Final Transcript

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Corporate Participants

Sarah Bowman

Temenos UK Ltd - Associate Director, IR

Andreas Andreades

Temenos UK Ltd - CEO

David Arnott

Temenos UK Ltd - CFO

Max Chuard

Temenos UK Ltd - Head of Corporate Finance and Investor Relations

Presentation

Operator

Thank you for standing by, and welcome to the Temenos Q3 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 *1 on your telephone keypad. I must advise you that this conference is being recorded today on Wednesday 27th October, 2010.

I would now like to hand the conference over to your first speaker today, Sarah Bowman. Please go ahead.

Sarah Bowman - *Temenos UK Ltd - Associate Director, IR*

Hello, everybody, and thank you for joining us this afternoon to discuss the Temenos Q3 2010 results. With me on the call are Andreas Andreades, our CEO; David Arnott, our CFO; and Max Chuard, our Head of Corporate Finance and Investor Relations.

The presentation to accompany the results can be downloaded from the Investor Relations section of our website, or you can follow on the webex presentation with the URL that was on the press release. And as usual, before I hand over to the speakers, I must make you aware of the legal disclaimer statement on slide two of the presentation. Various factors may cause actual results to differ materially from company estimates, and indeed may cause company estimates to change. Therefore, undue reliance should not be placed on the forward-looking statements made during the call, which reflects company opinions as of today only.

I would also like to mention that on 19th November, we will be hosting an Investor Day at the LSE which senior management, a partner and a customer of Temenos will present. We do hope that you will be able to join us on the 19th November.

And now I will hand you over to Andreas for the business update.

Andreas Andreades - *Temenos UK Ltd - CEO*

Thank you, Sarah. Good afternoon. Morning to all, wherever you are. I'll start today with the business update on slide number five, as usual.

After several strong quarters, Q3 confirms what we've been seeing gradually over the last 12 months, and that is that the market has been steadily gathering pace post the financial crisis. Our pipeline, which was already at a record at the end of the second quarter has translated into strong licence revenue growth of 41%, and 38% in like-for-like. In fact, we continue to see sequential growth in our pipeline, despite the record quarter in Q3, which is very exciting and gives us great confidence for the future.

Now, as I reported also at the end of the second quarter, deals continue to get bigger. The increase was significant this quarter as Tier 1 and Tier 2 banks come back to the market. This quarter, it was the turn of our European business to demonstrate exceptional growth, followed by Asia Pacific.

At this point, I'd like to note that the proportion of Tier 1 and Tier 2 banks in our total licence revenue is back to 33% in the quarter, and 22% on a last 12-month basis, which compares to 15% during the financial crisis period, as we first reported in the third quarter of 2008, as customers came to use for larger and multi-site deals.

Now all of that information is on slide 34 in the appendices to the presentation.

Now I'd like to move on to slide number six, and I'd like to highlight that how our organic growth drivers, both the partner strategy and our add-on product strategy continued to gain momentum and contribute to sales. In particular, on the partners, the strategy is progressing at a more rapid pace than we expected. Partners are playing already an important role in helping us to close our pipeline of deals, bringing influence and greater credibility.

Partners are also bringing us more deals than we would not have otherwise known about, and the pace with which we now sign partner sourced deals is increasing robustly.

As regards services, we are directing a greater share of the business to partners, including from now all activities such as testing support and data migration support, leaving our professional organisation to concentrate on a more focused portion of the services business, which I will address later.

The transition is occurring more quickly than initially expected, which in the short term, is showing towards a reduced margin in our services business. However, from our perspective, this is unequivocally good news. The success of the partner strategy is critical in order to establish Temenos as a fast growing software business for the years to come.

Now moving on to Odyssey, we're clearly very excited that the acquisition has now closed. This deal creates the undisputed software leader in the private wealth management space, particularly because we see this area as one of the fastest growing parts of the banking and industrial [space]. We'll go into greater detail on the Odyssey transaction a little bit later on.

As a result of the transaction, we are adjusting our revenue outlook for the balance of 2010, and again, I will discuss this in more detail in the outlook section at the end of the presentation.

Now over on slide number seven, we are… and moving on to the other sales, we are pleased to report that revenues from new products continued to grow as a percent of total licence revenue, standing now at 15% for 2010. As you can see, the add-on sales have been steadily increasing over time as we launch new products, but also as we build more functionality on those new products. As an example, what we launched in 2009 as a base analytics product in Insight is now being developed into a full data warehousing solution that is in a position to compete effectively in the business intelligence space. This strategy not only increases sales to existing customers, but also increase T24 deal size when bundled with our core products, and captures a larger share of our client spending. We expect this trend to continue in the future as the value proposition of offering more functionality integrated with T24 is very compelling.

