

Accenture

2nd 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. Welcome to Accenture's Second Quarter Fiscal 2018 Earnings call. At this time all participants are in a listen only mode. Later, we'll conduct a question and answer session. Instructions will be given at that time. Should you require any assistance during the call, please press star then zero. As a reminder this conference is being recorded.

I would now like to turn the conference over to your host, Managing Director, Head of Investor Relations, Angie Park. Please go ahead.

Angie Park

Thank you, Karen, and thanks, everyone, for joining us today on our Second Quarter Fiscal 2018 earnings announcement. As Karen 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 second quarter. Pierre will then provide a brief update on our market positioning before David provides our business outlook for the third quarter and full fiscal year 2018. We will then take your questions before Pierre provides a wrap-up at the end of the call.

As a reminder, when we discuss revenues during today's call, we're talking about revenues before 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 information presented on this conference call.

Now, let me turn it over to Pierre.

Pierre Nanterme

Thank you, Angie, and thanks, everyone, for joining us today. We are very pleased with our excellent financial results for both the second quarter and the first half of fiscal year '18.

For the quarter, we again delivered strong double-digit revenue growth, which was broad-based across all dimensions of our business. We continue to grow ahead of the market and are clearly gaining significant market share.

I am particularly pleased with our record new bookings. The very strong demand we are seeing – especially in digital, cloud and security – demonstrates that we continue to provide clients with highly differentiated and relevant services.

Here are a few highlights for the second quarter and year to date:

- We delivered excellent new bookings of \$10.3 billion for the quarter and \$20.2 billion for the first half.
- We grew revenues 10% in local currency for both the quarter and year to date.
- We delivered outstanding earnings per share for the quarter of \$1.58 on an adjusted basis, a 19% increase, and for the first half EPS grew 16% on an adjusted basis.
- Operating margin was 13.4% for the quarter and 14.5% for the first half, a contraction of 20 basis points year to date.
- We generated very strong free cash flow of \$791 million for the quarter and nearly \$1.7 billion year to date.
- And we continue to return substantial cash to shareholders through share repurchases and dividends, including \$2.2 billion year to date. Today, we announced a semi-annual cash dividend of \$1.33 per share, which will bring total dividend payments for the year to \$2.66 per share, a 10% increase over last year.

So, as we move into the second half of fiscal '18, I feel very good about the momentum in our business. We are raising our business outlook for revenues, earnings per share, and free cash flow, and I am confident in our ability to deliver another strong year.

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

David Rowland

Thank you, Pierre, and thanks to all of you for taking the time to join us on today's call. Let me start by saying that we were very pleased with our financial results in the second quarter, which put us on a strong trajectory to exceed the net revenue, EPS, and cash flow guidance provided at the beginning of the year. Once again, our results this quarter reflect broad-based momentum across every dimension of our business, and reinforce our relevance and differentiation as the market leader in innovating and leading in the New.

Before I get into the details of the quarter, let me summarize the major headlines of our results. Continued strong top-line growth was the first major headline with net revenues increasing almost \$1.3 billion, reflecting growth of 10% in local currency. The overall theme of broad-based growth was evident again this quarter with strong growth across all five operating groups and all three geographic areas, with double-digit growth in three operating groups and in both Europe and the Growth Markets. Growth continues to significantly outpace the market, driven by strong double-digit growth in all three components of the New, including digital, cloud, and security related services.

As a second major headline, we delivered EPS in the quarter of \$1.58 on an adjusted basis, reflecting 19% growth over last year. This level of EPS growth was driven primarily by 13% growth in our operating income. At the same time, operating margin of 13.4% decreased 30 basis points compared with quarter two of last year. Our operating margin primarily reflects the impact of lower profitability in H&PS, as well as the impact of the record level of investments made in fiscal '17 to acquire critical skills and capabilities in high-growth areas of our business. We do expect operating margin expansion in the second half of the year, and I'll come back to that in our business outlook.

The third major headline relates to outstanding cash flow in the quarter of \$791 million, resulting in \$1.7 billion on a year-to-date basis, which puts us on a very strong trajectory for the full year. For the first half of the year, we continued to execute against our strategic capital allocation objectives, first by investing over \$340 million primarily attributed to five transactions; and second, by returning roughly \$2.2 billion to shareholders via dividends and share repurchases.

With that said, let me turn to some of the details, starting with new bookings. New bookings were \$10.3 billion for the quarter, representing a record high and our third consecutive quarter with bookings of \$10 billion or more. Our consulting bookings were \$5.7 billion, with a book-to-bill of 1.1, and outsourcing bookings were \$4.6 billion, with a book-to-bill of 1.0. The bookings continued to be well balanced across the dimensions of our business. And the dominant driver of our bookings in the quarter continued to be high demand for digital, cloud, and security related services, which we estimate represented more than 60% of our new bookings.

