

Accenture

1st Quarter Fiscal 2018 Earnings Call

Conference Call Transcript

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CORPORATE PARTICIPANTS

Angie Park – *Managing Director, Head of Investor Relations*

Pierre Nanterme – *Chairman and Chief Executive Officer*

David Rowland – *Chief Financial Officer*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to Accenture's First Quarter Fiscal 2018 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session. If you wish to place yourself in queue for questions at any time, please press star then one. You may remove yourself from that queue by depressing the pound key. As a reminder, today's call is being recorded.

Your host and speaker today is Managing Director, Head of Investor Relations, Angie Park. Please go ahead.

Angie Park

Thank you, Kevin, and thanks, everyone, for joining us today on our First Quarter Fiscal 2018 Earnings Announcement. As the operator just mentioned, I'm Angie Park, Managing Director, Head 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 for the first quarter. Pierre will then provide a brief update on our market positioning before David provides our outlook for the second quarter and full fiscal year 2018. We will then take your questions before Pierre provides the 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 reimbursements, or net revenues. Some of the matters we'll 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.

During our call today we will reference certain non-GAAP financial measures, which we believe provide useful information for investors. 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

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

We had an excellent first quarter, and I am extremely pleased with our results. We delivered strong and broad-based revenue growth across all dimensions of our business and gained significant market share, once again.

Our strategy continues to differentiate Accenture in the marketplace, and we are seeing very strong demand for our services, particularly in digital, cloud and security.

Here are a few highlights for the quarter:

- We delivered very strong new bookings of \$10 billion.
- We generated revenues of \$9.5 billion, with 10% growth in local currency.
- We delivered very strong earnings per share of \$1.79, a 13 % increase.
- Operating margin was 15.6%, consistent with the first quarter last year.
- We generated strong free cash flow of nearly \$900 million
- And we returned more than \$1.4 billion in cash to shareholders through share repurchases and dividends.

So, we are off to a strong start in fiscal year '18 and I feel very good about the continued momentum in our business.

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

David Rowland

Thank you, Pierre. Happy Holidays to all of you, and thanks so much for joining us on today's call.

Building further on Pierre's comments, we were very pleased with our quarter one results which position us well to achieve our full-year business outlook, especially as it relates to our strong and broad-based top-line growth. Once again, these results demonstrate the durability and resiliency of our growth model and the high degree of relevance and differentiation of our capabilities in the marketplace.

Before I get into the details of the quarter, let me summarize a few of the important highlights. Starting with net revenues, we expanded our business by approximately \$1 billion in the quarter, with 10% growth in local currency. The diversity and durability of our growth model was evident with strong and extremely well-balanced growth across all five operating groups and all three geographic areas, with double-digit growth in four operating groups and in both Europe and the Growth Markets.

Strong double-digit growth in Digital, Cloud and Security continued to be the dominant driver of our growth and it was pervasive across the business. And, we estimate that our 10% growth significantly outpaced the market as we continue to gain share and strengthen our position as a leader in the New.

With the respect to our profitability, our operating margin of 15.6% in the quarter was consistent with quarter one of last year and continues to reflect a significant level of investment in our business. And, we delivered very strong EPS of \$1.79, which was up 13% compared to last year.

Looking at cash generation and capital allocation, our free cash flow of \$872 million in the quarter was consistent with our expectations and supports our ongoing objective to invest in our

business while returning significant cash to our shareholders. We invested roughly \$130 million primarily attributed to two acquisitions, and returned approximately \$1.4 billion in share repurchases and dividends. We continue to expect to invest approximately \$1.1 billion to \$1.4 billion in acquisitions during fiscal '18.

With that said, let me turn to some of the details starting with new bookings. New bookings were \$10 billion for the quarter, reflecting 19% growth in local currency over last year. Our consulting bookings were \$5.9 billion, with a book-to-bill of 1.1 and represented an all-time high. Outsourcing bookings were \$4 billion, with a book-to-bill of 0.9.

Once again, our new bookings were well balanced across the business, and we were especially pleased with strong bookings in North America and overall in our Strategy & Consulting business combined. Strong demand continued for Digital, Cloud and Security, which we estimate represented more than 60% of our new bookings. It's also noteworthy that we had 13 clients with new bookings in excess of \$100 million in the quarter.

Now, turning to revenues, net revenues for the quarter were \$9.5 billion, a 12% increase in USD and 10% in local currency reflecting a foreign-exchange tailwind of roughly 2%. Our net revenues were \$170 million above the upper end of our previously guided range as a result of stronger-than-expected performance across every dimension of our business.

Consulting revenues for the quarter were \$5.2 billion, up 13% in USD and 11% in local currency. Outsourcing revenues were \$4.3 billion, up 11% in USD and 9% in local currency.

Looking at the trends in estimated revenue growth across our five business dimensions, growth was led by Application Services and Operations, which both posted double-digit growth. We also saw an uptick in Strategy & Consulting Services combined, which grew mid-single digits. And, as I mentioned earlier, we continued to deliver strong double-digit growth in Digital, Cloud and Security by leveraging the significant investments we've made in recent years to build highly differentiated capabilities.