Now I'd like to give you an update on slide number eight on our partners. We are clearly excited by the transformation of the business through the establishment of the partner channel. On the services side, taking all our partners together, they now have nearly 1,000 trained, certified resources. This is actually larger than the Temenos services organisation itself today. And as I mentioned earlier, as part of the acceleration of our partner strategy, partners are taking over the full provision of some service activities like testing support, data migration, and soon, all system integration work, leaving our services business to become more specialised and focused.

I've got in the appendix on slide 35 a slide which shows the services landscape with a target division of responsibilities between… split between Temenos and partners, and in essence, we see ourselves concentrating on those services that use or create reusable Temenos intellectual property.

At our Q2 results, I mentioned that we were conducting benchmark testing with Microsoft, and in September, we announced that the high performance benchmark that we conducted has actually set dramatically high standards for speed and scalability for T24 and Microsoft technology, and as a result of this, this makes us the, if you like, the go-to provider for lowest total cost of ownership solutions together with Microsoft, and this is already driving significant new sales, leads and pipeline for us ahead of our original expectations.

Not to ignore our other partners when the process of high performance benchmark testing with the new Oracle Exadata server, and we look forward to those results as we expect that this will establish T24 as a preferred product on this platform as well.

Cognizant has won the first testing support contract, and is lining up to take on further service activities, and as an update, Cognizant currently has 400 trained certified resources.

Finally, the partnership with Deloitte continues to progress strongly as we increase our geographical scope, and Capgemini is actively ramping up its Temenos practice.

So with that, I'd like to hand over to David, who will take you as usual through the financial details of our results.

David Arnott - *Temenos UK Ltd - CFO*

Thank you, Andreas. If you turn now to slide 11, I'd like to start with a quick look at the third quarter financial highlights.

Licence revenue grew by 41%, total revenues by 17%, adjusted EBIT by 16%, and adjusted EPS by 18% in the quarter.

On slide 12, I've shown you the different revenue lines and EBIT/EBITDA metrics and cash flow for the quarter in the last 12 months. I'm not going to walk you through the whole thing, but there's a few numbers here I'd like to highlight which are the numbers I've circled.

Starting with licence revenues, they were up 41% as a result of an excellent performance in the third quarter, which I'll come back to in a second. Maintenance grew strongly by 27% as we grew our cumulative client base, and with the impact of acquisitions, maintenance has grown by 22% in the last 12 months, and is now at $139 million.

One point to note is how maintenance revenues correlate strongly with adjusted EBITDA, both in the last 12 months and the comparative 12 months. This model of correlating maintenance with adjusted EBITDA has held us for many years, and will also hold going forward, possibly with some lags in a year of growth; but overall, it should allow you to make yourself comfortable with the EBITDA growth going forward.

Through strong signings, good cost control and maintenance revenue increases, our adjusted EBIT grew 16% in both the quarter and the last 12 months. Adjusted EBITDA margins have now reached 31%, and we've got further upside potential over the next few years.

Adjusted operating cash flow was $15.3 million in the quarter, and $89 million in the last 12 months, and I'll come back to talk about that in a second.

Turning to slide 13, I'm showing the underlying business performance across our revenue lines by adjusting out the impact of foreign exchange and acquisitions, and you can see that on this basis, all of the lines are performing very well, with licensing up a very strong 38%. Maintenance grows at a healthy 13%, and services continues to drop as a share of total revenues as we execute the partner strategy. This takes total revenue growth up to 10%.

Coupled with this return to growth on revenues, we've exhibited very good cost control, and I've shown this on slide 14, where you can see that like-for-like costs have grown 9%. We made the majority of our investment at the start of the year, and you can expect underlying costs to stay flat throughout Q4, although it's important to note that there are around $12 million of variable costs still in our second… fourth quarter forecast. This should allow you to make yourselves comfortable with our cost outlook pre the addition of Odyssey for the year.

Our services margin in the quarter held back the overall margin impact of such a strong licensing performance, with adjusted like-for-like costs growing at 9%, giving a 16% adjusted EBIT growth. We're passing more and more of our services revenues off to partners without reducing our cost base to ensure that we retain the ability to support the partners in implementations if we need to. Whilst our utilisations are currently lower than in the past, over the next few quarters, we'll continue to pass new business to partners, and our utilisation will come back as we grow the business without the need to recruit people and retain some of the higher services work coming from the growth for ourselves, which will normalise the services margins again during 2011.

