TEMENOS Q2 2017 Results Call

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OPERATOR: This is Conference #53258631

Operator: Good afternoon, ladies and gentlemen, and thank you for standing by. And welcome to today's Temenos Q2 2017 results conference call.

At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session, at which time, if you wish to ask a question, you will need to press the star and one on your telephone and wait for your name to be announced.

I must advise you that this conference is being recorded today, Wednesday, the 19th of July, 2017. I would now like to hand the conference over to your speaker today, David Arnott. Please go ahead.

David Arnott: Thank you, operator. Good afternoon, or morning, everybody, and thank you for taking the time to join today's call. As usual, I will start with some comments on our second quarter performance and then I'll hand it over to Max for the financial update.

Hopefully, you've all managed to get your hands on the presentation -- so assuming you have, I'm starting on Slide 7. Starting on Slide 7, we had a very strong first half of the year. The momentum we saw in the first quarter continued in the second quarter and we saw high levels of market activity, which is reflected in our top line.

We grew software licensing 22 percent and total revenues, 15 percent in the quarter, driving a 21 percent increase in EBIT was also significantly growing our pipeline. It's clear that across the industry, banks have to change their systems to respond to the digital and regulatory pressures they face.

It's also clear that a digital strategy focused on changing front-end systems only isn't going to deliver the benefits and performance necessary to deal with these pressures.

The only way that a bank can move to its digital future is through a full front-to-back or back-to-front renovation, and we hear this everyday in our discussion with prospects, clients and partners.

In this context, Temenos continues to be recognized as a market leader by key industry analysts, most recently in the Gartner Magic Quadrant, which was published last week for Global Retail Core Banking and by Forrester, the Digital Banking Engagement Platforms.

I'm particularly pleased that our products are recognized as leading across the stack from the front end due to our best in breed core banking solutions and that there's clear light emerging between us and the competition, some of whom chose not even to participate this year.

On Slide 8 now. We have strong growth in signings and pipeline generation across all geographies in the second quarter. We continue to see very good momentum with Tier 1 and Tier 2 clients, with 55 percent of total software licensing coming from this segment over the last 12 months.

We also have good momentum with our existing customers, with 64 percent of software licenses sold to our installed base over the last 12 months. This reflects the traction we have with our clients.

It also demonstrates a number of Tier 1 or Tier 2 banks that have embarked on progressive renovation journeys with us over the last few years, which, of course, is a cumulative number.

To sustain this momentum, we continue to invest in sales and marketing in the second quarter and we'll keep up this investment over the coming quarters to ensure that we capitalize on the market opportunity.

Slide 9 now. Just as a backdrop to the quarter, I'd like to take a minute to reflect on the key drivers of growth in our markets. Clearly, digital transformation is the overarching theme. In Europe, our client is very focused on the cost base given the high salary, special charges and labor agility in labor-intensive back office functions.

That means big margin improvements can be derived from tackling this once and for all as well as the specter of being marginalized without a real digital story, which is what's driving progressive renovation in the European region. Activity in developed Asia has been driven by asset growth in private banks predominantly.

These banks are trying to ensure they have a modern platform that can provide the service the end customers demand. With the acquisition of Rubik, we've expanded our presence in Australia.

This is an exciting market for us as banks focus on digitalization and with certain work players looking to combine their wealth management in superannuation businesses as we talked about when we announced the acquisition.

Emerging markets continue to be driven by the urgency of time-to-market for digital services to capture the demographic growth opportunity. And lastly, our clients in North America are concerned about increasing competition from new market entrants specifically the problems they themselves face in coping with the regulatory burden using legacy systems.

From a tier perspective, we see larger banks seeking to bring some sense to the data coming out of the hundreds of different systems they've built or acquired over the years but don't communicate to get a real-time customer view to make decisions from or smaller banks, these are bank in box quick-to-implement products, so they're not spending up to a 1/4 of their revenues on what is largely a fixed-cost banking IT platform given that you still have to keep up with regulation, et cetera, even if you're small.

So again, like the geographical dimension, different sizes mean different challenges and is natural hedge for us without a single growth engine puts us in great position. Similarly, in terms of segments, we've seen sustained momentum across retail, corporate and wealth, again, in the quarter. We have strength and depth across our geographies, tiers and segments to drive our growth going forward.