Looking at our operating groups, Financial Services led this quarter with an 11% growth in local currency, reflecting strong growth in both Banking & Capital Markets and Insurance. Growth was strong across all three geographies, including double-digit growth in Europe and the Growth Markets.

Communications, Media & Technology grew 10% in the quarter, representing their strongest growth rate in seven quarters, driven by continued strong double-digit growth in Software & Platforms. We delivered double-digit growth in both North America and the Growth Markets, and we're particularly pleased with a return to strong growth in Europe.

Products delivered its tenth consecutive quarter of double-digit revenue growth with 10% growth, led by double-digit growth in Consumer Goods, Retail & Travel Services, as well as Industrial. We continued to see strong demand for our services in Europe and the Growth Markets, both of which grew double-digits.

Resources built further on the momentum established in the second half of last year and delivered a strong quarter at 10% growth. The highlight of the quarter continued to be strong double-digit growth in Chemicals & Natural Resources, and we were also pleased with continued signs of stabilization in Energy, resulting in positive growth in the quarter.

Finally, H&PS grew 8%, reflecting a significant improvement over growth rates in fiscal '17. We saw strong growth in both Health and Public Service, led by double-digit growth in both Europe and the Growth Markets and strong growth in North America.

Gross margin for the quarter was 32.1%, consistent with the same period last year. Sales and marketing expense for the quarter was 10.5% compared with 10.4% for the first quarter last year. General and administrative expense was 5.9% compared to 6% for the same quarter last year. Operating income was \$1.5 billion in the first quarter, reflecting a 15.6% operating margin, consistent with quarter one last year.

Our effective tax rate for the quarter was 20.5% compared with an effective tax rate of 20.4% for the first quarter last year. Diluted earnings per share were \$1.79 compared with EPS of \$1.58 in the first quarter last year and, again, this reflects a 13% year-over-year increase.

Days Services Outstanding were 43 days, compared to 39 days last quarter and 44 days in the first quarter of last year. Free cash flow for the quarter was \$872 million, resulting from cash generated by operating activities of \$1 billion net of property and equipment additions of \$133 million. Our cash balance at November 30th was \$3.7 billion compared with \$4.1 billion at August 31st.

With regards to our ongoing objective to return cash to shareholders, in the first quarter we repurchased or redeemed four million shares for \$563 million at an average price of \$139.69 per share. At November 30th we had approximately \$2.6 billion of share repurchase authority remaining.

Also, in November, we paid a semi-annual cash dividend of \$1.33 per share, for a total of \$854 million. This represented a \$0.12 per share, or 10%, increase over the dividend we paid in May.

So, in summary, we're very pleased with our quarter one results, and we're off to a good start in fiscal '18. Now, let me turn it back to Pierre.

Pierre Nanterme

Thank you, David. Our very strong results in the first quarter demonstrate that we continue to execute our strategy very well, and are clearly benefiting from the substantial investments we have made to build differentiated services and further enhance our competitiveness.

I am especially pleased with our continued rotation to the New – Digital, Cloud and Security – which again grew at a very strong double-digit rate this quarter. We have been particularly successful with Accenture Digital, nearly tripling the annual revenue from this business since we launched it four years ago, and we have expanded our capabilities to help our clients with their digital transformations.

Now, given the increasing importance of artificial intelligence, automation, machine learning and other innovative technologies, we are evolving Accenture Digital to be even more relevant to our clients and drive even greater differentiation in the marketplace.

Going forward, Accenture Digital will be focused on three big areas – Accenture Interactive, Accenture Industry X.0 and Accenture Applied Intelligence. Let me bring this to life for you.

We'll start with Accenture Interactive, which is all about serving the CMO and the marketing function, helping the world's leading brands transform the customer experience. We are working

with Maserati to do just that across all of its channels, leveraging our expertise in data-driven marketing, digital analytics and creative services.

We are also strengthening our end-to-end marketing capabilities for CMOs by investing to scale Intelligent Marketing Operations. This capability, which is part of Accenture Operations, combines platforms, analytics, and artificial intelligence to run marketing campaigns as a seamless managed service.

Second, Accenture Industry X.0 focuses on the digital reinvention of manufacturing and production, helping clients create smart, connected products and services using advanced technologies, including the Internet of Things, connected devices and digital platforms.

A great example is how we are partnering with Schneider Electric to create a Digital Services Factory to build and scale new services in predictive maintenance, asset monitoring and energy optimization. By combining real-time analytics with connected technologies on an IoT platform, we are helping anticipate customer needs and reducing the time to launch new services at scale by 80%.

And, to give our clients hands-on experience, we are opening Industrial IoT Innovation Centers, including one near Munich, where we are working with clients to design and prototype digital solutions that will improve engineering, manufacturing and production. We plan to open new centers soon in the US and Asia.

The third area, Accenture Applied Intelligence, brings together the capabilities we have built in advanced analytics and artificial intelligence. Increasingly, we are embedding artificial intelligence into the core of our clients' businesses across every function and process. And, given our technology independence, Accenture holds a unique position in the tech ecosystem, and we are working with all the leading providers of artificial intelligence technologies – including Microsoft, SAP, Google and Amazon – to bring the best solutions to our clients.

