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## Conference Call Transcript

ACN - Q2 2006 Accenture Earnings Conference Call

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## CORPORATE PARTICIPANTS

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**Bill Green**

*Accenture - CEO*

**Mike McGrath**

*Accenture - CFO*

**Steve Rohleder**

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## CONFERENCE CALL PARTICIPANTS

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*UBS - Analyst*

**Greg Gould**

*Goldman Sachs - Analyst*

**Rod Bourgeois**

*Sanford C. Bernstein & Co. - Analyst*

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## PRESENTATION

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### Operator

Good afternoon, ladies and gentlemen, thank you for standing by, and welcome to Accenture's Second Quarter Fiscal Year 2006 Earnings Conference Call. (OPERATOR INSTRUCTIONS) I would now like to turn the conference over to Carol Meyer, Managing Director of Investor Relations. Please go ahead.

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**Carol Meyer - Accenture - Managing Director IR**

Thank you, operator, and thanks, everyone, for joining us today particularly on such short notice. We wanted to make sure that we shared this information with you promptly, which is the reason we moved up our normal release time and call. With me this afternoon are Bill Green, our Chief Executive Officer, Mike McGrath, our Chief Financial Officer, and Steve Rohleder, our Chief Operating Officer.

I hope you've had an opportunity to review the news release we issued just a short while ago. Let me quickly give you the agenda for today's call. Bill will begin with an overview, Mike will take you through our results in more detail, and Steve will add some operational perspective. Mike will then take you through our business outlook for the third quarter and the full fiscal year, and Bill will close the presentation before we take questions.

As a reminder, when we discuss revenues during today's call, we are talking about revenues before reimbursements or net revenues. Some of the matters we will discuss on this call are forward-looking. You should keep in mind that these forward-looking statements are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements. Such risks and uncertainties include but are not limited to general economic conditions, and those factors set forth in today's press release and discussed under the "Risk Factors" portion of the Business section of our annual report on Form 10-K and other filings with the SEC.

Accenture assumes no obligations to update the information presented on this conference call. During our call today, we may reference certain non-GAAP financial measures, which we believe provide useful information for investors. You can find reconciliation of those measures to GAAP in today's news release and on the Investor Relations page of our website at [accenture.com](http://accenture.com). So, now let me turn the call over to Bill.

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**Bill Green - Accenture - CEO**

Thanks, Carol, and good afternoon. Thanks for joining us today on such short notice. We accelerated the timing of this earnings announcement because we wanted to provide you with new information regarding our contracts with National Health Service in England and its impact on our results in the second quarter. As you will hear in more detail from Mike, the need to take decisive action in terms of both the management of these contracts and the accounting provision became apparent in the second quarter. As I'm sure you can appreciate, in order to provide a comprehensive and meaningful assessment of these significant but isolated issues, this afternoon was the earliest opportunity we had to report on NHS and our second quarter.

We are proud of our accomplishments to date and committed to NHS and their vision. We have made significant progress on our work and are very committed to the program. We are disappointed that the recent developments prevented us from meeting expectations this quarter. I want to assure you that we have devoted additional management resources at the highest level to resolve this matter as quickly as possible.

The rest of our business has never been stronger. The strength of our business is broad-based, with local currency revenue growth across all five of our operating groups. We also saw strong revenue growth in all of our geographic regions, with the Americas growing at nearly 20% for the third straight quarter. Our consulting revenue growth in local currency was at an all-time high. Absent NHS, gross margin, operating margin and EPS showed significant expansion. Our balance sheet remains rock solid, with industry-leading metrics in DSOs, and we continue to generate tremendous cash flow.

We have great momentum around our people agenda. Our Q2 attrition was at 16%, a significant improvement over 19% in Q1, and our utilization was 85%, the 12th straight quarter of utilization above 80%. Our opportunity pipeline continues to expand and we are well on our way to achieving our new bookings target for the year.

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These are important indicators of the underlying strength of our business, and while we are intensely focused on keeping the NHS matter clearly defined and contained, we want to make every effort to ensure that the strength of our core business is not lost in the discussion of NHS. We feel it is important to provide you, our shareholders, with a balanced view of our business. Now, let me pass it over to Mike.

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**Mike McGrath - Accenture - CFO**

Thanks, Bill, and good afternoon. Before I get into our standard review for our results, let me address the NHS situation to make clear what this affects, and just as important, what it does not affect, in our financials. You might ask why we are announcing today. In point of fact, the issues that I am discussing solidified during our closing process. Our auditors have just completed their review of this matter earlier today.

To give you some perspective, this year the NHS contracts represent roughly 1% of Accenture's annual net revenues. I point this out to remind you that while this is a significant issue, it is in fact an isolated one. Accenture's contract with NHS consists of two major components -- Deployment, which is accounted for using the percentage-of-completion method, and Services, where revenue and costs are recognized monthly on an as-earned basis.

Based on the new developments in the second quarter, we now estimate that future costs of deployment will exceed future deployment revenues under current contract terms. As required under GAAP percentage of completion rules, we have recorded a \$450 million provision for future losses on deployment. On the income statement, this provision is reflected in Cost of Services for the second quarter of fiscal year 2006. On the balance sheet, substantially all of the balance is contained in a separate contra-account classified as Unbilled Services. The \$450 million NHS provision has no impact on current period cash flow. Rather, it provides for estimated losses over the life of the contract, chiefly the next three to four years. The financial impact of the provision is that the deployment component is expected to operate on a break-even basis over this period.

There were three major developments in the second quarter that impacted our estimates. One, our determination that there would be significant delays by one of our major subcontractors in delivering software critical to the systems' deployment. Two, our determination that we will incur somewhat higher development costs and increased integration costs due to our recent experiences and revised program release schedules. Three, our assessment that there will be a reduction in the pace and level of demand for new systems from local healthcare providers primarily due to software delays and the announced government initiatives to allow local healthcare providers to choose alternate systems.