On Slide 10 now. I'm pleased to report all our key implementations are progressing well. Just to highlight a couple of these. Nordea has been underway since late 2015 and has been very successful in meeting its targets either on or ahead of schedule.

Bank Leumi in Israel has gone live with Pepper, its Greenfield digital-only bank that they're using to target millennials and ultimately migrate their existing customers to.

Similarly, in Canada, Laurentian Bank is also progressing well and an excellent large retail reference for the North American market. As each of these implementations reaches key milestones and go lives, they become the benchmarks for their peers, opening up the market further and driving incremental growth.

A lot of banks are looking to these comparable references as benchmarks for what they themselves can embark on -- and keeping hitting the milestone is absolutely top focus for us, which is why we're attracting these for you here, today. And interestingly, we're starting to see more and more demand for cloud assisted systems as well.

Turning to Slide 11. I'd like to give you an update of our U.S. progress. As I mentioned earlier, our prospects and clients in the U.S. are focusing on new competition and risk around legacy systems. Either home-built or packaged products has become legacy, coupled with the very real burden of legislation in the U.S.

This is reflected in the strength and quality of our pipeline, which continues to improve month-on-month and is now the highest it's ever been. Our strategy working closely with partners has also produced a number of high-quality new leads.

We're investing further in our U.S. sales, pre-sales, marketing, branding and partnering activities to expand our coverage and capitalize on the momentum that we've built in the market.

Lastly, I'm pleased to report that the Commerce Bank implementation process is on track and going very well. On Slide 12, now – we've a brief snapshot of our client event, the Temenos Community Forum, which took place in Lisbon, in April of this year.

This was our 19th event. We had over 1,200 attendees across prospective clients, clients, partners and Fintechs. What really struck me at this year's TCF was the strength of the Temenos ecosystem as demonstrated by the diverse range of individuals and institutions that came together to share products, ideas and strategy to solve the challenges our clients are facing.

It was fantastic event and a great opportunity to learn more about our products and technologies, see live demos and understand where we're investing for the future. And our MarketPlace initiative was particularly well received.

If any of you would like to join us in 2018, next year's TCF will be held in Dublin, in May, and I'd be delighted to welcome you there. I'll hand you over to Max now to give you an update on the financials.

Max Chuard: Thank you, David. Starting with Slide 14. I'm very pleased with the quarter and the first half of the year. I'd like to give you some of the key financial highlights for the quarter.

Our total software licensing grew 22 percent in Q2 on the back of 19 percent growth in Q1. This performance has been driven by high level of activity across all of our geographies, tier, and segment.

This diversity is also reflected in our pipeline, which has grown significantly year-on-year. The strength of license signings has also driven the growth in our maintenance revenues, which were up 11 percent in the quarter and 10 percent over the last 12 months. Total revenue grew 15 percent in the quarter, driving growth in EBIT of 21 percent and giving an LTM EBIT margin of 30 percent.

We continue to have strong cash collection in the quarter with an operating cash inflow of $44 million and a reduction in DSOs by six days to reach 124 days by quarter end.

I'm also pleased with our services margin, which reached 10 percent on an LTM basis, up 3 percentage points on last year. Lastly, in June, we completed the CHF 99 million share buyback that we launched in November, 2016.

On Slide 15, there are a couple of numbers I will focus on. As I said, we grew total software licensing by 22 percent in Q2, which reflects the increasing digital and regulatory threshold that banks are facing, which is driving market growth as well as our leadership position, where we are consistently taking market share.

Over the last 12 months, total software licensing is up by 16 percent and total revenues by 13 percent, demonstrating the strong organic growth in the business.

Similarly, our EBIT has grown by 18 percent over the last 12 months, showing the operation leverage we've been able to achieve. Our EBIT margin reached 30 percent for the last 12 months, an expansion of 2 percentage points.

Lastly, our services margin reached 10.4 percent over the last 12 months, an expansion of 2.9 percentage points. Our partner-led delivery model results in our services to be more focused on governance expertise, which typically attracts better margin and are billed on a time and materials basis.

On Slide 16, you will see our like-for-like revenues and costs. As a reminder, we closed the acquisition of Rubik in Australia on the 22nd of May, which is expected to bring an additional (circa) $15 million of revenue and cost for 2017, although the contribution in Q2 itself was very small.

