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ACN – ACCENTURE'S Q2 FISCAL 2014 EARNINGS
CONFERENCE CALL

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Accenture's Q2 FY '14 Earnings Conference Call

CORPORATE PARTICIPANTS

KC McClure *Accenture - Managing Director IR*

Pierre Nanterme *Accenture - Chairman and CEO*

David Rowland *Accenture - CFO*

CONFERENCE CALL PARTICIPANTS

Tien-Tsin Huang *JPMorgan Securities - Analyst*

Joseph Foresi *Janney Montgomery Scott - Analyst*

Keith Bachman *BMO Capital Markets - Analyst*

Jason Kupferberg *Jefferies & Company - Analyst*

Edward Caso *Wells Fargo Securities - Analyst*

James Friedman *SIG - Analyst*

Bryan Keane *Deutsche Bank - Analyst*

Katy Huberty *Morgan Stanley - Analyst*

Darrin Peller *Barclays Capital - Analyst*

Ashwin Shirvaikar *Citigroup - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, good morning. Thank you for standing by and welcome to Accenture's second-quarter FY14 earnings conference call.

(Operator Instructions)

And as a reminder, today's conference is being recorded.

I would now like to turn the conference over to our host, Managing Director of Investor Relations, Ms. KC McClure. Please go ahead.

KC McClure - Accenture - Managing Director IR

Thank you, Tom. And thanks everyone for joining us today on our second-quarter FY14 earnings announcement. As Tom just mentioned, I'm KC McClure, Managing Director of Investor Relations. With me today are Pierre Nanterme, our Chairman and Chief Executive Officer, and David Rowland, our Chief Financial Officer. We hope you've had an opportunity to review the news release we issued a short time ago.

Let me quickly outline the agenda for today's call. Pierre will begin with an overview of our results. David will then take you through the financial details including the income statement and balance sheet along with some key operational metrics for the second quarter. Pierre will then provide a brief update on our market positioning. David will then provide our business outlook for the third quarter and full FY14, and then we will take your questions before Pierre provides a wrap up at the end of the call. As a reminder, when we discuss revenues during today's call we're talking about revenues before reimbursement or net revenues.

Some of the matters we'll discuss on this call are forward-looking, including the business outlook. You should keep in mind that these forward-looking statements are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements and that such statements are not a guarantee of our future performance. Such risks and uncertainties include, but are not limited to, general economic conditions and those factors set forth in today's news release and discussed under the risk factors sections of our annual report on Form 10-K and quarterly reports on Form 10-Q and other SEC filings.



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During our call today we will reference certain non-GAAP financial measures, which we believe provide useful information for investors. As a reminder, in Q2 of last year our results included benefits from final determinations of prior-year US Federal tax liabilities and a reduction in reorganization liabilities. We include reconciliations of non-GAAP financial measures, where appropriate, to GAAP in our news release or in the Investor Relations section of our website at www.accenture.com. As always, Accenture assumes no obligation to update the information presented on this conference call. Now, let me turn the call over to Pierre.

Pierre Nanterme - Accenture - Chairman and CEO

Thank you, KC, and thanks everyone for joining us today. Our results for the second quarter were pretty much in line with our expectations. We achieved record new bookings, delivered revenues within our guided range and grew earnings per share, while continuing to return substantial cash to our shareholders.

Here are a few highlights.

- We delivered outstanding new bookings of more than \$10 billion, including record Consulting bookings of \$4.6 billion, and record Outsourcing bookings of \$5.5 billion.
- We generated revenues of \$7.1 billion, a 3% increase in local currency and above the midpoint of our guided range.
- Earnings per share were \$1.03, compared to \$1.00 on an adjusted basis in the second quarter last year.
- Operating margin was 13.3%, which is flat compared to the second quarter last year on an adjusted basis.
- Our balance sheet remains very strong, ending the quarter with a cash balance of \$3.7 billion.
- And we continue to return cash to shareholders through share repurchases and dividends. Today, we announced a semi-annual cash dividend of \$0.93 per share, which will bring total dividend payments for the year to \$1.86 per share, a 15% increase over last year.

So overall, we are pleased with our results for the first half of FY14, and encouraged by our very strong bookings of nearly \$19 billion year-to-date, which position us well for the second half. We have updated our business outlook for the full fiscal year, and David will cover it later in the call.

Over to you, David...

David Rowland - Accenture - CFO

Thanks, Pierre. And as always, it's great to have the opportunity to talk with you about our financial results and how we're positioned for the full year. Before I get into the detailed results for the quarter, let me start by providing a few overall highlights.

Our second-quarter results reflected some clear areas of strength, but also some areas where we expect to perform better in the second half of the year. The bright spot was clearly in our new bookings where we posted \$10.1 billion, setting new records in several areas of our business, and providing further indication of how our differentiated capabilities are resonating with the market. Net revenues landed in the general zone that we expected, with 3% local-currency growth, slightly above the midpoint of our guided range.

On the profitability front, our operating margin for quarter 2 was flat with last year, resulting in 20 basis points of expansion for the first half of the year, solidly in our annual guidance range, but does reflect pricing and cost pressures in certain areas of our business which we're working hard to address. At the same time, we continued to invest at higher levels in our business and return a significant portion of our cash to our shareholders. So all in all, quarter 2 was a solid quarter.

With that, let's get to the numbers, starting with new bookings. New bookings for the quarter were extremely strong at \$10.1 billion, representing an all-time high. Consulting bookings were \$4.6 billion, with a book-to-bill of 1.2. Outsourcing bookings were \$5.5 billion, with a book-to-bill of 1.6.

Looking further at our new bookings, there are several additional insights worth noting. Consulting new bookings were the highest quarter on record, building on our strong Consulting bookings performance in quarter 1. We saw good demand in both Systems Integration and Management Consulting, with both posting book-to-bills above the upper end of our target range.

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Outsourcing bookings were also at an all-time high, driven by extremely strong, record bookings in BPO, where the demand environment remains robust, and where we saw particularly high demand for our Finance & Accounting offerings. Technology Outsourcing bookings were a little lighter this quarter, following strong bookings performance in quarter 1.

