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ACN – ACCENTURE’S Q3 FISCAL 2014 EARNINGS
CONFERENCE CALL

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Accenture's Q3 FY '14 Earnings Conference Call

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Bryan Keane *Deutsche Bank - Analyst*

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Accenture third-quarter FY14 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. I would now like to turn the conference over to our host, Ms. KC McClure, Managing Director of Investor Relations. Please go ahead.

KC McClure - Accenture - Managing Director of IR

Thank you, Katie. And thanks everyone for joining us today on our third-quarter FY14 earnings announcement. As Katie 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 take you through the financial details, including the income statement and balance sheet, along with some key operational metrics for the third quarter. Pierre will then provide a brief update on our market positioning. David will then provide our business outlook for the fourth 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 are talking about revenues before reimbursements, or net revenues. Some of the matters we will discuss on this call, including our business outlook, are forward-looking and as such are subject to known and unknown risks and uncertainties, including but not limited to those factors set forth in today's news release and discussed in our annual report on Form 10-K and quarterly reports on Form 10-Q and other SEC filings. These risks and uncertainties could cause actual results to differ materially from those expressed in this call.



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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 Q3 of last year, our results included benefits from 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 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 & CEO

Thank you, KC, and thanks everyone for joining us today.

We are very pleased with our financial results for the third quarter. We generated strong revenue growth and earnings per share, grew operating income, returned substantial cash to our shareholders, and delivered another quarter of very strong new bookings.

Here are a few highlights:

- New bookings were \$8.8 billion, bringing us to \$27.6 billion for the first three quarters of the year.
- We generated revenues of \$7.7 billion, a 7% increase and above our guiding range.
- We delivered earnings per share of \$1.26, up 11% from adjusted EPS in the third quarter last year.
- Operating margin was 15.2%, consistent with the third quarter last year.
- We generated solid free cash flow and our balance sheet remains very strong, ending the quarter with a cash balance of \$4 billion.
- We returned approximately \$1.1 billion in cash to shareholders through share repurchases and dividends.

With Q3 behind us, the second half of the year is shaping up as expected, with stronger revenue growth, and we are well-positioned to continue the momentum into the fourth quarter.

Now let me hand over to David who will review the numbers for the quarter in greater detail. David, over to you.

David Rowland - Accenture - CFO

Thank you, Pierre, and thanks all of you for joining us today.

As I review the results on this morning's call, you'll see that we delivered very good results in the third quarter, highlighted by a significant uptick in net revenues, with growth of 7% in local currency.

Net revenues were higher than expected, well above the top end of our guidance range, and driven by improved growth rates across essentially every dimension of our business, meaning the majority of our operating groups, the three geographic regions, and in both Consulting and Outsourcing. The higher revenue growth was underpinned by yet another strong new bookings quarter, which is indicative of the high degree of relevance our offerings and capabilities have in the marketplace.

We delivered double-digit EPS growth, and while our focus on pricing and overall cost efficiency is ongoing, our third quarter reflects progress with the challenges highlighted last quarter. We generated strong cash flow, and of course, we continued to return a substantial portion of cash to shareholders. So we're very pleased with the quarter.

With that, let's get to the numbers, starting with new bookings. New bookings for the quarter were strong at \$8.8 billion. Consulting bookings were \$4.3 billion with a book-to-bill of 1.1. Outsourcing bookings were \$4.5 billion with a book-to-bill of 1.2. Year-to-date bookings were \$27.6 billion, reflecting 12% growth in local currency.



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Taking a closer look at our new bookings, there are several additional points that are worth noting. Coming off record bookings last quarter, Consulting bookings continue to reflect healthy demand for both Systems Integration and Technology Consulting. Additionally, Management Consulting bookings were solid and within our target book-to-bill range.

We were also pleased with another quarter of solid Outsourcing bookings, which included an uptick in Technology Outsourcing from the second quarter, driven by higher demand for Application Outsourcing. Strong demand for our BPO services continued, driven by Finance & Accounting and Procurement offerings, even after the extremely strong record BPO bookings we had in quarter two.

From an operating group perspective, CMT and Products were key drivers of our strong bookings performance, which positions both for continued strong growth rates. Finally, we continue to be the partner of choice on complex transformational projects, with seven clients with bookings in excess of \$100 million.

Turning now to revenues, net revenues for the quarter were \$7.7 billion, an increase of 7% in U.S. dollars and local currency, reflecting a flat FX impact, consistent with the assumption we provided in March. Consulting revenues for the quarter were \$4.1 billion, up 6% in USD and 5% in local currency.

Outsourcing revenues were \$3.6 billion, up 10% in USD and 9% in local currency. Again, revenues came in even higher than expected, driven by strong performance in H&PS, Products and CMT. Let me give you some additional highlights from the operating groups this quarter.

H&PS grew 11%, delivering the significant improvement in growth we had signaled in quarter two. Growth rates improved across all three geographic regions, but a strong uptick in the Americas was the primary driver in the quarter. Within the Americas, our Health business in Public Service was very strong, including the recent acquisition of ASM Research, which expands our capabilities within the military and federal health businesses. Within our state and local practice, both our human services eligibility and ERP offerings made a strong contribution.