These developments affected our estimates for both the deployment and services components of the contracts. I have discussed the deployment impact and the resulting provision. The Services component is accounted for on an as-earned basis. We expect Services losses for fiscal year 2006 to be approximately the same as aggregate contract losses were in fiscal 2005, \$140 million. We had previously included this services loss estimate in our 2006 guidance. Looking forward to fiscal 2007, based on current estimates, we anticipate Services losses moderately higher than 2006. Beyond 2007, we expect to drive losses down significantly as the Services revenue and cost curves converge. Clearly, we are dissatisfied with these recent developments and the effect they have on our 2006 results. We take the matter seriously and are taking all necessary steps to contain and resolve these issues in the best interests of both Accenture and our client.

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**Bill Green - Accenture - CEO**

Mike, let me comment here for a minute, if I can. I want to tell you exactly what we've done and what we plan to do regarding our contracts with the NHS. I am personally committed to doing whatever it takes to get the financial implications behind us as quickly as possible. Here's what we've done over the last few weeks. We've developed a re-estimate given the contracts as they currently exist, with up-to-date assumptions on revenue streams and costs. We conducted a specific fact-based determination of all changes and conditions affecting the original contract baseline and the ability to deliver the program to the vision. We've assigned a new team to deal with these changes

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consisting of two senior leaders who will report directly to me. We have mobilized external advisors from a variety of disciplines, and personally I have inserted myself into the oversight of this process. We are committed to working with the NHS to overcome the challenges ahead and deliver a world-class system. We plan to realign the objectives and conditions of the contract with our client to reflect the current realities and intend to conclude an acceptable agreement to move forward that creates value for taxpayers and Accenture shareholders.

We have taken this provision as required under current contract and conditions. Our efforts are focused on mitigating the outcome through our performance enhancements and changes related to the contract in light of the current conditions. Thank you, Mike.

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**Mike McGrath - Accenture - CFO**

Thanks, Bill. As noted earlier, our underlying business continues to perform very well. Let me now walk you through the income statement, balance sheet, and cash flow, and provide some detail behind the numbers.

For the second quarter, net revenues were \$4.1 billion, up 13% in local currency and 8% in U.S. dollars. Breaking that down by type of work, consulting accounted for \$2.47 billion, or 60% of total revenues, a year-over-year increase of 13% in local currency and 7% in U.S. dollars. Outsourcing accounted for \$1.64 billion, or 40% of total revenues, an increase of 13% in local currency and 8% in U.S. dollars.

As you know, on September 1 we began expensing stock options and employee stock purchase plans. As I did during our last conference call, I'll walk you through the year-over-year comparisons using options adjusted numbers. You can find reconciliations to GAAP figures in our news release, on the Investor Relations section of our website, and in the financial statements in the 10-Q that we'll file in a few days.

Now, let me take you through the rest of the income statement. Gross margin for the second quarter of fiscal 2006 was 21.2% on a GAAP basis. Absent the impact of the NHS provision, gross margin was 30.2%, an expansion of 60 basis points compared with options-adjusted gross margin of 29.6% for the second quarter last year.

SG&A costs for the second quarter were \$739 million, or 18% of net revenues. Absent the impact of the NHS provision, SG&A for the second quarter was 18.7%, compared with 19.4% of net revenues for the second period last year.

Our operating income results for the second quarter of this year included a \$14 million benefit from a reduction in reorganizational liabilities, compared with a \$42 million benefit in the second quarter last year. Operating income for the second quarter of 2006 was \$137 million, or 3.3% of net revenues. Excluding the impact of the NHS provision and the reorganization benefit, operating income in the second quarter of 2006 was \$466 million, or 11.4% of net revenues, compared with \$379 million, or 9.9% of net revenues, in the second quarter last year. This would have been a 150-basis-point expansion.

Our effective tax rate for the second quarter was 35.7%, in line with our expected range of 35 to 38% for the year.

GAAP-diluted EPS in the second quarter of 2006 were \$0.11. Excluding the NHS provision, EPS were \$0.38, which compares with \$0.35, or \$0.31 on an options-adjusted basis, in the second period last year.

Now, let's turn to our cash flow and balance sheet. For the second quarter of fiscal 2006, free cash flow, defined as operating cash flow net of property and equipment additions, was \$606 million. This includes operating cash flow of \$678 million, less property and equipment additions of \$72 million. For the first six months of fiscal 2006, free cash flow was \$902 million, including operating cash flow of \$1.05 billion, less property and equipment additions 150 million. Our total cash balance on February 28 was \$2.03 billion, compared to the \$2.48 billion at August 2005. Cash combined with \$491 million of fixed income securities classified as investments on our balance sheet was

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\$2.52 billion, compared with \$3.18 billion at August 2005. Total debt on February 28 was \$52 million, compared with \$54 million at November 2005.

Accenture's balance sheet metrics are strong. In the second quarter, on an options-adjusted basis, our return on investment capital was 45%, our return on equity was 49%, and our return on assets was 14%. Days services outstanding, or DSOs, in the quarter were 35 days. Excluding the impact of the NHS provision, DSOs were 43 days, in line with our target and down from 46 days at the end of the second quarter last year.

During the second quarter of fiscal 2006, we repurchased or redeemed 12.5 million shares, for a total of \$384 million. Accenture's board recently approved \$1.5 billion in additional repurchase authority, bringing our total outstanding authority to \$2.5 billion. This level of authority should give us coverage for the next 18 to 24 months.

Excluding the impact of the NHS provision, I want to emphasize that we had a strong second quarter highlighted by good top line growth, margin expansion and strong cash flow.

