way is what we call the branded EnhancedClean, where a client will come to us and say, "Listen, I want to talk about a longer-term program over the next 3, 6, 9 months. So can we just make sure, like every night, you come and you disinfect. We have 4 people permanently," right? So work orders are short term in nature and EnhancedClean is longer term. We're seeing similar margins in both. And they're not competitive, right? And taking a work -- a client that's on a work order and moving them to EnhancedClean, if we don't do that, it's really not a fail.

It's really dictated by the client themselves because you may be a client that's saying, "Listen, I can't really judge yet the occupancy cadence of my team. I'm not sure how many people are coming back, when they're coming back. I don't want to commit to a longer-term spec right now." It could be a client that's saying, "The pandemic has shifted our business. We're having our own financial issues right now. So I don't want to commit to the longer term. So let's just do this on a short-term basis." So they're not competitive projects. And we like EnhancedClean better because we always like -- like any business, you want to lock into a longer-term contract. But in our mind, a work order is not a fail. It's just a reflection of a client's own situation.

And if you think about what we did this year, $300 million worth of pandemic and EnhancedClean activities in such a short period of time. Because remember, COVID wasn't a full year. So I think we're super excited about that. And the $300 million that we did in sales in this area ended up being $200 million in a year on the P&L, and we expect that to more than double next year.

Sean D. Eastman - *KeyBanc Capital Markets Inc., Research Division - Senior Equity Research Analyst*

Okay. Super helpful. And then also just piggybacking on Andy's question. Just wanted to understand, as we think about -- and I don't want to steal the thunder of the Strategy Day next year, but as we think -- this digital transformation, leveraging data, is it more of a market share angle? Is it a customer stickiness angle? Or is it a margin angle? Just sort of curious how you're thinking about that payback and that benefit from these investments.

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Sure. That's -- it'll have elements of all 3, right? But clearly, the key to our future is how do you connect better with clients? How do you give them data, dashboards, insights that is going to make them more sticky with us, right? Where they don't want to detach from us, right? But then there's a whole other element internally about how we manage our workforce. More and more, it's a mobile workforce, right? So what are the tools that we could give our team in terms of task orders every day, safety moments in the morning. How could they punch in and punch out. So the ability to -- like to enhance our workforce and create margin on labor management by being more efficient, by dealing with our workforce in real time through digital tools, it's just phenomenal. And you'll find that there are a lot of service companies, especially with the distributed workforce that are all working on these tools. So we're just trying to jump ahead of it.

And I think in the short term, it's going to be about kind of stickiness with clients. It's going to be about getting a data foundation because if you don't have good data, there's no point, right? So you have to create a data framework. And then over the long term, if we can actuate and activate our distributed workforce, we expect to see margin accretion there for sure.

Sean D. Eastman - *KeyBanc Capital Markets Inc., Research Division - Senior Equity Research Analyst*

Okay. Got you. And one last one for me. I mean it is noteworthy to see you guys exiting fiscal '20 in the low 2x range from a leverage perspective. So I just have to ask how you're thinking about use of cash. Clearly, you have this digital transformation as a big priority. But it seems like you have enough dry powder to start looking at acquisitions or maybe even the buyback. So just curious how you guys are thinking about putting this huge free cash flow number in fiscal '20 to work?

Earl Ellis - *ABM Industries Incorporated - Executive VP & CFO*

Yes, Sean, thanks for the question. It's Earl. I would say a couple of things. First of all, I'd love to take the opportunity to really thank the teams for the focus and efforts put forward in really managing our cash this year. It's been an amazing job in that they've actually been able to take 4 days out. So we are sitting on a fair amount of cash, and we feel really good about our liquidity.

As far as our hierarchy of priorities, when looking at cash allocation, first -- we first look at really investing in our organic growth while maintaining our dividend program, and then followed by that, looking at opportunities with respect to both M&A and share buybacks. So this strategy, we do not see this changing at this point in time. However, in light of the uncertainty with regards to our current environment, we are going to be very prudent and cautious with regards to making cash choices.

Operator

Our next question is from Tim Mulrooney with William Blair.

Timothy Michael Mulrooney - *William Blair & Company L.L.C., Research Division - Group Head of Global Services & Analyst*

Earl, congrats on the new gig.

Earl Ellis - *ABM Industries Incorporated - Executive VP & CFO*

Thanks very much. Appreciate it.

Timothy Michael Mulrooney - *William Blair & Company L.L.C., Research Division - Group Head of Global Services & Analyst*

Yes. So I had a bunch of margin questions, but that's been beaten to death on this Q&A. So I'm just going to ask a couple on your segments. So on your T&M segment, do you think the Technology side of this business will be a headwind moving forward? I've seen quite a few articles across my desk from tech company CEOs who are planning to shift some of their workforce to a permanent work-from-home situation. Obviously, the manufacturing side should stay strong, but I'm curious how you're thinking about the tech side of the business from a 3- to 5-year perspective.