In Products, the 10% growth demonstrated a continuation of broad-based demand, with strong growth in both the Americas and EMEA. We saw a good demand for BPO, specifically for our Procurement offerings. Overall, our clients are focused on four main themes: the digital customer; efficiency and cost optimization; industry-specific solutions; and advancing the technology agenda, including new technologies, extending ERP, and network optimization.

Communications, Media & Technology growth was 7%, in an overall environment that continues to be in a cycle of rapid change. CMT's growth was primarily driven by very strong performance in the Americas, and we continue to be very pleased with our performance in Electronics & High Tech. The revenue growth also reflects the ramp-up of several of the large transformational deals that we've signed in recent quarters. More broadly, we continue to focus on extending our footprint in E&HT; working with our Communications clients to drive their cost optimization agenda; and increasing our penetration in certain areas such as Media & Entertainment, Cable, and Social Media & Internet.

Financial Services grew 5%, consistent with last quarter. We are particularly pleased with the significant growth in Banking and Capital Markets in EMEA and Asia-Pacific. Americas growth was negatively impacted by a slowdown in a few clients, as large-scale transformation programs are going through their natural cycle, as well as reduced demand in our mortgage business. Overall, we see good opportunities in the FS market, driven by our clients' focus on cost efficiency, which resulted in strong demand for our BPO offerings, and also driven by risk and regulatory, and increased investments in digital, primarily in distribution and marketing.

As expected, we saw moderate improvement in Resources, with 2% growth. Energy continues to generate strong growth globally, but we did see some moderation from previous quarters, particularly in North America. While we are pleased with the moderate improvement in the quarter, we still have work to do to position the business for sustained positive growth. North America and Natural Resources globally continue to be our most challenged markets.

Moving down the income statement... Gross margin for the quarter was 32.8%, compared with 33.9% for the same period last year, down 110 basis points. Sales and Marketing expense for the quarter was 11.6% of net revenue, compared with 12.3% of net revenues for the third quarter last year, down 70 basis points. General and Administrative expense was 5.9% of net revenues, compared with 6.4% of net revenues for the third quarter last year, down 50 basis points. As a reminder, in quarter three of last year, we had a reduction in the reorganization liabilities that impacted certain metrics. The following comparisons exclude the impact and reflect adjusted results.

Operating income was \$1.2 billion in the third quarter, reflecting a 15.2% operating margin, roughly equal to the adjusted operating margin for the same period last year. Our effective tax rate for the quarter was 25%, compared with an adjusted tax rate of 24.8% for the third quarter last year.

Net income was \$882 million for the third quarter, compared with adjusted net income of \$824 million for the same quarter last year. And diluted earnings per share were \$1.26, compared with the adjusted EPS of \$1.14 in the third quarter of last year, an increase of \$0.12.



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Turning to DSOs, our days services outstanding continue to be industry-leading; they were 35 days, up from 33 days last quarter. Free cash flow for the quarter was \$1.3 billion, resulting from cash generated by operating activities of \$1.4 billion, net of property and equipment additions of \$85 million.

Moving to our level of cash, our cash balance at May 31 was \$4 billion, compared with \$5.6 billion at August 31 last year. The current level reflects the cash returned to shareholders through repurchases and dividends, as well as the acquisitions we've made year-to-date.

Moving to some other key operational metrics, we ended the quarter with a global headcount of more than 293,000 people, and we now have approximately 194,000 people in our Global Delivery Network. In quarter three, our utilization was 88%, up from last quarter, and consistent with quarter three last year. Our attrition, which excludes involuntary terminations, was 14%, up 2% from both quarter two and the same period last year. And lastly, we now expect that at least 65,000 people will join our company in FY14.

Turning to our ongoing objective to return cash to shareholders, in the third quarter we repurchased or redeemed approximately 5.5 million shares for \$441 million, at an average price of \$80.13 per share. Year-to-date, we've purchased 24.4 million shares for \$1.9 billion, at an average price of \$77.90 per share. At May 31, we had approximately \$5.3 billion of share repurchase authority remaining.

Finally, as Pierre mentioned, on May 15, 2014, we made our second semi-annual dividend payment for FY14 in the amount of \$0.93 per share, bringing total dividend payments for the fiscal year to approximately \$1.3 billion.

So in summary, quarter three was an important quarter for us, as we delivered the uptick in revenue that we had signaled at the beginning of the year. While we delivered good profitability, our focus on cost-efficiency will continue to be a priority for several quarters to come. Now let me turn it back to Pierre.

Pierre Nanterme - Accenture - Chairman & CEO

Thank you, David. Our strong results for the quarter demonstrate that we continue to execute very well against our growth strategy. We are leveraging the investments we have made in assets and solutions, in strategic acquisitions, and in building the skills and capabilities of our people. Our services are highly differentiated in the marketplace and are clearly resonating with the needs of our clients, as demonstrated by our record bookings year-to-date.

Our growth strategy is all about, first, operating at the heart of our clients' businesses; then, capturing new opportunities in key growth areas, especially in digital and across the different geographic markets where we operate; and finally, investing to further differentiate our capabilities and services.

Let me bring each of these areas to life, starting with how we leverage our unique global end-to-end capabilities to drive value for clients and help them with their large-scale transformation programs.

We are helping Baker Hughes, a leading oilfield services company, transform its finance and accounting operations across 90 countries, delivering more than \$50 million in annual cost savings so far.