This is a one-off cost, which is important to stress, the majority of which has been absorbed… will have been absorbed by the end of this year, and is a small price to pay to ensure the success of accessing the partner channel for licence sales going forward. We're forecasting to be at the bottom end of our 10% to 15% adjusted services margin for the year as a result of this strategy of supporting the migration towards partner-led implementations, and have absorbed this accelerated shift in our outlook for the year. In fact, the total cost of supporting a bench in services this year on profits has been a margin impact of around $4 million, which has been more than covered by the licensing and locked in maintenance from licence deals that partners have brought us during this year alone. As we move into 2011, we look forward to being able to grow the business faster as a result of our progress on partners.

Let's move now to the below the line P&L items on slide 15. Adjusted EPS grew by 18% in the quarter, driven by very good management of below the line items, including excellent rates on our financing, a very efficient tax structure, and good management of below the line foreign exchange. And really, these are the three drivers for EPS accretion, other than the strong EBIT growth, of course.

Turning now to cash flow, I've shown on slide 16 two metrics, as I discussed last quarter. The left hand side shows adjusted operating cash flow conversion of adjusted EBITDA, and the right hand side shows our classic operating cash flow to EBITDA conversion. The adjustments made between the two are the same as for adjusted EBIT, so backing out amortisation of acquired intangibles, and also restructuring costs.

Cash conversion in the quarter was as usual seasonally low. The comparative is slightly misleading, as it contains around $15 million of Metavante cash, without which the cash conversion would have been about the same as this third quarter, which is as expected. Clearly, as is usual for Temenos, our deferred revenues will grow strongly again in the fourth quarter as we bill and collect the vast majority of our maintenance, which is one of the key drivers for our full year cash outlook confidence.

We expect a $26 million swing in deferred revenue for the fourth quarter, excluding the addition of Odyssey deferred revenues at the end of the year. In fact, if you take our year-to-date operating cash flow of $23 million, add the fourth quarter's outlook EBITDA of $58 million, add back the $12 million variable cost that I've just talked about that's included in the Q4 EBITDA but won't be paid in cash this year, and then as a fourth item add on a $26 million inflow from the movement in deferred revenues in Q4 and maintenance, you'll be able to prove the full year operating cash flow number. If you've got any issues on this or questions, feel free to call me afterwards.

This pattern on deferred is not new, but I thought it was important to walk through it again. Our cash OpEx in the fourth quarter is around $79 million.

If you move now to slide 17, I've given you some highlights of our debt refinancing which we've just completed. Our existing facility matured in 2012 and was fully drawn, and we took advantage of market conditions to increase the amount, improve the terms, and push out the repayment profile into 2014, whilst also maintaining moderate leverage. The new facility is for $350 million, and will be used to roll over our existing debt, provide working capital for the business, and some level of acquisition capital.

In the appendix, I've put a slide containing all of the key terms of the facilities, but in summary, it's an excellent deal on investment grade terms with a very strong banking group. By the end of the year, and excluding our convertible, which is really equity at this point in time, we expect to have leverage of less than 0.2 times EBITDA on our balance sheet. The facility comprises $100 million term loan, and a $250 million RCF.

On slide 18, I've shown some metrics around our current cash and debt and leverage at the end of the third quarter. Other than a small generation of free cash flow in the quarter, the only real movements since the end of June have been a draw down under our old facility to pay for Odyssey in October, so slightly after the quarter end, which increased both cash and debt at the end of September.

Turning below to our leverage, if you treat the convertible as equity, as we do, we have no net debt on our balance sheet today. Looking forward, in any future transactions, we continue to favour debt over equity, given the momentum in our business to deliver future shareholder value, whilst at the same time remaining cautious as to acceptable leverage levels, as we've demonstrated successfully in the past.

As I've just mentioned, if you take our operating cash flow outlook for Q4, you'll see that by the end of the year, we'll have virtually no net debt if you exclude the convertible on our balance sheet, despite just completing the Odyssey transaction and buying Viveo only a year ago. This leaves us very well positioned to take advantage of any opportunities that do arise, either on our financing/capital structure, or to support M&A.

That ends the financial update part of the presentation, so now I'd like to hand you over to Max for an acquisition update.

