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ACM - Q1 2013 AECOM Earnings Conference Call

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OVERVIEW:

ACM reported 1Q13 EPS of $0.36. Expects 2013 EPS to be $2.40-2.50.

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PRESENTATION

Operator

Good morning and welcome to the AECOM first-quarter 2013 earnings conference call. I would like to inform all participants that this call is being recorded at the request of AECOM.

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

Lynn Antipas Tyson - *AECOM Technology Corporation - SVP, IR*

Thank you, John. Good morning, everyone. I would like to remind you 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 two 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 & CEO*

Thank you, Lynn. Good morning, everyone, and thank you for calling in on today's earnings call. Joining me for our presentation today are Mike Burke, President, and Steve Kadenacy, Chief Financial Officer. And for the Q&A portion of the call, Jane Chmielinski, Chief Operating Officer, will also be available.

I want to start off by saying we enjoyed hosting those who attended our analyst meeting last December. Hopefully you walked away with a better understanding of how we are investing to expand and enhance our capabilities and execute our strategic priorities.

Our results this quarter support the three pillars we shared with you at that meeting. First, we are well positioned to take advantage of the strong fundamentals we see in our global markets. In our first quarter we achieved record backlog of $17.1 billion, up 8%, driven by $2.7 billion in new wins in the quarter, which is an acceleration over the fourth quarter.

Second, consistent with our disciplined and balanced capital allocation strategy, we believe one of the highest returning investments we can make is in our own company. As a result, our Board has authorized an additional $500 million in share repurchases which brings the total amount of capital committed to repurchases to $1 billion over the last 18 months.

And third, we are focused on improving profitability through cost containment, high productivity, and enhanced execution. Despite the global macroeconomic headwinds, we've started 2013 stronger than in the last few years and we are well positioned to take advantage of the growth opportunities that exist. Now I will turn it over to Steve.

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

Thanks, John. Last quarter we delivered strong growth in Asia and Europe posted net service revenue growth for the first time in over two years, aided by its renewed focus on large pursuits. Our energy, Management Support Services, and transportation markets also delivered solid growth. Operating margins increased in the Americas, Asia, Europe, and the Middle East supported by our global margin improvement initiatives.

As expected in the quarter, we absorbed the effects of the industry-wide slowdown in mining in Australia which I will detail for you in a few minutes.

Other highlights for the quarter are as follows. Net service revenue was up 1% to $1.2 billion while organic net service revenue on a constant currency basis was down 1.4%. Operating margins were down 126 basis points; however, excluding Australia, operating margins were flat.

We delivered earnings per share of $0.36. In what is typically a seasonal low for us we generated $54 million in free cash flow, which positions us well to generate free cash flow at least equal to net income this year. And we invested $173 million to repurchase 8 million shares.

Before I turn to our segment results let me spend a minute on Australia. As most of you know, in late 2012 there was an industry-wide slowdown in mining in Australia which led to the deferral of major projects. And as we discussed when we reported our fourth-quarter earnings in November, we anticipated absorbing costs in our first quarter to swiftly right-size our business to adjust to these new realities.

Our teams took aggressive action during the quarter and executed remediation plans, including reducing headcount and consolidating office space. Due to these costs, PTS margins were down 112 basis points to 6.8%, which reflects the negative impact of $8 million of restructuring costs and the financial impact of the slowdown of our Australia business. Excluding Australia, PTS margins were up 60 basis points which demonstrates the progress we have made on our cost optimization and productivity initiatives.

Looking at the balance of the year, we expect a significant improvement in profitability in PTS as Australia completes its right-sizing and benefits from improved utilization.

Looking at total PTS, net service revenue was down 1% as growth in Asia and Europe were offset by declines in Australia and the Middle East and a slight contraction in the Americas. We do have a healthy new award level; however, similar to last year, our conversion of backlog remains slower than our historical levels. From a market sector perspective, we had solid net service revenue growth in energy and in transportation.

Moving to MSS, gross revenue was up 11% and net service revenue was up to 16%, aided by growth in the Middle East. Operating income declined $2 million driven by a decline in earnings from unconsolidated joint ventures. Nevertheless, we do expect full-year operating income to double versus last year, which indicates a strong profit trajectory for the remaining of the year.

Now let me turn to our EBITDA margin and cash flow targets. We continue to make progress against our longer term goal of 12% EBITDA margins. Our focus on operating leverage and efficiency drove a 90 basis point increase in utilization. On the cost side we are on track to hit our target of at least $38 million in real estate savings by fiscal 2015 and our culture of continuous improvement is driving us to more fully leverage our global clout in the areas of procurement and travel.