From an operating group perspective, CMT and Financial Services were the primary drivers to our strong bookings performance, which further strengthens their position for higher growth in the second half of the year. And finally, our results include 10 clients with bookings in excess of \$100 million, as we continue to be the business partner of choice for helping our clients tackle their largest, most complex projects.

Turning now to revenues. Net revenues for the quarter were \$7.13 billion, an increase of 1% in US dollars and 3% in local currency, reflecting a negative 1.5% FX impact, consistent with the assumption we provided in December. Consulting revenues for the quarter were \$3.7 billion, down 1% in US dollars and flat in local currency. Outsourcing revenues were \$3.4 billion, up 4% in US dollars and 5% in local currency.

Let me give you some highlights from the operating groups this quarter. Financial Services grew 5% in local currency with broad-based double-digit growth in Capital Markets as well as continued strength in Outsourcing overall. We're very pleased with growth rates in both EMEA and Asia-Pacific, and continue to be focused on driving improved growth rates in North America.

Once again, our Products operating group delivered a very consistent level of growth, well above the Accenture average growth rate, at 5% growth in quarter 2. The revenue drivers were similar to last quarter, meaning we continued to see broad-based growth with positive growth in both Consulting and Outsourcing in all three geographic areas and in the majority of our industry segments.

CMT returned to growth, at 2% this quarter, and we continue to see signs of positive momentum driven by demand for transformation-led, value-driven projects. Our efforts to focus the business on new growth areas continue, and we're seeing the impact in strong Consulting growth across all of our geographic regions. The Americas region continues to be the primary driver of growth, especially in Electronics & High Tech.

H&PS growth for the quarter was 1%. And while we did signal some moderation in growth from quarter 1, growth in the quarter was a little lower than we expected. Our Health business continued to have strong growth, particularly in the Americas. Our Public Service business had a modest decline in the quarter as the environment in Europe continues to be challenging. Looking ahead, we expect a ramp up in H&PS growth in the second half of the year, beginning with a significant uptick in quarter 3.

Resources growth was flat in quarter 2. The Energy business continues to be the real bright spot globally with double-digit growth. But cyclical challenges in Natural Resources continue to negatively impact the overall growth rate of our Resources business. Having said that, we do still expect to have positive growth for the year.

Before moving down the income statement, let me provide some overall context on the factors impacting our profitability this quarter. Specifically, our operating results for the quarter reflect lower contract profitability, primarily driven by pricing pressures and our challenge in absorbing higher payroll costs, and to a lesser extent, lower margins in the early stages of a few large contracts. At the same time, our results also reflect a higher level of investment in the quarter to build new capabilities, including strategic acquisitions aimed at enhancing our capabilities in key growth areas.

And while we have accrued a significant amount of variable compensation this year, we did accrue a lower amount in quarter 2 compared to the second quarter last year, which offset the factors previously mentioned. This lower variable compensation expense reduced accrued payroll on the balance sheet and is the primary driver for the reduction in our free cash flow guidance for the year, which I'll cover later.

To be clear, our profitability does vary quarter to quarter and it's normal for us to have certain periods where we have areas of cost pressure which require intervention. And as always, we understand the areas that need attention and we're taking action at speed and with the rigor and discipline that our investors have come to expect.

Now to the numbers. Gross margin for the quarter was 31.3%, compared with 31.6% for the same period last year, down approximately 30 basis points. Sales and Marketing expense for the quarter was 11.7% of net revenues, compared with 11.8% of net revenues for the second quarter last year, down about 10 basis points. General and Administrative expense was 6.2% of net revenues, compared with 6.5% of net revenues for the second quarter last year, down approximately 30 basis points.

As a reminder, we had two unusual items that impacted certain metrics in quarter 2 of last year. The following comparisons exclude the impact and reflect adjusted results. Operating income was \$951 million in the second quarter, reflecting a 13.3% operating margin, equal to the adjusted operating margin for the same period last year. Our effective tax rate for the quarter was 24%, compared with an adjusted tax rate of 24.8% for the second quarter last year.

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Net income was \$722 million for the second quarter, compared with adjusted net income of \$720 million for the same quarter last year. Diluted earnings per share were \$1.03, compared with adjusted EPS of \$1.00 in the second quarter last year, an increase of \$0.03.

Turning to DSOs, our days services outstanding continue to be industry-leading. They were 33 days, down slightly from 34 days last quarter. Free cash flow for the quarter was \$216 million, resulting from cash generated by operating activities of \$292 million, net of property and equipment additions of \$76 million. Cash flows for the quarter and year-to-date have also been impacted by lower accrued variable compensation expense, which I previously noted.

Moving to our level of cash, our cash balance at February 28 was \$3.7 billion, compared to \$5.6 billion at August 31 last year. The current levels reflect the cash returned to shareholders through repurchases and dividends as well as the higher level of acquisitions we've made in the first half of this year.

Moving to some other key operational metrics. We ended the quarter with a global headcount of about 289,000 people, and we now have approximately 192,000 people in our Global Delivery Network. In quarter 2, our utilization was 87%, consistent with last quarter and slightly down from quarter 2 last year. Attrition, which excludes involuntary terminations, was 12%, up approximately 1% from both quarter 1 and the same period last year. And lastly, we continue to expect that at least 60,000 people will join our company in FY14.

Turning to our ongoing objective to return cash to shareholders... In the second quarter, we repurchased or redeemed approximately 9.2 million shares for \$739 million at an average price of \$80.40 per share. Year-to-date, we have purchased 18.9 million shares for approximately \$1.5 billion at an average price of \$77.25 per share. At February 28, we had approximately \$5.8 billion of share repurchase authority remaining.

As Pierre mentioned, our Board of Directors declared a dividend of \$0.93 per share, representing a 15% increase over the dividend we paid in May last year, and this dividend will be paid on May 15, 2014.