Max Chuard - *Temenos UK Ltd - Head of Corporate Finance and Investor Relations*

Thank you, David. I will start with a brief update on Viveo on slide 19. The restructuring that started early this year is now essentially complete. We executed our restructuring plan well, primarily through the disposal of non-core assets. On the 30th September, we won the judgement against the Viveo Works Council, and we now expect the small remaining part to be fully completed by year-end.

We have therefore improved margin by circa 15 percent points, so this means that we increase Viveo margin for approximately 5% to 20%, and are well on track to be in line with the Group margin in 2011.

The AML and STeP are fully integrated into T24, and are successfully contributing to our growth. Finally, we are nicely leveraging the Viveo customer base, with early successes of V-Bank replacement and pipeline looks promising. The conclusion of the Viveo integration gives us the ability to focus on the integration of Odyssey, our latest and largest acquisition.

Over on slide 20, I set out some information on Odyssey. Odyssey is a leading provider of application software for private banking and wealth management institutions. The company was founded in '95, in 1995, and enjoys a leading position through its global network with 14 offices, and with headquarters in Luxembourg. The transaction closed on the 18th October, and valued the company at an enterprise value of $101.3 million. Odyssey will be consolidated into Temenos from that date onwards.

For the remainder of 2010, we expect Odyssey to contribute $16 million to total revenues, and to remain earning neutral. In 2011, we expect Odyssey to contribute $8 million to Group revenues, with a bit less than half coming from maintenance, and the rest split roughly equally between licence and services. We expect Odyssey to be 6% accretive to our 2011 adjusted EPS, and to achieve Group margin within two years, i.e., in 2012.

On slide 21 now, we set out the rationale for the deal. With this transaction, Temenos established itself as a clear leader in private wealth market, with more than 170 clients and 68 Tier 1 and Tier 2 banks. It creates scale in private wealth with the ability to invest more in the product, and dedicated sales force. In 2010, Odyssey is expected to generate around $75 million of revenues, which alongside will demonstrate wealth business creates a division with pro forma revenues of more than $130 million revenues, significantly larger than any other vendor in the space.

This will allow us to gain market share in a growing market. It broadens our product portfolio in this vertical which will allow us to service customers of all sizes globally from (inaudible) to high net worth. Customers will benefit significantly, not only from our standalone products, but from the ability of the combined product set supported by one company, and with a highly [competitive] roadmap.

And finally, we believe this transaction offers significant synergies through the scale it creates out of the combination with the Temenos business.

With that, I will pass over to Andreas to go through the outlook for this year, and concluding remarks.

Andreas Andreades - *Temenos UK Ltd - CEO*

Thank you, Max. I'd like to move over to slide 23. Clearly, Q3 provides one more data point which demonstrates improving dynamics in the core banking market. As in many other industries, banks are investing in technology to deliver better profits. The… what is special with [core] system replacement is that the reason financial and economic downturn forced banks to postpone decisions by a good two to three years, creating even more legacy than before, and even more urgent and fundamental need to restructure.

In addition, I would like to highlight some of the additional drivers for IT spending in banks like regulation, the need to show deposit bases by attracting new and better customers, coping with rapid growth, improving customer experience and M&A, which is to increase as banks begin to think strategically again and pursue growth strategies more vigorously.

Now we clearly believe that Temenos has a significant role to play, and we are proving this in… with our performance in this trend, as you'll see on slide 24. We are able to grow ahead of the market due to the superiority of our products and the greater scope of the market that we cover with those products. Our focus on one single industry vertical and our solid execution brings the greatest value to our customers, and together with our superior reference base, we ensure that we remain the market leaders. Going forward, our partnership with the strongest industrial players should only serve to reinforce that position.

Now I'd like to turn to slide 25 where I would like to set out our outlook for 2010. As you are aware, Temenos only gives annual outlook, and frankly… and most of you are already aware of this, I'm not in favour of changing that outlook every quarter based on individual quarterly performance. Naturally, the addition of Odyssey will add to our overall revenue guidance in the fourth quarter, and of course, 2011 and beyond. As Max mentioned earlier, Odyssey will be earnings neutral in the first two months of full consolidation, so for 2010, we upgrade our full year revenue outlook to reflect this.

We therefore see a revised revenue outlook of $451 million to $461 million compared to $435 million to $445 million without the inclusion of Odyssey.

Now at this point in the year, we do recognise that in the nine months year-to-date, we are ahead of where we wanted to be in light of revenue, and this better performance will reflect in our full year licence outlook which goes up by $5 million compared to prior outlook. This increase results in a like-for-like licence growth of 15% for the full year compared to 12% previously, and 19% performance for the year-to-date; that's the nine months.

