

Accenture Ltd (ACN)

Revenue Miss and Poor Guide – Why is ACN Still a Buy?

- Target Price Change
- Estimate Change

■ **A Fair Question** — We got the above question from several investors – it's a fair question given its second guide-down in a row, fourth quarter of negative consulting revenue growth and a richer valuation recently. From a macro standpoint, European weakness is likely deepening, Asia-Pac is spotty and Brazil is a negative. Finally, from a tech spending perspective, ERP is not "working" – it's debatable if this is an ERP slowdown or due to the rise of SaaS – neither alternative is great really.....the tech spending environment is weak and buyers are either more disciplined (only doing what was contracted) or waiting for another shoe to drop (particularly in Europe).

■ **Hopefully, a Fair Answer...ACN is a Buy because** — (1) Certain kinds of outsourcing are doing quite well – BPO, for example. (2) North America is a clear area of strength – this strength is incremental and North America is the largest IT market in the world. (3) Solid bookings for several quarters in a row – it will flow through eventually. (4) The large outsourcing client Accenture referenced as a drag should only be a drag for another 1-2 quarters and 1%-2% of help afterwards. (5) ACN is one of the best positioned companies in terms of benefiting from the diversification of tech buyers – CMOs are more important and ACN has built a solid digital marketing portfolio; COOs are more important and ACN has good platform BPO. (6) Focus is shifting to better margin performance. (7) \$800 million buyback in the next 6-8 weeks. (8) After-market price is \$74.50, or off 6%+.

■ **Results, Estimate and Price Target Changes** — Specific results commentary is inside and our EPS changes are below. We are raising our target to \$84.50 from \$82.50 which entirely reflects using 2014 as a basis & ACN's higher cash balance.

■ **Derivative Impact** — Between this and Oracle's results, it probably doesn't bode well for enterprise spending – investors likely to draw parallel to IBM, Capgemini, etc. But companies with more US/outsourcing (say CTSH) or with specific focus to European cost-takeout (EPAM) should be fine. Also BPO companies like WNS and EXLS should be fine. Note that yesterday's Senate passage of immigration reform is a factor for CTSH.

Buy	1
Price (27 Jun 13)	US\$74.50
Target price	US\$84.50
	from US\$82.50
Expected share price return	13.4%
Expected dividend yield	2.2%
Expected total return	15.6%
Market Cap	US\$51,707M

Price Performance (RIC: ACN.N, BB: ACN US)



EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2012A	0.96A	0.97A	1.03A	0.88A	3.84A	3.84A
2013E	1.06A	1.00A	1.14A	0.99E	4.18E	4.28E
Previous	1.06A	1.00A	1.12E	1.08E	4.26E	na
2014E	na	na	na	na	4.56E	4.67E
Previous	na	na	na	na	4.69E	na
2015E	na	na	na	na	5.11E	5.06E
Previous	na	na	na	na	5.17E	na

Source: Company Reports and dataCentral, Citi Research. FC Cons: First Call Consensus.