So in summary, with the first half of the year behind us, we're generally where we expected to be at this point in time. We see definite signs of building momentum in the market and in many areas of our business, yet the environment continues to be challenging and we're focused on what we need to do to deliver the year.

Our focus, as always, is to leverage our strong position in the marketplace to capture the growth potential we see and to proactively manage the operations of our business to maximize profit, cash generation and our overall return to our shareholders. With that, let me turn it back to Pierre.

Pierre Nanterme - Accenture - Chairman and CEO

Thank you, David. At Accenture, we're extremely focused on executing our growth strategy. And our record new bookings for the second quarter and for the first half of the year demonstrate that our services remain highly differentiated and are clearly resonating with the needs of our clients. One of the things that truly sets Accenture apart is that we combine our capabilities across consulting, digital, technology and business process outsourcing to deliver tangible results for our clients. Let me bring this to life with some key wins in the second quarter.

We were selected by a global communications equipment company to provide HR, IT and Finance & Accounting services as part of a multi-year business transformation that is expected to deliver cost savings of more than \$1 billion. We signed a long-term agreement with Monte dei Paschi di Siena, a large Italian bank, to provide finance and accounting, administration and other back-office services as part of a strategic restructuring plan to enhance the bank's competitiveness in the marketplace.

We were also selected by a high-tech leader in security systems to support the company's transformation across more than 90 countries. We will provide HR, Finance & Accounting and Procurement services, leveraging our recent Procurian acquisition to reduce costs and improve operational efficiency.

And I am personally very pleased that a few weeks ago we announced a unique new business model with SAP that we believe is a true game-changer in the industry. Through the newly formed Accenture and SAP Business Solutions Group, which includes dedicated experts from both companies, we will jointly develop integrated, industry-specific, cloud-based solutions.

Our broad industry and technology capabilities have enabled us to build long and enduring client relationships with the world's leading companies. We continue to operate at the heart of our clients' businesses, especially when it comes to executing large-scale, mission-critical programs that deliver tangible outcomes.

For Schneider Electric, we designed, implemented and deployed a Salesforce.com solution to more than 26,000 users in 100 countries, the largest Salesforce implementation in Europe. The new cloud-based solution has already delivered value by increasing cross-selling and account coverage by 20%.



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For Endesa, one of the world's largest electric power companies, we are supporting the roll-out of more than 13 million smart meters in Spain. Through a multi-year business process outsourcing agreement, we are facilitating the expansion of smart metering operations and integrating existing billing systems and business processes. And for a global pharmaceutical company, we are arming sales reps with a variety of digital technologies across tablets, smartphones and PCs, to deliver a personalized user experience to doctors in more than 200 countries. This new digital promotion and sales program has already delivered \$15 million in savings.

Turning now to the geographic dimension of our business... In the Americas, we grew revenues 4% in local currency, which is consistent with Q1. Growth was driven by the United States, and we are pleased that our business in Brazil is starting to turn the corner. In EMEA, revenues were flat in local currency compared to the second quarter last year. We are starting to see good pickup in growth in important countries such as Switzerland, the UK, Italy, Germany and France. And in Asia-Pacific, we grew revenues 4% in local currency, driven by continued strong growth in Japan.

Before I close, I want to share something I'm personally very proud of. You have often heard me speak about our Diamond Clients, which are our largest client relationships, and increasing the number of Diamond Clients is clearly a priority for us to drive more growth. I am pleased that we added 16 new Diamond Clients in the first half of the fiscal year, which brings us to a net total of 138 Diamond Clients, an all-time high.

Before I hand back to David, I want to comment on the global economic environment which, frankly, continues to be challenging, especially in the emerging markets. As you would expect, we are carefully monitoring the recent geopolitical developments in Eastern Europe, which are introducing an additional level of uncertainty in the marketplace. That said, given our strong bookings year-to-date and the level of activity we are seeing, I continue to feel confident that we are well-positioned to drive more growth in the second half of the year. With that, I will turn it back to David, who will provide our business outlook for Q3 and the full fiscal year.

David Rowland - Accenture - CFO

Thanks, Pierre. Let me now turn to our business outlook and let me start by saying, based on where we are for the first half of the year, we've updated most of the metrics in our business outlook.

For the third quarter of FY14, we expect revenues to be in the range of \$7.4 billion to \$7.65 billion. This assumes the impact of FX will be flat compared to the third quarter of FY13. For the full FY14, based upon how the rates have been trending over the last few weeks, we continue to assume the impact of FX on our results in US dollars will be negative 0.5% compared to FY13.

With strong bookings in the first half of the year, balanced with 3% revenue growth year to date, we now expect net revenue for the full FY14 to be in the range of 3% to 6% growth in local currency. For the full FY14, we now expect new bookings to be in the range of \$33 billion to \$36 billion.

For operating margin, we continue to expect FY14 to be in the range of 14.3% to 14.5%, a 10 to 30 basis-point expansion over adjusted FY13 results. We now expect our annual effective tax rate to be in the range of 25.5% to 26.5%. For earnings per share, we now expect full-year diluted EPS for FY14 to be in the range of \$4.50 to \$4.62, or 7% to 10% growth over adjusted FY13 results.

Turning to cash flow. We now expect operating cash flow to be in the range of \$3.3 billion to \$3.6 billion, with property and equipment additions remaining at approximately \$400 million, and free cash flow now in the range of \$2.9 billion to \$3.2 billion. We've lowered our cash flow guidance to reflect our updated assumption that we will accrue lower variable compensation due to higher current-year operational spending as compared to what we assumed in our original guidance range.

Finally, we continue to expect to return at least \$3.7 billion through dividends and share repurchases, and also now expect to reduce the weighted average diluted shares outstanding by approximately 3%, as we remain committed to returning a substantial portion of cash to our shareholders.

With that, let's open it up so that we can take your questions. KC?

KC McClure - Accenture - Managing Director IR

Thanks, David. I would ask that you each keep to one question and a follow-up to allow as many participants as possible to ask a question. Tom, would you provide instructions for those on the call, please?