We leave organic total revenue outlook unchanged to reflect the faster adoption of the partner model, resulting in an unchanged adjusted EBIT range of $110 million to $115 million. We also maintain the cash to EBITDA conversion at 100%, same as prior quarter, and our [profit] in the way David has explained during his presentation.

Looking out, we maintain that our view, that organic licence revenue growth is sustainable over the medium term at 15% to 20% per annum. In fact, we are already within the range this year, which is the first year of recovery, and this is particularly exciting.

As you can see on slide 26, this ability to grow at such a pace resulted in a very exciting profit growth, which for the past five years has averaged 40% per annum compound. After the dip in the growth trend observed during the financial crisis, we've clearly retaken our growth path, and I look forward to continuous progress and acceleration along that path in the years to come.

The structural changes we've made in the business, the scale we're achieving through the acquisitions and organic growth, the services partner strategy which makes us more agile, suggests to us that we should be able to continue the profit trajectory very successfully in the future.

Thank you very much for listening to the presentations, and I'd like to hand over back to the operator for Q&A.

Questions and Answers

Operator

Thank you. We will now begin the question and answer session. If you wish to ask a question, please press *1 on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the # key. Once again, that's *1 to ask a question.

Your first question comes from Takis Spiliopoulos. Please ask your question.

Takis Spiliopoulos

Good evening, gentlemen. Great result. I have a question on your businesses. Looking at what your competitors did in the last quarter, like i-flex down licensing revenues about 20%, Misys orders down 19% in banking, so what is really happening out there? Has there been any material change during Q3, because the difference is quite substantial to your organic licence growth rates. And then I have a second question. Thanks.

Andreas Andreades - *Temenos UK Ltd - CEO*

Thank you, Takis. It's Andreas. I'll take this one. Well, from our perspective, what we have reported the last three quarters is a consistent, if you like, improvement in the way the market behaves, and as people feel more confident about the future and there's more stability, and I keep repeating stuff which I said before that it is stability, financial stability which is driving our business, the demand side, if you like. It's not necessarily huge cyclical growth, but the ability of banks to forecast the future a little bit, and this has resulted in increasing demand as the quarters went by.

And banks are looking at their fundamental businesses and they do recognise that they do need to restructure those businesses. And they inevitably turn to vendors that have proven that they can deliver a sustainable business advantage by implementing package software. We believe our business model, our products, the strategy are absolutely spot on. They are where the market is, and this is why we continue to be very successful; in fact, coming out of the downturn, even more successful than before.

So it is true that competition has been reporting weak numbers. We've been observing that ourselves. Not everybody has reported Q3 numbers yet. Based on those that have and looking at recent growth rates, I wouldn't be surprised if our licences in the quarter were bigger than the next four biggest players combined, put together.

So partner strategy and greater distribution has some, if you like, play into that. A fuller product; we take a bigger share of the wallet, if you like from bank spending is also very important, and this is what we are seeing.

Takis Spiliopoulos

Okay, thanks. And maybe one on, let's say, the current trading business. Have you observed any change in October versus Q3, or do you see a further improvement? Or what's the update for October? Thanks.

Andreas Andreades - *Temenos UK Ltd - CEO*

It's of course in the software business, three weeks, beginning of the quarter… it's still very early I the quarter, but as I said in my prepared remarks, our pipeline at the end of September even went up sequentially to the pipeline at the end of the second quarter, so the activity continues to be very robust and we see consistent, if you like, growth in the market.

Clearly, one cannot take a 40% performance and say every quarter will be 40% growth, but we feel good where the market is.

We haven't seen any change, if you like, in the last three weeks or two weeks, not either positive or negative that we would be reporting.

Takis Spiliopolous

Thanks. Great result.

Operator

Your next question comes from [Orimo Lench]. Please ask your question.

Orimo Lench

Yes, congratulations on the quarter as well from me. Could you maybe, Andreas, could you maybe talk a little bit about the partner programme? When I read through your presentation, a lot of that seems kind of more early stage engagement with the partner side in terms of… on the testing side, on the data migration side. Where do you think the capabilities are on your partners in terms of running a full implementation? And where are these partners on the ramp-up programme on being able to do that? So I guess Cognizant will be a bit further than Deloitte, and Deloitte will be a bit further than Capgemini, but just to get an idea about timeframe and capacity in the market.