Looking now at revenues. Net revenues for the quarter were \$9.6 billion, an increase of 15% in USD and 10% in local currency, reflecting a foreign exchange tailwind of roughly 5.5%, compared to the 4.5% impact provided last quarter. This result was approximately \$95 million above the upper end of our FX-adjusted range. Our consulting revenues for the quarter were \$5.2 billion, up 17% in USD and 11% in local currency. And our outsourcing revenues were \$4.4 billion, up 13% in USD and 8% in local currency.

Looking at the trends in estimated revenue growth across our five business dimensions, growth was led by Application Services, which posted double-digit growth, driven by strong demand in Application Development services to deploy new technologies. Operations grew high-single digits, and Strategy and Consulting Services combined grew mid-single digits. And as I mentioned earlier, we continued to deliver strong double-digit growth in digital, cloud and security related services by leveraging the significant investments we've made in recent years to build highly differentiated capabilities.

Taking a closer look at our operating groups... Communications, Media & Technology led all operating groups with 15% growth in local currency. Continued momentum was driven by double-digit growth in both Software & Platforms and Communications & Media, as well as double-digit growth across all geographies.

Resources grew 11% in the quarter, driven by strong double-digit growth in Chemicals & Natural Resources and further improvement in Energy, which posted strong growth. We were pleased with the strong balanced growth across all three geographies in Resources.

Products delivered 10% growth in the quarter, representing its eleventh consecutive quarter of double-digit growth, which is an incredible accomplishment. Growth was led by strong double-digit growth in Industrial, and strong growth in Consumer Goods, Retail & Travel Services. Europe and the Growth Markets both grew double-digits, reflecting continued strong demand for our services.

Financial services grew 7% in local currency, reflecting strong balanced growth in both Banking & Capital Markets and Insurance. Growth was strong across all three geographies, including double-digit growth in the Growth Markets.

Finally, H&PS grew 6% with relatively balanced growth in both Health and Public Service, led by double-digit growth in Europe and the Growth Markets and solid growth in North America.

Moving down the Income Statement, gross margin for the quarter was 29.7% compared to 30.1% in the

same period last year. Sales and marketing expense for the quarter was 10.4% compared to 10.5% for the second quarter last year. And general and administrative expense was 5.9%, consistent with the same quarter last year.

Operating income was \$1.3 billion in the second quarter, reflecting a 13.4% operating margin, a decrease of 30 basis points compared to quarter two of last year.

Before I continue with the other metrics, I'd like to highlight that this quarter we recognized a provisional tax expense of \$137 million, primarily to remeasure our net deferred tax assets at the new, lower tax rates. This expense increased our quarter two tax rate by 11% and decreased diluted earnings per share by \$0.21. The following adjusted results exclude this impact.

Our adjusted effective tax rate for the quarter was 15.1%, compared to an effective tax rate of 20.7% for the second quarter last year. Adjusted diluted earnings per share were \$1.58, compared to EPS of \$1.33 in the second quarter last year, and again, this reflects a 19% year-over-year increase.

Our days services outstanding were 40 days, compared to 43 days last quarter and 42 days in the second quarter of last year.

Our free cash flow for the quarter was \$791 million, resulting from cash generated by operating activities of \$924 million, net of property and equipment additions of \$133 million.

Our cash balance at February 28th was \$3.6 billion, compared with \$4.1 billion at August 31st.

With regards to our ongoing objective to return cash to shareholders, in the second quarter we repurchased or redeemed 5.2 million shares for \$804 million at an average price of \$155.30 per share. At February 28th, we had approximately \$2.1 billion of share repurchase authority remaining.

And as Pierre mentioned, our board of directors declared a dividend of \$1.33 per share, representing a 10% increase over the dividend we paid in May last year. This dividend will be paid on May 15, 2018.

So, at the halfway point of fiscal '18, we've delivered very strong results and are very well-positioned for the remainder of the year.

Now, let me turn it back to Pierre.

Pierre Nanterme

Thank you, David. Our excellent performance in the second quarter and year-to-date demonstrates that we have the right growth strategy and that we are executing extremely well.

With 10% revenue growth in local currency in the first half, we continue to grow much faster than the market. And indeed, we have outperformed our basket of competitors for now 16 consecutive quarters – four full years.

Our strong and durable performance reflects our ability to rapidly scale our market-leading position in the New – digital, cloud and security services. And for the first half, revenues from the New were nearly \$11 billion, more than 55% of total revenues, and continued to grow at a very strong double-digit rate.

The accelerated rotation of our business reflects the significant investments we have made over the last few years – including record investments last year – in strategic acquisitions, in building assets and solutions, and in hiring and developing the most relevant talent. Let me bring this to life in two key parts

of our business, Accenture Interactive and Accenture Security.

With Accenture Interactive, we are scaling to further strengthen our leadership position, and for the last two years we have been recognized by Advertising Age as the world's largest provider of digital marketing services.