For a large European bank, we are providing application development and management services to support the bank's repositioning to a new digital platform. This is a major strategic IT transformation, designed to increase productivity by up to 20%.

And we are working with a leading global software company, leveraging our analytics and technology capabilities in finance and accounting to deliver cost savings of more than \$150 million over the next seven years.

We are executing very well in capturing new opportunities in key growth areas. I am particularly pleased with the momentum we are seeing in Accenture Digital.

We are bringing together our capabilities in Accenture Interactive and Accenture Analytics to help Telefonica Spain significantly increase its online sales. In just six months, Telefonica drove more than 50% higher sales, a year ahead of schedule.

We are leveraging the assets and capabilities from our recent digital acquisitions to help a leading global fashion retailer launch a new online store based on an innovative e-commerce platform. The new channel, which is going to be rolled out to 50 countries, is already driving higher-than-expected revenues.

To me, what is truly distinctive about digital at Accenture is our ability to deliver digital at scale and to help our clients create even greater value and business results.

We continue to benefit from the return on the investments we have made to enhance our capabilities and services. A great example is our Accenture Duck Creek software solution for property and casualty insurers, which was recently selected by both Zurich Insurance and Berkshire Hathaway. Berkshire Hathaway Specialty



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Insurance is deploying our software through an innovative software-as-a-service model hosted on the Accenture cloud platform, which will reduce IT costs, improve business agility, and support growth.

In Life Sciences, through our Accelerated R&D business service, we have developed a new cloud-based platform, which is now being used by five major pharma companies. This unique solution accelerates the clinical development process by collecting and analyzing data from across studies, helping our clients conduct clinical trials in a more efficient and cost-effective way.

And we also continue to make targeted acquisitions. In Accenture Strategy, we just completed the acquisition of PureApps, a UK-based company that specializes in Enterprise Performance Management, helping CFOs to analyze their businesses and improve their cost management.

In Accenture Digital, we acquired i4C Analytics, an advanced analytics software provider based in Italy. i4C specializes in tailored industry- and function-specific applications to speed up the delivery of new insights and business outcomes.

Now turning to the geographic dimension of our business, our growth in Q3 was broad-based, and I am particularly pleased that we delivered stronger results in Europe.

In the Americas, we grew revenue 7% in local currency, driven by high single-digit growth in both the United States and Brazil.

In EMEA, revenues increased 7% in local currency, with double-digit growth in France and Italy, high single-digit growth in Germany, and solid single-digit growth in the United Kingdom.

And in Asia Pacific, we grew revenues 6% in local currency, driven primarily by strong double-digit growth in Japan.

So overall, we are performing well in the context of a market environment that remains very demanding. We continue to improve our competitiveness through a relentless focus on operational excellence, applying rigor and discipline across the board to increase our efficiency so we continue to build and position our business for sustainable, long-term, profitable growth.

With that, I will turn the call back to David for our business outlook.

David Rowland - Accenture - CFO

Thank you, Pierre. Let me now turn to our business outlook.

For the fourth quarter of FY14, we expect revenues to be in the range of \$7.45 billion to \$7.7 billion. This assumes the impact of FX will be a positive 1.5% compared to the fourth 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 U.S. dollars will be negative 0.5% compared to FY13.

Based on our year-to-date results of 4% revenue growth in local currency, and the outlook just provided for quarter four, we now expect our net revenues for the full FY14 to be in the range of 4% to 5% growth in local currency.

For the full FY14, we now expect new bookings to be at the upper end of our previously guided range of \$33 billion to \$36 billion.

For our operating margin, we now expect FY14 to be 14.3%, an approximate 10 basis-point expansion over adjusted FY13 results.

We continue to 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 \$4.54, or 7% to 8% growth over adjusted FY13 results.

Turning to cash flow, we continue to expect our 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 in the range of \$2.9 billion to \$3.2 billion.

Finally, we continue to expect to return at least \$3.7 billion through dividends and share repurchases, and also 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.



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So all in all, I'm pleased with how we're positioned to close out the year, and as we have in the past, we will provide you with our FY15 outlook at the quarter four earnings call in September. With that, let's open it up so we can take your questions. KC?

KC McClure - Accenture - Managing Director of IR

Thanks, David.

(Caller Instructions)

Katie, would you provide instructions for those on the call please?

QUESTION AND ANSWER

Operator

(Operator Instructions)

Darrin Peller, Barclays.

Darrin Peller - Barclays Capital - Analyst

Yes. Thanks, guys. Nice job on the bookings. I just want to hone in a little bit on the bookings trends we're seeing. You gave some good color on what types of business you are gaining -- just with respect to the types of book-to-bill conversions we should expect to see, and how long it takes for the conversion to occur?

And then maybe, really, just give us a profile of the kind of profitability in terms of the margin impact on the business given that, obviously last quarter, we saw a little bit of a slower trend on the margin side; and you talked about Europe. But I think here, we're looking to see what these bookings really mean for the next year or so. So, a little more color on those two variables would be great.

David Rowland - Accenture - CFO

Okay. First of all, let me give you a couple of comments, and perhaps Pierre will add some thoughts, as well. But in terms of our book-to-bill, on the Consulting side, we continue to target overall a book-to-bill of 1.0 to 1.1. I think what we've commented on in previous calls is that given the conversion trends that we started to experience in the third quarter or so of last year, we felt that it was important to be more toward the upper end of the range. But, nonetheless, that range continues to be what we are focused on.