Before I turn to guidance I want to expand on the five-year free cash flow target of at least $1 billion we shared with you in December. As we mentioned then, this is a floor and based on a range of growth, profitability, and working capital assumptions we would expect our five-year cumulative free cash flow to be in the range of $1.3 billion to $1.8 billion.

This brings me to our EPS guidance for this year. We expect our EPS to being in the range of $2.40 to $2.50 and we now have increased confidence in the high end of that range. When we initially set guidance for the year we said that the low end of the range assumed flat revenue and the high end assumed modest top-line growth. Our lower share count of 103 million shares and our lower full-year tax rate of 27% gives us confidence in our ability to reach the high end of the range despite the overall flat growth we have been experiencing.

The share count does not include the impact of any future share repurchases. We continue to focus on cost containment, productivity, and improved business mix, and as top line strengthens we are confident we are well-positioned to improve margins.

With that I will turn the call over to Mike.

Mike Burke - *AECOM Technology Corporation - President*

Thanks, Steve. I would like to discuss how we plan to deploy capital this year to drive profitable growth, enhance our competitiveness, and improve returns over time. Our priorities are straightforward. First, organic investments, particularly those with our multinational clients in emerging geographies; second, share repurchase; and, third, niche acquisitions.

Starting with organic investments. As we shared with you at our analyst meeting last December, a key focus for us is to increase our penetration in 100 major private and multinational clients. These clients are increasingly looking for preferred multi-service global relationships with companies that can deliver integrated, standardized offerings no matter the location.

Corporate CapEx among these firms is expected to exceed $1.5 trillion annually, and through our diverse range of services, our addressable market is about 10% of this spend, which gives us plenty of headroom. No other pure design firm has our geographic footprint and service offerings, both of which position us well to capitalize on these opportunities.

For an end market perspective, we are focused on three markets where our multi-national clients are making significant long-term investments -- oil and gas, mining, and industrial. We have distinct competitive advantages in these markets as we already provide services such as enabling infrastructure and core civil infrastructure such as ports and roads, environmental services, and construction services.

To broaden our relationship with our multinational clients we have invested in strategic key account leadership teams and technical thought leadership, who are charged with driving incremental sales across all business lines and geographies. A prime example is that we have been selected to be the largest environmental remediation supplier globally for a super major in the oil and gas sector. By leveraging our key account team we were able to displace an incumbent, provide an industry-leading solution, and increase our global penetration.

Next, we continue to evaluate niche acquisitions that provide technical capability we can drive across our global platform or that provide a geographic base from which we can expand and offer our global services. In some cases we can achieve both with one acquisition. As we evaluate these opportunities we are mindful of the returns these potential acquisitions must generate to be accretive to our overall portfolio.

In our first quarter we completed three acquisitions, the largest of these was BKS in South Africa, the second-largest engineering firm in that country with a footprint that spans the continent. While BKS gives us a strong base in this rapidly growing region, the firm also has a core competency in the design of FIFA World Cup stadiums. BKS was involved with more 2010 FIFA World Cup stadiums than any other engineering design firm.

This expertise fits well with the global leadership position we are building in major sporting venues and it also positions us well for future World Cup projects.

And the last, but largest, use of our capital is share repurchase. As John mentioned, today we announced that our Board authorized the repurchase of $500 million of stock, which reflects our confidence that our company is one of the best long-term investments we can make right now. This new authorization provides the base for us to target returning at least 50% of our free cash flow to our shareholders over the next two years.

Based on our balanced results of growth, profitability, and liquidity this quarter and our expectations for the full year, it is evident that our approach to capital allocation is bearing fruit. At the heart of this is our heightened focus on cash flow. During the past two years we have raised the internal awareness about the importance of working capital and incrementally increased the weighting of cash flow for performance-based compensation.

In fiscal 2013 we sharpened our focus even further and now link at least 50% of the performance-based compensation for key executives to cash flow. The solid progress we made last year, coupled with an even greater emphasis on cash flow this year, provided good foundation for further improvements in our cash returns. Our strong cash flow yield, strong balance sheet, $591 million in cash, $855 million in undrawn borrowing capacity, and a net debt to EBITDA ratio of 1.3 ensure we remain nimble while preserving our financial flexibility to take advantage of high return investment opportunities.

Now let me turn the call back over to John. John?

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

Thank you, Mike. Let me take you through a quick overview of how our three super geographies, namely the Americas, EMEA, and A-Pac performed this quarter.

Based on net service revenue, the Americas accounted for 49% of our business this quarter. We saw particular strength in our transportation, environment, power, energy, and mining end markets. During the quarter our wins increased 80%, the second consecutive quarter of a 50% or better increase in wins.