Just this month, Walt Disney Studios named Accenture Interactive, along with Fjord, an innovation partner for its new StudioLAB. With our expertise in strategy, design and technology, along with our deep industry experience and the applied R&D capabilities of Accenture Labs, we are helping Disney apply emerging technologies in immersive entertainment, artificial intelligence, and the Internet of Things to create the future of entertainment.

And we continue to invest in Accenture Interactive to enhance our capabilities and market differentiation, including four acquisitions we made in the first half: Mackevision, a leading producer of 3D and immersive content in Germany; Altima, a French digital commerce agency; Rothco, a creative agency in Ireland; and MATTER, a design innovation firm in the U.S.

We're also rapidly scaling Accenture Security. Less than three years ago, we committed to building a market-leading cyber-security business to help clients become more resilient to cyber threats. Today, Accenture Security is one of the largest providers in the market, approaching \$2 billion in annual revenues.

Our Security business benefits significantly from Accenture's global scale. And we tailor industry-specific solutions across the full range of security services, including identity & access management, cyber defense, managed security, and strategy & risk.

We are helping a leading insurance company transform its cyber defense with an advanced threat and incident response program, including automation and training for their people, which has dramatically reduced the time to detect and respond to threats.

Accenture has a unique ability to scale the New. With the breadth and scope of services we provide end-to-end – from strategy and consulting to digital, technology and operations – together with our deep industry expertise, we are positioned at the core of our clients' largest transformation problems.

We are working with The Hershey Company on a global transformation program with SAP S/4HANA designed to streamline manufacturing and supply chain processes, gain real-time customer insights to improve decision-making, and accelerate innovation to drive growth.

And we continue to work with clients on mission-critical integrations. We helped DBS Bank, the largest bank in Southeast Asia, with a successful post-merger integration of the wealth management and retail banking businesses acquired from ANZ Bank in five key markets, including, Indonesia, Taiwan, and Singapore.

Now turning to the geographic dimension of our business. I am particularly pleased that we continue to deploy our capabilities in the New at scale in the largest markets around the world.

In North America, we delivered 8% growth in local currency, led by another uptick in growth in the United States.

In Europe, we had another quarter of double-digit growth with 10% in local currency, driven by strong double-digit growth in Germany, Italy, France and Spain. And I'm especially pleased that given our

significant market share gains over the last few years in Europe, we are now positioned as the market leader.

And we delivered another excellent quarter in Growth Markets, with 15% revenue growth in local currency. Japan, again, led the way with very strong double-digit growth, and we had double-digit growth as well in Australia, Brazil, and Singapore.

Before turning it back to David, I want to say a few words about innovation, and how we are building scale through continued investment in our unique Innovation Architecture, which integrates our capabilities from research, ventures and labs to studios, innovation centers and delivery centers.

To bring even more innovation to clients, we have built a global network of more than 100 world-class centers, where we collaborate with clients and co-create innovative digital solutions. And we're extending this network to be even closer to clients.

In the last few months, we opened new Innovation Hubs in Zurich, Tokyo, Boston, and Columbus. We launched a new Liquid Studio in Madrid... and we opened our newest Industrial IoT Innovation Center in Modena, Italy.

Quite simply, innovation is at the heart of everything that we do at Accenture. And we will continue to invest, not only to scale our current capabilities in the New, but also to anticipate the next waves of technology and business disruptions to keep Accenture ahead of the curve in the New.

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

David Rowland

Thanks, Pierre. Let me now turn to our business outlook.

For the third quarter of fiscal '18, we expect net revenues to be in the range of \$9.90 to \$10.15 billion. This assumes the impact of FX will be about 5.5% compared to the third 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 U.S. dollars will be 4% compared to fiscal '17.

For the full fiscal '18, we now expect our net revenues to be in the range of 7% to 9% growth in local currency over fiscal '17.

For operating margin, we now expect fiscal year '18 to be 14.8%, consistent with adjusted fiscal '17 results. This assumes approximately 20 basis points of expansion in the second half of the year.

We expect our GAAP annual effective tax rate to be in the range of 24% to 26%. Excluding the impact of the U.S. tax law changes, we continue to expect our annual effective tax rate to be in the range of 22% to 24%.

For earnings per share, we expect our GAAP diluted EPS for fiscal '18 to be in the range of \$6.40 to \$6.49. Excluding the charge related to U.S. tax law changes, we now expect full-year diluted EPS to be in the range of \$6.61 to \$6.70, or 12% to 13% growth over adjusted fiscal '17 results.

For the full fiscal '18, we now expect operating cash flow to be in the range of \$5.2 billion to \$5.5 billion,

property and equipment additions to be approximately \$600 million, and free cash flow to be in the range of \$4.6 billion to \$4.9 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, let's open it up so that we can take your questions. Angie?