Now, I'll turn the call over to Steve for some more detail on our operations.

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**Steve Rohleder - Accenture - COO**

Thanks, Mike. I know everyone's eager to get to the Q&A, but we've had some strong operational results in the quarter that I'd like to share with you.

Operationally, our pipeline remains strong, and we feel good about both the quality and the economics of the opportunities we're pursuing.

Our total new bookings for the second quarter were \$4.33 billion, with outsourcing accounting for \$1.79 billion and consulting accounting for \$2.54 billion. This is the fourth time in the past five quarters that consulting bookings have exceeded 2.5 billion. With total bookings for the first six months of fiscal year 2006 up 13% in local currency, we're well positioned to meet our full year bookings target of 19 [billion] to 21 billion.

Pricing of consulting work remains stable and is consistent with the improvements that we saw in Q1.

We continue to make great progress improving SG&A efficiency.

We ended the quarter with 129,000 people. This is a net increase of nearly 19,000 people, or 17% over last year. We continue to recruit aggressively across all major markets and in the key locations to meet the demand for our services.

Our global delivery network now has more than 44,000 people, including more than 17,500 in India.

We were delighted to see a significant improvement in our attrition in the second quarter, which was 16% annualized, compared to 19% in the first quarter.

Utilization was just under 85% for the quarter, up from 82% last quarter, and is the 12th consecutive quarter with utilization above 80%.

All five of our operating groups had local-currency revenue growth, with three of the five experiencing double-digit growth. All of our geographic regions also saw local currency revenue growth, with the Americas delivering strong double-digit growth for the third straight quarter. Revenues in our Europe, Middle East and Africa region — or EMEA — increased 7%, and Asia Pacific achieved 15% growth.

In closing, I'm extremely pleased with our progress. I'll turn it back over to Mike now for the business outlook.

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**Mike McGrath - Accenture - CFO**

Turning now to our business outlook. For the third quarter of fiscal year 2006, we expect net revenues to be in the range of \$4.3 [billion] to \$4.5 billion. This range assumes a negative FX impact of 3 to 4%. We expect GAAP diluted EPS for the third quarter to be in the range of \$0.45 to \$0.47.

For the full fiscal year we continue to expect net revenue growth of 9 to 12% local currency. We now expect GAAP diluted EPS to be in the range of 1.25 to 1.30, reflecting a \$0.27 EPS impact of the NHS provision in the second quarter.

We continue to expect operating margin for the full fiscal year to be in the range of 12 to 12.5% excluding the impact of the NHS provision. We're continuing to expect operating cash flow for the full fiscal year to be \$2 [billion] to \$2.2 billion. We now expect property and equipment additions to be \$400 million, a \$50 million reduction from our prior estimate, and free cash flow to be in the upper end of our previously announced range of \$1.55 [billion] to \$1.75 billion. We continue to expect our annual effective tax rate to be in the range of 35 to 38%. We are still targeting new bookings in the range of \$19 [billion] to \$21 billion for the full fiscal year.

Before I turn it back to Bill, let me close with a few additional thoughts on NHS. There is no doubt that NHS is a serious situation which requires immediate attention. It would come as no surprise that I'm extremely disappointed with the current status. At the same time, my responsibility as CFO is to maintain balance and perspective around our financial affairs.

In fiscal year 2005, we absorbed a loss of \$140 million on the NHS contracts. To offset this loss, we reduced other costs in order to meet our commitments. The end result was that we delivered strong top-line and bottom-line results, with 28% growth in EPS. I might also add that we began executing a clearly defined program to return cash to shareholders through a combination of share repurchases in our first-ever dividend payment.

We began fiscal 2006 with an assumption of a NHS loss built into our guidance, as I just mentioned. Absent the NHS provision, we will have a strong year. Even with the provision, the upper end of our EPS guidance range for fiscal 2006 will equal or exceed the options-adjusted GAAP EPS for fiscal year 2005, and we will have record or near-record cash flow.

Looking forward to fiscal 2007, we are in the early stages of our annual planning. While I'm obviously not here today to provide fiscal 2007 guidance, I can tell you that in our planning process, our objective is to cover the estimated 2007 NHS loss and still deliver on our four key financial objectives -- generating industry-leading revenue growth, maintaining or expanding operating margin, achieving double-digit EPS growth, and maintaining strong cash flow and a strong balance sheet.

The bottom line is we have the capacity and the resolve to deliver growth and strong financial results. With that, let me turn it back to Bill.

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**Bill Green - Accenture - CEO**

Thank you, Mike. Let me reiterate that Accenture's underlying business remains very strong and is in line with our expectations. We believe that our second-quarter results, even with the NHS provision, illustrate that Accenture continues to build on its leadership position among top-tier IT services firms. Our business, in short, has great momentum. We are disappointed to deliver lower EPS this quarter; however, our core business is growing well. We expect to have cash flow at the upper end of our range. We have redoubled our efforts to continue to improve pricing margins, SG&A, and utilization. Our pipeline has never been stronger. Our cost-of-quality metrics have improved dramatically as the new processes and policies of the management team have taken hold.

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I am taking personal responsibility for getting the NHS issue behind us. These results are unacceptable to me. Although we have laid out a plan and a current view, I intend to do everything in my power to improve on these results. Our business is extremely strong and is well poised for even further growth. We intend to handle this recent event in a forthright, professional and prompt manner, while not losing sight of our success and the great opportunities we have before us.

Now, let's take some questions.

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**Carol Meyer - Accenture - Managing Director IR**

All right, operator, I think we're ready to take some questions now, please.

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**Operator**

Thank you. (OPERATOR INSTRUCTIONS) Our first question is from Adam Frisch from UBS. Go ahead.

