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ACM - Q3 2012 AECOM Earnings Conference Call

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OVERVIEW:

ACM reported 3Q12 EPS of $0.63. Expects FY12 EPS to be $2.30-2.45.

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PRESENTATION

Operator

Good morning and welcome to the AECOM third-quarter fiscal 2012 earnings conference call. I would like to inform all participants this call is being recorded at the request of AECOM. This forecast is the copyrighted property of AECOM. Any rebroadcast of this information in whole or part without the prior written permission of AECOM is prohibited.

As a reminder, AECOM is also simulcasting this presentation with slides at the investors section at www.aecom.com. Later we will conduct a question-and-answer session. (Operator Instructions).

I would like to turn the call over to Lynn Antipas Tyson, Senior Vice President, Investor Relations.

Lynn Antipas Tyson - *AECOM Technology Corporation - SVP Investor Relations*

Thank you, operator. Before we begin, I wanted to make you aware of several upcoming IR activities. On September 5, John Dionisio will present at the Bank of America conference in Boston and on September 12, Mike Burke will present at the D.A. Davidson conference in San Francisco. Also we will be holding our annual analyst meeting on December 4 in New York City.

Please turn to slide 2. I remind everyone that today's discussion contains forward-looking statements based on the environment as we see it today and as such does include risks and uncertainties. As you know, our actual results might differ materially from those projected in those forward-looking statements. Please refer to our press release or slide 2 of our earnings presentation and to our reports filed with the SEC for more information on the specific risk factors that could cause actual results to differ materially.

Note that we are using some non-GAAP financial measures as references in the presentation. The appropriate GAAP financial reconciliations are posted on our website. Please also note that unless otherwise mentioned, all gross percentages refer to year-over-year progress.

Beginning today's presentation, is John Dionisio, Chairman and Chief Executive Officer. John?

John Dionisio - *AECOM Technology Corporation - Chairman and CEO*

Thank you, Lynn. Good morning, everyone, and thank you for joining our call. With me today are Mike Burke, our President; Steve Kadenacy, Chief Financial Officer; and Jane Chmielinski, our Chief Operating Officer.

First let me say that I am pleased with the improvements in the balance of growth, profitability, and liquidity this quarter. In the face of challenging headwinds, we made progress against key initiatives and also delivered a 2% increase in organic revenue and $2 billion in new business driven by strength in each of our geographies.

We delivered a 41% sequential increase in operating profit led by our professional technical services segment and we generated $186 million in free cash flow, our strongest third-quarter cash performance yet.

These results reflect the heightened focus our team has had at every level on client service, execution and cash flow. Our success in these areas underpins our ability to extend our diversification advantage in geographies and end markets, making AECOM even more competitive.

Our position as a number one design firm in the United States and also globally according to Engineering News Record is evidence of this.

Part of being more competitive is ensuring we have the right capital allocation strategy to drive sustainable returns. Today we would like to devote the bulk of our prepared comments to precisely that -- how we are building consistent and sustainable value.

Steve will start off with a brief review of the quarter and then move into more detail about tactical steps we are taking to improve margins and free cash flow. Mike will follow with a review of our capital allocation priorities and the strategic enhancements we are making to improve return on capital.

And then before we turn to Q&A, I'll share with you my thoughts on how AECOM continues to build capabilities targeted to improve competitive differentiation in the marketplace.

With that, I'll turn the call over to Steve. Steve, please go ahead.

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

Thanks, John. Please turn to slide 5. This morning I'll discuss our financial performance in the context of four areas. First, our financial highlights for the quarter; second, the progress we are making our margin initiatives; third, the actions we are taking to drive a sustained improvement in our ability to convert profit to free cash flow; and fourth, our guidance for the balance of the year.

Turning to the quarter, we posted strong growth in Asia, Australia, and Canada as well as in power, energy, mining, and civil infrastructure. We also had better cost leverage in the US and Europe and our management support services segment showed a sequential improvement in both growth and profitability.

Net service revenue of $1.3 billion was up both year-over-year and on a sequential basis. On a constant currency basis, organic NSR was up 2% year-over-year and 3% sequentially.

Operating and EBITDA margins both improved over 100 basis points sequentially, driven by our cost-containment actions and stronger net service revenue. EPS was up 2% year-over-year to $0.63, a 47% increase sequentially. As John mentioned, we delivered $186 million in free cash flow, a record for our third quarter.

Backlog ended the quarter at $15.8 billion, flat year-over-year excluding the impact of foreign exchange.

Please turn to slide 8. Looking at the segments, PTS delivered a 4% increase in revenue and a 1% increase in organic net service revenue on a constant currency basis, a slight improvement from the first half. The highlight for PTS this quarter was the year-over-year and sequential improvement in profitability. Operating margins reached 10.3%, a 48 basis point improvement year-over-year and 245 basis points sequentially. This improvement reflects the benefit of actions taken this year across the board to better align our cost structure with the realities of the markets in which we participate and it positions the business well as growth improves.

