Full Reviewed Transcription

Temenos AG

Q3 2020 Results

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COMPANY REPRESENTATIVES

Max Chuard – *Chief Executive Officer*

Takis Spiliopoulos – *Chief financial Officer*

PRESENTATION

Operator

Ladies and Gentlemen, welcome to the Temenos Q3 2020 Results Conference Call and Live Webcast. I am Sandra, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode and the Conference is being recorded. The presentation will be followed by a Q&A Session. You can register for questions at any time by pressing * and 1 on your telephone. For operator assistance, please press * and 0. The Conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Max Chuard, CEO. Please go ahead, Sir.

Max Chuard

Thank you. Good afternoon and thank you for joining today's call. I hope you've been able to access our results presentation on our website. I'd like to start with a brief reflection on our progress in Q3. And we've reached a turning point with good underlying sequential growth in licenses from Q2, which clearly show that Q2 was a trough. And I think this is very important, and the return to profit as well on growth. We've learned from all the crisis that it's only a matter of time before banks refocus on the IT renovation program.

The structural pressures banks are facing are too strong to be ignored or dismissed. Banks are compelled to invest in their IT platforms. In fact, COVID-19 is strengthening these structural drivers. The operating environment improved in Q3 and we expect a steady improvement in Q4 and a return to growth in 2021. So as usual, I will start with some comments on our Q3 performance, and then I will hand over to Takis for an overview of the financials before giving some concluding remarks.

Starting on Slide 7, we delivered strong recurring revenues growth of 16% in the quarter with SaaS in particular growing at 61%. We delivered SaaS ACV of 14 million which is up 108% year-on-year as banks increasingly seek to benefit from SaaS and clouds. We saw some level change clearly on that side. We never achieved such an ACV quarter which was great. Further what we saw as well is some cannibalization from license to SaaS in the quarter with approximately 16 to 18 million of license that converted to incremental SaaS ACV of 7 million in the quarter.

Total software licensing declined by 23% in the quarter. Now this is an underlying sequential improvement when you exclude the contribution from HCL deal that we signed in Q2 which clearly shows, as I said before, that Q2 was a trough.

Now, the underlying improvement would have been even stronger if we had taken into account the license that ultimately turned into an ACV. And if I provide also some more details and if you were to remove in fact the relicensing contribution from Q3 2019 and from Q3 2020, on an underlying basis, we will have been growing in Q3, 2020. I am giving this level of details as I think in this environment, I tried to give you the picture of where we are from an underlying trend and why we are confident in the fact that we've reached a trough and that we are back on track and that this will continue in Q4 and in 2021.

We continued obviously to be very focused on cash in the quarter and our operating cash flow was up 27% and importantly obviously our EBIT returned to growth of 4% and which is clearly expected to continue in Q4. We are reconfirming our revenue... recurring revenue guidance of at least 13% growth and are revising our EBIT guidance to reflect those deals that moved from license to ACV. As an acceleration in our SaaS and cloud investment as well, so we revisit the EBIT guidance as I said for the conversion from license to SaaS and some investment we are making on our cloud and SaaS business. So our revised guidance for EBIT is broadly flat year-on-year when you take this into account.

Moving to Slide 8, COVID19 is clearly accelerating demand for SaaS and cloud with SaaS ACV up 108% in Q3. Banks understand the operation and cost benefit to be gained by using the cloud and there is also an increasing regulatory acceptance globally. Our clients recognize that turning our software in the cloud allows for lower infrastructure cost, elastic scaling, active or increased resilience. And since we expect this trend to continue and to accelerate and as we will discuss shortly which is supported by a very strong pipeline.

This quarter, I was very pleased that we signed our largest ever ACV deal globally and this was for U.S. client taking Transact as SaaS and reflect also our growing presence in the U.S. And as I said, we had a number of Transact deals this quarter that converted from 16 to 18 million of license to around 7 million of SaaS ACV. And we do expect that this SaaS cannibalization on the license will continue in the following quarters.

On Slide 9, I'd like to spend a minute discussing our SaaS ACV pipeline, as I said before, and as I mentioned, clearly Q3 we saw a step change in our business for cloud and this is very consistently expected to continue going forward. We've got a pipeline which has grown by around 120% for the last couple of 2 years and we've seen this even accelerating in the last 12 months growing at 160%. And this will clearly drive material growth in our SaaS revenue in 2021 and over the medium term.

This is very exciting because Temenos is perfectly positioned to win in that market with an offering which is uniquely positioned as we benefit from very advanced cloud native, cloud agnostic technology, but at the same time and compared to other vendors that don't have that, we've got a very broad and rich banking functionality, so really those 2 element are extremely strong and unique.