FX continued to be a small headwind for revenue this quarter versus last year, due to the weaker euro. Equally, our cost base benefited from the weaker sterling. The next FX impact on EBIT was immaterial in the quarter.

Total revenues are up 13 percent like-for-like in the quarter, including total software licensing growth of 18 percent. Total like-for-like cost increased 10 percent in the quarter as we continue to invest in both sales and marketing and product to capture the market opportunity.

On Slide 17, we continue to see strong growth in our net profit, which was up 25 percent both in the quarter and over the last 12 months. Similarly, our EPS was up

24 percent in the quarter and 22 percent over the last 12 months, to give us an EPS of USD 2.25 over the last 12 months.

Moving to Slide 18. Our cash conversion remains a significantly ahead of our target of at least 100 percent of IFRS EBITDA. For the last 12 months, our cash conversion was at 117 percent. We had an operating cash inflow of $44 million this quarter, up 17 percent year-on-year.

DSOs decreased another 6 days this quarter to reached 124 days. We expect DSOs to decline at around 5 to 10 basis per year to reach 100 days in the medium term, driven by an increased contributions from Tier 1 and Tier 2 clients and the positive impact of partners on our services business.

On Slide 19, we show the changes to the group liquidity this quarter. I would like to highlight a couple of items in particular. In Q2, we paid out a dividend of USD 40 million, bought back $31 million of shares, completing the 2016 share buyback and closed the acquisition of Rubik.

We also received the proceed of the most recent bond we issued in March, part of which we will be used to repay our CHF 1 million bond that matures at the end of this month. We ended the quarter with $253 million of cash in balance sheet and with net debt of $300 million, which equals to a leverage of 1.2x EBITDA.

Turning to Slide 20. We completed the acquisition of Rubik in May. This has given us significant presence and scale in Australia, which is an attractive market, given its growth and spend on banking and software as well as being the fourth largest expansion investment market globally.

The integration of Rubik into our Asia-Pac region's operation is progressing well, and we are already going to market under the Temenos brand in Australia. We have seen a high level of pipeline activity in the market for both core banking renovation and wealth.

The activity is driven by the digital threshold that we see in all geographies as well as by wealth players looking to integrate the wealth and superannuation businesses.

Moving now to my last slide, on Slide 21. As you remember, at the end of May, we completed the acquisition of Rubik. At that time, we increased our guidance to reflect the contributions from Rubik. The guidance is in constant currencies and on a non-IFRS basis.

We've updated our FX assumption, which you can find in the Appendix. So we are guiding for a total software licensing revenues growth of 15 percent to 20 percent; total revenues growth of 10 percent to 13 percent; and EBIT ranging from $210 million to $215 million.

Our EBIT guidance is unchanged as Rubik contributes $15 million of both revenues and cost for the year. I will note that our guidance does not include the impact of new large transformational deals as the timing and potential impact of this are hard to predict.

In the first half of the year, we've significantly grown our pipeline for 2017 and 2018. And given our performance in H1 and the strong start we've had to Q3, I'm very confident in achieving our guidance for the full year. With that, I will hand back to David.

David Arnott: Thank you, Max. So in conclusion, I think it's very clear that we had strong momentum across all of our KPIs in the second quarter.

Digital and regulatory pressures are forcing banks to reconsider their approach to IT, with more and more banks understanding that core renovation is critical to digital transformation and to addressing their problem. And this is driving growth in our markets across all geographies, cities and segments -- both in the deals signed and pipeline point of view.

We've had a strong start to the third quarter, as Max has said, and our increased levels of visibility and the strength of our pipeline give us confidence in our outlook for the full year and into 2018. So with that, operator, we'd like to open up the call for questions, please.

Operator: Yes, your first question comes from the line of Adam Wood. Please ask your question.

Adam Wood: Hi. Good evening David, good evening, Max. Thanks for taking the questions. I've got a few, if I could --hopefully straightforward. Just first of all, on the outlook.

It looks as if, as you suggested, Rubik and currency were the reasons for the (topline) upgrade and now underlying change. You've obviously done a lot better than consensus was expecting.

Is there anything in the pipeline or anything in the environment that will get -- did it give you the confidence to at least put that beat into the full year guidance.

