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Accenture Plc (ACN)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Katie O'Conor
Managing Director & Head - Investor Relations

GAAP AND NON-GAAP FINANCIAL MEASURES

- 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

Julie Spellman Sweet
Chair & Chief Executive Officer

Q2 HIGHLIGHTS

Stakeholders, Bookings and Revenue

- And thank you to our 738,000 people around the globe for your incredible work and commitment to our clients which has resulted in our delivering another strong quarter of financial results and the broader 360° value we continue to create for all our stakeholders
- Let me share a few highlights of value we created in our continued disciplined execution

- I'm very pleased with our record bookings for Q2 at $22.1B our highest ever including 35 clients with quarterly bookings greater than $100mm, our second highest quarter on record for such bookings, representing the continued trust that our clients have in us
- We delivered revenues of $15.8B representing 9% growth in local currency bringing us to $31.6B of revenue at 12% growth through H1 and we continued gaining market share growing approximately 2 times the market
- We continued our inorganic investments with six acquisitions in strategic areas including cloud with the acquisition of SKS in Europe, which will expand our specialized technology, consulting and regulatory capabilities enabling us to better serve our financial services clients

Acquisition of Morphus

- Security with the acquisition of Morphus in Brazil, a cyber-defense risk management cyber threat intelligence service provider, and supply chain with the acquisition of Inspirage in the US which will enhance our technology capabilities to accelerate innovation with our clients through emerging technologies such as touchless supply chain and digital twins
- We also continued our investment in our people with 10.3mm training hours, a 12% increase y-over-y
    - We are optimizing our business to lower cost in FY2024 and beyond while continuing to invest in our business and our people to capture the significant growth opportunities ahead
- KC will be giving you more detail on these actions

Strategy

- Finally, we believe our focus on creating 360° value differentiates us in our market
- We earned the number one position in our industry for the tenth year in a row and number 32 overall on Fortune's list of the World's Most Admired Companies
- We ranked number one in our industry and number four overall on the JUST Capital List on America's Most JUST Companies and we've been recognized by Ethisphere as One of the World's Most Ethical Companies for the 16th year in a row
- I'm very pleased that our results demonstrate once again that our strategy to be the execution partner of choice for transformation, lead in the five forces and have a diverse business across markets, industries, and services continues to allow us to lead and take market share
- And in a world in which all strategies lead to technology, we have distinguished ourselves and our impact in the market

KC McClure
Chief Financial Officer

FINANCIAL HIGHLIGHTS

Revenue Growth

- We were pleased with our overall results in Q2, setting a new bookings record at $22.1B, $2.5B higher than our previous record set in Q2 of last year with Consulting bookings close to matching our previous record
- We delivered revenue growth for the quarter at the top end of our guided range as we continued to deliver on our shareholder value propositions

Business Optimization Action

- Before I summarize results for the quarter, let me spend a moment on the business optimization actions we are taking to reduce costs for fiscal 24 and beyond which includes streamlining operations, transforming our non-billable corporate functions and consolidating office space
- We estimate costs of $1.5B through FY2024 of which we expect to incur approximately $800mm in FY2023 and $700mm in FY2024 comprised of approximately $1.2B in severance and $300mm for the consolidation of office space
  - These actions are expected to impact roughly 2.5% or 19,000 of our current workforce, of which, over half are non-billable corporate functions and include over 800 of our more than 10,000 leaders across our markets and services
- Nearly half of the 19,000 people will depart by the end of FY2023

Revenue

- Now let me summarize a few of the highlights of the quarter
- Revenues grew 9% in local currency, driven by broad-based growth across all markets with more than half of our 13 industries growing double-digits
- We also continued to extend our leadership position with growth estimated to be about 2 times the market which refers to our basket of publicly traded companies

Costs and Adjusted EPS

- In Q2, we recorded $244mm in costs associated with the business optimization actions which impacted operating margin by 150BPS and EPS by $0.30
- The following comparisons exclude these impacts and reflect adjusted results
- We delivered adjusted EPS in the quarter of $2.69 reflecting 6% growth over EPS last year
- Adjusted operating margin of 13.8% increased 10BPS with 20BPS expansion YTD and includes continued significant investments in our people and our business

FCF

- Finally, we delivered FCF of $2.2B and returned $1.8B to shareholders through repurchases and dividends
- YTD, we've invested $1.1B in acquisitions primarily attributed to 15 transactions
- With those high-level comments, let me turn to some of the details starting with new bookings

New Bookings

- New bookings were a record at $22.1B for the quarter representing growth of 17% in local currency with an overall book-to-bill of 1.4
- Consulting bookings were $10.7B with a book-to-bill of 1.3
- Managed Services bookings were also a record at $11.4B with a book-to-bill of 1.5
- We were very pleased with the strength of our new bookings which were broad-based delivering a very strong book-to-bill across all of our geographic markets and across our services with a book-to-bill of 1.5 in Operations, 1.4 in Technology, and 1.3 in Strategy & Consulting