Now turning to Slide 10, I'd like to give an overview of our sales performance in the quarter, and as I said, overall we saw an improvement in the operating environment and more consistency around closure rates this quarter and which I expect to continue into Q4. I already highlighted the very strong momentum in SaaS and the pipeline activity, which we have also I will say on our more traditional license on premise activity which you know give us the confidence in 2021. This with the installed base continued to be more resilient as we've seen for the last few quarters and some deals that were delayed in H1 did close as well in Q3. Finally, we had a total of 17 new clients that we won across our products in the quarter.

Moving to Slide 11, we had 15 implementation go-lives in Q3 and a total of 78 year-to-date and this compares to 69 for the same first 3 quarters of 2019. We... our clients continue to adopt our remote implementation methodology and this allow them to progress through the project throughout any travel restrictions or lockdowns. And one recent example was flow in Italy, which is the digital Bank of Banca Mediolanum, which went live in just 5 months and totally 100% remotely. And I have to say that we have more and more of the successes, which give more and more confidence on our customers to the project 100% remotely. Clearly, the use of cloud in this implementation is a key factor and is very important. Our services margin continued to improve and we reached 14% this quarter. And the fact that those projects are now delivered mainly remotely, clearly is supporting of the increase of the margin.

And finally, I would like also to highlight, we had an amazing event in the U.S. which we called Synergy, which was held at the end of September, it was an online, obviously event. We had a bit more than 20 clients that gave testimony of what they are doing with Temenos and how successfully they are using the system. I think that was great. It was very well attended by around 3'000 attendees from the fall of the U.S. market. And that really showed the progress we've made over the years in the U.S.

Now on Slide 12, I'd like to spend a minute looking at the state of bank IT spend during COVID-19 and how we expect it to develop going forward.

And banks initial response was to focus on the business continuity. We focused on more short term discrete project with immediate benefit during the crisis. And this clearly created an initial slowdown in banks IT spend for larger CAPEX projects.

In Q2, we saw banks focus on the client needs, focus on digital channels and AI, on financial crime mitigation and to focus on supporting the overall community and society. And this quarter, we've started to see banks to refocus on more infrastructure type of project, more operational IT spend. And also clearly what we've seen is COVID-19 accelerating demand for SaaS and cloud as a trend.

Now from a regional perspective, we saw Transact demand in the U.S., which was mainly driven by innovative banks looking for best-in-class solution. We also saw neo and challenger banks, bank front and back office solutions. In Europe, we started to see the demand for digital back and front as well. And also there is clearly a need in Europe to engage into broader projects to restructure and improve return on equity.

APAC and the Middle East, both markets where we saw very strong demand for infinity, so our digital front office solution. And overall, I would say that the delayed CAPEX we've seen in 2020 clearly is expected to accelerate in 2021 as banks re-prioritize IT modernization initiatives. And this is also very consistent with feedback from customers that do want to accelerate the IT transformation.

Now turning to Slide 13; COVID is accelerating demand for SaaS and cloud that’s very clear, and we've seen this in the quarter. Again, with conversation with banks those who run on legacy technology have struggled... continued to struggle to deliver a digital experience to the customers and this has become, you know, more and more important.

COVID-19 is also an accelerator or amplifies the structural driver that underpins our market growth. Banks need more digital, they need... they’ve got regulatory pressures, they've got cost pressures and this is forcing them to address the IT innovation.

Finally, we expect a steady improvement in the operating environment in Q4 and to return to growth in 2021 driven by the strong growth in our pipeline.

So I will now hand over to Takis to go through the numbers for the quarter.

Takis Spiliopoulos

Thank you, Max. Starting on Slide 15, I'd like to give you an overview of the financial performance in Q3. We saw a good sequential improvement in the quarter with recurring revenue growth of 16% and SaaS growing a strong 61%. As Max has already outlined, we had very strong ACV growth of 108%.

Total software licensing was down 23%, a good improvement on Q2 in particular taking into account the SaaS cannibalization in the quarter. Overall, total revenue was down 8% driven by lower license revenues. We return to EBIT growth this quarter, with EBIT up 4% driven by our recurring revenue and tight cost control and we reached an Q3 EBIT margin of 39.1% up 440 basis points and the Q3 EPS of U.S. Dollar 90 Cents, which is flat year-on-year.

We continued to have very strong cash performance with an operating cash flow of U.S. Dollar 63 million up 27% year-on-year, and with a strong operating cash conversion of 119%. We ended the quarter with DSOs at 111 days down 12 days versus Q3, ‘19. And with leverage standing still 2.6 times unchanged versus Q3. Q4 is as usual; our strongest cash quarter and we expect our leverage to be around 2 times by year-end.