Thanks.

Andreas Andreades - *Temenos UK Ltd - CEO*

Very good question. You are right. We started, if you like, peeling the onion from the outside and we are… from a landscape perspective, we are moving first in the areas of activity where our partners clearly have a competitive advantage in delivering those services compared to us. As I said earlier, and in fact, I gave the wrong slide reference, it's slide 33 which sets out the services landscape, from our perspective, we want our consulting organisations to forecast on activities that are very close or generating intellectual property; so they touch our product, they create product that is original, if you like, relevant. They project manage, they account manage, and they quality assure the success of projects.

How far are partners away from being able to deliver projects by themselves? We already have partners that are delivering smaller projects. In fact, we are… not our biggest strategic partners, some of our smaller partners, and in fact, we will probably move with a segmentation for 2011 where any project that has a probably $0.5 million licence would be entirely implemented by a partner organisation.

So we clearly improve every day. We believe it will have a material impact on the business in 2011 in terms of, if you like, core implementation capability. Bigger projects probably would start towards the end of 2011 and into 2012.

Orimo Lench

Lovely. Thank you.

Operator

Your next question comes from Adam Wood. Please ask your question.

Adam Wood

Andreas, it's Adam Wood speaking. Also congratulations from me on good work in the quarter. Maybe just coming back to the partners first of all. Could you give us a little feel for how influential these partners are being in actually winning the business for you? Maybe whether it's the influence on the licences in the quarter or the influence on the pipeline that you're seeing.

And could you just confirm I heard you correctly that the pipeline, you actually added more to the pipeline than you consumed during the third quarter?

And then maybe just finally on deal sizes. You mentioned in the press release and talked on the call about Tier 1 and Tier 2 banks coming back. How does that change the average deal size if you get back to a kind of normal mix of spread of banks, Tier 1, Tier 2, as we look into next year? And then as you add the new products as well onto those core T24 licences, how much bigger if a client took everything from you could a sort of traditional deal be versus what it would have been just with T24 on its own?

Sorry, there's a few there, but thank you very much.

Andreas Andreades - *Temenos UK Ltd - CEO*

Okay, Adam, I'll answer them in order of (inaudible) first. Pipeline has gone up sequentially. I reconfirm that is what we said, so we added more than we consumed during Q3. So that's that.

Now deal size; deal size, we reported that deal size has gone up probably by something like 25% in the quarter, and that's both a result of pricing but also mix, and add-on products if you like, if you wanted to of course change on that basis.

Now just to give you an… okay, it's a significant mix in size, and one can understand how we can grow 40%. Once sales grow 25%, it's quite simple really. What scope is there for growth in 2011? I think a lot. However, I would… and I know where you guys go with this, and you know, if you put all the initiatives together, you'll end up saying, well, Temenos 15% to 20% organic growth in the medium term is probably conservative. I'm not going to say that. Growth initiatives are there. We stick with $15 million to $20 million (inaudible). Now which one is going to be higher than the other and how they are going to end up in 2011, you know, is more difficult to say, but clearly, this kind of growth rate we are confident about.

In terms of partners, what we have said at the beginning of the year that we were looking for something like 5% of the business of licensing for 2010 to come from partner sourced deals, so it's like a mix of 5% and what I'm reporting is that we are ahead of that for the full year, therefore, you can do the maths. It's… there are… and it's a combination. There are situations where there are truly partner sourced deals that we were not aware of and we were introduced and we won the business and signed it, and there are deals where existing relationships are significant and it is a question of, if you like, broad influence. There are situations where having a partner to co-deliver a project makes a difference in winning a deal, so it's a combination really. But the 5% mix of licensing is what we are tracking as the baseline and reporting on this.

Adam Wood

That's great. Thank you very much.

Operator

Your next question comes from [Fred Greig]. Please ask your question.

Fred Greig

Hey, guys. It's a couple from me, real quick. Could you speak about customer purchasing behaviour in the third quarter? Basically, I know you guys had strong licence sales. Was that due to good closure rates, or just a factor of that larger pipeline with more larger deals?

And then a second question. Is there any risk that you have a great Q4 in terms of licence revenue that this could cause you to miss your cash conversion guidance, or is there some conservatism baked into that 100% cash conversion [figure]?

Andreas Andreades - *Temenos UK Ltd - CEO*
Okay. I'll take the conversion. Conversion was a little bit higher, a few percentage points higher than one year ago, if you like. Therefore, and sequentially therefore, it came, if you like, the growth came because of much higher pipeline. So I reported at the end of Q2 that pipeline had grown significantly and was supporting the forecast for the year, and this is what's happened.