Revenue

- Turning now to revenues
- Revenues for the quarter were $15.8B, a 5% increase in US dollars and 9% in local currency, and were at the top end of our range, adjusting for a foreign exchange headwind of approximately 4% compared to the 5% provided last quarter
- Consulting revenues for the quarter were $8.3B, a decline of 1% in US dollars and an increase of 4% in local currency
- Managed Services revenue were $7.5B, up 12% in US dollars and 16% in local currency
- Taking a closer look at our service dimensions: Technology Services and Operations grew double-digits and Strategy & Consulting declined mid-single-digits

Geographic Markets

- Turning to our geographic markets
- In North America, revenue growth was 5% in local currency, driven by growth in public service, health and utilities
    - These increases were partially offset by declining communications and media and high tech
- Revenue growth was driven by the United States

Europe

- In Europe, revenues grew 12% in local currency, led by growth in industrial, banking and capital markets and public service
- Revenue growth was driven by Germany, Italy and France
- In Growth Markets, we delivered 14% revenue growth in local currency, driven by growth in banking and capital markets, chemical and natural resources, and public service
- Revenue growth was led by Japan

INCOME STATEMENT

Gross Margin, Sales and Marketing Expenses

- Moving down the income statement, gross margin for the quarter was 30.6% compared with 30.1% for the same period last year
- Sales and marketing expense for the quarter was 9.9% compared to 9.4% for Q2 last year
- General and administrative expense was 6.8% compared to 7% for the same quarter last year
- Adjusted operating income was $2.2B in Q2, reflecting an adjusted 13.8% operating margin and increase of 10BPS from operating margin in Q2 last year

Effective Tax Rate, Adjusted Diluted EPS and FCF

- Our effective tax rate for the quarter was 20.4% compared with an effective tax rate of 19.2% for Q2 last year
- Adjusted diluted EPS were $2.69 compared with diluted EPS of $2.54 in Q2 last year
- Days service outstanding were 42 days compared to 48 days last quarter and 41 days in Q2 last year
- FCF for the quarter was $2.2B compared to approximately $400mm last quarter, resulting from cash generated by operating activities of $2.3B, net of property and equipment additions of $108mm

Cash Balance

- Our cash balance at February 28 was $6.2B compared with $7.9B at August 31
- With regards to our ongoing objective to return cash to shareholders, in Q2, we repurchased or redeemed 4.1mm shares for $1.1B at an average price of $273.55 per share
- As of February 28, we had approximately $4.2B of share repurchase authority remaining
- Also in February, we paid a quarterly cash dividend of $1.12 per share for a total of $708mm
    - This represents a 15% increase over last year

Cash Dividend

- And our board of directors declared a quarterly cash dividend of $1.12 per share to be paid on May 15, a 15% increase over last year
- Finally, turning to the 360° value we are creating for all our stakeholders, we are partnering with Save the Children to connect with new audiences and invigorate donors through fundraising and creative campaign excellence
    - So at the halfway point of FY2023, we are pleased with our results

Julie Spellman Sweet

Chair & Chief Executive Officer

Q2 HIGHLIGHTS

Macro Environment

- I will start with the overall demand environment, which is more of the same
- We believe that the ongoing volatility and uncertainty in the macro environment is making it even clearer to clients that they need to change more, not less, and that two of the five key forces of change that we have identified for the next decade, the need for total enterprise reinvention and the ability to access, create and unlock the potential of talent are critical to succeed in the near, medium and long-term
- We see two common themes
- First, all strategies continue to lead to technology, particularly cloud, data, AI and security
    - This is reflected in the latest market estimates, which are down slightly, but are still hovering around 5%

Core Operations

- And second, companies remain focused on executing compressed transformations to achieve lower cost, stronger growth, more agility and greater resilience faster
- We remain laser-focused on pivoting to our clients' changing needs and being relevant across the enterprise, from the front line to core operations to corporate functions
- Our ability to advise, shape and deliver value-led transformations, leveraging the breadth of our services from Strategy & Consulting to our strategic Managed Services across all industries and geographic markets is what differentiates Accenture

Shionogi & Co

- Now I will give you more color on the quarter, and in particular, how total enterprise reinvention and talent are critical to our clients
- For example, we are helping Shionogi & Co., Limited, a Japanese pharmaceutical company with a compressed transformation to improve its business process efficiency and create a more agile organization
- We will enter into a joint venture with the company that will provide a Managed Services capability to oversee back-office functions such as human resources, finance and accounting, public relations, facility management, procurement and marketing
- The joint venture will also be charged with the management of pharmacovigilance function from safety management operations to post-marketing operations, to regulatory compliance

Strategy & Consulting

- As part of this transformation, we will upskill over 400 employees, enabling them to play a greater role in the growth and development of the wider business, hence demonstrating the value of all our services from Strategy & Consulting, our deep industry knowledge to Technology and Operations coming together to enable the clients' transformation
- I would like to take a moment to recognize Egawa-san, our Head of the Japan market unit and our extraordinary people in Japan for how they are consistently creating value for our clients with double-digit revenue growth for each of the past five years