We are working with a leading European insurance company to use analytics and artificial intelligence to understand what their customers want and deliver a personalized experience. Our solution – across marketing, claims processing, and customer service – is enhancing customer loyalty and making a significant bottom-line impact.

We also continue to invest in this area with our acquisition of Search Technologies to expand our expertise in big data and enterprise search, and our investment in Paxata, which helps companies generate value from data more quickly.

Of course, we continue to work with clients on their largest and most complex transformation programs – delivering services end-to-end across our five businesses to drive business outcomes.

With Marriott International, we are working at the heart of one of their most important business imperatives, the integration of Starwood, including the massive data migration. We are also leveraging key elements of our Innovation Architecture to help Marriott achieve its goal to enhance the travel experience and accelerate growth. And today, we are very proud to be a flagship innovation partner for Marriott.

Turning to the geographic dimension of our business, I am very pleased that we delivered strong revenue growth in all three of our geographic regions. In North America, we delivered 7% growth in local currency, driven by the United States.

In Europe, we had another excellent quarter with growth of 11% in local currency, driven by strong double-digit growth in Germany, France, and Italy, as well as high single-digit growth in Spain.

And I am extremely pleased with our performance in Growth Markets, where we delivered 16% growth in local currency, led once again by very strong double-digit growth in Japan, as well as double-digit growth in Australia, Singapore, and Brazil.

Before I turn it back to David, I want to mention that the digital capabilities we have built, along with our highly differentiated talent in the New, are absolutely key to the successful execution of our strategy. That is why I am pleased we continue to receive recognition by industry analysts in key areas – ranging from the strength of our execution capabilities in digital strategy and consulting ... to our digital experience services in design, content, and co-innovation ... and for our overall market leadership in digital services.

I am also pleased Accenture was recognized by *Fortune* as a company changing the world, and by Just Capital for our leadership in environmental sustainability, and in the training and development of our people. I truly believe Accenture is a magnet for top talent in the New, not only because of the work we do for clients, but because our culture supports employees who want to make a difference in the communities where we live and work.

So, with that, I will turn the call over to David to provide our updated business outlook. David, over to you.

David Rowland

Thank you, Pierre. Let me now turn to our business outlook. For the second quarter of fiscal '18, we expect net revenues to be in the range of \$9.15 billion to \$9.4 billion. This assumes the impact of FX will be about positive 4.5% compared to the second quarter of fiscal '17 and reflects an estimated 6% to 9% growth in local currency.

For the full fiscal year '18, based upon how the rates have been trending over the last few weeks, we now assume the impact of FX on our results in US dollars will be positive 2.5% compared to fiscal '17.

For the full fiscal '18, we now expect our net revenues to be in the range of 6% to 8% growth in local currency over fiscal '17.

For operating margin, we continue to expect fiscal '18 to be 14.9% to 15.1%, a 10 to 30 basis-point expansion over adjusted fiscal '17 results.

We now expect our annual effective tax rate to be in the range of 22% to 24%. This range does not include the impact from the US tax legislation.

Before I move on, let me add some additional comments on our view of the new tax legislation. Our current assessment is that we do expect to record a non-cash expense in fiscal '18, which

could be up to \$500 million, to reflect the impact of lower tax rates on our US deferred tax assets. Beyond this expense, we expect the impact to our fiscal '18 tax rate to be minimal.

For earnings per share, adjusting for the updated net revenues, FX and tax assumptions, we now expect full-year diluted EPS for fiscal '18 to be in the range of \$6.48 to \$6.66, or 10% to 13% growth over adjusted fiscal '17 results.

For the full fiscal '18, we continue to expect operating cash flow to be in the range of \$5 billion to \$5.3 billion, property and equipment additions to be approximately \$600 million, and free cash flow to be in the range of \$4.4 billion to \$4.7 billion.

Finally, we continue to expect to return at least \$4.3 billion through dividends and share repurchases, and also continue to expect to reduce the weighted average diluted shares outstanding by about 1% as we remain committed to returning a substantial portion of cash to our shareholders.

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

QUESTIONS AND ANSWERS

Angie Park

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. Kevin, would you provide instructions for those on the call?

Operator

Thank you. And, once again, if you wish to ask a question, please press star then one on your touchtone phone. You will hear a tone indicating that you are in queue. You may remove yourself from that queue at any time by depressing the pound key.

The first question is from the line of Tien-Tsin Huang, JP Morgan. Please go ahead.

David Rowland

Good Morning, Tien-Tsin.

Tien-Tsin Huang

Good morning, David. Good morning to you. Very strong results here. I guess I'll hone in on the consulting book-to-bill metric. Like you said, it was the highest you've seen. Wouldn't that imply acceleration for the Consulting segment here in the short to mid-term? Maybe you can update us on that and just growth across Consulting and Outsourcing and if that's changed for the fiscal year.