David Arnott - *Temenos UK Ltd - CFO*

I'll take the problem of too big a licence number for the year. I suppose theoretically, based on the statement Andreas has made, we could exceed the licensing. We're not guiding for that. The markets, as you know, could do anything, but we're confident with the number we've given. Were we to beat that number, unless they all paid a large part of their cash upfront, I suppose we'd be looking at a cash conversion of less than 100%, but in absolute terms, we would deliver the operating cash flow because that's based on the outlook as we see it.

So a large chunk driven by existing maintenance, some upfront cash on the Q3, a little bit on the Q4, and some project milestones to get us there.

What we really focused on internally is the long term reduction in DSOs. To get to our outlook, we need DSOs around 164, which is a trend that is not inconsistent with what we've been showing over the last couple of years with shorter projects and partners and so on. Looking forward beyond that, that DSO number should continue to trend down, but I suppose mathematically, we could end up in a situation with more licensing and a lower conversion rate, but that should not make you think that we won't deliver the cash flow in absolute terms.

Fred Greig

Great. Thanks a lot.

Operator

Your next question comes from [Jonathan Sang]. Please ask your question.

Jonathan Sang

Hey, guys. I suspect that's (inaudible) kind of a nice problem to have there. A quick question on the margin potential. You said that there's a potential for margins to increase from where we are now. Any thoughts on how far you could push the model whilst maintaining the 15% to 20% growth?

And a second question in terms of partnering. What potential is there in the US I guess if the [CSE generation] goes out there or with other partners? Obviously, you've had a go at it in the past, the kind of IP developed with Metavante, have you got that? Could you redeploy that with another partner in the US? Thanks.

Andreas Andreades - *Temenos UK Ltd - CEO*

I'll take the US question and then David can take the margin question. From our perspective, yes, we do have the IP, if you like from our Metavante partnership. We did say that, and we could redeploy that with a partner. What I've said during the year is that for us, the US is a 2011 if you like strategic objective and what I would like to be able to do in the United States is have a direct strategy for the mid sized market complemented by partners on the delivery side, but also on the selling side. And what I said is that we wouldn't want to have, and we don't need at this point in time to do, if you like, an agreement like, if you like, the Metavante agreement we had three years ago. Our size today, our scale and leadership in the market we believe would be enough for us to be successful in the United States.

David, do you want to take the first question?

David Arnott - *Temenos UK Ltd - CFO*

Okay. I think… tell me if this doesn't answer exactly the question you asked, but I think you were saying that up to 20% growth, how much margin improvement could we deliver. Up to around 20% top line growth we would, as we've been saying regularly, and as we've delivered in the last few years, we could increase margins, excluding the impact of the acquisitions by between 100 basis points and 150 basis points a year, and then obviously part of that goes back in the first year post acquisition. But certainly, up to 20%, we could continue to deliver what we've done in the past, which is those sorts of levels.

Jonathan Sang

But I guess where can that get to? Because you know, you have companies like the more mature Oracle and Microsoft as well doing 40% to 45% margins on a low growth maintenance heavy top line. There's obviously a mix there between licence and maintenance which dictates the margin. If you carry on growing and delivering the increase, how far can that go before you have a natural ceiling?

Andreas Andreades - *Temenos UK Ltd - CEO*

I mean, should… this is Andreas. Okay, you know, we would not be modelling to be at the size of Oracle in the next three years, therefore, for us, if you like, a point or point and a half per annum as a margin improvement is a good benchmark, if you like, to go forward. Long term now, if the question is what should you put in your DCS model type of Temenos kind of margin, if growth slows down, and the model matures in ten years, then one could see margins significantly going up, because as you said, the maintenance content goes up and that is highly profitable and therefore drives margins.

But we definitely from our perspective, we today could not put a limit on the margin. We leverage products, we leverage intellectual property. We've got a services led… partner strategy services led, so in software creating scale gets the margin to numbers that are truly very exciting.

Jonathan Sang

Cool. Thanks very much.

Operator

Your next question comes from Chris Grundberg. Please ask your question.

Chris Grundberg

Yes. Hi, guys. Just a couple from me. Just on the DSOs that you mentioned there, obviously, up quiet sharply in the quarter. I wonder if you can give a little bit more colour around what actually went on there (inaudible) for almost three years. Any regional perspective would also be potentially interesting.