State of Missouri

- As clients focus on building their digital core with a modern cloud-based infrastructure, our cloud business continues to grow very strong double digits
- For example, we are working with the state of Missouri to replace its legacy applications and infrastructure with a modern ERP in the cloud, introducing new capabilities in finance, supply chain management, human capital management, payroll and budgeting
- As the current ERP system no longer fully meets the business needs of the state, they are looking for a modern system that is efficient, scalable and flexible, all delivered by a best-in-class implementation partner
    - This compressed transformation, one of the earliest and most complexed ERP implementations for any state, will help reduce operating expenses, provide opportunities for upskilling and improve customer experience and services
- We are partnering with minority and women-owned businesses on this transformation and we will bring in apprentices to program's life cycle, part of our shared commitment with the state of Missouri to foster diversity and inclusion

Cloud First Strategy

- With our Cloud First strategy, our approach has been to help clients, migrate to the cloud and then partner with them on their journey to grow and innovate in the cloud
- Our cloud growth is driven by both migration and clients from moving forward on this journey such as Enel, one of our largest utilities clients who's taken their mass migration to cloud a few years ago to the next level, changing their operating model, tools and talent, and largely automating IT operations

Market Leader

- We are now helping them accelerate the modernization of their application landscape, reduce greenhouse gas emissions by up to 80%, support a significant acquisition and divestment agenda and pivot to platform-based business model for integrated retail delivery beyond meter services, grid, and renewable energy
- Using cloud as their operating system is helping this market leader manage increasing levels of complexity by bringing together data, AI, and applications to optimize their operations and accelerate growth

Enterprise Reinvention

- A strong and secure digital core also is essential to total enterprise reinvention
- We're seeing continued very strong demand for our security services which experienced another quarter of very strong double-digit growth
    - We're working with Empresas CMPC S.A., a Chilean pulp and paper company and a cybersecurity transformation of their plants operations
- We will implement a security program across its 48 industrial sites, focused on threat detection, management, and response as well as governance and workforce training
- Through our global and local industry X capabilities, we will help strengthen the company's cybersecurity expenses through continuous monitoring of its physical locations and equipment
    - We continue to lead in Managed Services which experienced strong growth again this quarter at 16%

Managed Services

- Managed Services are strategic for our clients because they enable clients to move faster, leveraging our digital platform expertise and talent as well as delivering cost efficiencies
- And our clients are turning to Accenture because of the depth and breadth of our industry, functional, and technology expertise that we bring together into the transformation journey
- Our approach to managed services is to both run and transform and run and modernize
    - We deliver cost savings as table stakes

UK DEPARTMENT

- For example, we are partnering with the UK's Department for Work and Pension which is responsible for welfare, pensions, and child maintenance policy to modernize its legacy systems, eliminating backlogs and delivering a better experience for citizens and employees
- We developed a cloud-based intelligent automation platform that combines robotic process automation, AI, analytics and machine learning to provide Bots-as-a-Service to create the equivalent of a virtual workforce available 24/7
- With routine tasks now automated, the organization has already saved 2.4mm human hours which can be reallocated to more complex, higher value tasks

Global H&PS

- Let me pause to thank our global H&PS colleagues for their amazing contributions as evidenced by 14 consecutive quarters of double-digit growth

- As our clients continue to prioritize cost optimization as well as growth and resilience, Song is more relevant than ever
- In Song, which grew strong double-digits this quarter, clients are focused on more capital efficient growth that creates efficiency, drives short-term growth and optimizes existing assets with clear outcomes and shorter time horizons to keep up with the pace of change with customers and technology
    - We've moved quickly to help clients seize new opportunities in contact centers not only for enhanced customer service but also customer acquisition and growth
- We are working with the global biopharmaceutical leader in North America to reinvent digital marketing at scale

SynOps

- Driven by data and using technologies integrated with SynOps, the company will be able to create, produce, and deliver consistent world-class content that informs and educates healthcare providers and patient communities around the world, helping to deliver innovative health services
- We are working with the Prada Group, the Italian luxury fashion player to offer its customers an entirely new customization experience through an online 3D configurator
- Accenture Song created a digital twin of Prada's iconic show called America's Cup, which allows shoppers to fully customize it from material to color to trim across the overlay, lining, sole and other parts

Resolution 3D Model

- With more than 50mm possible configurations more than any web platform could handle this innovative approach allows customers to see high resolution 3D models of their custom builds with the same quality and fidelity as a physical shoe
- Song solution to online product customization is fully scalable through the cloud, it gives Prada the flexibility to apply the same strategy to other products ensuring the outstanding experience their shoppers expect
- As I continue to move across the enterprise, industries and markets, I want to also highlight industry X, which grew very strong double-digits again this quarter and which we believe is the next digital frontier, where our digital engineering capabilities are advancing sustainability services

RECHARGE INDUSTRIES

- For example, we are working with Recharge Industries, a battery research and production company in Australia to help design and engineer one of the world's largest lithium-ion battery facilities
- Once built, the facility will generate up to 30 gigawatt hours of storage capacity per year
- Finally moving to the metaverse and the ongoing tech revolution, we've talked about the importance of artificial intelligence in building the digital core for our clients
    - While generative AI has recently burst into the popular imagination, at Accenture, we've been working with the technology from its earliest stages and are already applying it at clients