David Rowland

Let me start by saying that we are very, very pleased with our Consulting bookings, obviously, in the first quarter. We do see good momentum in the business. We're pleased with our pipeline. In fact, if you look at our bookings overall, we expect to have another strong bookings quarter in quarter two.

So, if you look at momentum, really, broadly across our business including Consulting, but not limited to Consulting, we are very, very positive. Perhaps your question really was getting at, therefore, why we didn't raise guidance further, perhaps.

On one hand, we have a lot of reasons to be optimistic. We clearly see momentum in our business, but on the other hand, it's just one quarter in the books, and as we normally do, we want to have a little bit more visibility to the full year before we significantly change guidance. We feel, obviously, very comfortable with taking the low end of the previous guided range off the table, and we will see where we end in quarter two. At that point, we will re-evaluate the upper end of the range. But, overall, very comfortable with our business and feel very good about the momentum.

Tien-Tsin Huang

Got it. That makes perfect sense. Just my quick follow-up, then, I'll just ask the obligatory question around acquisitions and the contribution to revenue or even bookings if you have that in the quarter from acquisitions.

David Rowland

Okay. Thanks, Tien-Tsin. For the full year our view of acquisitions hasn't changed. We expect the revenue contribution, the inorganic to be in the 2.5% to 3% range. Now, that will be heavier or higher in the first half of the year, where in the first half of the year the impact is in the 3% to 3.5% range, and certainly in the first quarter, let's say it was probably more toward the upper end of that 3% to 3.5% range. And in the second half of the year, it will be lower, in the 2% to 2.5% range. So, 2.5% to 3% for the full year, higher in H1, a little bit lower in H2.

We continue to focus, obviously, on acquisitions as an essential part of our strategy. We did have a lower level of acquisitions in the first quarter. There's nothing you should read into that. It's driven by market dynamics, and the timing, and lumpiness of the way the pipeline evolves in acquisitions. We continue to focus on investing \$1.1 billion to \$1.4 billion this year, heavily focused on the New and acquiring critical capabilities to further support that part of our business, which is growing at such a high rate.

Tien-Tsin Huang

Understood. Thanks so much. Wish all of you a happy and safe holiday. Have a good holiday.

David Rowland

Same to you. Thank you, Tien-Tsin.

Operator

Our next question is from the line of Bryan Keane, Deutsche Bank. Please go ahead.

Bryan Keane

Hi, guys, and Happy Holidays as well. Just looking at Strategy & Consulting, that was kind of a key segment that we saw last year kind of decline through the year, and I think it was flat in the fourth quarter on a constant currency basis, and then it's bounced back here to mid-single-digits, also I heard positive bookings comments about Strategy & Consulting. So, maybe you can just talk about, a little bit, on the turn here we've seen in Strategy & Consulting.

David Rowland

Let me make a comment or two, and then Pierre may want to add some comments or not, depending on what I say. So, first of all, let me just remind you, when we had this discussion last year we noted for the group that all of our businesses are subject to going through ebbs and flows in cycles. We commented on the fact that in fiscal '15 and '16 we had consistent double-digit growth in Consulting & Strategy Services combined.

We mentioned last year that Application Services and Operations were very hot, and we also talked about the fact that our Strategy & Consulting practitioners really play two roles. One role is to serve our clients in delivering strategy and consulting services specifically, but the other role is to really bring the full scope of Accenture's services and offerings to the client. So, they have a dual role of both selling the full suite of Accenture's capability to drive transformation, as well as, let's say, business-specific services.

So, in that context, as we indicated, these parts of our business can go through natural ebbs and flows. We're at a point in time now where if you look at the transformation that a lot of industries just continue to go through, if you look at the high level of growth in the New, we're at a point where the convergence of factors was such that the demand for those services was just higher in quarter one. It was fairly broad-based, and it was heavily focused on the New. In fact, the growth rate for Consulting and Strategy in the New was much higher than the average growth rate of mid-single-digits that I commented on.

Pierre, let me just see if there's anything you'd want to add to that.

Pierre Nanterme

Yes, sure. Complementing just what you said, I clearly see three main drivers for Strategy & Consulting growth. I think, of course, the number one is pretty obvious, is there is a stronger demand around digital strategies and digital transformations in all industries and across the world.

Number two, there is still the same appetite today for rationalization. You know all this around the evolution of the industries, digitalization on one hand, rationalization on the other hand. In terms of rationalization, as an illustration, we've had great success with what we're calling ZBB, zero-based budgeting, a kind of approach which is all about rationalizing operations and costs to make our clients more effective.

And three is a clear rebound in what I would call the platform business, and by platforms I'm thinking about SAP, I'm thinking about Microsoft, I'm thinking about Salesforce.com as an illustration. Clearly, their new platforms, cloud-enabled, are creating demand for our technology services, but as well, are driving demand for our Consulting services because you have to significantly transform the organization as well as the processes.

Bryan Keane

Okay. Very helpful color. Just one quick follow-up, when thinking about the 10% constant currency revenue and growth rate, I know that's up from 8% constant currency last quarter, just trying to think about the two big dimensions. Did the New growth portion accelerate that caused that acceleration, or did just the core growth business improve? Thanks so much.