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ACN.N: Fiscal year end 31-Aug						Price: US\$74.50; TP: US\$84.50; Market Cap: US\$51,707m; Recomm: Buy					
Profit & Loss (US\$m)	2011	2012	2013E	2014E	2015E	Valuation ratios	2011	2012	2013E	2014E	2015E
Sales revenue	25,507	27,862	28,298	29,572	31,494	PE (x)	21.9	19.4	17.8	16.3	14.6
Cost of sales	-17,120	-18,875	-19,050	-19,931	-21,258	PB (x)	12.4	11.5	9.1	7.6	6.4
Gross profit	8,387	8,988	9,248	9,640	10,236	EV/EBITDA (x)	12.0	10.6	10.1	9.3	8.2
Gross Margin (%)	32.9	32.3	32.7	32.6	32.5	FCF yield (%)	5.5	7.2	5.4	7.3	8.1
EBITDA (Adj)	3,985	4,467	4,627	4,924	5,370	Dividend yield (%)	1.3	2.0	2.4	2.7	3.0
EBITDA Margin (Adj) (%)	15.6	16.0	16.4	16.7	17.1	Payout ratio (%)	29	39	43	44	43
Depreciation	-513	-594	-576	-591	-630	ROE (%)	75.1	69.6	74.2	55.6	52.1
Amortisation	0	0	0	0	0	Cashflow (US\$m)					
EBIT (Adj)	3,472	3,873	4,051	4,332	4,740	EBITDA	3,984	4,465	4,900	4,924	5,370
EBIT Margin (Adj) (%)	13.6	13.9	14.3	14.7	15.1	Working capital	39	569	-1,036	-68	-82
Net interest	26	27	18	27	36	Other	-581	-777	-603	-629	-710
Associates	0	0	0	0	0	Operating cashflow					
Non-op/Except	15	5	7	8	8	Capex	-404	-372	-403	-414	-441
Pre-tax profit	3,512	3,904	4,349	4,367	4,784	Net acq/disposals	-300	-163	-21	6	5
Tax	-959	-1,079	-810	-1,135	-1,244	Other	0	0	0	0	0
Extraord./Min.Int./Pref.div.	-32	-34	-36	-42	-42	Investing cashflow					
Reported net profit	2,521	2,791	3,503	3,190	3,498	Dividends paid	-644	-951	-1,159	-1,263	-1,360
Net Margin (%)	9.9	10.0	12.4	10.8	11.1	Financing cashflow					
Core NPAT	2,522	2,792	2,988	3,190	3,498	Net change in cash	863	939	471	1,485	1,629
Per share data						Free cashflow to s/holders					
Reported EPS (\$)	3.40	3.84	4.91	4.56	5.11		3,038	3,885	2,858	3,812	4,137
Core EPS (\$)	3.40	3.84	4.18	4.56	5.11						
DPS (\$)	1.00	1.48	1.79	2.00	2.20						
CFPS (\$)	4.64	5.86	4.57	6.04	6.68						
FCFPS (\$)	4.09	5.35	4.00	5.45	6.04						
BVPS (\$)	6.01	6.47	8.20	9.78	11.72						
Wtd avg ord shares (m)	646	641	646	632	617						
Wtd avg diluted shares (m)	742	726	714	700	685						
Growth rates											
Sales revenue (%)	18.4	9.2	1.6	4.5	6.5						
EBIT (Adj) (%)	19.0	11.6	4.6	6.9	9.4						
Core NPAT (%)	23.6	10.7	7.0	6.8	9.7						
Core EPS (%)	27.7	13.1	8.9	8.9	12.0						
Balance Sheet (US\$m)											
Cash & cash equiv.	5,706	6,643	6,296	8,599	10,227						
Accounts receivables	3,236	3,081	3,184	3,491	3,893						
Inventory	0	0	0	0	0						
Net fixed & other tangibles	1,723	1,475	1,455	1,303	1,157						
Goodwill & intangibles	2,497	2,574	2,790	2,850	2,942						
Financial & other assets	2,569	2,892	3,044	3,261	3,557						
Total assets	15,732	16,665	16,769	19,504	21,776						
Accounts payable	949	904	973	1,107	1,240						
Short-term debt	4	0	0	0	0						
Long-term debt	0	0	0	0	0						
Provisions & other liab	10,427	11,137	9,942	11,383	12,193						
Total liabilities	11,381	12,041	10,915	12,490	13,433						
Shareholders' equity	3,879	4,146	5,299	6,182	7,234						
Minority interests	472	479	555	832	1,109						
Total equity	4,351	4,624	5,854	7,014	8,343						
Net debt	-5,702	-6,643	-6,296	-8,599	-10,227						
Net debt to equity (%)	-131.0	-143.6	-107.6	-122.6	-122.6						

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For definitions of the items in this table, please click [here](#).

Results Summary and Analysis

- Fiscal 3Q revenues increased 0.6% year/year (+3.0% on a local currency basis) to \$7.198 billion.
- Consulting revenues declined 2% year/year (flat for local currency) to \$3.9 billion. Outsourcing grew 4% year/year (up 7% local currency) to \$3.3 billion.
- By operating group, Financial Services revenues grew 8% year/year local currency, and Health and Public Services had another strong quarter up 11% year/year. Products grew 4% on a local currency basis, Resources down 3%, and Communications/High Tech declined 3% in local currency.
- By geography, the Americas grew 7% year/year on a local currency basis, EMEA was down 4% versus the year ago period, and Asia-Pac grew 5% in U.S dollars and flat in local currency.
- Consolidated operating margins were 15.9% in 3Q13 (for GAAP) and 15.2% for non-GAAP excluding a reorganization benefit, which was 40 bps above our estimate.
- During 3Q13, ACN repurchased 7.8 million of its shares for a total of \$618 million.