Multinational Bank

- For example, we're working with a multinational bank to transform how it manages high volumes of post-trade processing emails every day
- We are leveraging a generative AI solution as it is built to understand the context of emails with high accuracy

- It automatically reads large numbers of emails daily to relevant teams and drafts responses with recommended actions and related information
- Our work will help reduce manual effort and risk, boost worker efficiency and improve interactions with customers

Tech Vision 2023

- And finally on that note, we will release our Tech Vision 2023 on March 30
- The fourth and fifth key forces of change we have identified for the next decade are the metaverse and ongoing tech revolution and this year's tech vision is particularly relevant and actionable as our clients face a rapidly changing landscape in which generative AI and metaverse, cloud, science tech and other technologies are driving more opportunities for change and reinvention
    - This year's vision will explore how these technologies and more are blending the physical world and the virtual world into a shared reality, creating a huge opportunity for our clients and for Accenture

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KC McClure
Chief Financial Officer

Q2 HIGHLIGHTS

Business Outlook

- Now, turning to our business outlook, for Q3 FY2023, we expect revenues to be in the range of $16.1B to $16.7B
- This assumes the impact of FX will be about negative 3.5% compared to Q3 FY2022 and reflects an estimated 3% to 7% growth in local currency
- For the full FY2023, based upon how the rates have been trending over the last few weeks, we now expect the impact of FX on our results in US dollars will be approximately negative 4.5% compared to FY2022
- For the full FY2023, we now expect our revenue to be in the range of 8% to 10% growth in local currency over FY2022 which assumes an inorganic contribution of 2%
    - We expect business optimization actions to impact FY2023 GAAP operating margins by 120BPS and EPS by $0.96
- We expect our anticipated gain on our investment in Duck Creek Technologies to impact EPS by $0.39

Adjusted Operating Margin

- Our guidance for full year FY2023 excludes these impacts
- For adjusted operating margin, we expect FY2023 to be 15.3% to 15.5%, a 10 to 30 basis point expansion over FY2022 results
- We expect our adjusted annual effective tax rate to be in the range of 23% to 25%
    - This compares to an effective tax rate of 24% in FY2022
- We expect our full year adjusted EPS for FY2023 to be in the range of $11.41 to $11.63 or 7% to 9% growth over FY2022 results

Operating Cash Flow

- For the full FY2023, we now expect operating cash flow to be in the range of $8.7B to $9.2B, property and equipment additions to be approximately $700mm, and FCF to be in the range of $8B to $8.5B, $300mm higher than our previous guidance
- Our FCF guidance continues to reflect a very strong FCF to net income ratio of 1.1

Dividend and Share Repurchasing

- Finally, we continue to expect to return at least $7.1B through dividends and share repurchases as we remain committed to returning a substantial portion of cash to our shareholders

QUESTION AND ANSWER SECTION

Tien-Tsin Huang Q
JPMorgan Securities LLC

I have to ask, given the great bookings year, your confidence in being able to replenish those bookings as we look to Q3 and ahead. I'm sure a lot of people are thinking what's going on in the months of February and March as well. I know your guidance applies some reacceleration in Q4, but just curious about your ability to replenish on the bookings side. Thanks.

KC McClure A
Chief Financial Officer

Yeah, thanks, Tien-Tsin. So we do feel good about our pipeline, even after our record bookings this quarter. And our sales outlook for the next quarter Q3 is solid. We expect to have slightly lighter bookings than what we've had compared to the record quarter that we just had.

Julie Spellman Sweet A
Chair & Chief Executive Officer

And maybe just to add a little color, look, as you can see in our bookings, there's just continued strong demand for the larger transformational deals, right, and the need to, in particular, build the digital core. And I'm personally working right now with clients across insurance, healthcare, consumer goods, banking, and telecom, all of whom are very focused on how do we upgrade or – get rid of our technical debt, how do we build more resilience. They're trying to build digital products but they've got really old systems. And so we remain in the early innings of building the kind of digital core that you really need to transform every part of the enterprise.

And so we continue to feel good not just about our pipeline but about the demand we're seeing really rooted in our view that all companies are going to have to do total enterprise reinvention across the enterprise and it's really a continuous cycle starting with a strong digital core. And there's a lot of work to do on building those cores out.

Tien-Tsin Huang Q
JPMorgan Securities LLC

That's good. Glad to hear. Very encouraging. So given that, given both your comments and the optimization, I'm just trying to think about is it more playing offense vs. defense? I'm just trying to think about – I know a lot of your clients are going through similar optimization efforts as well. How does this one fit given that? And should we still think about this within the 10 to 30BPS of typical margin expansion that we think about sort of philosophically, or could this be incremental? Thanks.

Julie Spellman Sweet
Chair & Chief Executive Officer

A

Yeah, so just let me answer the last part first is you should view this as creating the room in our P&L to ensure that we can continue to deliver on that enduring shareholder value model including the 10 to 30BPS which for a short period of time will be on an adjusted basis.

So – and as you think about it, it is – I like that, is it offense or defense. It is offensive. I mean, if you look at where we are today, right, we've got record bookings, a strong quarter of – a strong view of the year, 8% to 10%, 91% chargeability. We are going after structural cost, right, to ensure that we're in a better position.