From an Outsourcing standpoint, again, the range continues to be 1.2 as, let's say, the sweet spot for us; and of course, anything north of that is all the better. When you think about it -- the whole translation of bookings to revenue -- I think the thing that this quarter indicates is really what we've been pointing to for a while. And that is that the strength of our new bookings, we felt like would ultimately convert to revenue growth at higher levels starting in the second half of this year, and I think what you see is that obviously happening with our 7% growth.

The last comment, quickly, from a profitability standpoint: We really focus on operating margin. And our model, since we've been a public company, has been that we expect to manage the ebb and flow of the mix of work across the Consulting components of our business and the Outsourcing components of our business.

It is true that not all of them have the same level of profitability, let's say at a contract level, or if you wanted to loosely say in gross margin terms, but they also all have very different cost structures in terms of selling cost, investment requirements, investments in people, et cetera. What we're tasked with doing is managing those costs, so that if the ebb and flow of our business occurs, as it will across the portfolio, we meet our bottom-line objectives. That's what we've been very successful doing as a public company so far.



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Darrin Peller - *Barclays Capital - Analyst*

That's very helpful. Just one quick follow-up, and then I'll turn it back to the queue. Last quarter, obviously, there were some comments made around pricing and around some -- obviously, the implications of that on margins, and I think you did a good job explaining the types of bookings you're looking at and the conversion is obviously showing up much better this quarter. But are we still seeing any pricing pressures at all in the business? Or is it really just -- was it more of a blip in the quarter or in the year last quarter, and it's calmed down?

David Rowland - *Accenture - CFO*

Just as it relates to quarter three specifically, the environment is very much stable with what we saw last quarter, meaning we haven't seen any further deterioration. The pattern is stable. We did see, in fact, some pockets of improvement in the third quarter, but it's too early to call those a trend. So, I think the overriding theme is that it's stable relative to what we said last quarter.

Darrin Peller - *Barclays Capital - Analyst*

Okay. That's good to hear. All right, nice job, guys. Thanks.

David Rowland - *Accenture - CFO*

Thank you very much, Darrin.

Operator

Tien-Tsin Huang, JPMorgan.

Tien-Tsin Huang - *JPMorgan Securities - Analyst*

Good morning. Glad to see the revenue coming through. Just a follow-up on what Darrin asked: Did anything change specifically this quarter that allowed you to convert revenue faster this quarter? And just as a follow-through, has visibility on revenue realization improved from the first half of the year?

David Rowland - *Accenture - CFO*

Hey, Tien-Tsin. Again, I don't think anything changed or -- it happened as we anticipated and as we had signaled. When you look at why did we have stronger revenue growth... I'll anchor you back to what Pierre and I said consistently, starting with the first earnings call this year. We said that there were several things that we were encouraged by.

The first thing was our pattern of strong new bookings. The second thing was the fact that the large transformational deals would start to kick in revenue growth in the second half of the year; and we talked about the fact that we could point to individual contracts that gave us confidence that would occur. The third thing we talked about was business services; the investments we had made in business services starting to materialize. And then finally, we anchored to the investments that we had made in inorganic.

You wrap around all of that in the third quarter, we were really pleased with our BPO business, in particular, which we've talked about consistently. And we are also very pleased with the activity that we see in the digital space. So, there's a lot of things that came together, but very consistent, Tien-Tsin, with what we've been trying to signal for a couple of quarters.



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Tien-Tsin Huang - *JPMorgan Securities - Analyst*

All right, that's great, that makes sense, David. Just my follow-up -- I'll ask on the margin side. The revenue did come at a cost a little bit if we look at it on a gross margin front. I get that we should look at it on operating margins, but I'm just curious: Was there anything unusual in that gross margin line this quarter, and should we expect gross margin contraction to continue here in the near term? Thanks.

David Rowland - *Accenture - CFO*

Yes. Thank you, Tien-Tsin. Just starting -- let me answer the question on operating margin first. The thing that I will remind you and others of is that last year the third quarter was an all-time high level of profitability for Accenture. So, in absolute terms, last year's profitability was outstanding, and it reflected 40 basis points growth over the prior year quarter three.

So, when we look at the third quarter this year, we feel very good about the absolute profitability because, in fact, it is equal to the highest level of profitability we've ever had in any quarter. Having said that, what's different: We have worked hard on dealing with some of the points that we highlighted last quarter. I referenced in my script that we made progress on those points, but yet we still have work to do going forward. And especially as it relates to overall payroll efficiency, which will continue to be a focus area for us moving forward. But again, we feel very good about the absolute profitability in the third quarter.

Tien-Tsin Huang - *JPMorgan Securities - Analyst*

All right. That's great. Good stuff. Thanks so much.

David Rowland - *Accenture - CFO*

Thank you.

Operator

David Grossman, Stifel.

David Grossman - *Stifel Nicolaus - Analyst*

Thank you. David, it looks like growth accelerated for the third quarter, as you had thought, and you delivered a very strong revenue result. However, it appears you left the mid-point for the year unchanged. You sound very confident in the outlook, so perhaps you can help us better understand whether there are any specific headwinds in the fourth quarter -- maybe it's just the ordinary flow of revenue -- and whether the conversion rates that you saw in the third quarter are something that you see as sustainable, at least as far as the eye can see for now?