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

QUESTIONS AND ANSWERS

Operator

Ladies and gentlemen, if you'd like to ask a question, please press star then one on your touchtone phone. You may remove yourself from the queue at any time by pressing the pound key. Again, if you have a question, please press star, then one at this time.

Our first question will be from Tien-tsin Huang from JP Morgan. Please go ahead.

Tien-tsin Huang

Thank you, thank you, good morning.

David Rowland

Hi Tien-tsin, how are you?

Tien-tsin Huang

I'm okay, David. Good to talk to you. So, very strong revenue growth obviously. It looks like it might be coming at a slightly higher cost. Maybe, what surprised you exactly on the margin front? I think you mentioned H&PS. Can you elaborate there? We figured it was contract profitability, use of subcontractors. I may have missed it. If you can just elaborate, that'd be great.

David Rowland

Yes, so in H&PS, there's really two things at play. First of all, we had a decline in profitability that was primarily driven by lower contract profitability on a few large contracts, and some of that relates to renewals at lower levels of profitability than they had been previously contracted at. And then secondly, in the mix for H&PS is higher acquisition-related costs for a number of acquisitions that we've done over the trailing four quarters. So, those are really the two factors in H&PS.

Our leadership team is very focused on the profit agenda in H&PS, and we do expect H&PS's profit to improve in the second half of the year. But in the quarter, those were the two primary drivers.

Tien-tsin Huang

Right, so I guess this is my follow up then, just a follow up too on the confidence in the margin expansion in the second half, and I guess more importantly, any reason why Accenture can't return to the typical 10 to 30 bps that we've seen for so long here, it sounds like you can address those contract issues, but anything else to consider?

David Rowland

You know what I would say is, I mean it's stating the obvious, this year's guidance at 14.8 is in the context of this year. It in no way signals anything about what our ability is on an ongoing basis to deliver modest margin expansion. And while as you know, I'm not going to provide specific guidance, I do feel comfortable saying in general terms that our strategic objective to, over time, expand our margins modestly in the 10 to 30 basis point range remains intact. There isn't anything about this year that changes our view on that.

Tien-tsin Huang

Very good. Thanks so much.

David Rowland

Thank you, Tien-tsin.

Operator

Next question is from Joseph Foresi with Cantor Fitzgerald. Please go ahead.

Joseph Foresi

Hi, I wanted to ask about consulting. It seems like the New is driving a lot of the consulting work. Can you talk about the growth rate there and also about the conversion rate into more steady business? Is that about the same or has it changed since prior years?

Pierre Nanterme

Yes, indeed. Our consulting business, as you've seen, has become stronger and stronger and you've seen, especially we are very pleased with the bookings that we see in our consulting business. The rotation to the New is a factor explaining that we are gaining more consulting business, but as well, the rotation to the New is consulting, but is as well creating a ripple effect with the rest of Accenture. So, it has a good contribution in the full range of our services from strategy to consulting, digital and technology, and as well operations. So the New is really impacting across the board, but we see a very positive impact in our strategy and consulting business as well as in systems integration. Bookings are very strong. And if bookings are very strong, it's because we have a good win and conversion rate.

David Rowland

Yes, and I'll just add one point to what Pierre said. I think an important insight in the mix of consulting is a very strong market in our platform business. When we talk about our platform business, we're talking about SAP, Microsoft, Oracle, Salesforce and Workday, primarily, and that part of our business is growing very well. There's definitely a lot of market activity around next-generation ERP and we're benefitting from that in our consulting business. And as Pierre said, the conversion rate, with stronger growth in consulting, those projects on average tend to be shorter in duration, so bookings do tend to convert to revenue at a faster rate.

Joseph Foresi

Okay, and then just it looks like the business outside of the New is improving a little bit. Can you talk about that, and any comments on your strategy in the business outside of the New, thanks?

Pierre Nanterme

Yes, good question. Now we could say the New is the business of Accenture. So, I think we will continue talking about rotation to the New, because what we believe at Accenture is the waves of these new emerging, disruptive technologies will continue coming at an incredible pace. That's why we continue to talk about the New, because today, we've been talking a lot about interactive, mobility, analytics, cloud, security, but we know that to some extent the next New, if I could use that language, is

coming fast in terms of immersive realities, blockchain, even quantum gate, and other technology. So, the New is Accenture.

Now, the remaining core is pretty solid, and we are pleased with that because, frankly, we have invested as well to continue modernizing the core. So we didn't play defense, which is something we don't like to do at Accenture, frankly, but we played the attack by modernizing our core business. And I'm thinking about what we've been doing in terms of bringing a lot of robotics and automation in our services in terms of application outsourcing, in terms of business process services, so we improve and increase the competitiveness of our services vis-à-vis of our clients. And by the way, it does reflect in the good growth we had in technology and operations.

So, we don't let the core down. We invest in the core. We play the attack, we modernize. And we continue to be a very strong player and leader in the core.