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**Adam Frisch - UBS - Analyst**

Okay. Thanks, guys. Understanding the necessary accounting procedures that you're forced to perform, you stressed a few times that these projected losses on NHS are under current contract provision. I understand you can't throw a client under the bus here in a public forum, especially when that's part of a much larger client, but I find it hard to believe that this client can continue to throw its vendors and their shareholders consistently under the same or different bus, the analogy still holds. My question is whether there is a possibility to renegotiate a deal and for these projected losses to be lowered or mitigated in some form or fashion in future quarters?

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**Bill Green - Accenture - CEO**

Well, Adam, this is Bill. Let me first tell you, my intent is to -- we've established some principles that I think are important. The first is, we want to ensure that this contract delivers value to the customers of the NHS. We want to preserve the vision of the NHS, because we believe in it deeply. That said, I think our arrangement with the NHS has to reflect the current reality with some amount of flexibility as we go ahead and do this very important yet complex assignment. We need to work with the NHS to make sure that we get the risk/reward balance that's right for them and right for our Company. And we at Accenture need to put enhanced rigor around our execution and management of our suppliers. That said, we have a good relationship with the NHS. We engage in constant dialogue with them, and our intent is to work closely to them, to come to an accommodation around this agreement that delivers the result they're looking for and treats our shareholders and our Company in the appropriate way.

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**Adam Frisch - UBS - Analyst**

So, I guess yes or no question, is it safe to assume that you are under -- you are currently talking to NHS about renegotiating the current term?

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**Bill Green - Accenture - CEO**

We're currently talking to NHS, first of all, about revisions to the approach in the deployment schedule, and then what are the implications of those revisions, and what other changes have happened in the environment around this that we need to accommodate in our current contractual arrangement.

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**Adam Frisch - UBS - Analyst**

Okay. The only other question I have and then I'll turn it over, you guys seemed pretty confident that you had the issues around NHS well boxed in and so forth, and we, like a lot of people, were kind of saying it's okay unless updated, and obviously it wasn't okay. Financially, it begs the question like some other players in the States who have had recurring issues with big problem contracts, why we won't continue to see this going forward, announcements like this, where we're going to have to -- you're going to have to record big losses on this specific issue. So, why should we have confidence that this is not going to be a recurring development for your company?

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**Steve Rohleder - Accenture - COO**

Adam, this is Steve. Let me address that. We were talking earlier in the comments about the significant changes that all came together at the end of Q2. As you remember, I'm sure, we made it very clear that if there were any changes to our current estimates in guidance, we'd come forward and let you guys know. Late in Q2, we had concluded a detailed review of our subcontractor's delivery capability and concluded that there was going to be a delay. That was one thing.

The second thing is, we had been through enough deployments to understand that they were going to take longer and that there was going to be additional integration required, so we had to adjust our estimates based on that. That was also late in the quarter.

And then, finally, we had a number of circumstances coming together that impacted the future demand of the projects. We took all of those together, we had to re-estimate the project, and we've got a lot of confidence now in the estimates that we put together. We wanted to make sure that we did the right thing in providing for these things, and you should have the confidence going forward that we've estimated them properly.

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**Mike McGrath - Accenture - CFO**

Adam, this is Mike. Let me give you kind of a financial translation of what Steve said. As I said earlier on the call, this contract has two accounting components -- the deployment and the services. On the deployment side, we took a provision which we are comfortable with will cover us through the life of the contract in the sense, from an accounting sense, that is behind us. We feel comfortable with that. On the Services side, it's account as you go. We have identified the losses, we know what they are. I mentioned how we handled them last year and this year. We're comfortable we have them sized reasonable, and we feel we can, when they're out in front of us to manage or accountable, that we can manage them going forward.

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**Adam Frisch - UBS - Analyst**

Okay, thanks.

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**Operator**

Thank you. Our next question is from Gregory Gould from Goldman Sachs. Go ahead, please.

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**Greg Gould - Goldman Sachs - Analyst**

Thanks. I'm sure you're going to get lots more questions on NHS. You know, I wanted to step back for a second and why not just get out of the contract? Clearly, I know one of the arguments before was, well, this could be the stage to win another big government contracts, but we kind of know big contracts just don't work, and why bother going

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after -- governments are erratic anyways as clients, so what's the upside for taking a \$450 million charge and losing money for the next three years -- for a couple of years on the Services side? I don't know if this makes financial sense.

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**Bill Green - Accenture - CEO**

Well, Greg, let me just give you my point of view. We took back --

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**Greg Gould - Goldman Sachs - Analyst**

Why not just hold the NHS over the barrel, because they changed the rules, and this isn't fair to current shareholders that they're causing such a big loss?

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**Bill Green - Accenture - CEO**

Well, Greg, I'll give you my view. Number one, we took that provision because we needed to. That said, we have done all kinds of things on the ground there in order to get the ship sailing in the right direction. I would tell you this in all honesty, we believe in the vision over there. We think the whole aspect of the electronic patient record is an important component. We do think that this is an important pioneering assignment, and I think maybe most importantly to me is, we have had tons of deployments, we have had hundreds of deployments, and they have been very successful. But you're absolutely right, we can't and won't continue under the current terms, right, which aren't going to yield -- if they aren't necessarily going to yield an output for our client and a result for our client, and treat Accenture and the shareholders fairly. That said, we're prepared to step up to our responsibility and work closely with the NHS to get this thing right. That is my going-in position and that is my intent.

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**Greg Gould - Goldman Sachs - Analyst**

Is there a chance to get something better out of this contract from them, because they changed the rules, and it doesn't seem like a good client to have?

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**Bill Green - Accenture - CEO**

We have all our options open, Greg, but our preferred path is to come to an agreement that delivers the results they're looking for and treats Accenture fairly, and that is the path that we're going to head down. But, of course, we have all of our options open as the Company, as we have an obligation to do.