Secondly, I appreciate there's no large deals in the outlook for this year. And in terms of maintaining the type of growth that you've guided to and enjoyed, obviously, it gets tougher because large deals are now in the base.

Could you give us any help on that, maybe, as we look out two or three years. I appreciate -- not in this year's guidance -- but confidence they'll come through on that longer term, to be able to maintain the growth rates.

And finally, on Australia --- my impression has been certainly at the higher end of the market that SAP has enjoyed quite a bit of success there. Is the vision there that this is more of a kind of mid and -- large mid-bank sale rather than going for the largest banks in Australia, or have I missed the breadth of SAP's success out there. Thank you.

David Arnott: Thanks for that. Great questions. Let me try and do it as succinctly as I can. The beat in Q2, I think it's too early at this stage to take our guidance up beyond where it is today (for a beat) in Q2. It's another good data point. We feel very confident about the year, as we've said, but we've chosen not to increase our outlook.

In terms of large deals, as a deal starts with a large deal, it increasingly becomes a progressive renovation opportunity. So, you have banks like Nordea, Bank of Ireland increasingly looking at consuming more. So they themselves fall into this sort of run rate business over time.

And we are confident that we have a pipeline of large deals that are moving through on a portfolio basis at various speeds, which suggests that the trend is on a basically and will continue over the medium term such that we maintain the momentum.

In terms of Australia, the strategy is really around the 12 Tier 2 and Tier 3 banks. In the Tier 1 banks it's more of a progressive renovation story. A good entry point for us is clearly on the wealth side.

SAP have one client -- I think pretty much everybody has one client, one Tier 1 client in the Australian market -- but nobody has a Wealth offering, which is a good opportunity.

And, by line of business, not one of those Tier 1 banks is in anyway significantly penetrated by any of the core vendors. So I'm confident our quick wins will clearly be in (to them), but we got a great progressive renovation story in the Tier 1 space, as well.

Adam Wood: That's very helpful, thanks, David.

Operator: Thank you. Your next question comes from the line of Takis Spiliopoulos.

Takis Spiliopoulos: Yes, hi. Well done, guys, once again. Just two questions. David, you mentioned in your comments you saw more demand for cloud-based installation.

Can you be a bit more specific which banks are looking at that, which regions. What is the thought process there with these banks. And then one for Max -- what was the impact of Rubik on the DSO's number?

David Arnott: OK. Thanks, Takis, for that. So let me take the cloud one. It's a couple of quarters out – probably, possibly out through the year that we've seen banks looking beyond on-premise implementation.

So for two or three years, we've seen banks wanting to understand that the software they're buying now without the new installation of the same software, can be migrated onto a public cloud at some point, given that's it's probably going to be in the bank 15, 20-plus years. The last thing they want to do is to finally have to rip it out and put it in cloud-based products.

So that's been a theme to understand that the technology platform -- the software we have -- is based on going forward. And of course, the same software suite's running on the industry's (stack), including the public cloud, as we've seen. That's never been an issue.

What I'm saying is that we've started to see banks who are looking at their initial implementation in the public cloud as opposed to a private cloud. And this is just a few data points that includes Tier 1 banks and I'd rather not elaborate until we get to the end of the year and have got more data points. But there's definitely a trend there.

Takis Spiliopoulos: All right, thank you.

Max Chuard: On the DSOs, as you've seen, if you were to look at it on a pro forma basis, basically, you've got four days of impact from Rubik. I did not disclose it because it's not material. But clearly, this would normalize by -- in the next few quarters.

Takis Spiliopoulos: OK, thanks.

Operator: OK, your next question comes from the line of Michael Briest. Please ask your question.

Michael Briest: Thank you, good evening. In terms of the number of go-lives and wins, I think 12 wins were referenced for the quarter, which is relatively low compared with recent quarters. Can you also say something about the number of go-lives. And whether you expect to get to the same number of customer wins for 2017 and 2016 -- which I think was about 76.

And then just in terms of the balance of the licenses in Q2, David, you said that Nordea was running ahead of plan. And if I just look at the segmentation of bookings for the quarter, Europe figured is prominently, installed base figured prominently, Tier 1 figured prominently -- would it be fair to assume that Nordea contributed something in this quarter?