Joseph Foresi

Thank you.

Pierre Nanterme

Thank you.

Operator

Next question is from Bryan Keane with Deutsche Bank. Please go ahead.

David Rowland

Good morning, Bryan.

Bryan Keane

Hi, good morning. Just wanted to ask about the tax rate. I know the tax rate was lower. I think it was 15.1% for the quarter, but you kind of reiterated the guidance for the year I think at 22%, 24%, so I think that implies a second half tax rate that's higher, maybe 27% to 28%. So, post-tax reform, just thinking, is that a newer, higher tax rate going forward, just thinking about tax?

David Rowland

You know, our tax rate is lumpy by quarter. The tax rate in any particular quarter is essentially driven by four things. It's driven by the geographic mix, it's driven by change in reserves, it's driven by final determinations, and it's also driven by the tax impact of equity compensation.

So, for example, if you look at the second quarter, the second quarter typically has a structurally lower tax rate, the lowest of the four quarters primarily because of the equity compensation and the fact that the equity compensation is primarily granted on January 1. And as you know, when our stock is appreciating as it has been and the stock price is higher than when it was initially granted as opposed to the vest date, then we get a tax benefit from that, which is what we see, for example, in the second quarter of this year. So, do not read anything into the implied tax rate for the second half of the year or quarter three or quarter four. I would focus more on the annual tax rate and recognize that in any given year our tax rate is lumpy by quarter for any number of reasons.

Bryan Keane

Okay, and then just a quick follow up on tax rate. I know in the Q, I think it talked about the effective tax rate could go up 3.5 points in fiscal year '19 due to the adoption of the FASB, I think it's the inter-entity transfers of assets other than inventory. I'm just curious if we should just expect going forward a higher tax rate as well.

And then just, quick question on the Operations group, it just moderated a tad from its consistent double-digit growth. I just wanted to make sure there wasn't anything implied in that slower growth rate going forward. Thanks.

David Rowland

Right, so you are a student of tax, when you get into that question. So, yes, so we did disclose the ASU that you referenced in our K, and in that disclosure we commented on a potential impact of up to 3.5 percentage points. I think I might have also called out at that time that that is an impact in isolation. But as always, there are other things that impact our tax rate including tax planning. Also, you're asking about '19. In the case of '19, you're aware that the base erosion tax kicks in, but it kicks in at a lower level than it does in '20. And so there's a lot of things in the mix in '19.

Again, I'm not going to comment specifically on guidance, but I will say that as we sit now, subject to change as we continue to evaluate our tax situation, we don't see a material change in our tax rate in '19 from the adjusted guidance that we're providing this year. I'll update that in September, but that's our current view.

Bryan Keane

Okay, I'll turn it over. I just was asking real quick on the Operations group, just it had been double digits consistently and then it just, high single digits now, so I just wanted to see if there's any call-outs, but thanks. Congrats on the quarter.

David Rowland

Thank you very much.

Pierre Nanterme

I'm going to give you a quick one – no change.

David Rowland

No change. Yes, on Operations, yes.

Operator

Next question is from Bryan Bergin with Cowen. Please go ahead.

Bryan Bergin

Hi, thank you. I wanted to ask on the local currency revenue guide range for the year, relative to the strong 10% first half performance, anything you're seeing now in the second half that wouldn't leave you more bullish for the full year range?

David Rowland

You know, one thing is that the inorganic contribution will be incrementally lower in the second half of the year. You know, that's in the mix, but other than that there's not anything specifically. I think everyone knows that we work very hard to land toward the upper end of the range, and we feel very good about our business as we turn the page to the second half of the year. We feel great about our pipeline. We expect to have another good bookings quarter in the third quarter, and we're going to work hard every day to try to land at the upper end of the range, and that would be a good result.

Bryan Bergin

Okay, can you comment on where that inorganic was for the quarter? And then on the Interactive business, we've seen the challenges demonstrated by the traditional agencies with, marketing's been

evolving. What do you think's the biggest difference in your model that's enabling your stronger relative growth?

David Rowland

I'll comment briefly on inorganic, and then I'm going to let Pierre pick up on the second. Previously we had said 2.5% to 3% for inorganic, and I would think now we're looking at more like 2.5%. So, really it's 2.5%, for the year, I'm referring to.

Pierre Nanterme

On Accenture Interactive, and I clearly understand your question, when you look at the typical business of the agencies, there are things we are competing against and things we are not doing at all. And the things we are not doing at all are all in this media buying business you have in the agencies, and this business is trending down significantly as we all know. So we are not in this typical part of the business. Where we are focused on is clearly the high-growth part of this digital marketing environment where, what we're calling brand meets creativity enabled by technology. This is the sweet spot we decided to invest in, and we benefit from the investment.