As you know, we've been dealing with the difficult challenges of compounding wage inflation, and we've been doing that with pricing, but we've also been doing that with cost efficiencies and digitizing. And we have identified an opportunity to go after more structural costs to kind of create that resilience and that room in the P&L as we look forward.

So very much, in our view, getting ahead of and dealing with these structural issues that have been created over the last couple of years.

James E. Faucette
Morgan Stanley & Co. LLC

Q

I wanted to follow up on a couple of those items. First, can you talk a little bit about what you're seeing around the actual conversion and decision cycles? Obviously, the bookings themselves speak well to being able to do conversions, but are we seeing any changes in the sales cycle times or the types of projects that customers may want to engage in?

Julie Spellman Sweet
Chair & Chief Executive Officer

A

Well, let me just start with the type of projects. I mean, what we've been seeing over the last several quarters is just a laser-focus on costs, right. So most programs, clients want to see a shorter return on investment, right, more focus on cost. They love cost and growth, but it has to be, in most cases, a shorter return on the investment.

At the same time, it's important that not all industries are in the same place, right. So if you've got industries like, say, in the high-tech area, and some spots on retail, for example, cost optimization is very dominant, right. If you've got some of the other less affected industries, say, insurance, energy, everyone wants to be more resilient and lower costs, but they are really trying to deal with their technical debt. They're thinking about growth. How do you reimagine the customer experience?

And so I would say a common theme is that in this kind of an environment, everyone does want to be optimizing costs, but where they're focusing is different by industry is what I would say first.

And then to your first part of your question about are you seeing changes in decision-making, and I'll let KC talk to you about the yields in our pipeline, because you also are, in general, seeing a trend toward these larger deals. So there is, and we talked about this in the last couple of quarters, we're seeing less of the smaller deals in S&C, and to some extent, SI, particularly in North America where we're seeing more caution. North America had record sales this quarter, but in areas tending towards the bigger transformational deals, not the smaller S&C, and to some extent, SI deals.

And those – that transformational pipeline, which is our strategy, right, like, if you think about it, what have we been trying to drive for the last few years, we want to be at the center of our clients' business, we want to be able to be relevant, really help them transform and then be well-positioned to continue to be that partner.

And I would just say, Enel, in my script, is a great example of that. I mean, they're a hugely innovative utility. They were very early in cloud. We helped them get to the cloud. And now they're modernizing and once again being super innovative. That's exactly the way we want to work with our clients, be at their core and then be there for their next big transformation.

Maybe, KC, if you want to just comment on the yields real quick?

KC McClure
Chief Financial Officer

A

Yeah, sure. No problem. So let me just focus really on Consulting bookings because it is important to understand the impact of S&C in our Consulting bookings and also how that relates to what we're doing in our larger transformation deals because they do convert to revenue at a slower pace.

So as I mentioned in my script, I was very pleased with our S&C bookings and our overall Consulting bookings, which were very close to the record that we had last year. And S&C participates and is a critical part of winning the larger deals, which we have 35 clients over $100mm. And so what you'll see is in S&C, you may see a conversion that's a little bit slower than we typically have because we still do have some pressure in our smaller deals, particularly in North America.

And so maybe I'll just – how does that all work in terms of yield then? What that means for next quarter? As we look at S&C, and I mentioned that we had a modest decline, a decline in mid-single digits this quarter, we think we'll be in the same zone overall in Q3 and we're going to look to reconnect with S&C growth in Q4. It may take us a little bit more time than that. But I just want to make that connection to your question as it relates to our very strong Consulting bookings in S&C. They were definitely part of that discussion and clearly, part of that – the reason why we're able to get the 35 clients at $100mm. But you'll see that come into our P&L at a little bit slower conversion.

James E. Faucette
Morgan Stanley & Co. LLC

Q

Thank you. That's really helpful. And then just quickly on D&A. It seems like we've seen a little bit of a deceleration there. How are you thinking about D&A going forward? And what was inorganic contribution in the quarter and how should we think about that for the year? Thanks.

KC McClure
Chief Financial Officer

A

So I'll just maybe reiterate the contribution for the year. So we now see inorganic contribution to be about 2%. And acquisitions can be lumpy. And as you know, we can't always really control the timing, but there's no change to our strategy. In any given year, you'll hear us kind of go up or down a bit on the percentage of contribution. No change.

Bryan C. Keane
Deutsche Bank Securities, Inc.

Q

I just wanted to ask about the communications, media and technology group that did come in at flat local currency and is kind of a standout vs. the others. Can you just talk a little bit about what's happening there and what the outlook might be?

Julie Spellman Sweet
Chair & Chief Executive Officer

A

Yeah, that's primarily happening in North America where we've got comms and media and high tech are more challenged, cutting back spending for sort of obvious reasons and then our Software and Platforms business which has been really a strong business for us for the last few years is still slightly positive but has come down a lot. And I think for kind of obvious reasons that we're all reading in the press. And so we do think this will last for a bit of time as you look at sort of some of the ways they're approaching spending and that. And but it will eventually come back and these are great companies, and we're helping them in many places. But their spending is just lower right now.