Turning to Slide 16, I will run you through some key figures for the quarter and the last 12 months. The strong growth in recurring revenues demonstrates the resilience of our business model in the face of disruption from COVID-19, and is key to our strong cash and profit performance this quarter.

Our SaaS growth of 61% benefited mainly from a significant number of Transact signings, including the conversion of a number of deals from license to SaaS as Max already explained. Without these deals converting to SaaS license revenues would have only declined 16%. And total software licenses only around 5%, which is for both a material improvement over Q1 and Q2.

Maintenance grew 8% this quarter and we would expect some headwind in Q4 from the lower license signings year-to-date, but still good growth this year. Services revenues declined 6% this quarter, as we continue to work closely with our partners and as well as being impacted by the lower rate of license signings in H1 flowing through. Looking at the last 12 months, SaaS has now grown 92%, total software licensing is down 6% and total revenue has grown 3%.

Looking at the cost base, our operating costs declined 14% this quarter, driven by a combination of lower variable costs and the restructuring program we commence in Q2, which has now concluded. There is no further cost reduction program planned for the rest of 2020.

We have increased the estimate... the estimated full year restructuring costs to U.S. Dollar 25 million to 30 million to account for these cost savings initiatives. The restructuring costs linked to the cross-industry business within Kony and the acceleration in cloud and product investment. As we shift resources from more expensive locations to our Indian operations. The flexibility in our cost base has helped to return to EBIT growth of 4% this quarter.

Now on Slide 17, we show like-for-like revenues and costs adjusting for the impact of M&A and FX. As a reminder, we closed the acquisition of Kony at the end of Q3, 2019. In terms of FX, the stronger Euro had a small positive impact on revenue, and the stronger British Pound and Swiss Francs were small headwind on costs. Taking into account all currency movements and hedging FX had a small positive impact on EBIT in this quarter.

Total software licensing declined 29% like-for-like this quarter and services also declined 29% at some implementation processes continued to be delayed. And we started to see the impact of lower license signings in H1 on service revenue. Maintenance grew 7% like-for-like and we expect to continue... we continue to expect good growth through the year. The overall like-for-like decline in revenue was 17%. And our like-for-like cost base was down 27% driven by lower variable costs and the cost savings initiatives we outlined before.

Moving to Slide 18, net profit and EPS were both flat in the quarter and in the last 12 months, net profit declined 1% and EBIT declined 3%. Our tax rate in Q3 was 13.3% and our expected 2020 tax rate is still 14% to 15%. Our medium term tax rate of 18% to 20% is a normalized run rate for the business.

Moving to Slide 19, our DSOs ended the quarter at 111 days. This is down 12 days versus Q3 ‘19, which included the impact of the Kony balance sheet. We have seen no issues with our clients' ability to pay so far in 2020 nor did we have requests for revised payment terms. We still expect our DSOs to be around 110 days by the end of 2020. In the medium-term, we still expect DSOs to reach 90 days and this is driven by a strong cash collection on licenses and increased contribution from SaaS and the continued reduction in DSOs linked to services as more implementation are carried out remotely.

Moving to Slide 20, our Q3 LTM cash conversion was 119%, well above our target of converting at least 100% of IFRS EBITDA into operating cash. We expect our cash conversion to be above 100% for 2020, driven by strong growth in recurring revenue.

On Slide 21, we show the key changes to the Group liquidity over the quarter. We generated 63 million of operating cash flow in the quarter and had a net reduction in borrowings of 30 million. Our cash on balance sheet at the end of the quarter was 113 million with our net leverage standing unchanged at 2.6 times. We expect our net leverage to come down to around 2 times by year end with our strongest cash quarter ahead of us.

Now turning to Slide 22 for our guidance. On Slide 22 we show our revised guidance for 2020, the guidance is as usual on a non-IFRS basis and in constant currencies. You can find the respective FX rate assumptions in the appendix. The 2020 guidance is based on the assumption that recessionary crisis due to COVID-19 had the largest impact in H1 ‘20. We have seen that Q2 was clearly the trough and we expect there will be a steady improvement in our end market in Q4 ‘20 as banks adapt to the crisis. We are reconfirming our guidance for at least 13% growth in recurring revenues.

We have revised our EBIT guidance to broadly flat year-on-year to reflect the deals converting from license to SaaS, and the acceleration in our SaaS and cloud investments to ensure we are the market leader in this space and are best positioned to capture the growth in SaaS going forward. We have maintained our operating cash conversion targets of converting over 100% of EBITDA to operating cash and we expect DSOs to be around 110 days by year end. We expect a 2020 tax rate of 14% to 15% and our net leverage to be around 2 times by year end.