Please turn to slide 9. Moving onto MSS, as we discussed last quarter, we've worked aggressively to adjust our overhead in light of the unanticipated rapid withdrawal from Iraq. This has allowed us to better align our costs with our current revenue base, making us more nimble and competitive as we capture new growth opportunities.

I am pleased to report the actions we have taken started to bear fruit in the third quarter. While gross revenue was down year-over-year, it was up 18.5% sequentially and NSR was up 10% year-over-year with a 26% growth sequentially. Backlog improved by 6% sequentially which speaks to the future growth opportunity in the segment.

Profitability also improved sequentially as operating income nearly doubled and operating income margins improved 84 basis points, albeit off a low base. We expect an acceleration in profit growth in the fourth quarter as topline growth improves.

Please turn to slide 10. Now let me turn to the actions we've taken to improve profitability more broadly throughout the Company. In 2011, we announced plans to improve our margins by 200 basis points. The improvement in margins was projected to come from an improved mix of high margin services as well as cost savings from real estate consolidation, travel efficiencies, and support service consolidation.

For example in real estate between fiscal 2013 and fiscal 2015, we plan to reduce our real estate footprint by 20%, which translates to about $40 million in annualized savings by 2015. In addition to the pure financial benefit, this also allows us to co-locate our teams and drive improved collaboration. The result this quarter including the 187 basis point sequential increase in EBITDA margin is proof that our actions are now taking hold.

Further as NSR growth improves, we are well positioned to capture a higher level of profitability.

Please turn to slide 11. Now let me turn to cash flow. Over the past five years, we have converted about 70% of our net income to free cash flow. This compares to an industry average of about 100%.

Two things contribute to this difference. First on the positive side, growth requires cash and we grew significantly over this period organically and acquisitively. Second and not positive is increasing DSO. Over this period, in significant economic headwinds, our DSOs went up 16 days. As you know, we are committed to reversing this trend and our performance this quarter is a good indicator of the progress we've made. We improved DSOs by six days sequentially, which drove roughly $140 million in cash flow.

DSO reduction will be a key tool for us to drive free cash flow equal or greater than net income while still growing. By the end of fiscal 2013 we expect to be at 80 days, unlocking an additional $275 million in cash.

Some of the actions we've taken to improve DSO include standardized business exception reporting, which allows us to drive better execution and accountability; an intensified focus on the front-end contracting process to drive improved working capital turns and we have also fortified our billing and collection teams to drive improved speed on both fronts. Lastly, we have also raised cash awareness throughout the organization on the importance of cash returns.

To reinforce the right behaviors, you measure what matters and then align incentives with the desired behavior and we have done that. Over the last two years we have taken incremental steps to increase the cash modifier portion of our performance-based compensation plans and in fiscal 2013, every executive's performance-based compensation will be driven by at least a 50% cash [ABI]. This quarter was an important step for AECOM relative to cash and I look forward to updating you on our progress.

Please turn to slide 12. Now let me turn to guidance. For fiscal 2012, we reaffirm our EPS range of $2.30 to $2.45 and given our current outlook, we expect to be at the low end of this range. In the fourth quarter, we expect typical seasonal improvement in PTS, margin improvement across the Americas and Europe, and continued recovery in MSS. And on a full-year basis, we expect our free cash flow to meet or exceed our net income. Again, our healthy backlog and improved cost structure position us well for 2013.

Now let me turn it over to Mike. Mike?

Mike Burke - *AECOM Technology Corporation - President*

Thanks, Steve. After our second-quarter earnings, you spent a lot of time discussing our capital allocation priorities with our investors so we thought it would be hopeful to give you a bit more visibility into how we assess and prioritize our investment opportunities and also share with you some of the strategic changes we are making to improve our return on capital.

Our capital allocation priorities have been balanced. First, we strive to pursue organic and acquisitive investments that not only further our strategy but also present attractive long-term returns. Next, we want to maintain ample liquidity and a strong balance sheet, which is particularly important in times of economic uncertainty and volatility. We will also deleverage when it's appropriate and we will consider repurchasing shares.

For example, we spent $200 million on our first buyback program, which we completed at the beginning of our third quarter. Over the last five years, we've allocated capital across all four of these opportunities. However, we have had a bias towards acquisitions as we look to profitably expand in key markets.

The strategic criteria for acquisitions has been consistent. The target must either add technical expertise we can leverage across our global platform or the target must expand our footprint in high-growth emerging markets through which we can leverage our global expertise.

Our acquisitions have fallen into one of these two categories. For example in 2011, we acquired a global hydropower engineering firm based in Canada which added new depth to our technical offering. We leveraged this investment to create a preeminent center of excellence in hydropower and now 80% of our hydro work is performed by staff based in Canada but three quarters of the project locations are outside of Canada.