So that's I think long-term we're very positive. These are all great companies. And this will just – this is why it's so great that we're diverse, right. That we serve so many – and not just diversity in industries but in markets. Because you're seeing a different picture, for example, in comms and media in Europe where it was growing double digits last quarter and in growth markets where it was positive. So the diversity of our business really plays to our strength and why we're continuing to deliver strong financial results.

Bryan C. Keane
Deutsche Bank Securities, Inc.

Q

Got it. Got it. And I was just trying to reconcile in my head, the strong bookings but the actions also taken to lower costs in FY2024. What does that signal I guess for the demand environment in FY2024? Should we expect slightly lower growth rates than typical as a result of the actions taken?

Julie Spellman Sweet
Chair & Chief Executive Officer

A

No. I mean the actions, I can just kind of reground you in like what we've been saying, right, which is we've been achieving hyper growth and there's been wage inflation like none of us have ever experienced and it's compounding and we've been addressing that through a combination of improved pricing, cost efficiencies, and so this is really us taking a step back and being able to more structurally address the impact of compounding wage inflation.

So it's a real positive for how we're moving forward and think of it as really being creating more room in the P&L so that when you think about our enduring shareholder value proposition, we still expect next year to grow faster than the market. We expect to invest at scale in our business to deliver 10 to 30 basis point margin expansion on an adjusted basis to have a disciplined capital allocation including a meaningful return to our shareholders.

So that is a commitment and this is an offensive move to say yes, today we've got great demand, we've got great utilization, and we can take out more structural costs to put us in a better position as we move forward.

Lisa Ellis
MoffettNathanson LLC

Q

Maybe just to kind of follow up on the sort of connecting the dots questions, I noticed that your head count growth slowed a bit this quarter up 6% year-on-year and was flat sequentially. Can you kind of connect the dots that side what you're seeing and sort of what you're thinking about on the hiring side with the fact that you have record bookings in the quarter and then typically those two things kind of move a little bit more in tandem? Thank you.

KC McClure
Chief Financial Officer

A

Yeah, sure. Thanks, Lisa. So maybe I'll just first start with just looking back over the last two previous quarters. We added 28,000 people in the two previous quarters. So let's first start there. And you're right, Lisa, when you take a look at what we were able to accomplish this quarter, first off, we had record bookings. We drove 9.3% revenue growth, and we had 91% utilization of our people, right. So we have the skills and all the people we needed to deliver to the demand in the market.

And if I answer your question looking forward, we sequentially did not add head count from Q1 to Q2. We see that being about the same from Q2 to Q3, and then looking forward based on the outlook that we have now, we do see that we would add additional heads in Q4.

Lisa Ellis
MoffettNathanson LLC

Q

Okay. Great. And then my follow-up is related to AI. Maybe this one is, Julie, for you. Just – can you talk a bit about how you apply AI in your own operations? I know every time this topic kind of stirs up, there's this question of whether it's a positive or a negative for the operations of IT services firms. Can you just talk about how you sort of apply it internally and how you think about that over the long-term? Thank you.

Julie Spellman Sweet
Chair & Chief Executive Officer

A

Sure. In fact, I was just at a client this week where we're helping them really transform their whole IT department and one of the things they want from us is our My Wizard platform which is great way of explaining how over the last several years, we built a platform that integrates the best-in-class technology. So we didn't write our own code, right. We used the best technologies. And the way it uses AI, for example, is that when a ticket comes in to address something, an IT issue, AI looks at it, identifies whether or not it's been a problem solved before, in some cases can solve the problem, in other cases, routes it to the right people, and then it learns from every ticket.

And so in the past, when we've talked about with you about why is it – how do you think about revenue and people, we said, look, we've already been breaking that for years now because we are using so much technology and AI in how we're delivering all of our technology jobs.

The same thing is true, for example, with testing, which is incredibly automated using different technology, including AI. We're continuing to use AI in the way we run our business, for example, in how we look at our accounts payable and receivables and finding ways where we can automate to have better efficiencies there. We're using it today in the way we're delivering our Consulting services as well. And definitely very much so in how we look at sales and being able to predict based on lots of factors should we be running after this sale or not or can we show the data that these – this is not the right kind of sale, we're not the right fit.

So we've increasingly been using AI both in how we deliver services as well as in how we run ourselves. Of course, our SynOps platform for operations is also very AI-enabled. It's one of the reasons why clients turn to us because it's helping them digitize faster. They're not having to build these things.

So long-term, we see these technology changes, things like generative AI as playing to our strengths because to use these technologies, it requires deep understanding of the industry, the use cases, the process changes. When people talk about the new kinds of generative AI which we're super excited about being a co-pilot to human beings, the entire process has to be changed in order to make that work. You've got to upskill the people and you have to be able to do all of that in a very responsible way.

So we're already working with – there's been a lot of demand to understand this, and in understanding it, understanding actually how hard it is to be able to implement at scale and in enterprise vs. I'm assuming we're all having fun playing with it but how you build that into an enterprise is very different and a great opportunity and we're partnering with all the major players to help them take the technology, go from technology to implementation to impact.