In transportation, where we have invested in light rail expertise, we were appointed design engineer for Boston's Green Line light rail service, the largest infrastructure project in Massachusetts. And we were recently awarded a $16 million contract for engineering design work for the Minneapolis Southwest rail transit line, which builds upon our existing client relationships on the Central Corridor light rail project.

In our facilities end market, for the second consecutive quarter we saw an increase in new US commercial construction, multi-residential, high rise, and healthcare projects. In healthcare, for example, where we have invested in technical expertise, we were awarded three high profile projects in the New York metropolitan area.

Within power, energy, and mining we leveraged our strong Canadian and US presence for the assignment as owners engineer on the $2.2 billion Champlain Hudson Power Express project. At completion this project will bring 1,000 megawatts of clean power from Canada to New York City through underground and underwater transmission lines.

Within the federal market we continued to broaden our agency relationships, evidenced by our recent award of a $350 million IDIQ contract by United States AID to provide clean energy technical assistance globally. As our PTS segment expands its footprint and relationships with non-US governments, we are positioning MSS to provide additional services and support directly to emerging nations.

Many of you have asked about our involvement in the recovery efforts from Superstorm Sandy. We are now mobilized on over one dozen contracts supporting a range of federal, state, municipal, and private sector enterprises. We are encouraged by the recently approved $50 billion in Sandy relief funding, but it is important to note that the majority of this funding will not likely be distributed until the 2014/2016 timeframe.

Turning to Europe, Middle East, and Africa, EMEA represents 24% of our business in the quarter. Growth improved in the region and the turnaround in the top-line reflects a greater number of opportunities and more targeted pursuit efforts where AECOM's competitive advantages are strongest. This was most evident within the Europe market which posted positive growth for the first time in over two years, supported by an increase of over 150% in new business wins.

Early in the quarter we won an eight-year $500 million contract for highway maintenance and improvement in London which significantly improves AECOM's positioning in the large highways operation and maintenance market. This is an example of how our strategic investments in the region are producing positive results.

While conditions have improved in Europe, we continue to approach the market prudently and drive for further improvements in profitability over the balance of the year. In the Middle East the opportunities are both significant in scale and spans all our addressable markets. For example, Qatar has embarked on $150 billion infrastructure investment program which dovetails with the country's preparation for the 2022 World Cup games.

Major infrastructure projects are to include airports, ports, highways, rail lines, hotel and lodging, and sports stadiums. Under this investment program we were recently awarded an $80 million framework by Qatar's Public Works Authority to support local road and drainage infrastructure.

Neighboring Saudi Arabia is investing roughly $400 billion in infrastructure over the next few years directed towards key AECOM end markets including social infrastructure areas of healthcare and education, and civil infrastructure projects of rail, airports, water infrastructure, city planning, and housing infrastructure. As a part of this we were recently appointed by the municipality of Jeddah to provide city planning services that will help reshape Jeddah for decades to come.

Even in more developed parts of the region such as the United Arab Emirates, we were encouraged by ongoing investments. For example, Abu Dhabi is investing $3 billion to expand its primary airport and AECOM is participating as construction managers on this important infrastructure project.

Our expansion in Africa continues via our most recent niche acquisition which allows us to increasing leverage our global capabilities in civil and social infrastructure throughout the continent. For example, we were appointed project managers for a large-scale education facilities program in Liberia. This assignment draws upon our education and cost consultants from both Europe and Africa.

Turning to the Asia-Pacific, which accounts for 27% -- which accounted for 27% of our business this quarter, performed in line with our expectations. Asia delivered double-digit growth once again, led by our environmental and transportation end markets. Across Asia-Pacific we are most optimistic about prospects within our transportation and facilities markets.

Asia-Pacific is a region that has benefited greatly from our new geographic structure, especially from cross-border collaboration. For example, we recently leveraged our healthcare engineers from Australia to secure the project management role for a major hospital expansion program in Hong Kong, which will be the largest single construction project implemented by the city's hospital authority at just over $1 billion in CapEx. This project significantly improves our positioning in the local healthcare market.

We are also benefiting from our multinational clients -- as our multinational clients expand their geographic footprint. For example, we are now building a data center in Southeast Asia for an Australian client. These are just two examples of how we continue to better leverage our global footprint and presence in key markets.

Before we move to Q&A I would like to mention that last month we brought our global leadership team together. We focused on honing priorities, mapping ways to be more collaborative, and improving client satisfaction -- all while driving improved growth, profitability, and cash flow. I can tell you firsthand that our teams are energized and focused on the right areas to execute our strategy and grow long-term shareholder value.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Tahira Afzal, KeyBanc.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

Good morning, gentlemen, and congratulations on a very strong quarter.