And when we think about seasonality on licenses, I think, traditionally, that was more of a Q3 win --would you expect some slowdown in Q3 licenses, Max. And then finally, if I can, on the sales and marketing expenses, there was a big step-up there, when you talk about hiring.

On the other hand, G&A seemed quite low given the acquisition costs and maybe restructuring. Can you give us a feel for how the different cost line items will develop in the second half. Thank you.

David Arnott: Hi, Michael. OK. We're scribbling as fast as we could. We'll give it a go. So 24 go-lives in the second quarter. We were thinking earlier about whether we need to keep publishing this every quarter or stand back on a rolling 12-month basis and deal with some differences -- obviously there's KPIs.

We're pleased with the 24 and certainly in terms of the new name wins, and the go-lives of those new name wins. There's nothing -- there's no particular trend that highlights the projects are getting shorter, they're more partner-led, the go-lives can be a bit lumpy.

But the reason I focused on the key go-lives is because the more and more we step away from implementations, go-live in the Tier 3 or Tier 4 banks is not meaningful for you guys, I don't think. We'll report on it on an annual basis. Whereas the big flagship opening dealers -- like the Nordeas, the Bank of Irelands, the Laurentians -- are going to open up new markets. So I was really focused on that. I hope that's okay.

In terms of Nordea's contribution, we clearly don't talk about contribution of revenue from any one customer. I would say that there's no underlying trend driven by any contribution from the growth of rest of renovation story for any Tier 1.

And the more we get a cumulative number of Tier 1s going through various milestones of various sizes, the more the quarters are going to even out. So that's going to get flatter and flatter, and certainly, there's nothing distorting in the second quarter at all.

Sales and marketing has a large variable component driven by the success of sales in the second quarter. And underlying that, a continued investment in both sales, presales, headcount and marketing activities themselves. And the last one, I couldn't quite understand. I think it was for Max, it was something around Q3 licensing?

Max Chuard: Yes. Obviously we've -- as we said, we feel very confident on the full year guidance, which I think is the key point. And clearly, we had a strong start, too. In the [start], we are saying that Q3 started well, as well. So I think we feel extremely confident on delivering a great year for 2017.

Michael Briest: OK, thanks. I was asking about the number of customer wins as well because there was 12 new logos in the quarter and you've been running at 20-plus a month to the last two years.

Max Chuard: Yes, I think -- yes, we’ve had 12. Typically, as we -- what we discussed is you've seen the penetration of our Tier 1, Tier 2, and how much business we've done in the last 12 months in the quarter with our existing customers.

So there's clearly a lot of activity done with, we'd say, from a progressive renovation point of view. Now the new wins on a quarterly basis, I'm not sure it gives much of a picture.

David Arnott: But again, I wouldn't signal a trend. Sometimes you get lucky on them and sometimes you don't, it depends on the timing. The focus really for us, as you've seen, is getting into a Tier 1 or Tier 2 where they've got huge potential to spend, and impressing them enough to continue to draw down on our software.

So again, probably the discussion we were having earlier about reporting go-lives, now it's more partner-led similarly reporting Tier 3, Tier 4 wins are a relatively small size. We're trying to extract the really meaningful KPIs, and I think we need to get that (inaudible). But from the 12, nothing to extrapolate, nothing to -- no trends to highlight.

(Mike Gawbry): Thank you. And just on the margin, I guess, is 50 basis points lower than when you guided in May because of currency, Max?

Max Chuard: Yes. It's mainly currency and a very small impact from Rubik, as you know, given for the year.

(Mike Gawbry): OK, thanks.

Operator: Your next question comes from the line of Gerardus Vos. Please ask your question.

Gerardus Vos: Hey, thanks for taking my question. I have a few, if I may. First of all, on the U.S., what are you targeting there for signings over the coming 4 quarters. Secondly, just want to come back on the question earlier around the new signings.

From what I hear, it's a bit more of phasing -- was this a phasing from Q2 into Q1. Or is it more phasing from the second quarter into the third quarter. And perhaps, you've incurred some slippage during the quarter.

And then finally, on the total software license guidance -- you did around 18 percent organic growth in the first half. It seems to imply 5 percent to 13 percent growth in the second half on an organic basis implied in your guidance. Is that because the compass is getting a bit tougher into the second half. Thanks.