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QUESTION AND ANSWER

Operator

(Operator Instructions)

Tien-Tsin Huang, JPMorgan.

Tien-Tsin Huang - JPMorgan Securities - Analyst

I want to first ask on the comment that you made on contract productivity and pricing pressure, can you elaborate there? Sounds like you're unable to pass along higher payroll costs or maybe you're seeing outright pricing pressure, can you just elaborate, and in what areas? Thanks.

David Rowland - Accenture - CFO

Yes I would say, Tien-Tsin, by the way, hello, good to talk to you this morning, I would say that the dial is probably turned up a little bit since last quarter in terms of the pricing environment, and there's a couple of factors that are worth noting. One is that the ongoing trend in vendor consolidation is influencing the pricing environment. And then secondly, we have seen more pricing pressure, if you will, in certain areas, and in particular in the application services area, where the environment... competitive characteristics are such that price is becoming very prominent in the bidding process. So that's what we see on the pricing front.

We also have seen some pricing pressures on our existing book of business, and what that means specifically, as you alluded to, is we're a little further behind where we had expected to be in terms of being able to pass cost rates through on our existing contracts. And so those are the two dynamics that we saw in our second-quarter results.

Tien-Tsin Huang - JPMorgan Securities - Analyst

Understood, makes sense. My follow-up then, obviously the bookings were very strong, high book-to-bills in Consulting which is great. Curious though on the revenue productivity or the revenue production, that came in the middle of guidance after beating the last couple of quarters, if I'm remembering that correctly. So what are the biggest factors that changed in terms of revenue production this quarter?

David Rowland - Accenture - CFO

Well, I would -- by the way, I think last quarter we were at the upper end of the range. But I think one factor clearly is what we just talked about, is the pricing both on new work and existing work, and then how that ultimately impacts the conversion to revenue. We do see a situation in Consulting, in particular, where from a volume standpoint we're actually seeing very strong growth. And in fact, I would say that our volume growth is where we expected, if not better. The pricing environment is impacting that such that we're getting the net result in our revenue growth in Consulting, in particular.

Tien-Tsin Huang - JPMorgan Securities - Analyst

That's helpful. I appreciate it.

Operator

Joseph Foresi, Janney.



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Joseph Foresi - Janney Montgomery Scott - Analyst

Going back to pricing, could you help us reconcile -- usually pricing competition is an indication of either a slowdown or a maturity, yet the bookings are really strong. Can you help us reconcile those two pieces?

David Rowland - Accenture - CFO

Well, let me make a comment and Pierre may have a few comments as well. I would say in this case, to the contrary. The environment is actually quite strong. We feel very good about our pipeline, even with the conversion of such a large portion of our pipeline to bookings last quarter. So the level of client discussions that are taking place and clients' willingness to contract work is actually quite strong.

Having said that, if there is a common theme, and we've talked about this for several quarters now, clients are by and large focused on cost optimization. I think that is a trend that we see almost in every industry and every market around the world. And so clients are moving forward, driving the business forward, looking at investments that they need to make, but they're doing it with an eye towards being very cost-conscious in the contracting investments they're making in their business.

Pierre Nanterme - Accenture - Chairman and CEO

Without piling on David, this is exactly right, we see demand in the marketplace definitely reflecting with our very strong bookings both in Consulting and Outsourcing and we have excellent win rates as well. So the main issue, and we're working on it, or challenge if you will more than an issue, because we're working on it, is more in application services. This business is highly competitive and clients continue to be very mindful, thoughtful, good negotiators with procurement, and so it's putting some very specific pressure in that part of the business.

Now that being said, we have other parts of the business, and I'm thinking about Digital for instance and Consulting, where the price is stable or even we can increase the price. So it's always the same pattern, if you will. When you can differentiate and provide differentiated innovative solutions, you can keep your price stable or even improve your price. But in the markets which are more like application services, less around innovation, if you will, even if we are working hard on it to differentiate, there is some price pressure because the competition is quite intense.

David Rowland - Accenture - CFO

And I'll, without piling on, there's probably one other nugget which is worth noting, is that the success that we've had with the larger transformational deals, we've actually seen very stable pricing on those large contracts that as a portfolio has met our expectations. We have seen, as I called out in my prepared comments, that on many of these contracts, the way they are structured, the profitability is a little lower in the earlier term of the contract. But overall, the pricing for these larger contracts where we are highly differentiated has held up very well as well.

Joseph Foresi - Janney Montgomery Scott - Analyst

Okay, that's helpful. And then my follow-up, obviously guidance is backend-loaded in your fiscal year. Maybe you could give us some color as to where the confidence is coming from that that's going to be the progression throughout the year. Obviously, the bookings are strong but we've seen quarters in the past where there's been a slower conversion rate of those bookings. So are these large deals that are going to hit in the back half of the year, how should we think about the ramp?

David Rowland - Accenture - CFO

I think there's probably four things I would call out. The first thing I would say is that first of all, we've got the foundation generally that we expected to be at the halfway point, and so there's no real surprises from that perspective. And the second thing is the fact that we do have strong -- very strong bookings and in fact, if you look at the bookings we've had over the last two quarters, it is as strong as any two-quarter period we've ever had.

The third thing I would say is that, the three themes that we called out last quarter, which you may remember, we talked about the impact that the transformational deals that we've sold over the last several quarters, the revenue ramp that we see in those contracts. We talked about the investment that we have made in business services and how that would begin to impact our revenue in the second half of the year. And then we also talked about the return that we would get from the investment that we



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have made in several acquisitions and the impact that that would have. Excuse me, I actually have a frog in my throat. But those are the main things I would call out in terms of the reasons for our confidence in the back half of the year.

Joseph Foresi - Janney Montgomery Scott - Analyst

Thank you.

Pierre Nanterme - Accenture - Chairman and CEO

Sorry for the frog, David. Hopefully, nothing to do with the French...

Joseph Foresi - Janney Montgomery Scott - Analyst

Water could probably help right there.