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

Thank you very much.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

It seems that on the free cash flow outlook longer term you seem to be incrementally a little more positive versus your earlier commentary at the analyst day. So I guess my only question really right now is if you could give us some more color on whether that is the case and really what the drivers are for that. Thanks.

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

Tahira, this is Steve and thanks for the question. I don't think we are any more bullish on our cash flow than we were in December.

We said in December that that $1 billion was a floor for what we expected from free cash flow over the five-year period. But if you model is out, and I did take you through some scenarios in December that varied our growth, varied our gross margin, varied our utilization and played with the cost-savings initiatives that we have going on.

If you do run those scenarios you find that you have increasing profit, and since we intend to convert net income to profit and we have confidence in that, you can get two numbers as high as $1.8 billion. So this clarification was just meant to be a little more specific on that.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

Got it, okay. Could you give a little more color maybe on the US construction market in general? It seems that even if I look at front leading indicators, such as the ABI Index and all, things do seem to be getting better. Any sort of other indicators that you have that you can talk about would be helpful. Thank you.

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

This is John Dionisio here. We are cautiously optimistic about the construction industry in the United States. One key indicator is over the past two quarters we have won approximately $2.1 billion worth of new work. Clearly it is long-term work. It is a little bit different than our PTS business, but it is a really good indicator of where we are this year as compared to last year.

Take an example, the New York construction spending is expected to reach in 2013 $30 billion, that is up 20% from the post-recession trough in 2010. In December of this past year the industry private non-residential construction was up 6% year over year and the 19th consecutive month of year-over-year growth.

And looking at some of the successes we have had; I have mentioned the $2 billion in wins, but also it is in residential housing, commercial. It is in healthcare, as well as education. So from where we stand compared to where we were last year, we see it to be a significant improvement.

Tahira Afzal - *KeyBanc Capital Markets - Analyst*

Got it. Thank you very much and congratulations again.

Operator

John Mirshekari, Fidelity Investments.

John Mirshekari - *Fidelity Investments - Analyst*

Good morning. Thank you for authorizing the additional $500 million of share repurchases and thank you for clarifying your five-year free cash flow target in a range of $1.3 billion to $1.8 billion, 55% higher than the target provided at your analyst day.

I'm still trying to understand, though, why the range isn't 100% higher, or $2 billion dollars, at the midpoint with the range actually being $1.7 billion to $2.2 billion, or $400 million higher than the revised target.

The math is pretty straightforward. Your current cash net income of about $295 million, backing out the amortization on your income statement, multiplied by five years in addition to the approximate $240 million of excess working capital that you expect to collect this year produces just over $1.7 billion of free cash flow over the next five years, assuming no growth in the business. The balance scenario of 1% to 2% revenue growth should produce $2 billion of free cash flow over five years and the high-growth scenario of 5% revenue growth should produce $2.2 billion.

You've have stated that 12% EBITDA margins under the no-growth scenario through cost reductions are possible and through revenue growth under the high-growth scenario. Could you clarify which of these assumptions are incorrect?

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

John, hard to follow every number that you threw out there, but without giving net income guidance we do get on flat growth something far less than the $1.7 billion that you threw out. But when we run higher growth scenarios we deploy cash for that growth, so if you get into significantly higher growth you won't convert 100% of net income. But in moderate growth scenarios we believe we will.

Then we look at every 1% of gross margin gets us $50 million of income, every 100 basis points of utilization gets us $50 million. Our savings, just real estate and procurement, could get us $50 million. You run different scenarios plus you add some DSO reduction gets you into the higher end of that range.

I think we can probably spend some time trying to reconcile your low end to get you to $1.7 billion, but our math gets us something lower there.

John Mirshekari - *Fidelity Investments - Analyst*

While, under a no-growth scenario there shouldn't be any growth CapEx required, if anything is should be below D&A since you are consolidating some operations. And the math is sort of $300 million or just shy of that plus $240 million of working capital. That gets you to $1.7 billion under no growth.

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

And we model getting -- you are modeling getting some of these upsides on margin that we are working towards and that gets us up into the ranges you are talking about.

John Mirshekari - *Fidelity Investments - Analyst*

Right. And so your $1.3 billion would not include margin expansion, which you expect?

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

That would be correct.

John Mirshekari - *Fidelity Investments - Analyst*

Okay. Then as a follow-up, you said that at least 50% of free cash flow over the next two years will be directed towards share repurchases. We calculate that $840 million of free cash flow should be generated over the next two years assuming no growth, which is 30% of your market cap even after today's move. My question is how much more than 50% of your free cash flow could be directed towards share repurchases?

Mike Burke - *AECOM Technology Corporation - President*

John, it is Mike; I will take that question. Listen, it is difficult for us to commit specifically to a buyback number with specificity that you are looking for over the next two year period. And the reason for that is there is other variables that we take into account to deploy our cash.