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Yes. I'm still bullish on the tech sector. I think that's the fuel of the economy. I think that's where we're going to see growth as a country. And it's funny. You read about -- I'm reading the same things you're reading, right? When we're talking to our clients, what we keep seeing is the Googles of the world, the Amazons of the world taking more space, right? They're expanding in New York City now. They're expanding in Texas. So I think the narrative out there for them is work-from-home. But when you really drill down and you talk to employees, they quite like being back in the office. And so I think there's going to be a mix. I think you'll see possibly less people in the office. But I think those companies are in such growth trajectories, Tim, that I think -- I'm just bullish on that sector.

And we've talked about this before, but I just want to keep hitting home because what I'm about to say is what I've heard from the top real estate companies in the country is, even if there is this foundational shift where 25% of the people work from home, and that is a massive shift, right, for a pandemic that's only 9 months in, but even if 25% of folks start working from home, you still have to space out your existing office space because we've been jamming people in, we've been having people trading desks and cubicles. So I think you're going to see floor plate shift. And so I am as optimistic as ever in office space in general because I think people want to collaborate and work. And on the tech side, I'm super optimistic.

Timothy Michael Mulrooney - *William Blair & Company L.L.C., Research Division - Group Head of Global Services & Analyst*

Okay, Scott. And then on the Technical Solutions business, which has been humming along really nicely the last several years and then obviously, decelerated materially in 2020. How does this setup look for 2021? I know school budgets across the country are tight, and you can sell them on the payback period with your solutions and indoor air qualities as a growing concern. But also schools are kind of distracted with other things right now. So just how do you think about 2021? Is it a rebuilding year for Technical Solutions? Or do you think we could have potentially another strong year like we saw in 2018 and 2019?

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Yes. I think Technical Solutions is going to be sequentially strong, right? So I think the way you have to think about this, there's a couple of ways we look at it, right? First is our sales pipeline, right, which is really what are the qualified leads we're going after. We haven't closed them yet, the qualified leads that we're going after. Our pipeline is as big, if not bigger than ever. So that's pretty exciting for us.

But then you have to look at backlog, which is the other term that we use. And backlog is committed work like signed contracts that we have that we just haven't started yet, right? And our backlog is really strong for '21. It's just -- the other term that we use is churn rate, which is how fast do you take that backlog and turn it into actual work where you really have people in the field installing the equipment, right, changing out the lighting. And that's what's been the inhibitor. We're probably maybe 50% down in terms of churn rate recently just because they haven't had access to the facilities, right, because of COVID. So we'd love to see the churn rate higher, it would be great, right, because that's really -- that's in-year revenue.

But as long as you have that strong backlog, you have the committed work and that is really strong. And we think now with the vaccine and with the economy getting some momentum, I think our churn rates are going to start picking up. And I think this is going to be a big back half of the year story, which, Tim, the back half is always the big time for ATS, right, because generally speaking, we do so much in school. So that's the time when schools are closed, and we have ultimate access. I think that's going to happen again.

And the last thing I'll say, which is pretty obvious, the tailwinds in this business are just so strong with energy, sustainability, all the green that's happening in society. And then you take that, coupled with what you mentioned, educational facilities being so strapped for cash, and this is a clear path to freeing up energy efficiency, I'm still all in on Technical Solutions.

Timothy Michael Mulrooney - *William Blair & Company L.L.C., Research Division - Group Head of Global Services & Analyst*

No, that's great color, Scott. I mean backlog very strong, churn rate improving. That's very helpful.

Operator

Our next question is from Marc Riddick with Sidoti & Company.

Marc Frye Riddick - *Sidoti & Company, LLC - Business and Consumer Services Analyst*

Earl, welcome to ABM. I'm looking forward to working with you going forward. I wanted to just touch -- a lot of -- first of all, thank you for being as thorough as you've been on your commentary. So a lot of my questions have already been answered, but I wanted to touch a little bit on future pricing dynamic and how we should think about how that's evolved, particularly with EnhancedClean.

And I was wondering if you could touch a little bit maybe on the parts of the program that are gaining the greatest level of client receptivity even if it's not necessarily what they did during the fourth quarter, what they're doing right now. Scott, if you can talk a little bit about what's the part that they like the most. And maybe if you could talk about maybe what that -- how that pricing structure has evolved so far, and how it may evolve going forward.