Second is, we are certainly one of the very few, if not unique, to provide the full range of services against our mentality of end-to-end, from design to production services, to commerce services, to analytic services, and now we're launching intelligent marketing services. So we have this full range of technologies from experience to enabling the customer to run the magic of marketing in digital but as well with the physical experience ... the combination of physical and digital.

And three, is just the leverage of the full scale and footprint of Accenture. Just bear in mind, we are among the very few, if you compare to any of our competitors, to operate in more than 50 markets, or 50 countries. We are covering more than 15 industries, I guess 19. So, when you look at the depth and breadth of our footprint, we have the opportunity to grow in much more industries and in much more markets bringing these end-to-end capabilities, highly differentiated, and targeted in high-growth areas.

Proof point, take Fjord as an illustration, we acquired now three or four years ago, with around 150 people, maybe 160. Now, they are more than 1,000 people, creating the largest experience agency in the world. This is the leverage which is provided by Accenture, and this leverage opportunity is absolutely second to none in the marketplace.

Bryan Bergin

Very helpful, thank you.

Pierre Nanterme

Thank you.

Operator

Next question comes from Brian Essex with Morgan Stanley. Please go ahead.

David Rowland

Good morning, Brian.

Brian Essex

Good morning. Good morning. Thank you for taking the question and congratulations on the quarter. It's nice strong growth.

David Rowland

Thank you.

Brian Essex

I was wondering if, first of all, I could dig into your conversation with Tien-tsin, just on Health & Public Service, the contracts that were signed at lower profitability rates. Was there anything in the quarter that was maybe one-time in nature in terms of upfront costs that gives you confidence in better profitability on a run-rate basis, or maybe a little bit of color on those just to give us confidence in margin expansion going forward?

David Rowland

I don't think, there's not anything one-time in nature that would be appropriate to call out on this call. I mean, in a big operating group there are a lot of things in the mix, and I would tell you that we have a very, very strong leadership team led by Dan London and our H&PS operating group, and they are very diligently focusing on both driving the strategy and the growth agenda, but also our profitability agenda. And I have confidence that the trajectory for H&PS in the second half of the year is going to be a positive trajectory. They are working all levers that we normally focus on, which is everything from our pricing to our cost of delivery through to the efficiency and effectiveness of our sales and marketing costs, our investments, etc., and I think they've got the levers at their disposal to navigate an improving trajectory.

Brian Essex

Got it. That's helpful. Then maybe on the Financial Services, you continue to outpace your peers with pretty strong constant currency growth there. Looks like more European focus. Maybe a little bit of color in terms of conversations that you're having with your customers, budget outlook for the remainder of the year and an outlook for ongoing strong growth in that segment?

Pierre Nanterme

Yes, of course. Frankly, Financial Services, by and large, if you look these last few years, it's been strong. It is an industry, despite all the halo effects around that industry, it is an industry which is still investing a lot in technology, because Financial Services is all about tech. They have to invest if they want to stay relevant.

Now, you have some very specific areas of growth. I'm thinking about risk and regulatory management. You know what is happening in Financial Services, there is a lot on regulatory requirements across the world, especially in Europe. We have the Basel II, the Basel III. In insurance and capital markets, they have their own regulations as well. And then we have all the risk management, which is a very hot place in Financial Services for all the reasons we know. So it's creating a significant market, all what we're calling now R&R, risk and regulatory management.

Of course the other part is always related to omni-channel management. In Financial Services and in banking, you need now to have an omni-channel architecture with your physical branches where you are adding your digital capabilities. And all of this should create a seamless customer experience. All of this has to be built. So you need a lot of strategy work to create the experience architecture and then you need to build the digital platforms, and all the new related processes.

And maybe three is data. Financial Services is an industry where you're mining tons of data, tons of information, and all this concept, for the banks mining their own data – I'm talking about the data of the banks – to find new business models that could create value, is very important.

So, the activities there, you mentioned Europe rightfully, because in Europe – it's true in the US, but it's

very true in Europe – the retail business is pretty depressed because the interest rates are pretty low. So when your interest rates are pretty low, you're not delivering the same profit in your core business, the retail business, so you need to do something in order to uplift your growth and to improve your margin. So, Financial Services is under pressure, but again, it's like the other businesses, they're under pressure so they are looking for new capabilities, new business models and this is where we positioned our services.

Brian Essex

Thanks for the color on the trends. Thank you.

Pierre Nanterme

Thank you.

Operator

The next question comes from Darrin Peller with Barclay's. Please go ahead.

David Rowland

Good morning, Darrin. Darrin? Hello, Darrin. It sounds like he had a bad connection. Do you want to go to the next one?

Darrin Peller

Can you hear me better now?

David Rowland

Yes, we can hear you. Yes, we have you.

Darrin Peller

[Indiscernible]

David Rowland

Darrin, we cannot hear you, actually. You're breaking up on us.

Angie Park

Why don't we go to the next caller, please?