And now on Slide 23, we also reconfirm our sustainable annual growth targets. We have seen banks temporarily slowing their CAPEX spend in 2020 as Max outlined, and focus on immediate IT issues around digital and AI. Our conversations with our clients indicate that they will increase spend on transformation IT going forward as well as the problems they are facing from their legacy IT are growing all the time. Research by industry analysts also shows there will be a rebound and acceleration in demand in 2021 and beyond. The structural trends driving our market are being amplified by COVID-19 and will drive our growth over the long-term.

With that, I will hand back to Max.

Max Chuard

Thank you, Takis. So to finish with Slide 25, we’ve seen a very strong acceleration in SaaS in this quarter, and this will continue in 2021 and in the medium-term. We've seen that Q2 was the trough and excluding the impact of which we had in Q2, we had a good underlying sequential improvement in Q3 with more consistency around closure rates.

As I’ve highlighted, a number of Transact deals converted from license-to-SaaS in the quarter, driving strong incremental growth in our SaaS ACV. Without this, the sequential improvement this quarter would have been even stronger. We continue to benefit from strong growth in our recurring revenues, which is driving our very strong cash generation and our profit. We expect steady improvement in the fourth quarter and a return to growth in 2021.

Finally, we are accelerating our investment in our SaaS on cloud capability to ensure we are best positioned to capture this big, massive opportunity in front of us.

With that, operator, I'd like to open the call for Q&A.

QUESTION & ANSWER

Operator
We will now begin the Question and Answer Session. Anyone who wishes to ask a question or make a comment may press * and 1 on their touchtone telephone. You will hear a tone to confirm that you have entered the queue. If you wish to remove yourself from the question queue, you may press * and 2. Participants are requested to use only handsets while asking a question. Anyone who has a question may press * and 1 at this time.

The first question comes from James Goodman from Barclays. Please go ahead.

James Goodman
Good evening. Thank you very much. First question on the accelerated conversion you're seeing from license to SaaS deals. It sounds like a number of clients have taken that route in the quarter. And I just wondered if you could help us a bit with what exactly it is that's really the driving force specifically for those deals, you know, is that the pandemic or is it the low upfront cost or is it the deployment? And is there something internally that you've done to accelerate that, is there a change in sales comp or anything sort of internally that's also catalyzing the accelerated shift?

And then just secondly on the cost side, down 27% like-for-like, can you help me with what the cost base would have looked like if these SaaS deals had been licensed, because clearly that would have driven a much stronger EBIT than expected. And I'm just trying to, again come back, I think, on the sales compensation for these SaaS deals, because I would have expected perhaps more sort of upfront sales compensation as a result of those deals. Thanks.

Max Chuard

Hi James, let me take the first ones on the cloud. What we saw, it’s interesting that, you know, those are few discussions that had started, you know, on the traditional license and on as the discussion evolved and as we were starting in fact even to exchange, you know, contracts with our different customers, they started, you know, asking more and more about our cloud capabilities. And I think ultimately what it shows is there is an acknowledgement in the market that the resilience that clouds provide, then ultimately, also the cost-benefit, we are talking about the elasticity of the cloud. And I think as we evolve through this crisis, everyone becomes more and more comfortable with operating in I would say on a digital and remote basis. And I think we've seen... it’s few of them and mainly in the largest one was in the U.S. that decided to take that route.

Now, you asked did we do anything specific internally too from a sales point of view. No, there were nothing specific in Q3 now. As you know, we've been getting ready for that for many, many years, and in fact we had our first cloud customer, we were the first one in fact to have a bank running on the cloud and that was in ‘20... 2011, with... sorry, in 2011, we've seen a steady improvement since, but definitely we saw a step change in this quarter, which is very exciting. We are clearly also accelerating the investments because the market is... the opportunity is very big. And, you know, I wanted also to show how the pipeline has developed, and I would say it's mainly between today North America and Europe, and it's both on the Transact and on the Infinity basis.

Takis Spiliopoulos

Hi, James. Let me take the question on costs. Yes clearly, if those deals were booked as licenses, we would have had some quite remarkable tailwind on top of what we've shown for the EBIT. However, we don't, you know, benchmark our operations against what consensus EBIT. But you have a number of factors which drive our cost base.