David Rowland - *Accenture - CFO*

Yes. Again, there's a couple of points of context that are worth mentioning. If you look at the way our revenue progressed in quarter three and quarter four of last year, quarter four last year was 1.5 points higher than quarter three. So, underneath the fourth quarter, we're comparing to a fourth quarter last year that was 1.5 points higher than quarter three last year.

The other thing that I would point out is that with the range that we provided for the fourth quarter, the upper end of that range reflects continued strong, healthy growth equal to what we just delivered in the third quarter. And so, we certainly see that as a possibility because we included it in the range. As we always say, although we provide a range which reflects a range of potential outcomes, we are always working to be as high up in the range as we possibly can.



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So, we do feel good about our business. We had, again, yet another strong bookings quarter. We feel good about our visibility as we move forward in the business. But yet, as Pierre highlighted in his script, we have an environment that has an abundance of opportunities, but it also is one that has ongoing -- I'm talking about the macro environment -- has ongoing challenges and uncertainty.

Operator

Bryan Keane, Deutsche Bank.

David Rowland - Accenture - CFO

Hello, Bryan.

Bryan Keane - Deutsche Bank - Analyst

Hi, guys. Good morning. Just looking on a full-year guidance, it's a little bit unusual that the revenues are coming in ahead of expectations, but EPS is moving to the low end; just what's causing that dynamic?

David Rowland - Accenture - CFO

Well, there's really two simple things. The first thing is that the guidance range that we had last quarter was based on a revenue range that included 5% to 6% growth for the full year, and it was based on an operating margin range that included 20 to 30 basis points of expansion.

So, what we have done is -- by the way, which is what we always do after the third quarter -- is we've narrowed the range for the year now. The reason it is narrowed to the range that it did is because we've narrowed the revenue range for the full year to 4% to 5%. So, the 5% to 6% is not within the range, and we are on a trajectory to deliver 10 basis points of expansion. So, if you look at those things in combination, that's the resulting range that you get for EPS, which, again, it is a growth rate above revenue, and that's one of the things that we talked about at our Investor Analyst day as an important objective.

Bryan Keane - Deutsche Bank - Analyst

Okay, and just as a follow-up then, the cause for the operating margin to fall in at the low end of the range as opposed to the high end, and then any risk that the model that Accenture always has of 10 to 30 basis points of margin expansion won't be continued on an annual basis? Thanks so much.

David Rowland - Accenture - CFO

Yes, the fact that our trajectory is at 10 basis points -- frankly, it anchors back to some of the things we talked about last quarter, plain and simple. Having said that, we've started the year guiding to a range of 10 to 30. And the 10 to 30 represents what we've generally defined as modest margin expansion; 10 basis points has met our definition of modest margin expansion.

We feel like, if we are moving the margins up year over year in that 10- to 30-basis-point range, that's very consistent with what our objectives have been. And we think that's a reasonable place for us to land. We are balancing many things within that, including investments in our business, which include the impact of acquisitions, just to name that as one. But those are the things that -- we are managing a mix of variables, but we feel very good about the 10 basis points of expansion.

Bryan Keane - Deutsche Bank - Analyst

Okay. Great. Thanks so much.



David Rowland - Accenture - CFO

Thank you.

Operator

Keith Bachman, Bank of Montreal.

Keith Bachman - Bank of Montreal - Analyst

Hi. Thank you very much. I wanted to ask about the inorganic contribution this quarter; you said it played a role. And if I look at your cash flow, it looks like your acquisitions this year for the first nine months, in terms of cash out, is about two times what it was last year. I was just wondering if you could talk about what the inorganic contribution to year-over-year growth was this quarter versus last quarter?

David Rowland - Accenture - CFO

The inorganic growth varies by quarter. It can be lumpy and, frankly, we really don't want to get in the position of giving a specific breakdown each and every quarter, but would rather talk in terms of the annual contribution. I will tell you that quarter three reflected an acceleration in both organic and inorganic growth; and we were pleased with both, to be clear. But there was that important acceleration in organic that drove the 7.1% overall.

For the full year -- if this will help you, Keith -- we think we're tracking to the 1.5% to maybe up as high as 2% range in inorganic contribution, which is consistent with what I said last quarter or the quarter before. But again, just to remind you that the inorganic for us is really all about a strategy to ultimately drive organic growth. So, our inorganic is an engine for organic growth.

When you look at these businesses that we are acquiring, they are essentially indistinguishable from our organic business, at least within a year. And Procurian, which was the most significant acquisition we've made this year, in the BPO procurement space, is a great example of that. So, we feel great about the mix of our business. We are very pleased with what we've done with acquisitions, really for the last four to six quarters. So, hopefully that helped.

Keith Bachman - Bank of Montreal - Analyst

Yes, it does. Thanks very much. For my follow-up, I'd like to just try to probe a little bit more around Bryan's question on targeted operating margins. I understand it is still within the range of plus 10 basis points, call it. I was hoping to dig a little bit deeper on the causes why it's coming down. I know you highlighted M&A as one of the causes.