Pierre Nanterme - Accenture - Chairman and CEO

Yes, yes, nothing personal between David and -- (laughter). But, no you're exactly right, I think we feel confident with the second part of the year, exactly, that we are where we expected to be. And the large scale transformation programs, together with the return on the investments we are making, and good pipeline, good book-to-bill, and good contracted revenues as well. If you combine all of these factors, they represent a strong basis for confidence for the second part of the year.

Joseph Foresi - Janney Montgomery Scott - Analyst

Thank you.

Operator

Keith Bachman, Bank of Montreal.

Keith Bachman - BMO Capital Markets - Analyst

Hi, I had two questions also, if I could. The first is on the Consulting side. Your book-to-bill was very strong this quarter. If I look back over the last six or plus quarters it's been over 1, yet it hasn't translated into positive revenue growth. So in the February quarter it was a relatively easy compare, it still came in zero. Could you comment on how you see the growth over the next couple quarters in Consulting specifically, please?

David Rowland - Accenture - CFO

Yes. For the full year, we still see Consulting being flattish to low single-digit positive. With our Outsourcing, by the way, being mid to high single-digit positive. So our view of Consulting really hasn't changed from where it was when we started the year. Again, a little bit of connecting the dots between the bookings and the translation to revenue is, what I referenced earlier, is that we actually are seeing quite a bit of growth from a volume standpoint.

What we've seen is in the application services area, especially, is that we've seen a higher ramp-up or a reacceleration, if you will, in using our Global Delivery Network. And so we have, if you looked at the work that we're delivering to our clients in volume terms in Consulting overall, it's actually up quite nicely. But again, we've got the dynamic of the revenue yield per hour as we're using our GDN capability at a higher level compared to the same periods last year.

This is a dynamic that we've seen before. It's part of the ebb and flow of our business. We've managed through it before and we're in the process of managing through it now.



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Keith Bachman - *BMO Capital Markets - Analyst*

Okay. Well, then my follow-up relates to the cash flow. You mentioned that cash flow guidance is coming down. I think you said because of lower variable comp, but also higher operational investments. And I was wondering if you could elaborate on what those operational investments are? Thank you.

David Rowland - *Accenture - CFO*

Yes. To be clear, it was not operational investments, it was operational spending. So if you think about it -- so we started the year with an assumption in our cash flow guidance for what our accrued variable comp would be. As that -- as our assumption has come down for the year on that now, by about \$300 million, that assumption for accrued variable comp has been replaced by operational spending, if you will, that has cash out the door as compared to the accrued variable comp which has no cash out the door this year, would have cash out the door next year. And so that dynamic is what has impacted our cash flow, which you could say is as much as anything else a timing issue, because to the extent it has an unfavorable impact on us this year, it will have a favorable impact next year if the scenario plays out, because we would obviously have less cash out the door next year.

Keith Bachman - *BMO Capital Markets - Analyst*

But David, what are those operational investments incremental?

David Rowland - *Accenture - CFO*

It would primarily be higher base payroll, as an example. With the volume growth -- in fact, as you look at our headcount statistics, you'll see that our headcount growth over the last couple of quarters has been meaningful, and so we have more heads, more payroll, base pay comp.

We also have slightly lower utilization on the margin as we've been building bench in certain areas in anticipation of revenue ramping. And so all of those dynamics come into play.

Keith Bachman - *BMO Capital Markets - Analyst*

Fair enough. Thank you.

Operator

Jason Kupferberg, Jefferies.

Jason Kupferberg - *Jefferies & Company - Analyst*

I want to get your views on this pricing and mix shift to offshore, as far as how much of this you think is structural and a new normal going forward. I know you're obviously talking about the application services piece, or do you see this as being more of a one-off?

Pierre Nanterme - *Accenture - Chairman and CEO*

Yes, both, if you will. I think what we've seen is there is a structural shift, if you will, from offshore -- onshore to offshore, especially in application services, that's something at Accenture we embraced a long time ago and we have, every year, more resources offshore participating to the application services and that will not change. We will continue to hire in our Global Delivery Network and we will continue to try to find the right mix between the offshore and the onshore. So this thing is more like, if you will, a secular trend.

Now, for all the reasons mentioned by David, at some point in time different factors are combining and impacting our pricing situation. We mentioned some renegotiations in the context of vendor consolidation. It has happened more in this quarter than other quarters.

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David mentioned that when you're selling large-scale transformation programs, typically the first years from a pricing standpoint are more dilutive in terms of margin and then you're recovering at the back end of the program. So I think we had a combination of factors in Q2 that has put pressure on the pricing. But the offshoring trend, this one is no change and is structural.

Jason Kupferberg - Jefferies & Company - Analyst

Okay. And then for my follow-up, coming back to the point on reducing the accrued comp by \$300 million or so this year, can you give us a sense of what percent cut in the total accrued comp is the \$300 million? And then do you have any concerns about the downstream impacts on attrition potentially?

David Rowland - Accenture - CFO

Yes, and it is important to have a little bit of context on this, so that it is not misinterpreted. The first thing I would say is that this particular program that we are referencing is one program as part of a much bigger set of variable comp programs that we have in the firm. And if you look at our variable comp accruals overall, as I've said in my prepared remarks, we accrued a significant amount of variable compensation.

In this one particular program, which is targeted at our Managers and above, it's not the only variable program targeted at them, but for this one program that is targeted to the Managers and above, where the determination of what we accrue in a quarter is based on a formula tied to specific financial metrics, in this particular program we have accrued less. And for the full year we expect that it could be in the \$300 million range, based on our current scenarios, although we are working hard in the back half of the year to improve that.

But you have to look at that \$300 million in the context of a payroll structure that is roughly \$20 billion overall. So it's meaningful in the context of our cash flow guidance, which is why we called it out so that you could understand the change to cash flow. In the context of our overall payroll structure it's \$300 million on a total base of roughly \$20 billion.

Jason Kupferberg - Jefferies & Company - Analyst

Right. But the vast majority of the \$20 billion is just base pay, right?

David Rowland - Accenture - CFO

Well, vast majority would be a true statement. We do have significant variable comp in our plan, but it would be true to say that more of the comp is fixed than variable.