Another good example of our emerging market strategy is our 2009 acquisition to create a regional beachhead in Eastern Europe. This allowed us to augment our local client relationships, construction management capability, and Russian marketplace expertise. Fast forward to today, just three years later, this region is one of AECOM's fastest-growing markets, up over 80% in the third quarter.

Looking back over the past two years, the M&A market has been challenging. First, valuations have held up despite difficult economic conditions and second, our acquisitions have been subject to the same macroeconomic pressure as the broader markets. In other words, they faced slowing revenue demand. However, they have added technical expertise that fits well with our long-term strategic objectives.

Going forward, we will focus our M&A activities in two categories, power, energy, and mining end markets and emerging geographies. For example, our mining business, which has grown by over 120% this year, will benefit from both increased presence in key geographies such as Africa and Brazil, where mining activities are growing rapidly.

Emerging markets like the Middle East, Africa, Asia, Eastern Europe, and Brazil have tremendous end market needs. Emerging markets now account for 70% of the growth in worldwide GDP, up from 45% just 15 years ago. By 2016, over 50% of worldwide GDP is projected to come from the emerging markets and our investments position us well to benefit from this growth.

Currently our focus is on acquisitions that will expand our footprint in emerging markets. We have three in our pipeline now that we expect to close by the end of the calendar year. In an aggregate, the purchase price of these deals will total less than $75 million.

We are firmly committed to deploying capital in ways that will enhance our strategy and drive long-term returns. I am extremely pleased with the progress we've made this quarter on our working capital initiatives because this provides us with more flexibility as we review our capital allocation alternatives and I look forward to providing you with an update of this review soon.

With that, I will now turn it over to John.

John Dionisio - *AECOM Technology Corporation - Chairman and CEO*

Thank you, Mike. Please turn to slide 14. Steve and Mike have taken you through some of the details on how we are improving profitability, return on investment, and cash flow. Now I want to share with you my perspective on the Company's development, the action we've taken to enhance our competitiveness and the many opportunities I see ahead for AECOM.

I've been in this industry for 40 years as an engineer and I have been -- I've seen firsthand how companies evolve going through different stages of development as they build capabilities. Companies go through a fairly predictable development process beginning with startup mode, which is characterized by minimal cross-functional processes, loosely defined organizational structure, and rapid growth. Over time, companies add expertise, market-focused organizational structures, and financial processes and metrics all geared to optimize both operational and financial results. This is where AECOM is today.

As I mentioned last quarter, we had our five year anniversary as a public company in May but we really began our organizational development in the mid to late '90s. During that startup mode, our initiatives were largely focused on expanding in the United States, enhancing transportation in the facility's expertise, and becoming an independent Company following our spin off from Ashland Oil. We established a presence in the major US regions and grew our revenue threefold to over $1 billion.

From 2000 to 2009, we emerged as the AECOM you know today, a global company with major diversified presence throughout the Americas, Europe, the Middle East, Australia, Hong Kong, and China.

Our initiatives were focused on planning more strategically, driving more enterprise-level processes and procedures, consolidating operating companies into our PTS and MSS segments, increasing our share of spend from clients via business line expansion, and bringing in additional leadership capabilities. These initiatives drove expansion from three markets to five, presence in 125 countries, up from 50, and we won a number of key projects based on world-class capabilities we strategically built over time.

For example, our deep transportation expertise helped us secure key roles on the New York 2nd Avenue Subway and Eastside Access project. In total, these massive projects will represent about $30 billion in infrastructure investment. And our project management expertise allowed us to win the master planning for the London 2012 Olympics as well as the program management for Crossrail, Europe's largest civil infrastructure project since the construction of the Chunnel.

This brings us to today. We have several operational initiatives underway that will further enhance execution and delivery, broaden our global footprint, and allow us to provide even more value to our clients.

For example, we have realigned our market into three super geographies, namely the Americas, Asia Pacific, and EMEA, which allows for improved collaboration across markets, improved cost leverage, and superior solutions for our clients. And we are leveraging our global footprint by expanding the capabilities of our high-value design centers and centers of excellence.

Let me share with you highlights of how these initiatives are driving growth for AECOM real-time. First in the healthcare infrastructure industry, a rapidly growing focus area for us. To capitalize on global investments in healthcare arena, we established a healthcare center of excellence where our design experts have worked on many of the world's most renowned facilities such as the Mayo and Cleveland Clinics. In the Middle East, growing populations and increased life expectancy are projected to sharply increase healthcare needs. In anticipating of meeting this demand, there are currently $40 billion worth of healthcare projects planned or underway in the Gulf, almost $15 billion of which are located just in Saudi Arabia.

To address these needs, we have invested in key healthcare capabilities in the region and have leveraged our global experts to win new assignments such as the $1 billion King Khalid Medical City project in Saudi Arabia where we were appointed to provide architectural and engineering design services.