Also, wage rates -- it sounds like it's continuing to play a role. If I look at the detail, it also looks like Financial Services, even on a non-GAAP basis, the operating margins were down a little bit more in those areas. Is there something specific in Financial Services or Products, which look like they had the most of the year-over-year decline that you'd call out, or any other forces to illustrate what's going on with operating margins would be helpful. Thank you.

David Rowland - Accenture - CFO

Yes. Products and Financial Services are both situations where the contract profitability is lower than it was last year. I'll remind you that we do have -- under any circumstances, we have ebb and flow of operating margin across our operating groups, as their portfolio mix just evolves. And so, a swing a point or two in either direction shouldn't be over-read at that level, because sometimes it's just the ebb and flow of the portfolio, and then the time to balance the overall expenses associated with that.

In terms of the 10 basis points, again, I guess to be blunt, I'm not going to -- I don't want to defend 10 basis points, in the sense that it's very consistent; it's within the range that's been very consistent with the range we've communicated for several years now. And in certain years, there are circumstances where we're at the upper end of that range, and other years there are circumstances where we are at the lower end of the range.



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The circumstances this year, I think we covered quite well on last quarter's call. And again, we're making improvement. We've seen progress in the third quarter in dealing with those points that we raised, but yet they are in the mix, nonetheless, for how we are positioned for the full year.

Keith Bachman - *Bank of Montreal - Analyst*

So, philosophically, investors should be thinking about next couple of years, 10 to 30 basis points operating margin improvement is still the right way to think about it?

David Rowland - *Accenture - CFO*

Yes, I'm not going to comment explicitly on forward-looking guidance. I'll just say that our overriding objectives as an organization haven't changed.

Keith Bachman - *Bank of Montreal - Analyst*

Fair enough. Many thanks.

David Rowland - *Accenture - CFO*

Great. Thank you.

Operator

Dan Perlin, RBC Capital Markets.

Dan Perlin - *RBC Capital Markets - Analyst*

Thanks. I'm not going to ask you to defend the 10 basis points, but I do just want to follow up on the margin concept, which is: If we're disaggregating what is a function of mix, that is shifting to what would ultimately be considered lower dollar profit, relative to, let's say, wage inflation cost, how would you have us parse that? As we think about this quarter, the combination of what you talked about last quarter, and then thinking about what is ultimately embedded in your bookings? Thank you.

David Rowland - *Accenture - CFO*

Yes. Frankly, there are so many nuances and so much detail in trying to answer that question. It's just -- even if that was information that we wanted to share at that level of detail, I can't really do it in three minutes on an earnings call, to be frank.

Again, in general terms, what I would say is that job number one for us in driving our profitability objective going forward is to get payroll efficiency right. And that is something that we have traditionally done very, very well, and that is something that we are extremely focused on, in particular, in the next several quarters, given some of the things we highlighted last quarter.

Job number two in optimizing our profitability is to manage the mix across our portfolio. So, finding the right mix where the opportunities are in the marketplace.

And then as the mix shifts across the different offerings that we provide, then job number three is to align our underlying cost structure to make sure that it is consistent with the realities of our portfolio of work. At a very simple level, those are the things that we've always had to focus on, and that's what we will continue to focus on going forward.



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Dan Perlin - RBC Capital Markets - Analyst

Okay. And then just quickly: How important, ultimately, is the correlated rebound in EMEA to your Consulting business, because we're seeing some trends in both of those and I'm just wondering, from a sustainability perspective, how important is that for you to have both trending in the right direction? Or do you think Consulting can actually throttle up, even in the face of EMEA maybe having problems in the future? Thanks.

Pierre Nanterme - Accenture - Chairman & CEO

We're definitely very pleased to see the rebound we had in EMEA. This is something we have been watching very carefully these last quarters. We've invested a lot in EMEA around client opportunities, especially around large-scale transformation programs combining consulting, outsourcing and BPO across the board.

As we expected, starting in Q3, we see EMEA coming back. And what I'm particularly pleased with is: When you look at the countries contributing to EMEA growth, both on a Consulting and Outsourcing standpoint, you have our largest markets and countries in Europe. I'm thinking about France, Italy, Germany, the UK. It is very encouraging to see that with the slow recovery of Europe, that seems to show some sustainability, the slow recovery in Europe is creating more confidence in the investors. And this is what explains the pick-up of our business in Europe, plus the execution of the strategy we mentioned before, large-scale transformation operating at the heart of our clients' operation, investing in the new -- by the new -- I'm thinking a lot around the digital and the excellent contribution of BPO. So, it's quite well balanced across the board, but again, with probably more on the Outsourcing than the Consulting, but anyway, pleased with both results.

Dan Perlin - RBC Capital Markets - Analyst

Excellent. Thank you.

David Rowland - Accenture - CFO

Thank you.

Operator

Steve Milunovich, UBS.

Steve Milunovich - UBS - Analyst

Thank you. Could you characterize how much of your business comes from emerging markets, and maybe discuss what's going on in some of those, particularly China and Brazil?

Pierre Nanterme - Accenture - Chairman & CEO

Yes. So, if you look at the way we now look at the markets, you have North America, you have Europe, and you have what we might call the Growth Markets, which is a little bit different from what you have in Americas, EMEA, and APAC. So, clearly the vast majority of the business we're doing is concentrated in North America and Europe. Now, we are pleased with what we are doing in APAC, in Africa, and in Latin America.