David Mark Togut
Evercore Group LLC

Q

Could you delve into demand trends in the financial services vertical in a little greater depth, especially given the evolving banking crisis we've seen in the last month or so particularly with some of the regional banks struggling? And maybe as part of that, if you could just remind us of your profile within bank-related IT services, smaller banks vs. regionals and money centers?

Julie Spellman Sweet
Chair & Chief Executive Officer

A

Sure. As a client base, we skew towards the larger banks across all of the markets. So we don't comment on individual clients. So we don't have any big exposure to kind of the smaller regional banks in general.

So if you sort of think about the stepping base, obviously the developments on the banks are still early in the last couple of weeks. So as I talk about demand trends for our clients, which are generally the bigger banks, a couple of things really stand out. So first of all, there's a lot of focus on their technical debt because the banks, a lot of them are still in the mainframes. Our mainframe practice really across industry is growing like gangbusters right now as clients across industry are really having to take on some of that harder technical debt which they need to do because the more and more they digitize their services which is a continuing trend in financial services, if the systems behind it aren't agile then it can take a lot of time to introduce new services. You've got to oftentimes will have multiple systems, you'll have to test things, you can't go as fast. And so the banks are kind of reaching their limits in terms of what they can do without touching their core. So we expect the sort of addressing the core to be a really important driver.

We're seeing in asset management more and more views, more and more companies in asset management really digitizing. They had been just kind of slower behind the banks. And then insurance, we are working with leading insurers across the world who not only are kind of trying to catch up because banking was ahead of insurance but finding sort of new and exciting opportunities on how to use data in particular to grow their business, how to transform their experience and claims. So financial services, which covers banking, capital markets and insurance, we continue to see as a vibrant area. Where things are slowing down a bit in the US, where we've been a big player is in integration. We'll see that might pick up again. Let's just see how all of this shakes out, but that has slowed down for a bit. Hopefully, that gives you some color.

Jason Kupferberg
BofA Securities, Inc.

Q

I just wanted to ask about Q3 bookings, if you can discuss Consulting vs. Managed Services, just expectations there? I mean I think the y-over-y comparison for Consulting at least gets a bit easier.

KC McClure
Chief Financial Officer

A

Yeah. Thanks, Jason. I'm not going to comment specifically on kind of individual breakout of the bookings, but maybe I'll just reiterate what I mentioned to Tien-Tsin. So we had record bookings this quarter. We do see that next quarter we will have lighter bookings than what we had this quarter in terms of the record bookings.

Overall, what you can see, Jason, you know us well, is that the mix right now is much more favored, halfway through the year, to Managed Services for all the reasons that Julie talked about. We were really pleased with Consulting this quarter that did. We thought it was going to be strong and it came in even stronger. And so that – we're very encouraged by that. And we do have a strong pipeline and we continue to see solid bookings for Q3.

Jason Kupferberg
BofA Securities, Inc.

Q

Okay. Understood. And then just on the cost side, what's the estimated savings from the cost takeout program? And I know the charges will aggregate to $1.5B, but I just wanted to understand kind of what the fully annualized run rate of savings is. And are you essentially reinvesting the savings? I mean, I know at least for this year, we're not changing the underlying margin guidance. So just wanted to get a picture of how much of this is being reinvested or are you essentially just offsetting some other headwinds around wage inflation, et cetera?

KC McClure
Chief Financial Officer

A

Thanks for the question. Let me just first start with FY2023. So the actions that we're taking are not about FY2023. They're about FY2024 and beyond. So in terms of what we'll do with those savings, it really is going to depend, Jason, on how the market develops, the growth opportunities that we have next year. And as Julie said, the key part of what we're really focused on is just going to give us more room to continue to execute our enduring shareholder value proposition, which she mentioned, and I know you know well.

Jason Kupferberg
BofA Securities, Inc.

Q

Yeah. All right. So just to -

Julie Spellman Sweet
Chair & Chief Executive Officer

A

So keep your model. To be clear, keep your model 10 to 30 basis point adjusted margin expansion. We're going to invest in our business, and we're going to grow faster than the market.

Darrin Peller
Wolfe Research LLC

Q

I mean when you put the pieces together with the bookings we're seeing and the actual changes in the efficiency, it really does sound like we're finally seeing more of a divergence in linearity between head count growth and bookings capabilities and revenue contributions. So, I mean, I know you mentioned AI, obviously, the big theme. But is there other factors that we can point to that are structurally part of the model now or is it a function of the mix type of bookings or anything else?

KC McClure
Chief Financial Officer

A

Yeah. Maybe I'll just talk a little bit about what you're seeing in terms of head count, Darrin, and what we're recording in revenue in terms of how we're generating our revenue, and Julie, if you want to add in, you certainly can.

But in terms of what you're seeing is, we've been very focused on hiring, balancing our supply demand to what we need to both sell and drive the revenue to meet our client demand and continue to take market share. And part of what you're seeing throughout the year is, we've been continue – you've heard us talk about us really focusing on continued strong pricing.

And again, a reminder that when we talk about pricing, it's the margin on the work that we sold. And that has been improving over the last five quarters. It's now stable, which we're really happy with. And so some of that is part – there's a part of that that's helping to drive our revenue production as well.