The second example shows how we are building our end market capabilities by leveraging our global expertise. In Europe, we have intensified our focus on the emerging economies of Eastern Europe and the Commonwealth of Independent States, which represents $200 billion in annual infrastructure investments that are expected to grow over 10% per year through 2020.

We assembled a cross-border team with colleagues from the Middle East and Europe, which allowed us to be appointed construction managers on a $1 billion commercial complex in Eastern Europe. This project win was our single largest ever signed in Europe.

The third example is in the Americas, our largest super geography, which represents $1 trillion in annual infrastructure spending. Year-to-date, we have won over $2.8 billion in new wins that span every one of our key end markets, which speaks to the broad capabilities we have built over time.

We can strengthen in the private-sector investments tied to energy, infrastructure. In addition, public-private partnerships continue to gain momentum.

Looking forward, we are encouraged by recent public policy initiatives that bolster our civil infrastructure practice. We expect the new federal $105 billion transportation bill to promote and accelerate projects that have been put on hold, driving an increase in front-end engineering work and design.

Please turn to slide 18. So as you see through the course of our 22-year history as AECOM, we consistently built our capabilities organically and acquisitively to extend our competitive advantage and provide a more robust and profitable suite of services to our clients.

Our results this quarter demonstrate we can continue to achieve all of this while optimizing our operating and financial performance via disciplined growth and improved returns on investments.

With that, I would like to open the line to questions. Operator, please open the line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Tahira Afzal, KeyBanc Capital.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

Good morning, gentlemen, and many congratulations on the quarter. I guess my first question is really in regards to your free cash flow, clearly a very notable improvement here. Could you talk a bit about some of the real key milestones that's really achieved in getting to this point and really how you see this being sustained going forward as well?

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

It's Steve. Thanks for the question. I think this is a culmination of a lot of different initiatives that have brought us to this point from the front-end of the project cycle to the backend. So we've done everything from increasing our focus on negotiating good working capital terms to driving the systems and exception reporting that allow us to monitor it and drive the pressure throughout the system. That is paying off and it's paying off in PTS and MSS across the board.

So we expect in terms of the future of -- as I said on the pre-call portion -- to exceed net income for full year, which would mean we'd produce another $100 million at least in the fourth quarter.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

Great and I guess my second question is with regard to the transportation bill, clearly you seem excited about it. Could you talk about really the timeframe you are looking at at which we could start to see really some of this (inaudible) coming through for you? Would it be early calendar 2013 or do you think we could even see something sooner?

John Dionisio - *AECOM Technology Corporation - Chairman and CEO*

I think first of all, that AECOM is well positioned to benefit from the $105 billion spend over the next 27 months and really what this does is it provides more certainty, reliability, and clarity for our state and local agencies. And it gives it more visibility so they can plan and accelerate these projects that they have and which they have had on hold.

Part of the bill is a streamlining of the environmental process, which will accelerate the startup of project. So we see that right now things are moving ahead and we could possibly see some of the improvements or start up of projects be as early as our first quarter of FY 2013, which is October to December timeframe.

But you know, another important thing about -- and it's a subtle improvement regarding the transportation bill, is the TIFIA funding, where the government is -- has increased their commitment involving the private sector and transportation projects. It's gone from about $120 million a year to about $700 million and basically this can leverage about $50 billion worth of investments. And it basically becomes almost like the infrastructure bank where it's encouraging private investment and will accelerate the use of public-private partnerships.

So overall, even though the spending is not going to be that much different than the reauthorizations that occurred over the 10 short terms, it has a significant impact in terms of the timing of projects which will be accelerated and also the pushing through of more public-private partnerships which are needed to get the private money into the game and to accelerate the type of capital expenditures, which are needed in the infrastructure market.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

Thank you very much. I've got several other questions, but I'll hop back into the queue. Congratulations again.

Operator

(Operator Instructions). Steven Fisher, UBS.

Steven Fisher - *UBS - Analyst*

Good morning. Just trying to gauge seasonality here. Typically fourth quarter is your best for cash flow. So I guess I'm wondering if things were earlier this year? I know you mentioned, Steve, at least $100 million in Q4. So I guess can the fourth-quarter cash flow be as good or better than Q3?

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

I certainly think it could be as good. I won't forecast being better. This was a very good quarter for us but all things seem to be forecasting that the trend is going to continue. And we talked about the DSO reduction over time. We expect that to continue in Q4 as well. So we are not necessarily predicting Q4 will be as good but the trend won't reverse in terms of the underlying fundamentals of our cash collections.

Steven Fisher - *UBS - Analyst*

Okay, I guess given your actions to improve the business and where the stock is even with the move today, I guess I'm wondering what your thoughts are on establishing a new buyback authorization. I know, Mike, you mentioned being opportunistic but I guess I'm wondering you thoughts about establishing a new authorization now.