Pierre Nanterme - Accenture - Chairman and CEO

And so, to answer your second question, whether we are concerned or not. I'm not pleased, but I'm not concerned. I'm not pleased because it's always better to accrue all the variable comp you could.

Now I'm not concerned because, first, it's mid-year, and I guess we have time to recover in the second part of the year, especially as we see the business shaping for the second part of the year. As David mentioned, this piece is more targeted to our executives and leaders, so I'm taking that as a strong incentive for them to perform in the second part of the year so they will receive their variable comp.

Jason Kupferberg - Jefferies & Company - Analyst

Very good. All right, thank you for the comments.



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Operator

Edward Caso, Wells Fargo.

Edward Caso - Wells Fargo Securities - Analyst

Can you talk a little bit about Accenture Digital Services? You didn't really mention that, I was sort of surprised.

Pierre Nanterme - Accenture - Chairman and CEO

Couldn't be more pleased with Accenture Digital, and you're right, probably -- thanks a lot for your question because we -- of course, we had to explain the part of the business where we have either, not issues but challenges, or things where we wanted to be very transparent with you and talk about where we are. Now the vast majority of our business is doing just extremely well. That's why I wanted to share with you a couple of programs including what we are doing for this pharmaceutical company, which is quite a large-scale digital business.

So we set up Accenture Digital January 1. In Accenture Digital we have now 23,000 people plus, so we have probably established in January one of the largest digital organizations in the world. We're combining all that is related to digital marketing with Accenture Interactive, Accenture Mobility around mobility, and Accenture Analytics, and we're very pleased with the results of this unit, which has continued to grow, I would say, with strong double-digits. So very pleased, the level of demand is extremely high.

But more important, I truly believe that Accenture is differentiated in the marketplace. We are more end-to-end than anyone else in digital marketing. Our mobility organization is just on fire. And as you know, there is great demand for analytics. And of course, through the creation of Accenture Digital, we have the unique ability now to create synergies among these three capabilities and be even more end-to-end. So, extremely pleased with Digital.

Edward Caso - Wells Fargo Securities - Analyst

Can you break out the components of the Health & Public Services, the health,-- the European government, the US government, give us a sense where strengths and weaknesses are?

Pierre Nanterme - Accenture - Chairman and CEO

Let me start, because indeed in HPS you have the H and the PS. We have commented a lot on Health which continues to be an industry where we are very pleased, we are very proud. We made a significant investment three years ago and now we're getting a strong return. If you're looking on a year-to-date basis, it's one of the industries where we're still growing double-digits, so it's part of our top-performing, especially in the US but as well in other parts of the world, in Asia-Pacific, to name a few.

PS is indeed a different story, and it has been these last years. We continue to be very pleased with what we're doing in the public sector, probably more from a US standpoint. Europe continues to be a challenge due to public sector spending, which is probably not big new news.

Edward Caso - Wells Fargo Securities - Analyst

Great. Thank you.

Operator

James Friedman, SIG.



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James Friedman - SIG - Analyst

Pierre, could you elaborate on your comments regarding Brazil and share some context for that?

Pierre Nanterme - Accenture - Chairman and CEO

Yes, of course. Probably exactly a year ago, we were taken by surprise, to be honest, with what happened in Brazil. Brazil has been performing extremely well for years at Accenture. We made the right investments. We had the right leadership and it's still a country where we probably have one of the highest market shares at Accenture. So all of this is not gone.

But indeed, 12 months ago, we probably didn't anticipate what happened in Brazil from an economic standpoint, from a geopolitical standpoint, and indeed Brazil didn't deliver what we expected. We've been working with the leadership of Accenture and the leadership of Brazil very hard these last four quarters to reposition Brazil for new growth. And I'm pleased to report that indeed in Q2 we feel that we are turning the corner, with Brazil coming back flat and hopefully positive for the remainder of the year. This is what I meant by turning the corner. So we've worked hard for four quarters and I guess Brazil will be back with growth.

James Friedman - SIG - Analyst

Thank you. I appreciate the context.

Operator

Bryan Keane, Deutsche Bank.

Bryan Keane - Deutsche Bank - Analyst

A couple of follow-ups. On the application services area, I'm wondering why now? I would have thought the move from onshore to offshore has already happened, so why in that particular area is it happening, and kind of surprising?

Pierre Nanterme - Accenture - Chairman and CEO

This market is -- it's a very large market if you look at application services, it's probably one of the largest IT markets in the world. So it's a market that's going to remain extremely competitive for a long time. You have many providers, all extremely competitive and they all want to grow, they all want to take market share, including us. So I don't think it's the end of the prior era, if you will, it's just a continuation of what's happening.

And you see many of our competitors, of course you have the Indian pure players, who are already very offshore-centric, if you will, but many of our more classic competitors are accelerating the move to offshore as well. And what we see, which might be, let's put that in the new new, is Europe is moving now offshore in a more robust way. So if you look at these offshoring waves, first the US, probably 10 years ago, then they moved toward what I like to call the Anglo-Saxon corridor, whatever that means to you. The US, UK, Nordic, probably all the countries not speaking the same language as mine. And here you have, for all sorts of reasons, earlier offshoring pick-up.

Now, and I'm taking this as good news for Accenture, Continental Europe, and I'm thinking about Germany, France, Italy, Spain, we see this offshoring picking up. So it's good news for us, because we've been able to leverage our Global Delivery Network, but it's creating a very competitive market as well in these four or five countries I mentioned.

Bryan Keane - Deutsche Bank - Analyst

And the pricing and cost pressures, I assume it's going to continue for the back half of the year, what are the offsets you guys are planning to do so you can still grow margin?



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David Rowland - Accenture - CFO

Well, we are working -- in the areas where the environment is more competitive, first of all, we're working very hard on aligning the cost to serve or our delivery cost with the pricing realities, and that is ongoing. The second thing we're doing is that we are managing all of the levers of our payroll structure, which we always do, but let's say we're doing it with an even higher level of intensity to make sure that we optimize the efficiency of our payroll structure against the revenue profile that we see.