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**Greg Gould - Goldman Sachs - Analyst**

Right. Good luck on those negotiations. On the Business side, I guess the more important side, it sounds like qualitatively things are still very good. Quantitatively, the consulting bookings were 1.8 billion, roughly, and that's down from 2.8 billion a year ago. So, is it just lumpiness here? Should we see a big sequential pickup in bookings in the second half of the fiscal year?

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**Mike McGrath - Accenture - CFO**

I think you picked up a wrong number for consulting bookings.

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**Bill Green - Accenture - CEO**

It was just over 2.5 billion, right?

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**Mike McGrath - Accenture - CFO**

Yeah.

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**Bill Green - Accenture - CEO**

We're delighted with our consulting bookings, actually, and as we look at the activity level we see in the pipeline right now, consulting continues to take the more dominant position that our portfolio of opportunities than it has in years, quite frankly, which we're delighted with, because of not only its profitability, but because of the sales cycles, and because of the innovative nature of it, which then serves us further downstream. As we've talked before, those consulting opportunities today are tomorrow's long-term revenue contracts as we deploy our outsourcing capabilities to it. So, we've been just delighted with the consulting momentum and we continue to see it. We've seen it for quarters, and we continue to see it in our pipeline. So we expect to continue this kind of momentum in the trajectory that's pointed up.

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**Mike McGrath - Accenture - CFO**

Just on the numbers, total bookings for the six months are almost \$9.9 billion, which puts us in the mid point of our range in terms of a \$19 [billion] to \$21 billion range for the year. We think bookings will be strong the last half of the year. I've looked at the book to bills across my rolling four-quarter average, so those look fine. So, basically, we're comfortable with the bookings.

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**Greg Gould - Goldman Sachs - Analyst**

Yeah, okay, I see I did switch the consulting and outsourcing numbers. But you don't see any changes in sales cycles or lengthening of cycles, or anything like that; is that true?

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**Bill Green - Accenture - CEO**

Greg, we have seen continued increases in activity. We have not seen increases in the sales cycles. Those one or two big contracts that everyone stands around waiting to hear the news on continue to take a long time to get closed. That said, those still exist out there, they're making progress, and we haven't seen any back off of any level of activity, or our win rate, or our ability to convert these things from a sale into revenue in short order.

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**Greg Gould - Goldman Sachs - Analyst**

Okay. Thanks, guys.

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**Operator**

Thank you. We will now go to Rod Bourgeois with Bernstein. Please go ahead.

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**Rod Bourgeois - Sanford C. Bernstein & Co. - Analyst**

All right, guys. I'll take one more crack at this to clarify one thing on the NHS contract. Can you give us a little more specificity on what went wrong during the quarter? This is a pretty dramatic turn in events. We know there were issues with iSoft, that was clear about a month ago, but can you just specify a couple of things that changed in your assumptions in terms of what actually happened on the contract?

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**Steve Rohleder - Accenture - COO**

Yes, Rod, let me go through the three items again, try to give you a little bit more color and detail around them. First of all, as I said, we had significant -- we had undertaken a detailed review that ended in February of iSoft and their ability to develop and deliver the solutions that we desired for NHS. We determined at the end of February that there was going to be a significant delay, and we had to then work that through our estimating process and assess the impact of that.

Secondly, as Bill pointed out, we've been through hundreds of deployments now, and we're in a situation where we've learned from those deployments, we understand the complexity of those deployments, and we had to factor in revised estimates for those deployments, as well as the integration of future deployments with the overall system.

Finally, there's been a number of circumstances that have taken place and taken hold in the UK that have contributed to a slower pace and a lower level of demand from all of the two regional organizations that we contract with. So, the point being that demand for our systems was dropping as well. So, all three of those contributed into what I would call the perfect storm to put us back into a re-estimate of the program.

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**Rod Bourgeois - Sanford C. Bernstein & Co. - Analyst**

Okay. And we knew with iSoft, there were issues with future releases, but was there also an issue with the current releases that are affecting your current deployment, or is this purely a function of anticipating a problem down the road in the contract because of future software released issues?

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**Steve Rohleder - Accenture - COO**

The latter.

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**Rod Bourgeois - Sanford C. Bernstein & Co. - Analyst**

Okay, good. And at least a chunk of what you described is actually a function of NHS having their own problems and so at least we should be somewhat hopeful that the contract can adjust to account for that. When we go back to the core business here, I guess the question I have is, you've effectively beaten consensus by \$0.03 if you take the NHS contract out, and I guess I'm wondering, could you be guiding up here on your full-year number? You really haven't changed your non-NHS earnings guidance for the year, even though you're beating by \$0.03 on non-NHS earnings. Given the margin strength, I guess I'm wondering, should we be expecting that guidance number for the year to creep up over the next couple of quarters?

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**Mike McGrath - Accenture - CFO**

Rod, we felt it was prudent to maintain certain guidance in light of the way the quarter wound down, and that we would address any revisions to guidance in Q3.

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**Rod Bourgeois - Sanford C. Bernstein & Co. - Analyst**

Is there any sort of concern over the next couple of quarters and the non-NHS business that may cause the strength you saw this quarter to deteriorate in any way?

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**Mike McGrath - Accenture - CFO**

No, to the contrary. I'd say the non-NHS business is stronger, if anything.

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**Rod Bourgeois - Sanford C. Bernstein & Co. - Analyst**

All right. Financial Services was the only vertical or geography that looked somewhat weak on the growth side. Is there a specific thing in that vertical that's holding it back some? You had pretty strong growth numbers in all of the other units, what's the difference in Financial Services? That's my final question.