So, let me give you some insights which are noteworthy, starting with Latin America. As you know, and we signaled that in the prior quarters, we were watching carefully what was happening in Brazil. We had excellent performance for many years, and we had a kind of pause almost a year ago, literally. So, again, it's very encouraging to see that through all the efforts made by our Brazilian leadership, Brazil is back with high-single-digit growth this quarter. So, again, we're going to watch that carefully, but it's a very encouraging signal.

Moving to APAC -- very consistent and very important for us because it's a large country for Accenture, Japan is sustaining a very strong double-digit growth. And it's not the story of a quarter, it's been true these last quarters, so we are building a stronger practice in one of the largest markets, as well, in APAC.

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To a smaller scale, but very interesting, we had very good performance in India, as well, which has continued to grow very well. And I can mention even the Middle East -- in new places where we see good prospects.

And maybe finally, getting to Africa -- this is probably a place where we need to put more attention, especially in South Africa. As you know, this is a country which is very dependent on natural resources, and very consistent with what David mentioned previously, natural resources is a very cyclical, challenging industry. South Africa is very dependent on natural resources, and it is a country where we are most challenged. All in all, we are pleased with the progress we're making in our emerging markets.

Steve Milunovich - UBS - Analyst

That's great. Thank you. And I was curious what role you're playing in helping companies think through their adoption of cloud, and if your cloud brokering business is doing well and could become significant?

Pierre Nanterme - Accenture - Chairman & CEO

We couldn't be more cloud-friendly at Accenture. We embrace the cloud, we promote the cloud, and the cloud is developing very well because it's bringing to our clients a true and compelling value proposition as a way to improve the efficiency and effectiveness of their operations.

You've seen, in the couple of cases I shared with you, that cloud was quite prominent, in the way we are proposing application packages as a service. I'm very pleased with what we are doing with our own solution called Duck Creek, delivered at Berkshire Hathaway as a service, and operated in Accenture cloud. And I think this case is probably a piece of art, if you will, in the way we are delivering a package in a new and compelling way, as a service, and we are operating this service in Accenture's cloud platform. So, we are a big fan of this.

Steve Milunovich - UBS - Analyst

Thank you.

David Rowland - Accenture - CFO

Thank you.

Operator

Joseph Foresi, Janney.

Joseph Foresi - Janney Montgomery Scott - Analyst

Hi. I just want to go back to profitability really quickly. Where are you seeing the biggest impact on profitability? Is that new or old work? And what does that imply going forward? I'm just wondering if it's renewals or the new work that you were seeing the pricing issues that you mentioned last quarter?

David Rowland - Accenture - CFO

Yes. In answering your question, maybe I'd start with saying that we were very pleased with the work that we contracted in the third quarter from a profitability standpoint overall. Again, some of the things we talked about last quarter, I would just be redundant with those messages.

We had, last quarter, declared some pricing pressure. We related that to some pressure on profitability, but yet we've said this quarter that it's been stable. We highlighted last quarter some pressure in contract profitability, but yet we actually were pleased with our contract profitability this quarter and saw some positive progression from where we were last quarter. So, that's our existing book of business.



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Maybe I could just be concise and answer it that way, in that we are always focused on improving contract profitability. We did see some improvement from last quarter to this quarter sequentially; and again, we were very pleased with the economics of the deals that we contracted in the third quarter.

Joseph Foresi - Janney Montgomery Scott - Analyst

That's very helpful. And just my follow-up: Consulting looked like it upticked a little bit -- what was the driver of that? And how sustainable is that driver going forward? What should we be looking for to see what the trends in Consulting can look like?

Pierre Nanterme - Accenture - Chairman & CEO

On the Consulting, if you look, and it's not the whole story, but clearly, all we are doing in Digital is a big contributor and is getting to be a stronger and stronger contributor, if you will, to our Consulting business. You will find, in this Consulting, all the work we're doing through Accenture Interactive, with all the capabilities from a Management Consulting standpoint to a Systems Integration standpoint, solutions we are providing to enable the digital consumer.

I am thinking about all the work we are doing through Accenture Mobility -- again, a good combination of Management Consulting and Systems Integration work to enable mobility. Couldn't be more pleased that recently Fiat accepted to communicate around the Uconnect solution we've been putting in place, which is absolutely cutting- and leading-edge in mobility. And of course, very pleased with the momentum of Accenture Analytics, which, again, is a good mix of MC and Systems Integration; so, what we are calling Consulting. All of this is now becoming a stronger driver for our Consulting growth.

Joseph Foresi - Janney Montgomery Scott - Analyst

Thank you.

Operator

David Togut, Evercore.

David Rowland - Accenture - CFO

Hey, David.

David Togut - Evercore Partners - Analyst

Hello, David. Employee attrition moved up 2 points in the quarter to 14% from 12%. What was the key reason for that?

David Rowland - Accenture - CFO

I don't think that there was anything in particular underneath that. That 14% is well within our tolerance zone, and there is ebb and flow. And so, just frankly, there really isn't a story behind that. It's just the normal flow of how attrition goes.

David Togut - Evercore Partners - Analyst

Just as a key follow-up, you mentioned a target of 65,000 gross employee adds for this year. Is that an uptick from what you indicated in Q2?