We're also focused, as you would expect, on discretionary elements of our operating expenses. And then we continue our journey in terms of our focus on our infrastructure cost and our business management function cost, if you will. And so none of those things are new.

As I said, we go through periods like this. This is a normal ebb and flow in our business and so the actions that were taken, there aren't new bullets in the gun. We're doing the things we always do to manage and optimize our profitability as the business ebbs and flows. And we feel good about the actions we have on the table.

Pierre Nanterme - Accenture - Chairman and CEO

Yes and at the end of the day, again, we feel confident in our ability to grow our revenues more in the second half of the year, based on very clear facts. And as we will ramp up our organic growth in the second part of the year, we will be able to absorb more cost.

Bryan Keane - Deutsche Bank - Analyst

Okay, very helpful. Last question for me. David, you said you're not expecting much improvement, it doesn't sound like, in the constant-currency Consulting growth rate. I guess with the bookings being where they are, they've been stronger, what's preventing that increase or acceleration in the Consulting side?

David Rowland - Accenture - CFO

Yes, flat to low single-digit positive. And again, I don't want to be redundant with what I'd said earlier, but one of the things we're navigating right now in the Consulting growth equation is this -- is the acceleration, if you will, of higher utilization of GDN for application services. But yet we see very strong growth in Digital. We see growth in other areas of our Consulting business as well. But the mix of all of that together is what leads us to the flat to low single-digit positive.

Bryan Keane - Deutsche Bank - Analyst

Okay, I got you. Thanks so much.

Operator

Katy Huberty, Morgan Stanley.

Katy Huberty - Morgan Stanley - Analyst

Any update on the average deal compression you're seeing in SaaS deals? Is that where you're seeing any of the pricing pressure? And then progress on driving new partnerships, like the expanded SAP relationship you talked about, in order to offset that impact from SaaS?

Pierre Nanterme - Accenture - Chairman and CEO

Yes, I'm going to take that one and I'm very pleased to answer it, and very excited with what we are doing. If you look at the Consulting market, the ERP market, the digital market, yes, this software, or this as-a-service world is evolving and is evolving quite rapidly. As you've seen, for instance, we are very pleased with the business we're doing with Salesforce.com.

I highlighted one of the largest European implementations of Salesforce, that we did with Schneider Electric. So very pleased with the progress we are making on the software as a service.



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We are investing, especially in the context of Accenture Digital but as well in the context of our cloud activities, to be much more relevant on this, and we are looking at critical partnerships to continue being differentiated in the marketplace. I absolutely wanted to signal what we are doing with SAP, with this Accenture and SAP Business Solutions Group, where indeed we're going to co-invest with SAP in quite a meaningful way to create very industry-specific and cloud-based and SaaS-delivered solutions. And we believe it's a true game-changer. So I'm very excited with that and what we are doing is very – is so far unique in the marketplace.

Katy Huberty - Morgan Stanley - Analyst

And the average deal compression, is that still in the 15% to 20% range for SaaS deals?

Pierre Nanterme - Accenture - Chairman and CEO

Yes, on the SI, on the pure SI side, you're right, we are monitoring that very carefully. So if you look at the -- when you look at a program, you have the specification, you have the design, you have the change management, you have the integration, you have the testing and you have the integration in the company. The systems integration piece, which is part of this overall program, yes we've seen this [15% to 25%] [corrected] less effort.

What we've seen as well in these large programs on SaaS, a significant level of reinvestment of the savings in the other part of the programs. So all in all, as David mentioned, it's interesting to see that from a volume standpoint the business is going up and is not going down. Now, we need to manage indeed the question around the pricing relative to the offshoring.

And it's not a volume issue, it's more, as in this program we have a higher level of offshore, it's putting some pressure on the pricing. So it's not a volume issue. It's how you're managing the new economics, if you will, and I'm extremely comfortable that we will manage that very well.

Katy Huberty - Morgan Stanley - Analyst

Got it, and then a follow-up on bookings. As you know, you enjoyed strong bookings growth in 2012 that didn't convert to the same strong revenue growth last year. What's different about the recent double-digit bookings growth? Is contract duration changing or something else impacting your confidence that we'll see the revenue conversion this time around?

David Rowland - Accenture - CFO

Well, again, I think what is different when you look at where we are this year to last year, is that last year we were in a situation that we expected a broad uptick in the market that did not materialize. This year, we're not expecting any change in market conditions. Last year, we had some concentrated areas of weakness that as Pierre said, using Brazil as an example, which were unexpected.

But it wasn't just Brazil, there were a few other areas where we had had concentrated areas of weakness. We don't see that this year, and in fact the areas where we had concentrated weakness have generally improved.

The third thing that we had last year is that we did have several large contracts that were winding down where we had an assumption of our ability to replace those revenue streams and then grow on top of it that did not happen as expected. This year, in the back half of the year, we don't have that same dynamic. And that actually benefits probably four of our five operating groups as they turn to the second half of the year.

And then again, this year we've got, we believe, more line of sight to sources of incremental revenue. And so we have our eyes focused on the things that we have to do to deliver this uptick in revenue that we see. But we do think the circumstances as we see it are different than they were last year.

Katy Huberty - Morgan Stanley - Analyst

Okay. That's very helpful, David. Thanks.



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Operator

Darrin Peller, Barclays.

Darrin Peller - Barclays Capital - Analyst

To follow up on that question around the book-to-bill timing. Is there a difference in percentage of what's actually contract renewals here versus new business? And in terms of the size of these contracts and how long they really take to accrue to revenue, for the outsourcing side given just how strong the growth has been there, can you give us a little more color on the characteristics and the profile of those contracts today versus maybe what they used to look like a couple years back in terms of size as well as, again, how long you'd expect that to turn into revenue?