Mike Burke - *AECOM Technology Corporation - President*

Sure, Steven, I will take that question. As I said earlier in the call, we are constantly looking at our capital allocation strategy and the obvious four big levers there of using our cash flow for an organic investments, for M&A, for debt pay down, or for stock buybacks. Given the stock pricing, given our strategic objectives at any point in time, we choose one or many of those.

But as you heard from Steve about the success of our cash flow in the quarter and our expectations for those results to continue, it allows us to think more broadly and review our capital allocation strategy in light of that cash flow.

And listen, at today's stock price, we -- and what Steve mentioned on the cash flow, you are looking at a mid teen free cash flow yield. And at those kind of numbers, buying back their stock is very attractive. So that's how we are thinking about it. We still think it's very attractive in light of these recent cash flow results and our expectations for continued success on that front, we will be reviewing this strategy very shortly and we will be getting back to you with our thoughts on that after we conclude on the implementation plan.

Steven Fisher - *UBS - Analyst*

Okay, great. Then just trying to gauge some of the more fundamental trends, you guys are thinking midpoint of the range last quarter, now it's a bit lower. So were there segments of the business that are still trending a bit weaker or was it perhaps you spent a little bit more on cost-cutting or FX or things like that?

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

The overall guidance at the lower end is really a combination of our having more clear visibility into the full year as we only have three months left in the year and our forecasts get more accurate as we go. General -- if we -- the ins and outs are really just macroeconomic, we expect the top line to grow more slowly, although still grow. And the margin initiatives that we have in place are going to yield results so that kind of underlying fundamentals are in place but our forecasts are getting more accurate as we get through the year.

Steven Fisher - *UBS - Analyst*

Okay, thank you.

Operator

John Rogers, D. A. Davidson. Please Proceed.

John Rogers - *D.A. Davidson & Co. - Analyst*

Good morning. I guess, John or Mike, relative to your comments about growth initiatives going forward, how should we think about the balance between organic and acquired growth relative to what you have seen over the past five years?

Mike Burke - *AECOM Technology Corporation - President*

John, we have long stated that the long-term -- if you look over the last 10 years, half of our growth has been acquisitive, half organic. Over the past couple -- over the past year, our acquisitions have slowed. You heard me mention earlier the size of the acquisitions that we are currently contemplating are fairly small. One of the things that we always look at is the relative returns for M&A versus buying our own stock and that's what I was referring to earlier when we have four different levers to pull.

This year we have only completed one smallish acquisition in a strategic market in China, Taiwan, and we spent $200 million on a stock buyback because we felt that the returns from that repurchase was greater than the returns that we were seeing in the M&A opportunities.

That can change over time, John. I wish I could give you a clear answer as to what the strategy will be or that balance will be over time because it is dependent on the returns that we see on the opportunities that are in front of us and we are constantly looking at M&A opportunities in the markets that I mentioned earlier.

But at the same time at today's stock price with the free cash flow yields on that, the stock buybacks are more attractive, so depending on where we see our stock price moving, you may see that balance between organic and acquisitive growth change from year to year.

John Dionisio - *AECOM Technology Corporation - Chairman and CEO*

But, John, to look at it from maybe a different perspective in terms of the organic side, we are looking at, say, the infrastructure business in the United States is expected to increase depending upon the segment at an average of 3%. So we don't focus on the average. We look at more aggressive growth and that's just in the United States in the infrastructure market.

We look at the growth opportunities in Latin America, which are significant. The Middle East right now is very, very hot and we could see our growth there being in terms of organic growth being double digits. We look at Eastern Europe again very significant growth opportunities. We are not -- we are seeing continued growth opportunities organically in Asia Pacific, China, India, Australia.

And then the markets that we have focused on and I mentioned some of the initiatives that we see, the healthcare, we are looking at also the oil and gas and mining where we are not a big player so we have a real significant growth opportunity. So we see that as an opportunity for organic growth.

And the other thing we haven't mentioned is the commercial markets. Here in the United States we expect a slow and steady recovery. And just in this past quarter in the New York market place, we won $1 billion worth of commercial work which is made up of either healthcare, education, or residential.

So the market is starting to pick up nicely and what Mike mentioned about how we look at M&A and organic, I think irrespective of how we're going to grow organically, we still will look at the M&A as an opportunity but I don't want you to think that we are not aggressive on the organic side. I think we see some good opportunities there.

John Rogers - *D.A. Davidson & Co. - Analyst*

Okay, and embedded in that I assume is still the 70 basis point improvement in SG&A or overhead leverage?

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

We will continue to focus on the cost side and a good way to book end what John's comments were is that this business and with the discipline that we've put into it on the cost structure side if we get the organic growth, which we're quite confident if you look at the backlog and the underlying fundamentals of the backlog, that growth will quickly translate to the bottom line.

John Rogers - *D.A. Davidson & Co. - Analyst*

Okay, thank you. I appreciate the color.

Operator

Andrew Kaplowitz, Barclays.