The following table presents Accenture's 3Q results versus our estimates.

Figure 1. ACN Fiscal 3Q 2013 Results vs. Citi Estimates

Fiscal Year Ending - August (all \$ in millions, except EPS)	3Q 2013A	3Q 2013E	Act vs Est	3Q 2012A	YoY
Revenue	\$7,198.1	\$7,369.3	(2.3%)	\$7,154.7	0.6%
Cost of services	4,760.1	4,961.0	(4.0%)	4,783.8	(0.5%)
Gross Margin	32.7%	32.7%	0 bp	33.1%	(50 bp)
SG&A	1,345.3	1,320.6	1.9%	1,309.7	2.7%
Operating income (loss)	1,092.7	1,087.7	0.5%	1,061.2	3.0%
Operating Margin	15.2%	14.8%	40 bp	14.8%	30 bp
Other income/(expense)	4.6	7.5	(38.5%)	5.7	(18.9%)
Pretax income (loss)	1,097.4	1,095.2	0.2%	1,066.9	2.9%
Tax Rate	24.8%	26.5%	(170 bp)	28.5%	(370 bp)
Net income (loss)	761.4	735.2	3.6%	689.5	10.4%
Diluted EPS before MI	\$1.14	\$1.12	1.6%	\$1.03	10.3%

Source: Company Reports and Citigroup Investment Research

Source: Company Reports and CIRA Estimates

Here is how our model estimates change:

1. Our overall FY13 revenue estimate is now \$28.3 billion (+3.3% local currency), down from \$29.0 billion. FY14 revenues are \$29.6 billion, down from \$30.9 billion. FY15 revenues are \$31.5 billion, down from \$32.9 billion. The currently tougher demand environment and less favorable currency environment figures into our new estimates.
2. Our margin estimates are higher than before as the company is pulling this lever to ensure EPS is less affected than it would otherwise be due to weaker revenues. Specifically, FY13-15 operating margins are 14.3% (from 14.2%), 14.7% (from 14.4%) and 15.1% (from 14.6%) respectively.

3. Our EPS estimate changes are shown on the table on page 1

Based on the after-market quote of \$74.50, we 15.6% total return for CAN shares.

Companies mentioned: (ORCL.O; US\$30.45; 1); (IBM.N; US\$195.65; 1); (CAPP.PA; €38.51; 1); (CTSH.O; US\$63.10; 1); (EPAM.N; US\$27.52; 1); (WNS.N; US\$16.90; 1); (EXLS.O; US\$29.71; 1)

Accenture Ltd

Company description

Accenture is a global management consulting, technology services and outsourcing company, with more than 265,000 people serving clients in more than 120 countries. The company's business is structured around five operating groups, which, together, are comprised of 19 industry groups serving clients in every major industry. Its operating groups are Communications, Media and Tech, Financial Services, Health & Public Services, Products, and Resources.

Investment strategy

We rate the shares of Accenture Buy (1) due to its market position (intellectual leadership), broad portfolio of contracts (diverse geographically and by industry), and strong balance sheet and cash flow. Balancing the positives, risks to Accenture include the late-cyclical nature of the IT services business and associated near-term headline risks.

Valuation

Our \$84.50 (rounded) one-year target price is based on the implied value derived from our price-to-earnings (P/E) valuation model plus the approximate \$8.81 in cash per share currently on the company's balance sheet. Our P/E model yields an implied value of \$74.50 per share by applying our 14x-16x multiple range to our \$4.70 calendar year 2013 GAAP EPS estimate. We believe our target multiple range of 14x-16x is appropriate as it: 1) is in line with ACN's recent comparable company P/E of 15x the 2013 estimate; and (ii) is in line with ACN's 2-year historical P/E based on FactSet.