We have strategic acquisitions that we look at from time to time. We have organic investments that we continue to make every day and so we weigh all of those options. As you heard me say earlier, every decision we make we are weighing it between organic investments, M&A, and stock buybacks.

And so if we are weighing those opportunities and stock buybacks continue to present a better opportunity than anything else available to us then we would exceed that 50% number that I mentioned. So it is going to depend on the opportunities that are put in front of us or that we identify over that two-year period of time that will have the greatest influence on whether we hit that 50% target or we exceed it significantly.

John Mirshekari - *Fidelity Investments - Analyst*

Makes perfect sense. I guess I was asking in theory if the stock buyback remained more attractive than other options, if stock remains as low as it is, in theory what would be the upper limit of the buybacks as a percentage of your free cash flow.

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

John, I am not comfortable responding in theory, but if there are no other available options for us and our stock remains low, in theory, it would be significantly more than that. I think the theory is if it is the best opportunity of everything in front of us there is no reason why we wouldn't invest all of our capital in that, if it is the best opportunity. I just can't hypothecate on the opportunities two years down the road.

John Mirshekari - *Fidelity Investments - Analyst*

That is an interesting idea, because if you do direct all of it towards share repurchases the earnings accretion generates cash earnings close to $5 and your stock is probably re around $60 in that scenario.

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

Yes, I think that math works, John. We have done probably the same models that you have done to plug-in assumptions that achieve that.

John Mirshekari - *Fidelity Investments - Analyst*

Thank you very much.

Operator

Steven Fisher, UBS.

Steven Fisher - *UBS - Analyst*

Good morning. So just on the factoring in the quarter, should we think about this as the highest you would do in the year? Because it should seasonally be your weakest quarter for cash flow and so if you are trying to smooth things out you might have less reason for factoring as the year goes on. Is that the way to think about it?

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

Well, I would say that we are going to sell more receivables in the first half of the year. We tend to burn cash in the first quarter. As you can see, we actually generated cash and we would prefer to smooth our cash flow throughout the year.

So I think that is probably right, but I wouldn't rule out in strategic situations where we want to take on a project that has significant milestone payments where we might still sell receivables in later quarters.

Steven Fisher - *UBS - Analyst*

Okay. Then, Steve, how are you thinking about that 80-day DSO target now? I think earlier in the -- a quarter ago it was characterized as more of a, I don't know if a stretch goal, but a little tougher. How are you thinking about that now?

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

It's an aggressive goal but DSOs are a tough thing to forecast on a quarter-by-quarter basis. But the underlying fundamentals of our DSOs are quite strong. MSS came down 48 days; PTS had a few anomalies in it because of the Australian slow down. Our revenue was down, which impacts the days in the wrong way, but if you look at the underlying DSO in PTS there was a significant decline there, although it won't look that way on the financial statements.

But, overall, we picked up a day year over year, even though we had a slowdown in Australia that impacted us. So I think we are very, very positive on that 80-day target. We still think it is aggressive, but we think we can achieve it by the end of the year.

Steven Fisher - *UBS - Analyst*

Okay. Then it seems like one of the things that is sort of weighing on growth is the progress of awarded backlog being converted. And so I guess can you talk about what is really holding up that progress?

Where in the business is it? What types of end markets? And what would be the most likely factor to change that or improve that situation?

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

Well, this is something that we have been experiencing now probably for the last 12 months, 18 months. We see a continued sluggishness in the conversion of our awarded backlog, (inaudible) backlog, especially here in the United States on some of the major transit programs that we have.

Also, one of the things that I mentioned previously regarding the construction business is that the conversion of wins into backlog takes longer and the projects are longer duration. So the combination of a sluggishness on our transportation business as well as the longer tail on our construction services business is a factor that we must consider in terms of how we forecast the future.

We are not seeing that. I mean, we are seeing a more robust conversion in, say, the Middle East. We are optimistic about the improvements in Europe. The first time that we can say anything optimistic about Europe over the past 24 to 36 months. And Asia is moving along as they have.

The one thing, which we pointed out in the discussion, is Australia. Australia we saw a slowdown coming -- we mentioned that in our last earnings call -- with the mining business really softening up. And the mining business, when they slow up they don't gradually slow up. It is like turning a light off.

But the good news is we have taken most of the costs out and the costs are represented in the first quarter's results. So going forward the Australian utilization will increase and they will return to profitability as they have in the past. I hope that answers your question regarding the backlog as well as how we see the other areas in terms of work coming through.

Steven Fisher - *UBS - Analyst*

Yes, that is helpful. Thank you.