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Sure. So I think what they like, particularly about ABM, it's the thoroughness of our program. Because there's a lot of janitorial companies that are coming in and say, "We can disinfect. We could do electrostatic spraying." And certainly, we can do that, but we haven't taken that approach. We basically said, no, no, no. We are different than everyone else. We have an expert advisory panel with people from the outside, from medical schools, from famed educational institutions that formed up this advisory panel with our own folks in the health care business because you know we have a health care business. So they like the fact that they get this extra piece of advice outside of just looking at the World Health Organization or the CDC. Then we're doing extra training of our people, and we have signage in place, right? We're doing evidence-based testing after we're done.

And the way you think about it, you're literally going to -- if you have our EnhancedClean program for your facility, you literally get the proverbial sticker in the window that says, "This facility is EnhancedClean certified." And when people come back to work, what you have to establish with your facility manager is trust and safety. People have to feel good about where they're going to, for their own health and for their family's health, right? So when you're dealing with a company like an ABM, a big public company that has these resources, we've really started differentiating ourselves.

And you know what, Marc, because of all the things I just said, we are getting a premium on pricing because it's not purely labor-based function. This is more of an upskilled function because of the training, because of the equipment that we use and the chemicals we're using, so we're seeing elevated pricing. And that's not going to change only because of what we're doing and everything that has to go into it. So we're enthusiastic about that. And we haven't had a pushback yet. Now, go in the future if clients are strained and they're looking for savings, my sense is, and I bet you'll agree with me, where they're not going to cut back is in disinfecting. I don't think any facility management or landlord wants to say, "We're going into tough times, so we're not going to be disinfecting." So we feel like we have some resilience in that product line. So the arrows are pointing up in this area for us.

Marc Frye Riddick - *Sidoti & Company, LLC - Business and Consumer Services Analyst*

And then I'm glad you mentioned that because that was one of the things I was sort of kind of wrestling with is if you look at the videos and things that you have on this side. I was wondering if you could talk a little bit more about that visibility to the end user and how that kind of -- how you're seeing that evolving? Because basically, to put it in a different way, at least the way I'm looking at it, it's almost like a -- A, it's branding extension; B, it's kind of like a good housekeeping seal of approval that is going to now be in people's visuals going forward.

So I was wondering if you could talk a little bit about that because that basically to me seems like something that's going to expand your brand going forward for years to come. Is that a reasonable way of looking at this?

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Yes, it is. I'm so glad you brought that up because this is the first time in ABM's history that we productized a service, right? EnhancedClean, registered trademark. It's our product, if you will, for a service company. And we've done a ton of social media outreach, we've been branding at Safety Seen and there's been ad campaigns on the web. We have -- we're going to be rolling out in calendar year '21, a very aggressive campaign.

And we've talked about the investments, and that was brought up earlier by Andy. And we've been so focused on the IT side, but we're going to be investing in EnhancedClean, too. That's part of our investments. We're going to take this and run with it. Awareness is heightened. And it's such an amazing opportunity for a company like ABM and the resources we have to differentiate ourselves between our competitors, which largely speaking, are smaller regional companies that just don't have the ability to put together an expert advisory council or to do the kind of social media outreach that we're doing and the branding and the advertising. So there's a lot more to come and really excited to follow up with you. Remember this question because we'll be talking about it on the next quarterly call.

Operator

Our next question is from Tate Sullivan with Maxim Group.

Tate H. Sullivan - *Maxim Group LLC, Research Division - Senior VP & Senior Industrials Analyst*

Welcome, Earl. And just follow-up questions, mostly. Scott, on Technical Services, and thanks for all the detail on there. And I understand the theme park related project, it sounds like that's a small end market in Technical Solutions for you. But can you remind us is most of your other work in the backlog for Technical Solutions, Education? Or can you provide more context on that market exposure for your backlog?

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Yes, that is -- Yes. Yes. We really have 2 foundational areas of Technical Solutions, the education space, which is the large majority. And then we do a lot of government work, whether it's mission-critical work. We have special clearances that we do for the government. And just in general, government buildings, it's a sector that we've been growing in. So yes, the theme park one was a little out of what we normally do. But in terms of from a safety and security standpoint, you should be thinking of that backlog as education and government facilities.

Tate H. Sullivan - *Maxim Group LLC, Research Division - Senior VP & Senior Industrials Analyst*

And has the bidding activity for Technical Solutions just shut down? Or are there still opportunities out there recently in Technical Solutions?

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Yes. No, it's actually going the other way. It's spiking up right now. We're seeing more activity. And I would also remind you, from a salesperson standpoint, we cut back on salespeople in 2020, from a prudent standpoint, right? We furloughed people, we reduced hours. All the things you would do in -- I'd say it half kidding, but the liquidity playbook, right?