David Rowland - Accenture - CFO

It is. Yes, I think KC could correct me, but I think we said 60,000 last quarter and then 65,000 this quarter.



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David Togut - Evercore Partners - Analyst

In which practice areas are you adding more employees versus previous plan?

David Rowland - Accenture - CFO

It's across our practice. There is not a particular area of concentration. There's clearly a mix of GDN in there, obviously. But beyond that, we are doing some level of hiring probably in most of the markets around the globe. Some of it relates to many of the things Pierre has commented on, where we have these new, exciting areas that are growth engines for us going forward, and we are always bringing skills and talent on board.

David Togut - Evercore Partners - Analyst

Understood. Thank you very much.

David Rowland - Accenture - CFO

Thank you.

Operator

Dave Koning, Baird.

Dave Koning - Robert W. Baird & Company - Analyst

Yes. Hey, guys. Good morning. Great job.

David Rowland - Accenture - CFO

Hey. Good morning.

Dave Koning - Robert W. Baird & Company - Analyst

Just a couple of cash flow items: This is the first year in a while -- we've talked about this before -- that free cash flow is going to be in line, maybe even a little below income. And just wondering if, over time, you expect that to exceed earnings? Just wondering your long-term expectations around that?

David Rowland - Accenture - CFO

Yes. I think I said last quarter that we feel very good about our -- the structural drivers, if you will, of our cash flow. So, we expect to be a business that continues to focus on cash flow as part of our economic model. We continue to have industry-leading DSOs. We have a capital-light business; we don't anticipate that that's going to change.

And we are always focused on managing our profitability, which gets to our cash operating expense outflow in a particular year. So, this year is what it is, but we think that the structural underpinnings of our business from that standpoint remain unchanged.



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Dave Koning - Robert W. Baird & Company - Analyst

Okay, good. And just because there haven't been quite enough questions on margins yet, one small item: Last quarter you talked a little bit about the bonus accruals being brought down a few hundred million just to manage costs. Given how good revenue trends are now, and that is very encouraging, I'm just wondering if that has been undone a little bit, and maybe that's part of the reason that margins are a little lower?

David Rowland - Accenture - CFO

Yes. Not to disappoint you with the answer, but I'll just remind you, David, and you and the others will remember that we really have had a practice of not talking about variable comp. The only time when we will talk about it is when it is important to understanding the story in a particular quarter, which is not the normal scenario. We commented on it last quarter because it was relevant to understanding the story. That is not the case this quarter. So, the expectation is going to be that we are not going to do a root canal on variable comp each and every quarter.

I appreciate the question. I appreciate why you asked it. We served it up with what we said last quarter, but that's our position on it.

Dave Koning - Robert W. Baird & Company - Analyst

Got you. Well, great progress.

David Rowland - Accenture - CFO

Thank you. Appreciate it.

KC McClure - Accenture - Managing Director of IR

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

Operator

Sara Gubins, Bank of America Merrill Lynch.

Sara Gubins - BofA Merrill Lynch - Analyst

Thanks for sneaking me in. Is Application Outsourcing growing faster, above or below, the overall Outsourcing segment? And if you could just talk about how you're responding to market pressures in this offering?

Pierre Nanterme - Accenture - Chairman & CEO

Yes. Again, we are very pleased with the Application Outsourcing, overall with the Outsourcing part of our business. Especially pleased with the Application Outsourcing business, which has been growing nicely. It's clearly responding to a strong demand from our clients in rationalizing their IT operations.

It is a very competitive market; it's a very competitive environment. And it's a very large market, as well. So, no doubt, Accenture will want to compete in that very large market, and be extremely competitive in this marketplace.

And we are, of course, benefitting from our Global Delivery Network. We talked about, now, the 190,000 people we have in our different delivery networks, supporting not only Application Outsourcing and BPO... So, we believe today that, despite the fact that it's a highly demanding and competitive environment, we are equipped to fight and win in that particular segment, and this is reflected in the excellent growth we had in Q3.



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Sara Gubins - BofA Merrill Lynch - Analyst

Thank you.

David Rowland - Accenture - CFO

Thank you, Sara.

Pierre Nanterme - Accenture - Chairman & CEO

All right. It's time to close the call, and thanks again for joining us on today's call.

In closing, very briefly, let me share a few thoughts. As we enter the fourth quarter, we feel good about our business and are confident that we are well-positioned to deliver our business outlook for the year. We are focused on executing our growth strategy, which, again, is all about delivering transformational change for clients at the core of their operations, capturing new opportunities in key growth areas, especially around digital and BPO, and investing to further strengthen our capabilities.

And each and every day, everywhere around the world, our Accenture people bring their unique passion and energy to drive value for both our clients and our shareholders.

We look forward to talking with you again next quarter. In the meantime, if you have any questions, feel free to call KC. All the best.

Operator

Ladies and gentlemen, this conference will be available for replay after 10:30 today through September 24 at midnight. You may access the AT&T Replay System at any time by dialing 1-800-475-6701 and entering the access code 328224. International participants dial 320-365-3844. Those numbers again are 1-800-475-6701 and 320-365-3844; access code 328224.

That does conclude our conference for today. Thank you for your participation, and for using AT&T Teleconference. You may now disconnect.

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