David Rowland

The primary driver of our growth in the quarter continues to be the New. So, the big story continues to be – underpinning that 10% is just very, very strong growth in the New.

Bryan Keane

Okay, congrats on the results.

David Rowland

Thank you.

Operator

Our next question is from the line of Lisa Ellis of Bernstein. Please go ahead.

David Rowland

Hey, good morning, Lisa.

Lisa Ellis

Good morning, guys. Happy Holidays. So, can you guys comment on, as you're now in the close of the calendar year and you're doing your discussions for calendar '18 with clients, what the underlying growth rate is looking like in their overall IT budgets? I mean, we talk a lot about the shift into the New, but I'm curious what the dynamic is with overall growth. I highlight that just because in our recent CIO surveys we're actually seeing a material uptick in actually overall budget growth. I'm curious if you guys are seeing a similar thing as you look into calendar '18.

Pierre Nanterme

Yes, thanks, Lisa, for your question. And indeed, I've been reading carefully the report you provided regarding your CIO survey. And I could only subscribe to the conclusion you've made from this survey, indeed there is an increase in the budget. But as you know, the investments – I mean, they continue to shift from the legacy to the New, to use our own terminology. And on the legacy, the demand is still around rationalizing the applications and rationalizing the infrastructure, which is creating good demand on our cloud services administration, or good demand as well, and we have good results this year, on our application outsourcing business, which is part of our Application Services.

And indeed, we see a shift of the budget to digital technologies at large, including the digital technologies in the IT shop, but I would extend to the digital technologies in the marketing budget as well. And all of these are increasing. I think we're moving in digital from what I would qualify as, these last couple of years, the proliferation of the POC, the proof of concept. So, the prototypes that have been proliferating across the different organizations and now we are moving to the industrialization of the deployment of the digital capabilities and of course, it's creating strong demand to Accenture services because we organized our capabilities exactly to support the industrialization of digital services.

Lisa Ellis

Terrific. Thank you. And then, David, my follow-ups for you, could you give a little color on the free cash flow numbers? I just noticed those are – actually free cash flow is a little bit down year on year, quarter to quarter, and also your guidance for the year, the midpoint of the guidance doesn't have growth year on year despite the strong earnings growth outlook.

David Rowland

Yes, as I said, I don't think there's anything particular to point out in our free cash flow guidance. The first quarter played out pretty much exactly as we'd expected. It's typical that we have an uptick in DSO in the first quarter from the fourth quarter, and that played out as expected in the range that we had expected. And, we continue to track well for our free cash flow for the full year.

Again, one of the things that you know, Lisa, we comment on is the relationship between free cash flow and net income. And, our free cash flow range continues to indicate that we have a model where the free cash flow exceeds our net income. So, we feel very good about it. We work hard every day on DSOs and other aspects of our cash flow to try to land as high in the

range as possible. But, we feel good about the range that we started here with and reconfirmed just a few minutes ago.

Lisa Ellis

Okay, cool. Yes, just wanted to make sure there were no specific callouts. Thank you.

David Rowland

All right, thank you, Lisa.

Lisa Ellis

Thanks, guys.

Operator

Thank you. Next we have Moshe Katri, Wedbush. Please go ahead.

Moshe Katri

Thanks, good morning. Can we talk a bit about digital, cloud and platforms? I'm assuming it's north of 50% of revenues. Maybe some color on that? You did indicate double-digit growth, maybe some more color on that. Is growth accelerating or are we still at the same levels that we've seen a year, maybe two years ago? Thanks.

Pierre Nanterme

Yes, I mean, very pleased to comment on this. I mean, first, what we're calling the New, Digital, Cloud, Security services, you added Platforms, I'm fine with that, we see continued momentum in the services we have built these last few years. Interactive, what we call mobility, analytics, cloud, and security, this is very strong, and we continue to enjoy good growth.

But, in addition, we don't stand still. And this is what I wanted to communicate especially in this call to all of you, is the new waves of digital technologies and innovations are coming extremely rapidly. And so what we want is to make sure we stay ahead of the curve and so we could provide to our clients, at scale, the services in these new technologies. And that's why we are launching these three new services that are going to join Accenture Digital. I'm thinking about Accenture Applied Intelligence, so bringing the artificial intelligence and the machine learning on top of our existing analytics business. So, the analytics business has good momentum, and we are adding artificial intelligence, machine learning, to accelerate this momentum and accelerate growth.

We're doing a very similar thing by the creation of Accenture Industry X.0, where we are bringing the new capabilities we have developed in terms of engineering, production on the Internet manufacturing, if you will, around the digital manufacturing platforms, and all the IoT and connected devices world to, again, sustain and accelerate our momentum in that space.

And the last one is around what we're calling intelligent marketing campaigns in Accenture Interactive. Again, Accenture Interactive has excellent momentum as we speak in the existing services, mainly design, content production and commerce production as well, and we are adding Intelligent Marketing Operations. So, we are adding on top of the good momentum an accelerator, if you will, with the new capabilities we are launching.

So, I'm very comfortable that we are continuing to drive excellent double-digit growth in this part of our business.