So now we're getting back on the track of hiring salespeople. We historically, over the last couple of years, have targeted net increases of 10% in salespeople. And if you remember -- and the majority of those are technical solutions people. And what we would typically say is we're going to hire 20%, but 10% would fall out of the bottom just because we keep raising the bar. This year, our aspiration is to grow by 20%. So we're going to be very aggressive about bringing people and really strong people that understand technical solutions because, again, the opportunities are so strong, especially on the education side, where every single community has cut their education budget and are cutting teachers and after-school programs. And we have the answer. We have the answer in our Technical Solutions segment. So super optimistic.

Tate H. Sullivan - *Maxim Group LLC, Research Division - Senior VP & Senior Industrials Analyst*

Great. And tailing on that, just the last one for me. I mean how receptive are your clients today in the current environment to hearing about your integrated solution? I mean I'm talking about combining the other facility services into contracts in addition to janitorial services. Can you comment just on that kind of -- those kind of conversations you're having, please?

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

I think more of the conversations are cross-selling within our industry groups. So it's less about, I want to hear more about how parking and janitorial are integrated, it's more about if you think about our Education segment, our proper Education segment, where we're starting to see traction. If we get a janitorial bid for -- in our Education segment, we'll come back and we'll respond to that bid, but we'll also say, "Hey, here's alternative B. We can also look at a bundled energy solution offering that could lower your cost on your facility. So if you hire ABM for your janitorial, we could really come up with a solution that could really offset some of those janitorial costs." So there's been a lot of reception from clients in our Education segment to hearing about how we can enhance a basic janitorial RFP. That's really encouraging for us.

Operator

We have time for one final question from David Silver with CL King.

David Cyrus Silver - *CL King & Associates, Inc., Research Division - Senior VP & Senior Analyst*

Scott, I wanted to follow up on your comment in your prepared remarks about shifting from defense to offense. And in particular, I was -- I'm just wondering about the client, their customer choices that you might be making. In other words, Scott, I think historically for you, the right customer retention rate was 100%, if not more. And I'm just wondering, but obviously, the business environment has changed a lot. You've come out with a differentiated offering. You're investing in training and other kind of upgrading of the workforce. So is this the type of environment where over time, you might be trying to target a particular more suitable or more ideal customer demographic, ones that are willing to pay the higher prices for the upgraded services that you're investing in?

And maybe going back a couple of years ago, I mean you've talked about culling your contract portfolio of kind of lower margin or less attractive forms of business. And I'm just wondering, again, that was more defensive, but maybe now, do you target certain customer groups that maybe are not fully represented in but the ones that represent the most ideal fit with the way your service offering is evolving?

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Yes. No, that's a good question. There's a lot there to unpack. But what I would say is that our sales group is really focused on that. We have an area called sales effectiveness, which are just basically data analysts that look at all these segments and figure out where we want to play, right, which is super important.

You may have seen or we've talked about in the past, how we've started gravitating towards retail distribution, like kind of the Amazons and the Walmarts of the world, people that -- because that's a really strong growing segment. And we've been doing really well there, and we see that as opportunity in the future. And historically, our retention rate, last year, you may remember, it was about 90%. This year, we're 92% to 93%, which is a really good trend in kind of where we're looking to go in the future. So I think this is something that we'll always be focused on.

And when I talked about going from defense to offense, that was really more in terms of investing into the business and making these investments. I have to tell you, there's so much data out there from past recessions, past -- bumps in the road like we're seeing here with the pandemic. There's so much data out there about companies who, at this time, kind of hunkered down and go on the defensive versus companies that take the opportunity to go on the offensive. And it's extraordinary in terms of the long-term profitability and success of companies to take this opportunity to go on the offense, and that's exactly what we're doing by investing in.

Again, cautiously investing in, but that's where that comment came from, which is we're not hunkering down, we're not going into a shell. We're doing really well. We're liquid. We're having record profitability, record growth. So it's really a sentiment that you look at ABM and you look at a company that's excited about the future and excited to have the ability to go on offense.

Operator

We have reached the end of our question-and-answer session. I would like to turn it back over to management for closing remarks.

Scott B. Salmirs - *ABM Industries Incorporated - President, CEO & Director*

Yes. Well, thanks, everyone, for coming on today's call. And I'll just make it brief, I think. You've heard the sentiment here. We're super excited about where ABM is going. I think '21 is going to be a great year for us. There's still a lot of uncertainty, but we're going to navigate it as adeptly as we did in 2020. And just we're going to be continuing to build the muscle strength. But the most important thing I could say at this time is just have an amazing holiday, everybody. And more importantly, don't let your guard down. Stay safe, and let's look forward to '21 and an effective vaccine, and we all get back to normal. So thanks, everybody.

Operator

Thank you. This does conclude today's conference. You may disconnect your lines at this time, and thank you for your participation.