Operator

John Rogers, D.A. Davidson.

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

Good morning. I guess maybe for John; the margins that you are seeing in the backlog right now are they notably different than what is flowing through the income statement? In other words, is pricing getting better?

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And how are you set up relative to some of the concerns we hear about higher engineering costs or labor costs and your multipliers and things like that as we think about this cycle?

Mike Burke - *AECOM Technology Corporation - President*

John, I will take that question. The margins are slightly up when you are looking at the big picture, but as far as labor costs, we are not seeing a dramatic increase in labor costs.

I think some of those stories that you are hearing are more related to the oil and gas sector than they are to the markets in which we participate. So our labor costs are moving at normal cost of living rates and we are not seeing a real cost constraint there. As a result, our margins are moving up primarily due to all the cost-saving opportunities that Steve identified earlier.

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

Okay. Mike, in terms of how you are hedged or -- I mean if we do see changes in cost structure is that a significant risk? I'm thinking more as we get into late this calendar year in 2013.

Mike Burke - *AECOM Technology Corporation - President*

So, obviously, the single biggest cost on our P&L is labor. Although we do not expect to see any dramatic increases there, remember that the majority of our revenue is earned through cost-plus contracts and so, generally, we are pushing the costs through with a markup. And so increased labor costs generally over time works to our favor.

Now, of course, if there was some precipitous increase in labor costs and you couldn't push it through the contracts fast enough that would be an issue, but we have not experienced that in the past. So generally we would welcome increased labor costs because of the cost-plus nature of our contracts, but more importantly, if there is an increase in labor cost it is probably due to the market heating up and growing faster than it is today. So we would actually welcome that issue.

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

John, if I just might add, as Mike said and I think he described it perfectly, the other area is those places where we have fixed price contracts. What we have done to protect ourselves against increased costs where maybe the project total value might not increase is the fact that we have created design centers in Spain and in India where we do transportation work in Spain and facilities work in India and we are able to, by shifting work to those two design centers, maintain our margins and support our profitability.

So the combination of design reimbursable and fixed price we try to organize ourselves so we can be very competitive in both.

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

Okay. If I could just go back to the buyback question one more time; as we think about the rest of fiscal 2013, and given the stepped up activity in the first quarter, is it reasonable to think about it as sort of the midpoint of possibilities is that you spend half your remaining cash flow on buybacks? Assuming the stock stays in this range, there is no great acquisition opportunities.

Mike Burke - *AECOM Technology Corporation - President*

John, I don't think we would want to give too much specific guidance on how much we are going to buy by quarter on that.

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

I know, but over the next 12 months, is 50% -- you have said it over the next two years but --?

Mike Burke - *AECOM Technology Corporation - President*

I am not prepared to give that degree of specificity just yet, but we will be updating you every quarter on the amount of shares that we buy back.

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

Okay. And how many shares are outstanding right now? I know we are going to get the Q later.

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

102 million at the end of the quarter.

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

Okay, great. Thank you very much.

Operator

Andrew Wittmann, Robert W. Baird.

Andrew Wittmann - *Robert W. Baird - Analyst*

Maybe a question starting out for Steve or Mike. Just kind of on the quarter a little bit. I think previously you talked about the first quarter representing about 12% of the year's earnings; came in clearly above that. Can you just talk about how to think about maybe the second quarter or the seasonality, now that you are looking at particularly as it relates to some of the costs that you experienced in the first and maybe even in the second quarter in Australia?

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

Sure. The largest impact on Q1 was our overall yearly look or profit forecast for Australia, which is about what we had expected when we updated you in Q4. But the spread of that was a little bit different and a little more profitable than we expected in Q1 and a little less profitable in Q2, but we still see a significant ramp-up in Q2. We are not giving quarterly guidance, but we do expect that uptick significantly.

The other thing, there was some tailwind on the tax rate was more of a shift of income to our foreign where we have lower tax rate. Those were the two biggest line items.

Andrew Wittmann - *Robert W. Baird - Analyst*

So as we look kind at the balance between the two segments for the year, I think previously you were suggesting that the MSS business would be sharply up. Now you have quantified that to be double. Certainly that was a little bit above where we were thinking about things.

Given that guidance is kind of unchanged, is it fair to say that maybe today versus when you gave guidance originally that MSS is maybe a little bit stronger and maybe PTS is a little bit softer?

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

Certainly MSS is very healthy. We have a more accurate view of what that full year looks like, barring anything significantly changing on the political environment. We said that we expect that to at least double. And PTS is I think about where we expected it.

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

PTS going forward is stronger, much stronger than it was this time last year, just by the amount of winds we have and when we look at the pipeline. And the fact that last year at this time, we still had ahead of us some issues that we had in the Americas as well as in the Middle East, which we are not facing this year.