Operator

The next question is from David Koning with Baird. Please go ahead.

David Koning

Hey, guys. Thanks. My first question is the other expense line, the \$44 million or so in Q2, how is that supposed to look in the future and what exactly is that again?

David Rowland

That is primarily FX losses, is essentially what is driving that this year. We have two types of hedging we do. We hedge certain balance sheet items to hedge against inter-company movement of cash and transactions, and then the other hedging program is on our GDN. But there are some balance sheet items that we don't hedge and some of those are unhedged losses, if you will. But then even for our hedging programs, at times the hedging programs can result in hedging gains or losses below operating income, so that's all in the mix. I mean, the simple answer is, it's all related to FX losses this quarter, and that can vary quarter-to-quarter.

David Koning

Okay, thanks.

David Rowland

And all that's accounted for, the important point, in our EPS guidance.

David Koning

Great. Then the one follow-up, the acquisition spending, the last two quarters has been less than it had been in several prior quarters. Is there the expectation that that kind of ramps back up in the back half?

David Rowland

We think it will be stronger in the back half of the year, but we think we could land a bit lower than a billion dollars for the full year.

David Koning

Okay, great. Well, thanks, guys.

David Rowland

Thank you.

Operator

The next question is from Arvind Ramnani with Key Bank. Please go ahead.

Arvind Ramnani

Hi. Thanks for taking my question. Can you talk about the nature of conversations on some of the newer areas, such as AI and blockchain, including the scope and size of these projects?

Pierre Nanterme

With great pleasure. Indeed, as I said before, what we're looking at, at Accenture, is called the New and the new New. And I encourage all of you, as I will mention in a few minutes, to participate in our IA Day, because we'll be hearing a lot about the new New and what next. So I'm going to give to you some flavor on the blockchain, on the artificial intelligence.

On the blockchain, we have more and more projects. And again, what we see is we're starting to move from typically prototypes, proof of concept, the famous POC, to projects that are starting to get some scale. We're not yet there but I think we're starting to see what's most important with blockchain – what are the relevant areas where blockchain could create value. That's what we are doing in our Labs, this is what we are doing with co-innovation with our partners.

When you have a new technology, the big question is how you create business and value out of this new tech. This is what we are doing currently with a consortium of banks in Singapore, so it's in the banking environment where we see a lot of applications of blockchain. Capital markets as well, this is what we are doing with the exchange in Australia. Very recently, we announced new opportunities in the shipping industry with a subsidiary of CMA CGM, which is one of the largest shipping companies in the world, in the contract management.

So we see the payment, we see the transaction exchange, and we see a lot around document and contract management. What we're starting to explore is as well around tracking and food security, or security in tracking the supply chain. So payment, transaction exchange, contract management, tracking of the supply chain, these are kind of four applied opportunities on the blockchain.

On artificial intelligence, probably it would take two days to mention all the opportunities we see in applying the artificial intelligence across the globe. But clearly, the way we look at it, because we are absolutely obsessed by applying technology to create value and not using this as a kind of buzz and hype thing where at the end of the day you don't know exactly what to do with it. So that's why we call it applied intelligence and not artificial intelligence, our unit. I am pushing our people to deliver value to our clients with agility.

Today, we are really focusing around analytics plus machine learning and then you're putting the algorithmic of artificial intelligence on top of it. It's playing a lot with data, it's playing a lot in the manufacturing industry where now you have tons of sensors where you can mine the data and do things such as predictive maintenance, just to mention an obvious application. But we see a lot of artificial intelligence in the predictive business, massive application in health care and life science.

Couldn't be more pleased with the partnership we made with Roche in the cancer research when we are working on what they have, which is called a Tumor Board, where we are integrating machine learning and algorithmic artificial intelligence to improve cancer diagnosis and recommendations for the patient.

I can speak forever, but I think we don't have time, Angie.

Arvind Ramnani

That was very helpful. Just a quick follow-up. When you think of this new New, which includes blockchain and AI, is the composition of work different? Do you have a higher mix of product solutions or do you have a higher mix of consulting? How is the nature of your work different than the other stuff that you guys do?

Pierre Nanterme

It's always the same. When you're starting something new, it's more rich, if you will, in terms of services, in terms of strategy, consulting and high-end tech. That's the way you start. And when these new businesses are starting to mature, in the S curve, if you will, then you add in more of the delivery services, more of the operation services coming behind.

Take security services, for instance, we started with security strategy, identity, cyber threat and we added managed security services. So the new New is clearly more around the high-end tech, high end consulting to bring the industry expertise, and this is what we see with – I meant to mention the three new New, and you will know more again at the IA Day – I'm doing a bit of advertising for the IA Day – around immersive realities, blockchain technologies and artificial intelligence and security services. So it's more on the consulting, strat, high-end tech.

Arvind Ramnani

Very helpful. Thank you so much.