As we mentioned with the previous results and you see now the full impact of the initiatives we announced earlier this year, you probably also saw the service margin was quite good. So also there, you know, efficiency gains are still, you know, as Max mentioned, yes, you know, Q1 or H1 was the trough, but still, you know, while we do a lot of business now remotely. The overall travel costs have further come down, so that's also helping efficiency gains... across our infrastructure, the profitability of our SaaS businesses has obviously also improved. I wouldn't single out, you know, one factor, but it's really, as we say a very tight cost control.

Now on the variable part with commissions it’s clearly, we always accrue for commission's on both you know, the traditional license business, but also for the ACV business.

So yes, you probably would have had a bit higher commission costs, so not all the, you know, license upside dropping down the EBIT, but clearly with the margin we have on those deals. Yes, it would have been quite a sizable upside. So it's not one factor, you know, I would highlight. And then, also for Q4, we still expect Q4 costs to be up sequentially. I mean, we expect, you know, a stronger Q4 versus Q3, which will obviously also drive up, you know, also the variable costs. Plus, we've mentioned, you know, the increased investments in SaaS and cloud in particular.

James Goodman
Yes. That's helpful. Thank you.

Operator
The next question comes from Charles Brennan from Credit Suisse. Please go ahead.

Charles Brennan
Great. Thanks for taking my question. I've got 2, if I could. The first, and I know it feels a long way away, but it's looking into next year. I feel like there were lot of moving parts for 2021. On the one hand, we've got an improving demand backdrop, and an accelerating digitization imperative, which is clearly a positive, but at the same time you are flagging up some cannibalization of license. You're flagging up the maintenance growth is starting to fade as we got the impact of low licenses. And again, with services that creates a drag into 2021. And then, on the margin side, I guess, we've got to analyze this higher investment from Q4. So I was wondering, if you could just help us with a framework to get our arms around next year? You've reiterated your medium-term targets. Are you suggesting that we should be expecting at least 15% software licensing growth and EBIT growth next year, is that the starting point for our analysis?

And then secondly, away from 2021, can you just talk about your win rates with some of these cloud-based deals versus traditional on-premise deals. And the reason for asking the question, as a number of investors have been suggesting you've been losing some cloud-based contracts in the U.S. to some of the incumbents. So I was wondering, if you could talk about win rates. Thank you.

Max Chuard
Charles, you know, I can start with the win rates, if you want. And if I look at our competitors, you could classify them as the more traditional ones, which we compete mainly for the on-premise activity. And those are the one that we have been competing for the last 10 or 15 years, which is Oracle, which is Infosys, TCS and so on.

And we had mentioned that with them our win rate is very, very high, so it's above the 70% and it continues to be like that, and when you look at the IBS League Table we tracked you know, the best vendors, you can see how far ahead of everyone we are. So I think that's on one hand and then on the other hand, about the new vendors that we see in the market.

There as well I would say our win rate is also extremely high. Now there are less data points, probably because you know, we've been competing the last few years with them, but just to give you a sense today, we have probably more than 40 neo banks, challenger banks on our software. So it's... and that we had that you know, we gained that in the last few years, and why we win above... against the... those new vendors, is because we know banking extremely well, it's because the functionality that we can offer is very, very rich, very broad. And we benefit from the advanced technologies, if you want, so it's cloud-native and cloud-agnostic and all of that stuff. But in addition to the advanced technology, we benefit from the knowledge of the banking and those 2 things together are what is unique about Temenos. And that's why we win, so much against both those neo vendors, and both the more traditional ones. So that's if you want on the win rate.

On 2021, if you want to go ahead, and I'll jump in if...

Takis Spiliopoulos

Yes. Let me give you, you know, a bit of a framework as you call it. Clearly, we're going to issue detailed guidance for 2021 in February only. But if you look at what Max said, and I think that's important to highlight, you know, despite the strong growth we have seen in ACV and which we expect to continue. Clearly, if you look at our license pipeline, this is growing as well, you know, it's good growth as well. So we expect licenses to grow next year, not just because there is an easier comparison base, but clearly, we see the pipeline supporting this.

Then on maintenance, yes, you know, there is some impact from the lower licenses we have seen this year, but there should be still good growth in maintenance also next year, which is obviously driving a considerable part for the profitability.

And then, strong ACV momentum, which is obviously gonna have a substantial positive impact on SaaS revenue growth. So putting this altogether, yes, clearly the ambition is for us to get as quickly back to our long term total software licensing target of, you know, 15%. We'll see in February where we stand.

In terms of cost base to address, the margin question clearly that's too early. We are only starting the budgeting process, what we said you know, and this is still valid despite the strong growth we see in SaaS revenues this year and next year and beyond. We still expect to reach our 36% plus mid-term target for the EBIT margin, so that's still valid.