David Rowland

If I could just add—let me just add one comment just on the quantitative side, and call out that our revenues in the New now represent approximately 55% of our total revenue stream. One of the things that Pierre and I were looking at yesterday is, and of course, we have been managing this for many quarters now, is just how pervasive that is across our business. I mean, literally, every industry, every geographic market, you see a level of rotation to the New that is, let's say, in the range of 50% or higher, and 55% overall. And I think that that's important for a number of reasons, not the least of which is that supports an essential element of our strategy, which is to create durability and resiliency in our revenue. And that's an illustration, one illustration of how our model is working to do that.

Moshe Katri

Thanks, and just as a follow-up to this, our surveys are talking about the fact, or indicating the fact, that average project sizes in this area are starting to pretty much scale and increase pretty significantly just given the fact that we're getting to a point where you are seeing your typical enterprise buyer connecting the front end to the back-end legacy backbone systems. Are you seeing that as well? And obviously, from your perspective that could be kind of a multi-year phase as well.

Pierre Nanterme

No doubt the digital projects are getting bigger. They are getting bigger, just consistent with the transition I mentioned before. We had this phase where clients were investing in smaller projects that qualified, in terms of prototyping or proof of concept type of projects. You're testing the thing.

Now, we've passed that phase where we have evidence that the digital transformation is driving growth and value for the different industries. And clients are shifting to industrialize the digital capabilities. You've seen more and more the creation of what we're calling, or clients are calling, digital factories, digital hub. That's exactly what we are doing with Schneider Electric, I illustrated a few minutes ago.

So, the projects are getting bigger on average as digital technologies are maturing and are scaling. So, it's a very good trend, and of course it is supporting our double-digit growth in digital-related services.

Moshe Katri

Excellent. Thanks a lot. Happy Holidays.

David Rowland

Same to you, thank you.

Operator

Thank you. The next question is from the line of Rod Bourgeois, DeepDive Equity. Please go ahead.

David Rowland

Hello, Rod. How are you?

Rod Bourgeois

Hi, doing fine, thanks very much. I want to talk a little about – the growth definitely came in strong. I want to talk about the margins for a second. Your operating margin was equal to the

year-ago quarter. But I know there's a lot of moving parts underneath that margin result, particularly since you're reporting a GAAP margin and essentially absorbing all of those acquisition investments. So, can you share the main puts and takes on your margin trend when you compare this year to last year? And I want to know, are there certain underlying factors that are meaningful headwinds year to year, and certain factors that are meaningful tailwinds?

David Rowland

Okay, great, very good question. So, first of all, I think you started with – let me just again, say that our operating margin can in fact vary quarter to quarter. That's the typical pattern in our business for a variety of reasons. Let me also reiterate that irrespective of what our margin was in quarter one, which we were pleased with, we feel very comfortable that we're on the trajectory of delivering 10 to 30 basis points of expansion for the full year, while also meeting our management objective, which is to invest at significantly higher levels than the rate of our revenue growth and then covering that by real underlying expansion in our margin.

As it relates to quarter one, there are probably two or three things that I would point out, none of which are too much of a surprise in terms of the normal flow of our business. The first thing I would highlight is that quarter one of last year was an extremely strong quarter for us. You may remember, Rod, that quarter one of last year, we reported 40 basis points of expansion, and so some of what you see in our first quarter result is compare against a very strong quarter last year.

I think, if I was to just point two other things in our results in the first quarter, one thing is, as you alluded to and I confirmed, we did have a very high level of investments flow through our P&L in the first quarter, which I think you and others would expect given many reasons, including the \$1.7 billion of acquisitions that we invested in last year. And I would say in general our investments are probably on balance higher in the first half of the year this year than the second half of the year.

The other thing that we called out is that we did see some of our operating groups had lower Consulting contract profitability, but again, as you know us well, our contract profitability ebbs and flows at different points in time in our business. And we expect that Consulting contract profitability improves as we progress through the year.

So, those are some things. I would say the higher compares, so really I would say we delivered a consistent level of very high profitability that we reported quarter one last year. And the rate of investment growth was much higher than the rate of revenue growth.

Rod Bourgeois

All right, very helpful. On a somewhat related note, I want to ask about your trend in your sole-source business. In our research, we're seeing some reasons for sole-source activity to increase, but some other factors that could put some pressure on that. I'd love to know, when you net all the trends together, what's the net impact on sole-source signings activity on a weighted average basis across your business? So, can you say where your sole-source percentage is now and whether it's heading up or down?

David Rowland

Yes, I mean, we have had – we track this every quarter, and frankly, we have an amazing level of consistency in sole-source deals as a percentage of the total. It continues to run in the range of about 70%. So, really, Rod, we've seen – we haven't seen a significant change in that pattern.

I think, Pierre, you wanted to add something.

Pierre Nanterme

Yes, I'm going to give some color on this because it's giving me the opportunity to give you information we didn't mention in the script. When you talk about sole-source, I think it does relate to the quality and the deepness of the trusted relationships we have developed with our clients over many, many years. And I'm very pleased to share with this group that we have now 169 Diamond clients.