Again, we have Australia, but I think we have taken out, if not all, most of the costs associated with the shortfall in terms of severance pay, in terms of consolidating offices.

Andrew Wittmann - *Robert W. Baird - Analyst*

Got it. So then just kind of building on that, as you look forward, obviously, good wins in this quarter. But is the level of activity that you have got bids outstanding for, is it your view that there is more to come on the backlog or are burn rates going to maybe accelerate a little bit that could make sequential backlog growth a little bit more challenging as you --?

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

We are one month into the second quarter and the activity hasn't slowed down. There is significant amount of opportunities out there which we are focusing in on.

One of the things we haven't mentioned in this call because we are just really starting to put forth a significant organic investment in that is on the oil and gas side of the business, where we see significant opportunities for us in a market which has not been one of our stronger markets historically. It has been transportation, environment, facilities.

But now utilizing the expertise we have on the infrastructure side, working with the oil and gas companies we see a very, very significant market for us going forward.

Andrew Wittmann - *Robert W. Baird - Analyst*

Got it, thanks. If you will afford me one last question; wanted to just kind of dig in on the utilization rates. This was something you guys talked about on the analyst day about the improvement that you have seen over the last three years. Can you just talk about kind of how the year-over-year utilization rates in the quarter compared and maybe how they are trending sequentially, and what you're kind of view is here as we go throughout the year?

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

We are trending upwards. I think we had a 90 basis point increase in utilization in the quarter. Something we are very focused on. Much of that had to do with the downsizing that we went through last year to match the operation to the revenue opportunities that we are seeing in the market, so it continues to be something we are focused on.

Of course, we were weighed down a bit by what was happening in Australia as we downsized that business significantly. But, overall, we see the trends going in the right direction and I would expect them to continue to improve when the downsizing is complete in Australia.

Andrew Wittmann - *Robert W. Baird - Analyst*

Thanks.

Operator

Andy Kaplowitz, Barclays.

Mark Mahalo - *Barclays Capital - Analyst*

Good morning, guys. It is actually [Mark Mahalo] on for Andy this morning. Thanks for taking my questions.

Just a follow-up on the discussion of margins though. You talked about how JV income impacted MSS margin in the quarter, but you still expect MSS op income to double in 2013 versus 2012. So when should we expect the op income or the margin in that segment to improve in the year? Should we think maybe a slight pickup in Q2 or do you think it is more significantly back-end loaded?

Mike Burke - *AECOM Technology Corporation - President*

We are expecting it to pick up significantly in Q2 through Q4. That business has, as you know, a number of significant large contracts and so you get a little lumpy sometimes as you are closing a contract out from quarter to quarter. But we have got pretty good visibility on that business and as I mentioned and Steve mentioned we expect our income to double in that sector in FY 2013 over FY 2012.

Mark Mahalo - *Barclays Capital - Analyst*

Okay, that is helpful. A more general question then. So now that you are through your first quarter what do you think has been the biggest positive surprise in terms of end market or geography versus I guess what you expected at the analyst day or at the end of fiscal 2012? Is it Europe or any other type of geography or end market?

Mike Burke - *AECOM Technology Corporation - President*

The biggest surprise, positive or negative?

Mark Mahalo - *Barclays Capital - Analyst*

Positive. And negative as well, if you would like.

Mike Burke - *AECOM Technology Corporation - President*

We already talked about Australia. Positive surprises, seeing growth come back to Europe. So Europe and Middle East are starting to grow again.

We were cautious on Europe. As you know, we incurred a lot of cost to restructure and right-size that business. We are delighted to see growth coming back to not just Europe but the EMEA region as a whole. So that has been a positive surprise for us.

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

And also, I think as -- us folks living here in the United States we read about the US economy and the sluggishness of it. We just went through the election cycle. But we were surprised at the pipeline, how robust it was, and the fact that the wins for us in the first quarter exceeded last year's wins at this time.

So despite some of the things you read in the papers and the macroeconomics that you hear about, when you look at individual areas where people are investing there is a good story to be told.

Mark Mahalo - *Barclays Capital - Analyst*

Helpful, guys. Thanks very much for the color.

Operator

Adam Thalhimer, BB&T Capital Markets.

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

Good morning, guys. I wanted to ask one more question on the MSS segment. So thinking about operating income doubling; is the right way to think about it revenue up a little bit, equity in earnings of JVs comes back, but then the real earnings power is in the operating margin?

Mike Burke - *AECOM Technology Corporation - President*

First of all, we do not expect the jump to be in the equity earnings JV line. Nothing to read into that other that it is the structure of our contracts. Either we are fully performing as the prime or we are partnering with somebody else, so I wouldn't read anything into that.