David Arnott: OK, Gerardus, let me take the first two of those. So the U.S. -- my wish list for the U.S. over the next two to three quarters will be to sign up another client of the ilk of a Commerce or an Ally bank.

And we'll be -- we've entered on the asset side, so with them -- as you know, with commerce, we're doing the DDA business -- which is a very large part of that business. It would be nice to sign up somebody on the liability side as well -- either one of our existing customers or new entrants.

I think it would just be nice to find our way into a number of new name banks and win the lion's share of the new deals that come to market to keep the competitors in the box and bring out the differentiation from us -- not only against the domestic players, which is a clear differentiation -- but also against the international players that are trying to get into the market with what we believe is not a strong value proposition, but what we believe, frankly, (inaudible) better.

So some key new wins would be nice. Hitting the milestones around commerce are very important. Looking forward, a lot of focus on branding, recognition through the consultancy and the consultants, the partners, the go-to advisers for banks who are looking for a new system.

So we're better-known in the market where we're not that well known at the moment, bringing in -- strengthening the sales organization with people from local players -- so all of the usual go-to-market in any new country, frankly. And we're very happy with the way everything is progressing, to be very clear.

In terms of new signing slippage, again, the 12, I assume your question is around the 12. What's happening is that the bulk of our revenue in any quarter is coming from milestones from the Tier 1, Tier 2s, which are driven by events. A bank will buy some pilot users, and then I'll come back to the go-live users when they're ready to go live.

And the new names is -- you might have one or two Tier 1 new entry points in there, but the bulk is Tier 3, Tier 4 and the revenue opportunity from those tends to be smaller. So I wouldn't link anything to do with the Q2 license to whether it's driven by a cutoff of the 12 and it should have been higher whether it comes from Q1 or Q3. It's a mix.

Some came earlier in Q1. Q2 itself was very strong. Some, as we have said, signed at the beginning of Q3. We said we had a strong start. So I'm not convinced that new name customers across all tiers is a particularly meaningful KPI, and we'll try and be a bit more crisp as we explain this on the next Analyst Day, if I'm right with the KPIs if that's the case. But nothing underlying, trending.

Gerardus Vos: Sure.

Max Chuard: So regarding the last question, from me. Listen, obviously, H2 last year we had two large transformational deal that were signed, which was BOI and Standard Chartered Bank. And as we've said, we are not including any potential large deals in our guidance.

Having said that, we still expect at the midpoint of the guidance H2 to be around 15 percent growth on quite a high comparative. So I think it's achievable. We are very confident we can do it. But it's still a good target to deliver.

Gerardus Vos: Sure. And one follow-up, if I may. Have you seen any kind of change at Avaloq since (inaudible).   (Inaudible) a big stake in that company?

David Arnott: No. We can't comment on that I don't think it would be appropriate.

Gerard Vos: OK.

Operator: And your next question comes from the line of Mohammed Moawalla. Please ask your question.

Mohammed Moawalla: I was wondering, guys, if you can comment a bit about your expansion plans, inorganically. You've obviously done the Rubik acquisition. And as you look at the global pace, you've expanded into the U.S. largely organically and some small M&A going into Australia.

Are there any other markets you think are poised to be exploited in terms of growth, where perhaps, you may take the inorganic route?

Max Chuard: Thanks for the question. We said last year, some markets were a small bolt-on acquisition, like the one that we've done with Rubik, could upset growth in such a market. And there are ongoing discussions, but it's always difficult to say if those will materialize.

But clearly, those are highly synergistic we can see it with Rubik within a couple of months, we've got a very large pipeline of opportunity there already. So we said, basically from a (inaudible) we will assess the markets where we could expand.

And as well as from a market point of view, clearly, today, we've got a very strong leadership position. The growth side, we could expand some of the markets as well as we've done with (inaudible) in the capital markets, we could build on that. So I think clearly those would be the areas where we could enlarge our market opportunity.

Mohammed Moawalla: Great. And I just had one follow-up. As you look at some of these opportunities, how do you think about the available capacity -- whether it's from the integrator side, so as you look at your strong pipeline and source deals, your capacity to be able to deliver and execute on these simultaneous opportunities -- is there a sufficient capacity in the market. Or is that something you have to be mindful of as you look at different opportunities?