Charles Brennan
Great. Thank you.

Operator
The next question comes from Hannes Leitner from UBS. Please go ahead.

Hannes Leitner
Yes, good evening. Thank you for letting me on. I got also a couple of questions. So if you look into the average deal size, so the average contracts... average license sale is divided by the customer wins. It seems quite like a similar pattern over the last 3 years compared to this year. So that would be the first question is, where do we see that conversion of SaaS deals? And then on the back of the SaaS conversion you pointed out a couple of times of license growth, so if we are excluding some portion of it... of the SaaS increase quarter-over-quarter, you have been at probably at best flat or down, could you maybe elaborate there more? And then, I have one follow-up.

Takis Spiliopoulos
Okay, Hannes, I don't know if we got the questions correctly. I mean, we did not report on... the average deal size, but clearly what we can say is, yes obviously there has been... if you look at the license business, of course, you know, some impact this year, because we have less large and transformational deals. So yes, the average deal size is down.

Now on the ACV, I think it's the opposite. You know, we have seen now compared to years ago where you had smaller banks with smaller deals. We have clearly seen now that the... and see that also reflected in our pipeline. The average deal size, really increasing in the pipeline. Yes, we had a number of a bit larger deals, you know, in this quarter, but clearly, it's... if you look at it on a, let's say, total bookings value or total contract value over the lifetime, then clearly this is both, you know in growth territory.

And I didn’t get your second question in terms of, you know, the sequential trend.

Hannes Leitner
Yes, on the SaaS revenues or when you take out that conversion which you mentioned that licenses was basically converted to SaaS.

Takis Spiliopoulos
Yes.

Hannes Leitner
Can you talk about the underlying sequential trends, because SaaS would be rather more viewed sequentially not year-over-year.

Takis Spiliopoulos
Yes. So correct, you know, the deals... and this is still... this is true... still true also for the ACV business, you know most of the deals gets signed in the last months of the quarter and then usually in the last couple of weeks. So this ACV business you have seen right now in Q3 had no impact on the... or minimal impact on the SaaS revenue this quarter. It will have some positive impact, you know, on Q4. But clearly, the full rate of this ACV will be visible, I mean, it usually takes a while until we go fully live with those. So you will see that partially in Q4, but especially then in 2021 and beyond.

Hannes Leitner
And... okay. So then just a small follow-up on that side. Could you elaborate what drove a license customer to switch to SaaS which is clearly over the lifetime on total cost of ownership more expensive and that’s quite unusual for banks? And then, my last follow up question was on the restructuring you slightly increased, that you reached already the 25 million. You have history this year of sequential increases of restructuring cost. And could you elaborate given the research guidance? And also if it includes the HCL deal, it is quite a significant drop in EBIT. What causes the delta, maybe you can talk us through the moving parts here, please?

Takis Spiliopoulos
Okay. So on the first one, clearly, you know we don’t disclose the details, but you know, if you were look on an NPV basis, clearly we don’t lose value if we move to ACV. So much for that. Then on the restructuring, I think, you know, there is a combination of reasons why we have increased the amount slightly from 25 to 30, giving us a bit of a bigger envelope. I think there is still a combination of costs linked to the transaction we have announced with Kony, so about the... with Kony cross industry with HCL. So there are some costs linked to that transaction.

And I think that's what... that's the main reason. Also there is some as we mentioned some costs related to transitioning our cloud... some of the cloud operations or our Indian operations. So that's also put in there, but it is not a big amount.

Now, HCL, as you know, it was not included in the original guidance. So when we issued the guidance in April we didn't know about this. Now, it is you know, when we reconfirm the guidance in July it was in... it was in there, so larger than 7%. Now, with a flat EBIT, you know, as Max elaborated, you know there are a number of reasons, it is actually 3 reasons why we took down the EBIT to around flat. number 1, the conversion we have seen in Q3. number 2, the expected some conversion in Q4 as well and the accelerated investments we have already started in Q3, but they will impact Q4 EBIT. So these are the 3 reasons for the guidance reduction in EBIT.

Hannes Leitner

Thank you. Good luck.

Operator

The next question comes from Adam Wood from Morgan Stanley. Please go ahead.

Adam Wood

Hi, good evening. Thanks for taking the question. Couple of... kind of follow-ups to Hannes' questions. Just first of all on the SaaS versus ACV debate. I mean, you flagged in one of the slides that ACV has moved materially over the last couple of years. But actually, if I look at the SaaS revenues over that time, you know sequentially ex-Kony, they've kind of been flat, and if I try to do the calculation organically, it looks as if the SaaS business hasn't really grown very much over that period. Could you maybe just give a little bit of insight? Am I doing the math correctly, is there something I have missed in terms of that SaaS organic growth? And, you know, why the confidence do we see coming through next year while we haven't seen it so far?