Andrew Kaplowitz - *Barclays Capital - Analyst*

Good morning, everyone. Good cash flow quarter. So Mike or Steve, just regarding the DSO target for end of next year, how achievable or aggressive is that target? It doesn't seem that aggressive given you were six days better just this past quarter and I assume you might be a little better in 4Q. But at the same time some of your customers tend to be a little long paying you back. Does it depend on a decent economy? What does it depend on that target?

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

A lot of different things. I think collecting cash requires broad execution, but we think it is quite achievable. We think that's the number that this business ought to operate in and if you look across our business, the Middle East may run higher but our construction services business might run lower. But the broad initiatives that we have already mentioned and I also spoke briefly about the compensation changes that we have put into the system, are driving increased focus on it and I think the 80 days is achievable as we exit FY 2013.

Andrew Kaplowitz - *Barclays Capital - Analyst*

Steve, maybe like if you're thinking about going from 92 to 80 days, how much of it is things you are doing that you can control versus how much of it is the market getting better and such? Are you able to talk about that? Is it half and half, three quarters you, that kind of thing?

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

Like I said, it's a broad domination of things. We work hard on every piece of the project cycle from negotiating better terms to the broad execution within our systems and the awareness at every level of the business on the importance of cash returns.

Then the market, the economic environment is something that we are fighting against now. I mean, it's not the healthiest broad economy in some of our developed markets. Nevertheless, we think we can get there and I think our efforts are showing up in our DSO now.

Andrew Kaplowitz - *Barclays Capital - Analyst*

Okay, that's great. Just shifting gears, Asia-Pacific region, Australia has some issues with costs, a slower economy. China is mixed. Can you talk about the Asia Pacific region for you guys? It has been a huge growth driver in the last few years. How is it doing? Maybe just an update there.

John Dionisio - *AECOM Technology Corporation - Chairman and CEO*

Yes, the market clearly is a dynamic market. We are looking at FY 2013 now projections and putting together our plan and the market remains strong, similar to what they did in FY 2012, which saw about 20% growth.

Now we have expanded our geographies with a merger last year with company in India which has given us a good base of operations, also creating a design center in India. China continues to expand. Hong Kong also there is the more competitiveness but the markets remain strong.

And in Australia even though there is in terms of their economy as a whole seems to be maybe softening up a little, in terms of the markets that we are in, the infrastructure markets and the building markets, we haven't seen the impact.

We are also heavily in the mining market in Australia. We're watching that carefully, but right now we still are forecasting strong, strong results in Australia.

Andrew Kaplowitz - *Barclays Capital - Analyst*

John, have you been able to do well because you've been taking share from smaller players in these markets -- is that part of it -- in a slower economic environment?

John Dionisio - *AECOM Technology Corporation - Chairman and CEO*

I think one of the things that has been a success factor for us -- this is across the globe -- is that these projects are getting bigger and bigger. There are major megaprojects; we're speaking about construction value in the billions of dollars. There are not many players in that market.

AECOM's differentiator is that we can play in the very, very big market. And so as these projects, opportunities develop, we can be more competitive, as well as that AECOM can provide full-service, full spectrum of services, from the front-end planning through to operation and maintenance.

We are -- and that is where clients are looking to put their attention with, someone -- they can deal with someone who could provide them the full spectrum of services. We are taking some market share.

Andrew Kaplowitz - *Barclays Capital - Analyst*

Thank you, guys.

Operator

Andrew Wittmann, Robert W. Baird & Co.

Andrew Wittmann - *Robert W. Baird - Analyst*

I wanted to dig in a little bit more to the MSS segment. And specifically last quarter you gave us some pretty good detail about Iraq winding down, Afghanistan taking a little time, a little bit longer to ramp up. Obviously, results this quarter a little bit better; clearly still not I think where you ultimately want them or maybe where they should be.

I just wanted to get kind of an update as to what might have been holding back the quarter a little bit more there, kind of where we were on the Afghanistan and Iraq things, as well as I think you had some project execution issues. I just want to get an update there, if those are behind us now or if we're close to being done or that sort of thing.

Mike Burke - *AECOM Technology Corporation - President*

Sure, Andrew. First of all the project execution issues are behind us. During this quarter, we executed very well on our strategic plans from the beginning of the quarter but most importantly, we exited the quarter on an uptrend. As we are watching the project staff up, we can see that coming through the end of the quarter into Q4 very strongly. In fact what we talked about in the last call was the need to ramp up in Afghanistan. It was ramping up a little slower than we had expected, but it really ramped up in the second half here. In fact in the quarter, that business was up 15% and now we are into Q4, where we are now almost at full staffing for that project, which is a fairly significant project, and we are now seeing a number of growth opportunities in front of us.

In fact, the backlog in that segment is up 6% quarter-over-quarter and more importantly, we are seeing new opportunities in areas that we have not previously exploited. You may have heard us mention the opportunities in the foreign military sales, which we have -- the skill sets for the work that we have done for the Department of Defense are easily transferable into the increasing opportunities in the foreign military sales space by the Department of Defense.