David Arnott: The question there, Mo, is about implementing the software. It's not an M&A question, is it?

Mohammed Moawalla: No, exactly.

David Arnott: (…and how to implement…)

Mohammed Moawalla: Correct -- and how that affects your ability to drive the pipeline.

David Arnott: All right, OK. Well, at the peak of our services, we were frantically writing methodologies, training our partners. And because our methodologies are so robust and the partner program is so well entrenched, we're not seeing any capacity limitations on our ability to handle the growth far.

And we have, as you would imagine, a very robust model for stress-testing growth by product, by segment, by geography. And we, with our focus on securing governance for this project, and the partners sharing our pipeline with us and the ramping up their skills ahead of our pipeline visibility -- or in line with our pipeline visibility -- the methodology is robust, and we believe we can handle the growth going forward. And implementation skills in the market will not be a constraint on our ability to grow.

Mohammed Moawalla: Great. Thank you very much.

Operator: Your next question comes from the line of Steven Goulden. Please ask your question.

Steven Goulden: Hi there. Just to pick up on the U.S. again. You were saying -- you said in the deck, U.S. pipeline, is focused on the strength and quality. Can you give us any more color there.

What kind of institutions you're talking to. What sort of opportunities. I know you touched on it already in the call, but anything a bit more concrete there would be helpful.

And secondly, in the U.S., which other international players, would you say, are your main competitors and how would you compare to them. And I suppose the last point would be, what do you see as the main challenges in terms of gaining significant share in the U.S. market?

David Arnott: OK, Steve, great questions. Let me take those. So I'll try and give you a little bit of flavor on the U.S. pipeline. So our target -- and I'd really refer you back to our strategic presentation in the Capital Markets Day, where we outlined our strategy being banks over $10 billion of assets -- has been, for us, more than that the differentiation doesn't come through for them and they're perfectly well served, especially at the bottom end, with local products.

So the pipeline is growing around our target market, which is banks over $10 billion. The larger banks is by line of business and the smaller banks is typically for more of a universal solution. So these banks -- our pipeline is developing in line with our strategy.

In terms of competition, there's really two groups of competitors. There's Infosys, TCS and Oracle, where we believe we differentiate ourselves as everywhere else through packaging, making the software upgradable, providing access to all the great ideas from around the world of our customers who rely on a single release of the product rather than more of a toolkit.

And the other international players will be some of the global players for whom, like I said, for whom banking is just one of many, many activities and therefore don't see the focus. So we do believe a combination of the business model, packaging, upgradability, marketplace -- all of the good things about Temenos -- is something that nobody has.

And the architecture as well, clearly, is something that nobody has. And this is starting to come through very clearly with them. Certainly, that's the reason we're making the shortlist on these deals so far. And what was the third one, sorry?

Steven Goulden: The third one was the challenges.

David Arnott: The challenges.

Steven Goulden: The challenges, yes.

David Arnott: The challenge is they love the software when they see it. They love our understanding of banking. They don’t think they can go anywhere else where they get such a global view and understanding distilled into one software company of the best practices in banking. And they love the fact that they can't get this from any local vendors because they're not international. So they love it.

The functionality scores very well. The architecture scores very well. The users love it. The implementation track record and the model where we will go into a bid with a partner, they absolutely love it. It's just name recognition. Everyone says if you had 10 or 11 customers live, then we would sign up immediately.

And overcoming that brand recognition just to be on an even playing field, and therefore let the differentiation come through, there's no shortcuts, really. We want commerce, we want ally, we want some other smaller banks. We're lobbying hard with the analysts and the consultants. We're leveraging the Accentures and the Deloittes, et cetera, to training programs.

We're investing in marketing. We just need to get better known. As soon as we have things like commerce go-live and some other ongoing implementations, we believe we're going to accelerate quite strongly, which is why I've always said, medium term, we're very excited about the U.S., but it's going to take time to build -- to break through that reference-ability.

Steven Goulden: Right, thanks a lot.

Operator: OK, your next question comes from the line of Chandra Sriraman. Please ask your question.

Chandra Sriraman: Hi guys, congrats on another good quarter. A couple, if I may. You are doing quite a few Tier 1 implementations. You're investing in sales and marketing. I was just wondering, based on this experience, you see any areas in your product that is lacking that you have to invest, say, in something like a U.S. model bank or something.