Then just on the cost side, we have seen pretty material declines this year, and you are talking about some need for investments, you know, that has already happened in Q3 and starts in Q4. Could you give us a little bit of more insight into the bounce back in costs next year, because if you do get back to growth again, I imagine that we have more variable costs coming in? So just to give us some metrics to help us think about EBIT?

And then maybe finally on this license to SaaS migration, I kind of... I was thinking about it more from the client side that if you are a bank, the lifetime contract value is going to be much, much higher on subscription as on licenses, and we would have thought that most are able to kind of do that calculation, and would have the cash to pay licenses upfront. Is there a way that's changed in terms of how you are selling that if company is going to run on cloud, they have to subscribe that's pushing banks to that or is it just they are willing to trade that greater cost or greater flexibility? Thank you.

Max Chuard

Adam, I was about to make comment before. And let me just answer the last question, the last question and then leave it to Takis. Definitely, I would say the... when we sell... when we engage on an ACV, and if you look at the life of that contract and if you had to do an (unintelligible) or whatever it takes. The value we get on the ACV is better than on the traditional... on upfront license.

There is no question about that. And there are different reason that clearly one of them is also... you will have a tendency and some of our sales people will have a tendency when there is a large upfront to discount it much more, where I would say we hold pricing much stronger on the ACV business, and we get really the full value. And I have to say that the last few quarters we've been able to improve significantly the value we are getting on our ACV business. So I think that's also on our side, the fact that we are maturing in that respect and we are able to capture very, very exciting values for those ACV deals.

Takis Spiliopoulos

Adam, let me address the other 2 questions. First of all, on the organic growth, you know, here we don't disclose this on the SaaS and ACV line. However, 2 elements which I think you need to consider.

Number 1 is, clearly there is a pretty considerable attrition element on the SaaS revenue line from the Kony cross industry business we had acquired back in, you know, which closed one year ago, and we had flagged this SaaS revenue attrition quite early. So that's clearly not showing the real growth.

Number 2, if you look at... and we mentioned this, so there was a lot of Transact business in the ACV number we have shown this quarter. So clearly Transact, there is no acquisition in there. Also we announced some deals earlier this year with Itau, that's also, you know, Transact organic. So we are very happy with the organic growth in both Transact and infinity this year.

On... maybe and you know to give you a bit more confidence, you know on the long term. Clearly, the ACV business and then you do the math with the SaaS revenues following then it should be at least, you know, 30% growth going forward, and now we have given at least one number to be a bit more specific and this is clearly on an organic basis.

And the last one was about the investments. Clearly, we have done a lot on the cost side, both on the viable but also on fixed. I would say as a run rate, maybe, let's say, 60% to 70%, maybe it is a bit more of the costs could return next year that's clearly based on 2 assumptions.

number 1 is, you know we deliver on our licenses. So we will have to pay more commissions or in general more variable costs and also there should be an element of rebound in terms of travelling maybe not in the first half, maybe in the second half. So, I would say, yes, maybe let's say one-third, 30% of the costs taken out this year, we still have for ourselves and the rest is probably going to come back.

Adam Wood
Perfect. That's very helpful. Thank you.

Operator
The next question comes from the Laurent Daure from Kepler Cheuvreux. Please go ahead.

Laurent Daure
Yes. Thank you. Good evening, Max and Takis. I have 2 questions; the first is on your comment on the investments that you do... starting to do in SaaS and clouds. Could you be bit more specific of the extra costs you are expecting for the rest of the year. Are we talking about adding people or any clarification on that would be useful. And my second point is on Europe. I mean it seems really weak on revenues, do you see some trends in terms of some pipeline or is there specific issues with converting the pipe into revenue in the open space? Thank you.

Max Chuard
Hi, Laurent. I can start with Europe. It's true that if you look at Europe, I would say year-to-date in fact it's the region that I think the most impacted by the crisis. And also the region that has been the... that it's taking the longer to adapt to that normal. So, I think that's a very fair comment. Now, when I look at the pipeline and when I look at Q4 and 2021, I expect to see an improvement as well in Europe in Q4 and also this to continue into 2021.

So, if on the activity is... the closure of the transaction are taking longer in Europe where in most of the regions, not in every region, but most of the regions except Europe, the improvement that we saw within specifically... specifically within Q3 has clearly improved a lot. The ability and the certainty of the closure rates has massively improved in Q3 in most of the regions. It is not yet there in Europe or in Europe it is still taking longer than normal to close this. However, I've seen an improvement during Q3. So, I think this will continue in Q4, so we would see a better situation in Europe in Q4, and obviously in 2021 as well.