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**Steve Rohleder - Accenture - COO**

Yes, Rod, this is Steve. The difference primarily is timing. I mean, our banking business is still strong across all three of the regions. We've actually – we've sold and are delivering 50% growth in our asset sales in Financial Services, but there is some restructuring of the business in the industry. We've got a stronger pipeline, pipeline's up, and I expect us to increase in terms of growth for Q3 and Q4.

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**Rod Bourgeois - Sanford C. Bernstein & Co. - Analyst**

All right. Good luck in fixing this NHS contract.

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**Steve Rohleder - Accenture - COO**

Thank you.

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**Operator**

Your next question is from Andrew Steinerman with Bear Stearns. Please go ahead.

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**Andrew Steinerman - Bear Stearns - Analyst**

Hi. Could you just give a concept on pricing? Usually at the beginning of calendar year is a good opportunity to go back to customers and discuss pricing increases. How has the receptivity been to pricing increases, and what do you feel is the outlook for gross margins on the basis of pricing versus wage increases?

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**Steve Rohleder - Accenture - COO**

Yes, Andrew, let me circle back to what we said in Q1 and our ability to raise prices and take on the increase that we had in payroll. When I said in my comments that we had seen continued stability in those prices, I meant that. Basically we were able to push through price increases, and we had been able to sustain those in Q2. There are pockets in our business consulting organizations, three or four areas, that we continue to press and attain additional pricing above and beyond our margin targets. So I feel very good about our ability to maintain the pricing levels that we put in in Q1, and we're continuing to focus on expanding those through Q3 and Q4.

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**Andrew Steinerman - Bear Stearns - Analyst**

Right. And you may have mentioned the consulting bookings for 2005 is a good level, but usually February is up from November, just seasonally given that this is the beginning of IT budgets. Could you just describe this quarter of why consulting bookings might not have been up from last quarter? Was last quarter just unusually high?

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**Mike McGrath - Accenture - CFO**

Yes, last quarter was like a \$5.5 billion quarter, so it was high and the bookings, as we said, is lumpy. I look at the rule in book-to-bills. And across consulting, outsourcing and in total, the book-to-bills are in line with our expectations. So I think based on our pipeline, my view would be we'd have strong bookings in the last half of the year.

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**Andrew Steiner - Bear Stearns - Analyst**

Okay. Thank you very much.

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**Operator**

Thank you. We'll now go to Brandt Sakakeeny with Deutsche Bank. Please go ahead.

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**Brandt Sakakeeny - Deutsche Bank - Analyst**

Thanks. Good evening. Just a couple of quick questions going back to the accounting on the NHS. I want to make sure I'm interpreting this right. So, 450 million loss, you know the net of accrual bonus is 342, so does that mean bonuses are hit by 108? Am I reading that properly?

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**Mike McGrath - Accenture - CFO**

Yes, you are.

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**Brandt Sakakeeny - Deutsche Bank - Analyst**

Okay. So, I guess the question to that is, obviously this is the second year in a row that bonuses have been negatively impacted by NHS. Can you just talk to maybe organizationally what the feedback is going to be, and certainly how you deal with that issue from an employee motivation and retention standpoint?

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**Bill Green - Accenture - CEO**

Yes, I'll speak to that, because we would like to be able to do a better job on the bonuses, but, first of all, 20% of our people take advantage of the bonus, so that's the participation if you look across Accenture as it relates to participation and how many people are affected. I think, secondly, we've done a good job of trying to educate people around what it is the management plan is about, how we drive this business, and what we have to do as a company in order to be able to earn the bonuses. We know what that is, we set challenging objectives for ourselves, and we work towards them. So, we're just disappointed that we weren't able to take advantage of what would have been a good bonus quarter. That said, we're going to stay the course on it. We intend to deliver good results over the next few quarters, and at the end of the day our Board will decide how our bonus thing gets adjudicated, if at all. I think an important thing to me is, the thing that keeps Accenture people going is the motivation and the excitement in the business. There is no better story to our people than growth, because that creates personal opportunities. At the same time, I am personally, as is Steve and Mike and others, very focused on making sure that we can try to deliver on some of that promise that we make to them.

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**Brandt Sakakeeny - Deutsche Bank - Analyst**

So, Bill, since you're all not articulating bonus levels, does this wipe out a full year's bonus, or is this just a quarter's bonus? How should we think about that?

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**Bill Green - Accenture - CEO**

Well, this is the impact in this quarter, right? We will execute across the next two quarters. We will see if we have the opportunity to accrue bonus there, and then we will discuss with our Board how that bonus should be handled.

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**Brandt Sakakeeny - Deutsche Bank - Analyst**

Okay, great. Thank you.

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**Operator**

Thank you. Our next question is from Cindy Shaw with Moors and Cabot. Go ahead, please.

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**Cindy Shaw - Moors and Cabot - Analyst**

Thanks. A couple of questions about NHS. If I interpreted what I heard correctly, the 450 million charge is under current contract terms which you're trying to change. Is it fair to assume, then, that that 450 million number might go down under a different contract agreement that you're hoping to negotiate?

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**Mike McGrath - Accenture - CFO**

That is a possibility, but obviously we have to account for the current circumstances in the current contract, so, is it a possibility? Yes. Is it something that we would say you should take to the bank at this point? The answer is no.

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**Cindy Shaw - Moors and Cabot - Analyst**

Is there a lot of wiggle room if it does move down? Would that be substantial, or is it more of a nominal amount?

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**Mike McGrath - Accenture - CFO**

I'm sorry, Cindy, I didn't hear what you said.

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**Cindy Shaw - Moors and Cabot - Analyst**

If you are able to change the terms such that it would impact the 450 million figure, is there potential for a substantial reduction in that charge?

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**Mike McGrath - Accenture - CFO**

That's difficult to say. It's certainly hypothetical. I mean, the bulk of the costs that are contained in the charge would occur over the next whatever, three to four years, so it's some years worth of work that would have to be reconfigured in some fashion.