Should that affect your targets in terms of R&D investment in the coming years. And maybe one quick question on Q2. I noticed a restructuring has jumped up. I guess it's too early for Rubik or was it driven by Rubik. Thanks.

David Arnott: OK, Chandra, let me take the first of those. So I think the base business model of our product development is very well established. We -- there's not much that happens in banking that we haven't seen built into the product.

The localization of that product for the country, as you rather described, is model banks –so, U.S. model bank, Canadian model bank, French model bank is something which is ongoing.

And as we get into our customers in a market, we capture what we find, we package it so the project gets shorter and shorter --by the time you go through your second and third client and so forth. And in fact, our U.S. model bank is very, very mature. So that's really in the run rate.

If I was to highlight one area in products where, going forward, I see our spending beyond the vision even of our customers, it's in the technology and architecture space.

I do believe we started to see a turning point in terms of banks, not just one thing robust or product on-premise, but intimately scalable, very high volume, industrial strength across a variety of the possible platforms and stacks.

I believe that if you take a long-term view, we can do something very, very disruptive around our architecture and technology component-ization, our API strategy --all of the things we talked about at our client event. So that will be one area that stands out from the sort of run rate (R&D).

Max Chuard: Chandra, it's Max. Listen, yes, it does -- it's related to Rubik and in fact, when we sent the press release back at the end of May, we had already announced that. So yes, the jump is related to Rubik and this is what you should expect for the full year.

Chandra Sriraman: Thanks.

Operator: Thank you. Your next question comes from the line of Gregory Ramirez. Please ask your question.

Gregory Ramirez: Yes, good evening, guys. Thank you for taking my question. In fact, I have a question regarding the chair structure of your revenues. Obviously, you have put a lot of focus and you have been very successful on your Tier 1 central banks and we see the results.

Now, looking into Tier 1 -- Tier 3, Tier 5 customers, what we observe quarter-to-quarter is that there is a trend of flattish or maybe slightly declining revenues. I would like to understand, what are the challenges out there. Is there, I would say, any particular defocus on this kind of customers because the top priority is the Tier 1, Tier 2 bank.

Or is there any additional competitive pressure. Or is there, I would say, an issue with the market conditions as maybe in some countries, especially emerging countries, you have some banks -- small to midsized banks -- which are, I would say, less receptive to digital transformation. Thank you.

David Arnott: (Greg) that's a very good question. I think it's a mixture of many of those things. When we were a Tier 3 - Tier 4 player and we weren't really in a position to deal with Tier 1s and Tier 2s, there was a 100 percent focus on that.

But now we see Tier 1s and Tier 2s opening up in a big way. Inevitably, that's where the battle is going to be won or lost. The winner in banking is they're not going to win and have a critical mass of Tier 3, Tier 4 banks.

They're going to win by winning all the biggest conversions in the industry. But inevitably, the focus (drawn) goes to where we're winning the lion's share, if not all, of the key deals in the industry.

The bottom end of the market, there's less differentiation between Temenos -- with our scalable architecture and which platform and so forth --and often, local players who've got a perfectly good system to run in a Tier 3 or Tier 4 bank in a country.

And for that end of the market, and therefore, pricing is held down. We compete with our own sales force, clearly. But we don't have the focus of a local player who can only sell, frankly, Tier 3 and Tier 4.

And I suppose that shows in the fact that we haven't been growing as fast as we did in the past. That bottom end of the market, we're looking more and we're seeing more cloud-based demands, so more bank a box and a model bank approach led through partners is the right way to go there -- pre-configure the software, deploy it in a simple way and sell that to partners.

So, more an industrialization at the bottom end, as you saw with Avaloq and SAP at this stage of their life when they focused themselves on the big must-win accounts and they industrialize the sale and distribution of the smaller tiers. And we're moving towards that, and you can see that in the numbers. (That’s fair.)

Gregory Ramirez: OK, thank you very much.

David Arnott: OK, I think that's all the questions for now. Thank you very much, operator. Thank you very much, everybody, for taking the time to join this evening's call. You know how to find us if you think of any more questions. Otherwise, look forward to speaking to you after the third quarter. Thank you.

Operator: Thank you. That does conclude the conference for today. Thank you for participating. You may all disconnect.

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