And then we are seeing a whole host of non-DOD opportunities where we are seeing our opportunities growing in the Department of Energy space, for instance, as well as cyber and Intel where we are taking advantage of some of the capabilities that we acquired over the past few years.

So as we look through Q4 here, you saw Q3, our operating income doubled over Q2 albeit a low base but we see in Q4 that operating income more than doubling again as we start to grow that business back again and we see the opportunities in front of us.

Andrew Wittmann - *Robert W. Baird - Analyst*

So that makes sense here. I guess last quarter you are saying you thought second half in that business would be about the same as first half in terms of total EBIT and if it's going to more than double, that kind of puts you on track with that kind of thing, right?

Mike Burke - *AECOM Technology Corporation - President*

That's right, we still feel comfortable with that same statement that we made last quarter.

Andrew Wittmann - *Robert W. Baird - Analyst*

Okay and then just one other thing. Just given that there has been some restructuring that's been taking place, was there anything kind of one time in terms of costs or maybe benefits in the third quarter?

And then if you could just dig into the tax rate, clearly it looks a little bit lower than what you guided to at least on the full-year basis. Anything that we should be aware of there?

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

No significant one-time charges that we took. On the tax rate side, it was really just driven by a favorable settlement of an IRS audit that we took into the provision in the quarter but we expect that to -- the tax rate to go back up to about 28% in the fourth quarter.

Andrew Wittmann - *Robert W. Baird - Analyst*

Okay, thank you very much.

Operator

Chase Jacobson, William Blair.

Chase Jacobson - *William Blair & Co. - Analyst*

Good morning. Two questions on the acquisition side of the business here. Given the fact that you haven't done an acquisition now in a little bit over a year, has the integration in terms of costs and the cross-selling opportunities manifested as you've expected?

And then the other question about acquisitions is now that you see a clear path to improving returns and cash flows, when you look acquisitions, have you changed the metrics that you focus on whereas in the past it seems like the acquisition strategy was really more solely focused around growth in terms of geographies and markets. Any color on those?

Mike Burke - *AECOM Technology Corporation - President*

Sure, there's quite a few points to that question. So let me try and take that multifaceted question. First of all, the acquisitions that we have done have integrated well. The integration is not the issue. The acquisitions have performed in line with the macroeconomic conditions that they face. So you have to look at each individual market and they have performed like the markets have in general but the integration has worked well.

On the acquisition front, we did do one acquisition as I mentioned in China earlier this year and I mentioned there are three more that we are currently working on that are getting very close to closure, albeit small ones.

So we will continue to look at opportunities strategically that fits the end markets that we talked about, both the mining, oil and gas end markets, as well as the emerging markets where we expect growth to outpace the general developed markets. And what John mentioned earlier on the organic growth front, we are always looking for those markets where we think the infrastructure opportunities will grow faster than normal GDP or faster than developed markets. So we will continue to do that.

But when you asked your question about what are the metrics that we are looking at? First of all, it has to fit our strategic objectives. Secondly, as I mentioned earlier, we have to weigh that opportunity against the IRR that we would expect from allocating our capital to stock buybacks and at current stock prices, that hurdle rate is much higher for an M&A deal relative to buying our own stock.

So hopefully that's helpful for you to understand how we are thinking about capital allocation, how we are thinking about M&A, and where we are thinking about M&A.

Chase Jacobson - *William Blair & Co. - Analyst*

Okay but I mean when you look at -- in terms of like cash flow, let's say, would you be willing to do an acquisition where the cash flow might not be as good as you expect and something that you would try to fix? Or are you looking at things that would immediately improve the consolidated AECOM cash flow?

Mike Burke - *AECOM Technology Corporation - President*

That's a good question and John is shaking his head vigorously no here. One thing we don't do is we do not look for companies that we think we can fix. We are looking for good companies, well-managed companies in good strategic markets that fit in well with our footprint. If they don't have good cash flow, we are not looking at a company and thinking that somehow we could be the miracle worker and fix that company. So generally we are looking for strong companies that fit our strategic plan.

Chase Jacobson - *William Blair & Co. - Analyst*

Okay, that's very helpful. I will take another shot at the guidance here. I know it's only six or seven weeks left in the fiscal year but I think it's helpful as we look out into next year. Even to get to the low end of the $2.30 to $2.45 range, you do need pretty significant step in revenue growth and margin in the quarter. Obviously you have good visibility at this point but I was just wondering if you could maybe speak to what some of the risks are in terms of getting to that point?

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

The way we are looking at it, there's a few things that are going to drive the improvement versus our normal seasonality. Remember that our normal seasonality in PTS would drive an increase between Q3 and Q4. So that's a piece of it. The margin improvement initiatives that we have taken mainly in MSS in the Americas would be the second piece will drive an acceleration between Q3 and Q4.