And then further on Odyssey, just wondering whether or not you could give a sense of the seasonality you expect next year within that $80 million of revenues, what the sort of quarterly trends might look like, and I know you're pointing to margins reaching Group levels within two years in 2012, is it fair to assume that that is the advanced Group margin? So a couple of hundred basis points beyond what you're looking for in 2010?

And then just lastly as a point of interest, I'm wondering, you mentioned some testing you're doing with Oracle on Exadata. How does that mesh with i-flex and how much support are you actually getting from Oracle within that? Thanks.

David Arnott - *Temenos UK Ltd - CFO*

Okay. Let me kick off by taking the DSO question. The long term trend in DSOs is down, as you can see. We've had quarters when it's dropped dramatically and quarters when it's gone up quite significantly. I think the main point there is that it's extremely volatile. In a year when you're collecting maybe $400 million of revenue, so $100 million a quarter, if you have $10 million of cash moving from one quarter to another, that's $10 million on $100 million on the inflows, but it's $10 million on [$150 million] of the DSOs. So the leverage on DSOs is really quite volatile.

In a quarter where we've grown 40%, clearly, in a seasonally weak quarter as well, with a large portion of your outflows largely locked in, it can move up or down quite a lot. It doesn't concern us. We've collected a lot subsequent to the quarter end. It's consistent with our model. And we have a clear roadmap, as I've said, just by collecting the maintenance, the upfront cash on the large part of the Q3 deals; very little new business to get to the 164 days for the end of the year. It just can be lumpy really.

Max Chuard - *Temenos UK Ltd - Head of Corporate Finance and Investor Relations*

On Odyssey, basically, the seasonality on the licence side tracks pretty much the Temenos model as well, so you should model it similarly as what Temenos does. And then for the Group margin, yes, it's reaching the enlarged Group margin target basically.

Chris Grundberg

Thanks very much.

Andreas Andreades - *Temenos UK Ltd - CEO*

I'll take the Exadata appliance question. In actual fact, from a technology perspective, our if you like biggest partner is today Oracle. Something like 50% of our sales are based on Oracle technology, so I would quote the partnerships with Microsoft and with IBM, and so on and so forth, but let's not forget that Oracle is a significant partner, technology partner of Temenos and our relationship is actually excellent, so no issues there.

Chris Grundberg

Great, thanks.

Operator

And your final question comes from [Mohamed Mawala]. Please ask your question.

Mohamed Mawala

Thanks for taking my question. I had a question around the add-ons. I don't know if you gave the growth rate in the quarter for add-ons; and secondly, given the perhaps faster than expected traction that you're seeing with partners, should we assume that perhaps the add-on business may kind of fade a bit more in the background, or can you just update us on the growth plans there?

Andreas Andreades - *Temenos UK Ltd - CEO*

I'll take this. It's Andreas. We did not give the add-ons growth in the quarter, but what I would like to say is that it wouldn't be more than the 40% we grew overall, it would be consistent with that number. And as I said earlier, because now we have quite a few of them, we feel that giving a percent of mix is probably a better way to model. For example, if you take 15% on the 2010 licensing compared to 10% on the '09, you probably conclude that add-ons probably grew by 40%, or are growing by 40% in the year. And it's quite normal that they would. We clearly want… and as I said in my script going forward, each one of these add-ons, it will come a point where it does become, if you like, a large enough business for this to be almost viewed as a parallel business. They are not there yet. They are, if you like, posted on T24; they are part of the T24 deals and so on and so forth.

And yes, we do have plans to invest in the add-ons further, and I gave the Insight example where in 2011, Insight is effectively a full data warehouse solution and competing with specialised data warehouse solutions. And clearly, that opens up new markets. We are committed to the add-on strategy and we believe it's a… it leverages a unique position we have within our client's IT operations in that when the core solution is installed, we effectively command a very interesting position. During the middle of the IT, you have the backbone of the IT infrastructure and therefore you can add more around that product.

So you are going to see us continue to grow that aggressively. You are going to see us invest in that significantly and expand the product reach, but also add more add-ons as the quarters go by.

Mohamed Mawala

Thank you.

Sarah Bowman - *Temenos UK Ltd - Associate Director, IR*

Thank you very much. I think that concludes our conference call for the Q3 results. Thank you very much and we look forward to speaking to you in another quarter's time.

Andreas Andreades - *Temenos UK Ltd - CEO*

Thank you.#

Operator

That does conclude our conference for today. Thank you for participating. You may all disconnect.