Pierre Nanterme

Thank you.

Operator

The next question comes from Rod Bourgeois with Deep Dive Equity Research. Please go ahead.

David Rowland

Good morning, Rod.

Rod Bourgeois

Good morning to you. A couple of questions on the margins. Congrats on the revenue side. What's the trend in contract profitability in both consulting and outsourcing outside of the H&PS vertical?

David Rowland

Sequentially, the trend is an improvement and we expect sequentially the trend to continue to improve throughout the rest of the year. We're always focused on contract profitability. No matter what the result, we always want it to be better than it was and that is certainly true in the second quarter. But sequentially it was a moderately improving trend.

Rod Bourgeois

Got it. And then, can you give us, David, a little more color on the puts and takes on your margin performance in the first half of the year? I'm specifically interested in the year-over-year impact of acquisition-related costs, but you also have bonus accrual and pricing and other factors. Can you call out any sort of significant changes year-to-year on those trends?

David Rowland

Yes. So purely in the context of, if you laid our first half results last year side-by-side with the first half results this year, really the two big impacts, and we always start with our segments, but the first big impact is H&PS. If you look at H&PS and if you were to look at the rest of the Accenture business absent H&PS, in the first half of the year, absent H&PS the rest of the Accenture business was flat in the first half of the year.

On the other hand, if you look at our inorganic, and if you were to look at the impact of inorganic in the P&L and you look at the side-by-side, the underlying business or let's say the organic part of Accenture, the margins would have expanded significantly in the first half of the year. Of course that is our whole model is to expand the underlying profitability in order to absorb investments. And for the full year, delivering consistent operating margins is, again, a reflection of that.

Rod Bourgeois

Got it. So absent acquisitions, your margin expanded. Then I guess on top of that, is there some added costs in the system because your growth accelerated? Is that an added cost or how do you look at that in terms of its impact?

David Rowland

Not really. Our business is growing rapidly and we are constantly in the talent market bringing people on board. Maybe there's a little friction cost there, but it's just normal business. That's all within the space of, kind of our normal supply chain management and hiring activities.

Rod Bourgeois

Understood. Thanks for the color.

David Rowland

Thanks, Rod. Appreciate it.

Angie Park

We have time for one more question and then Pierre will wrap up the call.

Operator

The last question will be from Jason Kupferberg with Bank of America/Merrill Lynch. Please go ahead.

Jason Kupferberg

Hey, good morning, David. Good morning, Pierre. So just maybe one more on H&PS. I just wanted to get a better understanding of what changed in the last quarter, because I know you talked about some renewals and then you talked about impact of acquisitions over the last 12 months. Those just kind of sound like factors that we would have been aware of maybe a quarter ago, that there was some pending renewals as well as the deals that were already done. So, maybe, can you just walk us through what kind of changed as far as the underlying assumptions there that led us to where we are on the new outlook for full year margins?

David Rowland

Nothing materially changed for H&PS. The explanation of H&PS is in the context of a year-over-year comparison. And the context of what we had expected this year, we had expected H&PS's profitability to be lower and it's in the range of what we had expected.

Our change in margin outlook for the year is really a reflection of a conscious decision that we're making to create the right capacity to continue making investments in our business this year in order to continue to execute our strategy. And to do that while at the same time generating significant returns to our shareholders with strong market-leading revenue growth, with double-digit EPS growth, and strong market-leading cash flow generation. So, everything is in the context of driving significant value to our shareholders and having the right investment capacity to position our business for the long run.

Jason Kupferberg

And just quickly for my follow-up, are there any more renewals than average across your business that you see during the balance of fiscal '18? I know the pace of renewals can obviously vary quarter to quarter and year to year, but is fiscal '18 a particularly high renewal year or no?

David Rowland

No, I don't think anything unusual in that regard.

Jason Kupferberg

Okay, perfect. Thank you.

Pierre Nanterme

All right, so it's time to wrap up. Thanks again for joining us today on this call.

Just in closing, clearly with the strong momentum in our business, our market-leading position in the New, we feel very confident in our ability to continue gaining market share and delivering value for our clients, our people and our shareholders.

We really look forward to talking with you again next quarter, and also to seeing many of you in person at our Investor & Analyst Conference, as I mentioned many times in the call, in New York on April 25th. In the meantime, if you have any questions, of course, feel free to connect and call Angie and the team.

All the best. Talk to you soon, and see you in New York.

Operator

Ladies and gentlemen, this conference will be available for replay after 10:30 a.m. Eastern time today through June 28th. You may access the AT&T Teleconference Replay System at any time by dialing 1-800-475-6701 and entering the access code 444873. International participants dial 320-365-3844.

That does conclude our conference for today. Thank you for your participation and for using AT&T

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CONCLUSION

Operator

Operator

This concludes today's event. Thank you for attending today's presentation. You may now disconnect.