David Rowland - Accenture - CFO

I guess if I just talk specifically about this quarter, every quarter is different and any single quarter doesn't necessarily indicate a trend. But if I just look at this quarter as an example, we did have several very large contracts. And if you look at the average size of these large contracts on balance, they're higher than what we've seen, let's say over the last four to five to six quarters. And because of that, the duration of those contracts, the contract term in this particular quarter has ticked up a little bit.

But again, I don't know that I would -- well, I do know that I would not declare that a trend. I mean this -- the composition of next quarter's bookings, mega bookings will probably be a little bit different. But for this quarter, we did see the average deal size go up and we saw the duration lengthen and that does have, for the contracts we signed, does have a dynamic in terms of how those convert to revenue with longer duration contracts.

Pierre Nanterme - Accenture - Chairman and CEO

It is interesting to see, if you look at 2013 and now the beginning of 2014, that indeed we've seen the average for Accenture and probably because of our positioning, successful positioning in transformation and mission-critical programs, that the size of the deals has been going up and the duration as well is a little bit longer. And it's of course giving us -- the positive is giving us more visibility in our business on a long-term basis. And of course we are monitoring carefully, as you might imagine, the rate of conversion from bookings to revenue. From a visibility standpoint, we couldn't be more pleased that with our level of bookings and the size of the deals and again, you mentioned, David, we had 10 transactions over \$100 million this quarter, and if you add Q1 and Q2 I guess we should be around 24. If you compare -- which is a very big number. If you contrast to last year at the same period of time, we were I guess around 21. So slightly higher. But it's the demonstration that if you take 2013 and 2014, we are in the 20-plus, if you will, transactions over \$100 million, which is for me the confirmation of our positioning in terms of large-scale transformation and that we are highly differentiated in that segment.

Darrin Peller - Barclays Capital - Analyst

All right, no that is positive. And it's not like we're seeing more renewals as a percentage of the mix than prior years, right?

David Rowland - Accenture - CFO

There's not anything notable in that regard.

Darrin Peller - Barclays Capital - Analyst

Okay, all right. One quick follow-up, on the organic -- if you look at the quarter, what actually was the organic revenue growth rate versus -- I noticed there were a couple of small tuck-ins, but --

David Rowland - Accenture - CFO

We -- as we shared before, we're really not going to get into specifics on the organic and inorganic, because again, our inorganic is really an engine for organic growth. And these businesses, really within the first year, in most cases, become indistinguishable from our organic business, because they get integrated very rapidly. And



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Procurian would be the latest example of that where we will quickly -- are in the process of quickly integrating it with our existing procurement business and it's hard to tell one from the other.

Darrin Peller - Barclays Capital - Analyst

Got it. All right, thanks, guys.

KC McClure - Accenture - Managing Director IR

Tom, we have time for one more question, then Pierre will wrap up the call.

Operator

Ashwin Shirvaikar, Citi.

Ashwin Shirvaikar - Citigroup - Analyst

So I guess the question I had was with regards to the ramping of the app services business. Most of your competitors operate their GDN at a higher level of profitability. My understanding is that you guys had normalized the cost equation there.

So I'm trying to bridge the disconnect between app services growing and your comments on profitability. How much of that is related to, Pierre, your comments that it was in the five countries that you mentioned, which might have tougher labor laws, and what's the time frame then?

David Rowland - Accenture - CFO

What I would say is that our cost rates -- our GDN cost rates are extremely market-competitive. And so, we don't segment our profitability by application services versus BPO versus Digital, et cetera. But I think, Ashwin, just to maybe correct a misperception that you might have, our GDN cost structure is very competitive which is why we are able to compete very effectively in the application services space. So that we should be clear on.

Ashwin Shirvaikar - Citigroup - Analyst

That part I was clear on. I was asking more -- not -- less about cost structure, more about the profitability. But we could take that offline. My quick follow-up on a different segment or a different area is do you expect the relationship between your net income and conversion to cash flow to be different than before, not just this year, but going forward?

David Rowland - Accenture - CFO

Well, Ashwin, what I would say is that all of the factors that have made us a strong cash flow generation business, those factors remain intact. We have a relatively capital-light business. We are very good at managing our billing and collections.

And as you know, we're focused on growing our business, gaining market share, and having modest margin expansion. And when you look at all of those things, we have to deliver on all those things. But if we do, fundamentally the structure that allows us to generate cash flow going forward should not be different than what it's been in the past.

Ashwin Shirvaikar - Citigroup - Analyst

The 1 to 1.2 times is a good --



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David Rowland - Accenture - CFO

I didn't say 1.2 times. I said that if you look at -- if you think about what would represent a strong cash flow generation, really, cash flow equal to net income would be indicative of a very healthy company. And we expect to be a very healthy company.

Ashwin Shirvaikar - Citigroup - Analyst

Got it.

Pierre Nanterme - Accenture - Chairman and CEO

It's five past, thanks a lot for staying with us. I'm taking this as a strong confidence you're putting in Accenture and a strong interest in our company, so thanks again for joining us on today's call.

With the first half of the year behind us, frankly I feel very confident that we are well-positioned to deliver our business outlook for the year, and of course the updated business outlook David mentioned. We continue to execute a strategy that I believe is differentiating us in the marketplace, with the opportunity to strengthen our leadership position in large-scale transformation programs ... we talked a lot about it ... in digitally-enabled solutions, a very strong market for us, and in new and innovative business services. At the same time, we have a relentless focus on developing the skills and capabilities of our talented men and women around the world, more than 289,000 people around the world, so we can deliver the best of Accenture every day and everywhere in the world.

We look forward to talking with you again next quarter. In the meantime, if you have any questions, please feel free to call KC. Thanks a lot for paying attention to us. All the best.

Operator

Ladies and gentlemen, this conference will be available for replay starting at 10:30 AM this morning and running through June 26 at midnight. You may access the AT&T Executive Playback service at any time by dialing 1-800-475-6701 and entering the access code of 320421. International participants may dial 320-365-3844.

Those numbers again are 800-475-6701. International participants dial 320-365-3844 and again, the access code is 320421. And that does conclude our conference for today. We thank you for your participation and using the AT&T Executive Teleconference. You may now disconnect.

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