Julie Spellman Sweet
Chair & Chief Executive Officer

A

Yeah. And I would just say, a lot of it's mix, right. If you have longer transformational deals, like the numbers of people that you need to drive are different. So I wouldn't say there's some big, wait a minute, we've got some new inflection point where you've disconnected more. As I talked about earlier, we've been disconnecting to some degree for a while now, but there's no big change in that perspective. It's just as we've executed our strategy.

And I think it's still important to understand that it has been a deliberate strategy to say we want to do transformational deals. We want to take our S&C people who have deep industry and functional knowledge, put them together with our Technology people to do either big implementations, right, that are changing the digital core, or transformations that are coupled with Managed Services, and so how that works out.

And so while we love when the economy is booming and S&C and the small deals are also booming, the strategy is to be at the core so that we continue – we help them with one big project, we understand their company even more, we take them on the next big project, and we're really getting that kind of stickiness in our relationships. And so we'll kind of deal with the sort of softness in the smaller deals, but, over time, like this is exactly what we want to do.

Darrin Peller
Wolfe Research LLC

Q

Yeah.

Julie Spellman Sweet
Chair & Chief Executive Officer

A

And in fact, when you think about this year, Consulting – last quarter, we thought Consulting this year would be mid to – mid-single digits to high single digits. We now see it as mid-single digits for the year and we're fine with that, right, because that's about kind of lower S&C and SI smaller deals.

North America in December, we thought it was going to be mid-single to high-single digits. We now see that as a mid-single-digits for the year. Again, it's because sort of the caution that's impacting the smaller deals, record sales, great large transformational deals. And that's just kind of how it deals with. And that's why, as KC said before, S&C, we're going to see a very similar performance next quarter probably and it may take a little bit longer to reconnect with growth, but remember we don't look at that as separate. We see S&C as a competitive differentiator for these larger transformational deals which is our strategy.

Darrin Peller
Wolfe Research LLC

Q

Yeah, that actually makes a lot of sense. One follow-up on that and related is just the cyclicality of the business is, it's not surprising you would see some of the smaller deals get impacted first by pause or concern among enterprise spending. When we think about the larger transformational side, the pipeline is longer, the sales cycle is longer there. So having that strong still is probably not – if you do – given how well you guys execute, it's not shocking I guess. But on the same side, the magnitude of strength was better than I think we expected. And so looking ahead, in your experience cyclically, when do you see that sort of slow down if the economy does take a step down?

Julie Spellman Sweet
Chair & Chief Executive Officer

A

Look, never say never against the economy slowing down on what we view it, but I really stay focused – we try to stay focused on our strategy being relevant across cycles and basically growing stronger than the market. And so the market is still – faster than market is still kind of hovering around 5%. And so that's what we kind of watch more than the economy because technology is so core to every strategy that when the economy goes down, what are you seeing? Well people are saying we've got to optimize. We've got to lower costs. We've got to do Managed Services.

So we watch more the – the economy can kind of do an uplift right, but what we're trying to always do is grow faster than the market. So that's a big indicator for us. And you see it's a very strong market. And it makes sense, right. I will just tell you like the amount of the just technical debt across these industries and how much work they do, we are still very much in early innings of what needs to be done.

Darrin Peller
Wolfe Research LLC

Q

Great.

Julie Spellman Sweet
Chair & Chief Executive Officer

A

To take advantage of cool things like generative AI. You've got to have data.

Darrin Peller
Wolfe Research LLC

Q

Yeah. Awesome. All right. Thanks, Julie.

Bryan C. Bergin
Cowen Inc.

Q

...consolidation activity. And how much this has helped to really offset some of the areas that have pulled back in the shorter cycle work. And I guess has that picked up meaningfully? And if you were to step back and look at those 35 deals over $100B, can you give us a sense of the mix of those that might include an aspect of under consolidation?

Julie Spellman Sweet
Chair & Chief Executive Officer

A

Yeah, vendor consolidation is certainly a part of what's going on in the market, but there's some industries that did that a long time ago in some clients. So I don't have the numbers offhand of what we have in our 35 clients. But I'm not seeing that as sort of the big driver of our growth right now.

We are often telling clients who basically need to get revenue faster but more – it's interesting, the vendor consolidation for many of our clients is less about costs and more that a lot of the industries like say consumer goods, telecom, where they have lots of different countries, it's very hard to move to a platform business and sort of build things consistently if you have a ton of different vendors, right. Because you want the stuff done in the same way. And so – it's interesting. The vendor consolidation play for many is more about how we actually implement a strategy of kind of moving to global platforms being able to have a single approach to data, super hard to do if you've got 50 to 100 vendors. So I would just say it's tied to exactly the kind of strategies that we're advising clients on. But no big theme for us.

Bryan C. Bergin
Cowen Inc.

Q

Okay. Okay. And then just a quick follow-up. With the record bookings in Managed Services, any near-term margin impacts we should consider as you ramp up and invest in those? Any considerations on adjusted operating margin cadence as you go through H2?

Julie Spellman Sweet
Chair & Chief Executive Officer

A

Yeah, no, there's nothing unusual.