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**Cindy Shaw - Moors and Cabot - Analyst**

Okay, great. Thanks very much.

**Operator**

Thank you. We now have a question from Pat Burton with Citigroup. Please go ahead.

**Pat Burton - Citigroup - Analyst**

Hi. Thank you. Two-part question on the NHS. My understanding is the head of the entire NHS resigned a couple of weeks ago over in the UK. Will that complicate or help in this renegotiation process? And then I have a follow-up question on the unbilled receivables. Thanks.

**Steve Rohleder - Accenture - COO**

On the personnel changes, I wasn't aware of the major resignation that impacts our program, Pat, so I'd say we're working with the program level organization within the NHS, and there's a lot of continuity in that organization right now.

**Pat Burton - Citigroup - Analyst**

Okay. I believe it's the head of the entire NHS resigned. It was in the UK paper a couple of weeks ago.

**Steve Rohleder - Accenture - COO**

Yes, I understand.

**Pat Burton - Citigroup - Analyst**

Second question on the unbilled, it's for Mike. The 1.24 billion remaining of unbilled, have you gone through that and looked at that, and is there any other contracts under percentage of completion that we should be aware of there, or are you comfortable with the status of those receivables?

**Mike McGrath - Accenture - CFO**

No, I'm very comfortable. As you all know, we had a problem, whatever it was, some number of quarters ago, and based on that problem at the time, we changed the whole series of procedures around here in terms of contract monitoring and put in an enhanced, what I would call classification escalation system, and we have executed that to the letter. We go through our contracts on a monthly basis in an organized fashion, and have no extraordinary issues which we are worried about. In point of fact, our outsourcing contracts are performing very well.

**Pat Burton - Citigroup - Analyst**

Thank you.

**Operator**

Thank you. We'll now go to Gregory Smith with Merrill Lynch. Go ahead, please.

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**Greg Smith - Merrill Lynch - Analyst**

Yeah, hi. First question just on NHS. I just want to be clear. What's caused the reduction in future demand as you're sitting here today, future demand on the Services side of the contract from the healthcare provider?

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**Bill Green - Accenture - CEO**

Let me give you sort of the short version, the CEO version, if you will. When we set out to do this, we were going to do this for everybody. In other words, whatever we implemented was going to be taken up and used by every component of the NHS. Since that time, there has been a couple of things that have changed. One of them, for instance, is the opportunity for some of those healthcare units to make an alternative selection or keep what they have. In other words, we were expecting 100% demand and now we're having dramatically less demand. Now, there are two reasons for that. One is their delay of software -- in other words, people wanted to take something up and it wasn't available. The second thing is that there were some choices given that weren't in place when we started the agreement that certain of the healthcare units could opt out, if you will, and choose alternative solutions or just keep what they had. So that had dramatic impact on our demand profile. So, when we look at our revenue stream, which is driven by our demand over time, right, we were projecting a significantly reduced revenue stream as a result of what we expect to be the drop-off in demand. I would just tell you that we have very specific examples of where we've seen the demand drop off. As a result, we have a basis for these projections that is very specific.

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**Greg Smith - Merrill Lynch - Analyst**

Okay, good. That was helpful. And then lastly, just quickly in the forward projection, you reduced capex by 50 million. I was just wondering what the reasoning behind that was?

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**Mike McGrath - Accenture - CFO**

It's a compilation of a lot of small items, as we've taken kind of a mid-year look at the capital as deployed both between client engagements and our infrastructure. The major reduction is in our assumption around what capital we need to run our client engagements.

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**Greg Smith - Merrill Lynch - Analyst**

Okay. So, there wasn't some new initiative put --

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**Mike McGrath - Accenture - CFO**

No. It's just a mid-year true-up of sort of facts in hand to what we thought they might be at the beginning of the year.

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**Greg Smith - Merrill Lynch - Analyst**

Okay. Thanks a lot.

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**Operator**

Thank you. Our next question is from Bill Loomis with Stifel Nicolaus. Please go ahead.

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**Bill Loomis - Stifel Nicolaus - Analyst**

Hi. Thank you. Just on NHS, looking at the \$450 million loss, and you said the revenue from that contract now is about 1%. I'm just trying to understand. It's obviously a very big number. At what level did you expect that revenue on NHS to go up to, because 450 million at current revenue run rate is almost three years worth of revenue. You obviously expected that to ramp up. It's a very large number, I'm just trying to understand how the loss could have gotten so big so quick.

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**Mike McGrath - Accenture - CFO**

Well, the facts are the original contract, when it was signed at the time of sale, if you will, was in the range of \$3.3 billion. That covered both the deployment and the services side. The \$450 million charge represents for the deployment component of the contract, our estimated difference between expected revenues and expected cost over the life of the contract. The \$450 million is comprised roughly of an assumption of one-third of that is revenue reduction in the deployment side, and two-thirds of it was incremental costs for the reason Steve and Bill have articulated earlier.

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**Bill Loomis - Stifel Nicolaus - Analyst**

As far as with iSoft, are you going to have to develop certain other solutions, or are you still depending on iSoft going forward?

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**Steve Rohleder - Accenture - COO**

We are working with iSoft both on their development side and in the management side. We're going to work hand in hand with these guys to make sure that we can mitigate the risk of the delayed deployment.

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**Operator**

Is that all, Mr. Loomis?

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**Bill Loomis - Stifel Nicolaus - Analyst**

Yes, thank you.

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**Operator**

Okay, thank you. Then we'll go to Shlomo Rosenbaum with Stifel Nicolaus.