Takis Spiliopoulos

Hi, Laurent, let me address the investment question, you know, yes, we have started this in Q3 already having seen how the strong pipeline has built for ACV and also delivered on the signing. So, I would say, if for this year if you do the math and exclude the impact from the conversion, it's a small low single-digit number which will flow into the P&L this year.

Laurent Daure

Are we talking about extra cost in R&D and or in sales, I am having a hard time to understand exactly what these extra costs are.

Takis Spiliopoulos

Yes, so as we mentioned, there were some initiatives already in place, you know, talked about the Indian operations, our 24/7 operation center we still have some, you know, local or regional cloud resources, you can... you need to invest in those areas, so that's one example, because you need you know, while you have an operation center, centrally you still need some local resources or, you know, this is adding there. And in terms of the product clearly, we are having the strong demand, and the pipeline, you know, some of the R&D pipeline, some of the road map is being accelerated.

Laurent Daure

Okay, great. Thank you so much.

Operator

The next question comes from Pillai Gautam from Goldman Sachs. Please go ahead.

Pillai Gautam

Yes, great. Thanks for taking my questions. I have a follow-up on the competition and the win rates point. We've seen a couple of contracts in the Middle East being announced by TCS and (unintelligible) announced a win at Barclays recently.

Is there any geographical or execution related dynamics we should be aware about, that's the first question. And then on the... just a clarification on the SaaS accounting point, then you kind of convert the ACV into revenues under IFRS 15, the license portion of these revenues can be booked upfront. Is that something that (not audible) as well? Thank you.

Max Chuard

Hi, on the win rates, yes, there are markets where we are more mature and really Eastern Europe is a market that's... this is where we started, so we are probably more mature in Europe. Middle East and Africa, you mentioned, we are very, very strong in that region, extremely stronger. Now, clearly the U.S. is a newer market, and so I will tell you the win rates comes also with the... the level of credibility and the reference you get in those regions. And I would say clearly the market where we are more mature, we have more references and hence, probably the win rates will be higher. But, overall the amounts... the number I was mentioning before this is globally, so you can imagine that in every region we've got very, very high level of win rates. This is not I would say regions where we are weak compared to all the others, broadly when we compete we win most of the time. Do you want to take the other one?

Takis Spiliopoulos

Yes, I will take the other one. So while we haven't given the disclosure the way we book, those SaaS contracts, it's really over the life time of the contract and this applies to both the license and the service part.

Pillai Gautam

Okay. Thank you.

Operator

The last question comes from Andreas Müller from ZKB. Please go ahead.

Andreas Müller

Yes, good afternoon, Gentlemen, I have 2 questions. Do you see kind of, you know, when you see that you converted roughly 16 to 18 million losses into an ACV yield 7 million, is that the ratio one can apply, also going forward for the deals converting or has the scope of these deals also changed at all? That's the first question. The second is since you have bought Avaloq, do you see there any competitive change in the landscape in wealth management at all, do you see some opportunity also for yourself creeping into our Avaloq's turf?

Max Chuard

Let me start with... hi Andreas, let me start with the last one. I think every time there is an M&A transaction it brings uncertainty and probably opportunities for people that have had very stable capital structure like us and now, I think this is the market that we know extremely well. And we are committed to this market. And I see this as an opportunity for us ultimately. Now, I could not understand personally the strategic question and it doesn't mean that others don't have a different view. But, I think for us this is the market that we have been operating for a long-term. As said, those M&A transaction usually brings opportunity. So I will see this one has opportunity for us.

Takis Spiliopoulos

Andrea, let me take the one on the equivalent ratio as we call it. And clearly, every deal is different and this makes it sometimes difficult, but if you do the math and take that one million license 1 million ACV deal, it's probably a right average, somewhere around that ratio, which you get from this calculation. So, I think, you know, for now that's probably a good way to think about.

Andreas Mueller

Okay. And these deals that I have changed, I mean, have they changed in any way regarding the scope that's you know, it's broader or whatever or is it... ?

Max Chuard

No, the scope was probably the same, so it was really... no, the scope had not changed.

Andreas Mueller

Okay. Okay, thank you.

Max Chuard

Thank you. Thank you very much, everyone. I think that was the last question. And looking forward to talking to each one of you every soon. Thank you.

Operator

Ladies and Gentlemen, there Conference is now over. Thank you for choosing Chorus Call and thank you for participating in the Conference. You may now disconnect your lines. Goodbye.

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