But you shouldn't be building a model that increases or sees the numbers coming back on the equity and JV line. But what you will see is the gross profit line coming back significantly with a dramatic improvement in the operating income margins.

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

Okay. Because the revenue line -- I guess back contract and backlog, both awarded and contracted backlog down, so I just wonder at some point do you see revenue declines year over year in that segment?

Mike Burke - *AECOM Technology Corporation - President*

No, I am glad you raised that question because it is a good point. One thing you need to be mindful of on the revenue side there is that you have IDIQ contracts in that space. And so if you look at the quarter you would see the wins were not as significant in the MSS that would support a doubling of profit.

But we did win the participation in a $23 billion IDIQ contract, the Army EAGLE logistics program. The way that works, as we have said in the past, when we win at a participation or qualify to participate in an IDIQ contract we do not book that backlog until we win the specific task order. So by virtue of winning the participation in that we have some pretty good estimates on what our share will be of that IDIQ contract that you don't see in the backlog yet.

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

Got it. Okay, very helpful. Then, lastly, I just wanted to ask about the outlook for acquisitions. A lot of focus has been on the share repurchases, but why not more acquisitions? Is it more an issue of where the multiples are? Because you do have certain end markets where you want to grow so I am kind of curious why not a little bit more on the acquisition front.

Mike Burke - *AECOM Technology Corporation - President*

Well, we did just three acquisitions last quarter. As you know, we completed the BKS as acquisition that I mentioned earlier in South Africa, giving us a real nice platform to take advantage of that emerging market. We did the KPK acquisition in Southeast Asia where we already have a strong presence, but this rounds out our service offering in that fast-growing region. And then we bought the construction capabilities in Europe, in Eastern Europe from Lend Lease, giving us more resources in the fast-growing Eastern European construction market.

So we continue to look at acquisitions that meet our strategic objectives of either giving us a platform in a geography that is important to us that we want to build off of or giving us a niche expertise that we can drive through the rest of our platform. So we continue to focus on that, but as I said earlier, we look at three different investment opportunities every day of the week.

It is either organic investments, niche acquisitions, or buybacks. We have been more focused on buybacks recently because the ROI was really good for us. If there is ever a crossover point where acquisitions look much better than that then we would consider them, but we continue to focus on strategic acquisitions as we always have.

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

Got it. Okay, thanks very much.

Operator

Chase Jacobson, William Blair.

Chase Jacobson - *William Blair & Company - Analyst*

Thanks for taking my call. So you have been talking about a little bit slower backlog conversion in the public markets, I think, for the last few quarters and now you are seeing it in some of the construction markets given the nature of the projects. But at the end of the day the backlog is still growing and it sounds like you expect it to continue to grow.

So when do we get to a point where there is enough work in the backlog where we can see organic revenue growth turn positive again?

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

Let me just clarify one thing. I said in the public markets the backlog takes longer to convert from awarded to contracted. What I wanted to say in terms of the construction, with the wins we have in the construction services business is just a longer tail. It's not the conversion; it's how the projects develop.

You start with a smaller piece of work to get -- and then it takes maybe 12 months before you get into ramping up on your services. So it's two different things, Chase. But we feel that by the end of -- in this fiscal year we will be seeing the organic growth being positive.

Chase Jacobson - *William Blair & Company - Analyst*

Okay. Then I think in the past you have talked about targeting acquisitions in the 5 to 7 times EBITDA range. Is that still the target? And maybe just a comment on what you are seeing in terms valuations for acquisitions out there; I apologize if I missed that.

Mike Burke - *AECOM Technology Corporation - President*

Yes, that is still a good range to think about. The boundaries of that range are really driven by the growth prospects. In core infrastructure markets it is on the lower end of that. In emerging markets and oil and gas sector it might be on the higher end of that and that is generally what we are seeing in the marketplace.

Chase Jacobson - *William Blair & Company - Analyst*

All right. Thanks a lot.

Operator

We have no further questions at this time.

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

Operator, thank you. Before we end the call I wanted to leave you all with a few thoughts.

One, we ended this first quarter of 2013 as a stronger company evidenced by our improvements in growth, profitability, and liquidity. I have to say this could not have been done without the commitment and dedication of all our team members around the world.

Second, we are prepared to be successful in a challenging global macroeconomic environment. We are focused on cost, productivity, and providing our clients with the best possible solutions. Third, we have a clear long-term roadmap for driving improved returns and we look forward to updating you on our progress in the next quarter.

With that, I would like to end the call. Again, thank everyone for taking the time to dial in and ask the questions you have. I look forward to seeing you in three months or listening to you in three months. Take care.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.