Risks

The key risks to our investment thesis on ACN include the following:

- (1) More than half of Accenture's revenue base (consulting) is susceptible to the changes in the discretionary spending environment.
- (2) Currency fluctuations can cause the top- and bottom-line results to fluctuate because almost half of Accenture's revenues are generated outside the U.S.
- (3) Accenture is not immune to problem contracts – this can cause fluctuations in its margin performance from quarter to quarter.
- (4) Accenture might use its significant cash balance to grow via acquisitions, which could create integration risk.
- (5) Accenture's response to the threat from offshore outsourcing (i.e., the build-out of its Global Delivery Network) does have risks, such as the possible cannibalization of revenues and margin risk. However, Accenture does appear to be executing well so these risks have moderated in our opinion.

If the impact on the company from any of these factors proves to be greater than we anticipate, it may prevent the stock from achieving our target price. Conversely, if the impact on the company from any of these factors proves to be significantly less than we anticipate, the stock may exceed our target price.

Appendix A-1

Analyst Certification

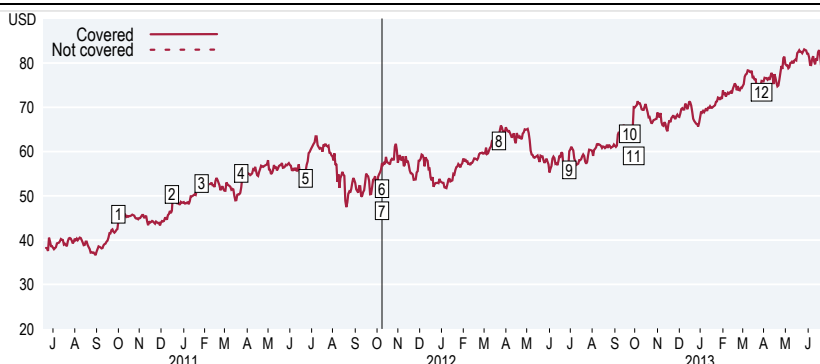
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Accenture Ltd (ACN)

Ratings and Target Price History Fundamental Research

Analyst: Ashwin Shirvaikar, CFA



	Date	Rating	Target Price	Closing Price
1	1-Oct-10	1H	*\$53.00	44.38
2	16-Dec-10	1H	*\$55.00	46.67
3	27-Jan-11	*1M	*\$60.00	52.36
4	24-Mar-11	1M	*\$64.00	51.96

* Indicates change

	Date	Rating	Target Price	Closing Price
5	23-Jun-11	1M	*\$66.00	55.69
6	8-Oct-11	Stock rating system changed		
7	8-Oct-11	*1	66.00	55.92
8	22-Mar-12	1	*\$73.00	63.52

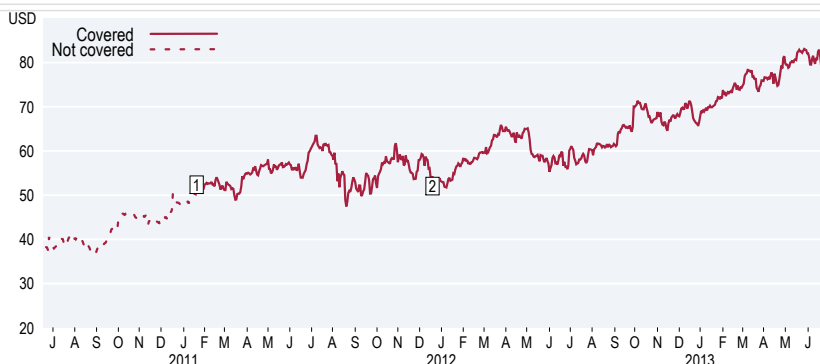
	Date	Rating	Target Price	Closing Price
9	29-Jun-12	1	*\$70.00	60.09
10	24-Sep-12	1	*\$75.00	65.78
11	28-Sep-12	1	*\$76.00	70.03
12	28-Mar-13	1	*\$82.50	75.97

Rating/target price changes above reflect Eastern Standard Time

Accenture Ltd (ACN)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Ashwin Shirvaikar, CFA



	Date	Rating	Target Price	Closing Price
1	20-Jan-11	*ADD MP	-	51.14

* Indicates change

	Date	Rating	Target Price	Closing Price
2	20-Dec-11	*REM MP	-	54.24

Rating/target price changes above reflect Eastern Standard Time

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