I'm mentioning this number because many of you know how important these Diamond clients are in the Accenture strategy, including in the economic model. It's a record high of Diamond clients at Accenture, 169, including the best brands across all the world. And the deepness and kind of relationship we've been developing for many, many years are, as well, driving these sole-source projects. Because, sole-source projects are directly correlated to the trust and the confidence our clients are putting in Accenture.

Rod Bourgeois

Wonderful. Thanks, guys.

David Rowland

Thank you. Thank you, Rod.

Operator

Our next question is from the line of Jason Kupferberg, Bank of America. Please go ahead.

Jason Kupferberg

Hi, guys, how are you?

David Rowland

Hi, Jason. Good morning.

Jason Kupferberg

Good morning. So, I just wanted to start with a question on Digital, which obviously is the biggest part of the New. We've estimated that the Interactive business might be upwards of maybe half of Digital. So, any commentary around that and just a general update on the growth trajectory of Interactive and the competitive positioning you see there versus the digital and the traditional ad agencies as the lines continue to blur there? We'd love to hear about that.

Pierre Nanterme

I mean, I couldn't be more pleased to comment on Accenture Interactive, which I would qualify as the darling of Accenture. And, I want to take this opportunity to recognize Brian Whipple for the amazing job he has been doing in providing leadership on Accenture Interactive.

Indeed, Accenture Interactive has been created not long ago, and as you know, for two years in a row, we've been ranked as the leading company in digital marketing by *Advertising Age*, in terms of size, in terms of growth. We have an amazing momentum. I was very pleased to announce in my presentation that we are now the agency of record for Maserati. It means something for us because it means that indeed, we are now a key player in the agency world. We are gaining massive market share. We're becoming certainly a leader in digital marketing solutions.

And, we have three major segments so far in Accenture Interactive. All the digital design, with Fjord, all the digital content production, and you'll remember from years ago we acquired a company called avVenta, being the basis for that. And, in commerce, e-commerce solutions, with Acquity, you remember the acquisition we made in the US. I'm very pleased with the acquisition of Altima we made in France as well, which is going to boost our digital business. And we are adding now this Intelligent Marketing Operations. We're going to use analytics and artificial intelligence.

So, that's the kind of fourth growth engine we are adding in Accenture Interactive. So, I'm extremely comfortable that we will continue to gain market share and to grow significantly with Accenture Interactive. And I'm very pleased, by the way, that to lead our Intelligent Marketing Operations we're going to welcome a very prominent and iconic leader from the industry, Nikki Mendonca, who's going to join Accenture soon to lead that business. I couldn't be more pleased.

Jason Kupferberg

Okay, terrific. So, Accenture, along with pretty much everyone else in this space, has seen this real bifurcation and growth between the New versus the legacy service offerings. I'm just wondering if you guys think that that may lead to some acceleration and industry consolidation, perhaps including larger deals and not just tuck-ins that have been more of the norm across the industry in recent years.

Pierre Nanterme

It's a good question. So, let me start by – I'm going to talk for David on this, because David has got a very strong point of view on the topic and he's always telling me that the big transactions in professional services have failed at 100%, which is quite a significant percentage, if you will. So, are we going to see that? I don't know.

This is not our game at Accenture. Our game is to drive organic growth on top of acquisitions of very specific companies with very specific and differentiated capabilities. And then what Accenture is offering to these companies we're acquiring is our unique access to the best brands in the world and our unique geographic footprint. That's the combo we're bringing. You imagine when these companies are joining Accenture with access to 169 Diamond clients, the best brands in the world.

So, I tend to trust David. I always trust David, 100% of the big transactions in professional services and consolidation failed.

Jason Kupferberg

Okay, well, trusting David has worked so far, so you might as well – Happy Holidays, guys.

Pierre Nanterme

You should always trust David. He's the best CFO of the industry.

Jason Kupferberg

Thanks, enjoy.

David Rowland

Hey, Jason, thanks for teeing that up.

Jason Kupferberg

Any time.

David Rowland

Thank you.

Operator

And the next question is from the line of Brian Essex, Morgan Stanley. Please go ahead.

David Rowland

Good morning, Brian.

Brian Essex

Good morning. Thank you for taking the call, and Happy Holidays from me as well. There's a lot of conversation about the New, certainly worth highlighting. I was wondering if maybe I could follow on a question, I think that Bryan had asked. We've seen some better than expected results, particularly recently from traditional on-premise hardware vendors, kind of driving the debate for on-premise workload computing environment and what's going on in that space.

What are you seeing? Are you seeing stabilization in the core and stabilization within legacy contracts as well? Or, do you have any insight into what's going on there? Or, do you view that as maybe an anomaly in the market?

Pierre Nanterme

What I can share with you is, indeed, our view on this Platforms market. As you know, we are working with all the major players in the ecosystem. I'm thinking about SAP, Oracle, Microsoft, Salesforce.com, Workday, to mention a few.