And then we have touched on it before. There's still a Europe improvement quarter-over-quarter. Recall that last year we took a restructuring charge in that business in Q4. So those four areas are really what's driving our ability to get up into the range that we referred to and of course we have the offset on the tax rate side.

Chase Jacobson - *William Blair & Co. - Analyst*

Okay, last question, any commentary around potential government sequestration particularly given that the contracted backlog in MSS was down 11% sequentially?

Mike Burke - *AECOM Technology Corporation - President*

Sure, a few comments on that. First of all, it's very difficult to plan for what is going to happen in Washington, but nevertheless, we are creating and have created contingency plans that will allow us to be as agile as possible if that does happen.

One of the good fortunes of AECOM is unlike some of the defense prime contractors, we are a little less vulnerable to sequestration since we have primarily a labor cost structure in the government sector unlike the big hardware manufacturers, so we have an ability to scale much more quickly than some of the hardware guys.

But it's not clear just yet if cuts are going to be across the board or if they're going to be program specific but at the end of the day, we need to recognize that even if sequestration is implemented and if the cuts are made, there's still $1 trillion annual budget there for us to attack and so there's plenty of opportunity there.

On the bright side what we are seeing -- last week in Washington where we saw the parties come together and agree through a continuing resolution agree to fund the government through March 31 of 2013, showed an indication to work together to avoid sequestration. So I think many of the people that we talk to in Washington felt that that was a real good signal that a hard-line sequestration on December 31 will not happen.

So our prediction is as good as anybody else's but we feel better about that not happening based on the current read of the tea leaves in Washington. But nevertheless, we are developing our contingency plans that we will be ready to implement should that unfortunate event occur.

Chase Jacobson - *William Blair & Co. - Analyst*

Okay, thank you.

Operator

Adam Thalhimer, BB&T Capital Markets. Please proceed.

Adam Thalhimer - *BB&T Capital Markets - Analyst*

Thanks. Good morning, guys. I wanted to ask first about the US commercial business. You said in an earlier question you said that that business was maybe incrementally a little bit better particularly in New York City. And I'm just curious because the Architectural Billings Index has been a little bit weak recently. When you look at the ABI, do you think that maybe understates the kind of modest recovery you are seeing in those markets?

John Dionisio - *AECOM Technology Corporation - Chairman and CEO*

I think that's an average. I don't doubt what the number is and it's not that promising, but we never focus in on what the average is. We always look at what the opportunities are on a micro basis. So we have through one of the acquisitions we did a year or two years ago, Tishman Construction, who has had a great performance run in New York City and great client relationships, we are able to capitalize on those areas where money is being spent.

And as I said in this past quarter, $1 billion worth of opportunities that we won. Again in commercial, commercial high-rise, healthcare, the universities, not to mention the Hudson Yards on there, the West side of Manhattan, the development of that.

So from our perspective, we are seeing these types of opportunities. It might not be market wide but I think with what we are seeing with the transportation bill and some of the funding getting public-private partnership activity really moving, we will see a continued growth over the next several quarters.

Adam Thalhimer - *BB&T Capital Markets - Analyst*

Okay, thanks for that. Steve, just wanted to ask you about what interest expense per quarter would you use going forward and also what are your thoughts on the tax rate going forward?

Steve Kadenacy - *AECOM Technology Corporation - EVP and CFO*

Tax rate, I referred to the full year tax rate earlier, 28%. I was -- the question was about the fourth-quarter tax rate, which is closer to 30%. On the interest expense, I think that the run rate in the last quarter is I think you should use about $11 million going forward.

Adam Thalhimer - *BB&T Capital Markets - Analyst*

Okay, thanks a lot.

Operator

And with no further questions, I would now like to turn the conference over to Mr. John Dionisio for closing remarks.

John Dionisio - *AECOM Technology Corporation - Chairman and CEO*

Thank you. If I could ask if you could please turn to slide 19, let me close with what I think are the most important takeaways about our performance this quarter.

We delivered an improved balance of growth, profitability, and liquidity, highlighted by record free cash flow, as we discussed. We are committed to a balanced approach to capital allocation with the goal of optimizing our long-term returns. And we continue to build capabilities targeted to improve our competitive differentiation in the marketplace and we are well positioned to capitalize on our growth opportunities.

Something I don't mention and I probably remiss in terms of these earnings calls, all those things are great but what we also have is we have a great leadership team across the enterprise who are seasoned and will deliver on the results that we are forecasting despite the challenges in the economic environment.

So AECOM is confident that we will continue to grow as we have had over the past 20 quarters since we became a public company.

With that, I would like to thank everyone for joining our call today and for your continued interest in AECOM. If you have any questions, please contact us for some explanation. Take care and see you in a few months. Thank you.

Operator

Thank you for joining today's conference. That concludes the presentation. You may now disconnect and have a great day.