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**George Price - Stifel Nicolaus - Analyst**

Hi, it's actually George Price. Two quick questions. First, just getting back to the local demand issues. How much of this -- how much is this an impact that you're aware of in regions beyond just the two regions that you're concentrated in? Are there any other issues that are more broad scoped to the overall effort that NHS is undertaking across all of the regions?

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**Steve Rohleder - Accenture - COO**

George, I don't want to comment. We don't even know what the demand impact on the other regions is. We've really focused on our forward projections of demand. So, it would be difficult to comment on that. As far as other issues, again, I wouldn't begin to comment on what the other LSPs are dealing with in terms of issues with the client.

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**George Price - Stifel Nicolaus - Analyst**

Okay. Then the second question is, how was outsourcing revenue in the quarter impacted by NHS, and was there anything else, I guess, in terms of maybe -- anything else going on in terms of maybe slower ramp-up of other contracts, or was it just the NHS impact? Thanks.

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**Mike McGrath - Accenture - CFO**

Well, outsourcing revenue in the quarter was not particularly impacted by NHS. The revenue was what it was, and the growth rate was what I cited. So, basically, the revenue number for the quarter for outsourcing is sort of a business-as-usual number. It's still about 40% of our business.

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**George Price - Stifel Nicolaus - Analyst**

Okay. It's just obviously is a pretty -- it was about 8%, I think, Mike?

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**Mike McGrath - Accenture - CFO**

No, it grew 13% in local for currency, and 8 percent in U.S. dollars with the FX drag and whatever. Our -- I would anchor back to our revenue growth aspirations for the Company; we continue to cite it as being 9 to 12% local currency, which is comprised of an assumption of upper-single-digit growth in consulting in local currency, and outsourcing over time that grows sort of in the mid to high teens. So this quarter we were 13, so we're a click below, but basically we think we're on track as we move forward.

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**George Price - Stifel Nicolaus - Analyst**

Okay. Thank you.

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**Carol Meyer - Accenture - Managing Director IR**

Operator, I think we have time for one last question, please.

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**Operator**

Thank you. That will be a follow-up from Adam Frisch. Please go ahead.

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**Adam Frisch - UBS - Analyst**

Hi. Thanks for taking the follow-up. Mike, can you just go over two things. One, how you cover the losses in future periods? I know it was somewhat admirable when you had the last problem that you cut your bonuses, but maybe provide a little bit more detail. You touched on the surface. And then, secondly, just to make sure we have everything right here, what is the incremental EPS and free cash flow impact of this latest development and the

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timing of those changes? Obviously, you're taking a charge now, but how does it impact '06, '07 EPS? '06 is obvious, and also on the free cash flow side?

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**Mike McGrath - Accenture - CFO**

Well, you've got a lot of questions there. Let me start with the last one first. Cash flow side and relative to the provision, the provision is a non-cash charge in fiscal 2006, and will play out absorbing the losses over the life of the contract, chiefly over the next three to four years. So, if you will, the cash necessary to fund the losses goes out the door over the next three to four years.

From an EPS standpoint, we have indicated that this year we expect an NHS loss on the services side, break-even on the deployment, loss on the services side, of something in the magnitude of \$140 million. That was built into our EPS guidance, so we're not changing our EPS guidance for NHS this year. I indicated that next year we expect a break-even on the deployment side and a moderate increase on the -- moderate increase in the loss on the services side. So, I think you can pencil that in and figure out what sort of -- whatever, \$16 million a penny, how you think that might affect our EPS from a gross basis. How we cover that, last year you know we took down the old variable comp. This year we've reduced our bonus. Going forward, I indicated we are looking at our '07 plan. Now as we plan '07, we are committed to our financial objectives as I outlined, and we will make other cost reductions, other assumptions around the '07 operations. We have a business that this year will have a round number of \$17 billion of revenue and some larger number next year. We have a cost base in this place of something to the tune of this year of about \$15 billion, and next year let's call it, whatever, 17, and we need to find, you know what, something north of \$150 million to manage it in a \$17 billion cost base. Then that's where we're going and thinking about how we do that.

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**Adam Frisch - UBS - Analyst**

Okay. Well put. Thank you.

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**Mike McGrath - Accenture - CFO**

I hope I answered your questions. You had an number of them there. If I lost one out, come back to me.

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**Adam Frisch - UBS - Analyst**

I'm actually going over the list. I think you got them.

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**Mike McGrath - Accenture - CFO**

All right. Thanks, Adam.

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**Adam Frisch - UBS - Analyst**

Thanks, Mike.

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**Bill Green - Accenture - CEO**

Let me just wrap up for a minute. First of all, Adam, I want to just remind you that one of our four objectives is double-digit EPS growth, and we intend to do that in '07. Because we take this matter seriously, yet we have a very successful and very durable company here, and we're going to absorb this challenge. We have the will and resolve

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and the capability to absorb this and steer our way to the future and not lose sight of the great things that are ahead for this company.

I do want to thank everyone for tuning in today, particularly on such short notice. We appreciate your continued support of Accenture.

As we said earlier, we are taking all the necessary steps to contain and resolve the NHS matter as quickly as possible, and we'll keep you updated as appropriate.

In closing, I do want to reiterate the momentum in our business continues to build, and that our underlying business remains very strong and is on a solid trajectory. I also want to remind you that Steve, Mike and I, as well as our broader leadership team, are available and happy to talk with you at any time. Please just call Carol to make any arrangements.

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**Carol Meyer - Accenture - Managing Director IR**

Thank you, Operator.

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**Operator**

Thank you. Ladies and gentlemen, this conference will be available for replay after 10:45 p.m. tonight through midnight, Tuesday, April 11. You may access the AT&T Executive Playback Service at any time by dialing 1-800-475-6701, and entering the access code 823722. International callers dial 320-365-3844, using the same access code, 823722. That does conclude our conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.

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