If you take what probably you would call the legacy players and not the, I mean, the cloud natives such as Salesforce.com and Workday, they had a kind of period, especially SAP and Oracle, of pause, where they were facing this transition from on-premise to cloud-enabled platforms. And then what you've been seeing is they've put their act together in a very strong way.

And, if you take just SAP, they launched S/4HANA, and then on top of HANA their in-memory analytics tools. They are putting now Leonardo, which is bringing more intelligence and artificial intelligence on top of it. And, all of this now is cloud-enabled, and you heard their partnership between SAP and Azure to provide their SAP solutions on the cloud. And now, this is what we've seen in our services, that our services on these platforms are growing significantly. And so to a great extent, I don't believe that there is any more the terminology of legacy players. I think they've been able to transition in the New and now they could compete in cloud ERP solution, likewise the Salesforce.com or the Workday.

So, I'm very impressed with the rotation they have been driving in their business to move from on-premise legacy to cloud as-a-service business.

Brian Essex

Great. And then maybe if I could touch on, as a follow-up, on a question that Lisa, I think, had asked with regard to budgets. I mean our CIO surveys also pointed to better spend next year, but that was a 3Q survey that was prior to tax reform. Are you having any – or do you have any incremental color for next year if there's any sensitivity to a lift from reform and potential upside

to what you've initially had in terms of conversations with your customers?

Pierre Nanterme

No, I could mention, there are many analysts who have been providing information, as well as you, are driving CIO surveys. And they're all very consistent that the budget would increase with the shift from legacy to digital. For me, to be honest, with \$10 billion bookings in Q1, it would be hard not to acknowledge there is a demand out there.

Brian Essex

Very helpful, thank you. Have a nice holiday. Take care.

David Rowland

Thank you, Brian. Appreciate it. You, too, thanks.

Angie Park

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

Operator

Thank you. That question is from the line of David Grossman, Stifel Financial. Please go ahead.

David Grossman

Good morning, thank you. David, sorry if I missed this, but I think you mentioned the tax reform had minimal impact on fiscal '18 EPS. Can you provide us with any parameters that may help us understand the potential impacts of tax reform beyond this fiscal year?

David Rowland

Yes, so just I guess to reconfirm, to ensure I was clear in the remarks I made in the script, again, we expect our tax rate this year, again, to be in the 22% to 24% range, and that does not include the impact of the US tax legislation. Again, our current assessment is that the impact on the effective tax rate will be minimal other than a non-cash expense for fiscal '18 which could be up to \$500 million which reflects the impact of lower tax rates on our US deferred tax assets.

I didn't say it in the script, but let me also add that we do not expect an impact on our tax cash payments this year. So, having said that, over time on an ongoing basis, the legislation could modestly impact our ongoing effective tax rate by imposing taxes on our intercompany transactions and limiting our ability to deduct certain expenses.

And so, the specific answer to your question beyond what I said about '18 is that on an ongoing basis we think it could modestly impact our ongoing effective tax rate. And, essentially, you've got the lower rate which is let's say offset essentially or closely offset by the loss of certain deductions and then the other thing in the mix as well is the tax imposed on intercompany transactions. But in the mix, we see a modest impact over time.

David Grossman

So, that's a modest impact, either plus or minus, is that it?

David Rowland

I would say more likely a modest upward pressure than downward.

David Grossman

Got it. Great, thanks for that. Just one very quick follow-up, so just at a distance, you've done a

great job of using acquisitions to accelerate your ability to reskill around change in the marketplace. So, if in fact that's an accurate observation, given that the guidance is for a slower pace of acquisitions this year, should we assume that you're recruiting and training infrastructure is now at a point that you can better satisfy end-market demand or are there other dynamics that play in that equation?

David Rowland

I would say that, I understand that if you just look at it purely numerically, you would say that we have a lower rate of acquisitions. I wouldn't say that – what I would say is that this year's estimate of \$1.1 billion to \$1.4 billion is entirely consistent with our strategic objective. It just so happens that last year the nature of the opportunities in the marketplace was such that we went above what would be our typical strategic range. That could happen at any time in the future. And so it's not a slowdown, as much as it was last year was just above our strategic range, and this year we're guiding at \$1.1 billion to \$1.4 billion which is right consistent with our strategic objective, and we'll see how the year plays out.

David Grossman

All right, great. Thanks very much. Have a very nice holiday.

David Rowland

Thank you, you, too, David.

CONCLUSION

Pierre Nanterme

All right, I think it's time, right, Angie, to wrap up the call. Thanks again for joining us on today's call. So, in closing, and with the first quarter now behind us, as you probably heard from David and I, we feel very good about where we are, and I'm personally confident that we are very well positioned to continue gaining market share, driving profitable growth, and delivering value for both our clients and all our stakeholders.

I want to wish you, our investors and analysts, and everyone at Accenture, a very happy holiday season and all the best for the new year. We look forward to talking with you again next quarter. In the meantime, if you have any questions, as always, please feel free to call Angie and her team. All the best. Happy New Year. Talk to you next year.

Operator

Thank you. Ladies and gentlemen, that does conclude your conference. We do thank you for joining, while using AT&T Executive TeleConference. You may now disconnect. Have a good day.