Full Reviewed Transcription

Temenos Group

Q2 2021 Results

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COMPANY REPRESENTATIVES

Max Chuard CEO

Panagiotis Spiliopoulos CFO

PRESENTATION

Operator

Ladies and Gentlemen, welcome to the Temenos Q2 2021 Results Conference Call and Live Webcast. I am Sacha, 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 is my pleasure to hand over to Max Chuard, CEO. Please go ahead, Sir.

Max Chuard

Thank you. Good afternoon, and thank you all for joining today's call. I hope you've been able to access our results presentation on our website. As usual, I will start with some comments on our Q2 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 had strong momentum in the second quarter, as more banks embarked on digital transformation journeys, in response to the pandemic, and the ongoing structural pressures on traditional banking models. We also benefit from significant numbers of new entrants to the market. Our success with new entrants and challenger banks has driven significant growth in SaaS ACV, which were up 409% in Q2. Combined with strong license growth, this has delivered excellent growth in total bookings of 1% and 4%.

Our total booking this quarter are higher than they were, in Q1, in Q2 2019, demonstrating the strength of recovery and underpinning our future outlook. We introduced total booking as new KPI this year, to reflect the increasing contribution from SaaS and to enable you to track the over growth in our business. Our EBIT grew 16% this quarter, and our EBIT margin expanded by 300 basis points, driving strong operating and free cash flow generation. With a strong momentum in our business, we have raised our SaaS ACV guidance for the year, to between 50% to 60%, up from between 40% to 50%. We have reconfirmed the order guidance items, which Takis will run through later on.

Moving to slide 8, we had significant SaaS ACV growth this quarter, up 409%, with ACV of 17.4 million Dollars, our highest ever ACV quarter.

The U.S. was the strongest contributor by region, and we expect this to continue going forward. We signed a number of new SaaS logo this quarter, as well as, benefiting from volume growth within some existing clients, who have rapidly scaled the business.

On slide 9, you can see that our SaaS growth is largely incremental to the business. Large banks are buying licenses from us, to progressively renovate the bank, based on packaged business capabilities, and those will be run, either on-premise or in the cloud directly themselves, or with a hybrid model that combines the 2. Mid to lower tier banks are also largely on-premise, renovating the entire bank, and we do see increasing use of cloud and SaaS in this segment.

And finally, challenger banks and FinTechs are almost entirely SaaS for the operations, and this is where we see the incremental demand, and we can achieve rapid SaaS ACV growth with successful plans at the scale the business massively.

Turning to slide 10, we had an excellent total booking growth of 104% this quarter. Total booking hit 165 million Dollars, which is higher than what we had in Q2 2019, and as you know, 2019 was our best year so far, so this reflects the strong sales momentum we see in the business. Demand this quarter was broad based, across most geographies and products. Total booking is a key metric for us, as this... it drive growth in our backlog and increases our long term visibility. It underpins our guidance for the year, shows we are building backlog for 2022, and give us confidence in our 2025 targets. Our growth in total bookings was driven by significant growth in SaaS, as well as, strong growth in licenses. As with Q1, we also saw an increase in average tenure this quarter, compared to last year.

On slide 11, we saw continued momentum in the second quarter, building on Q1, with the sales and development improving across most geographies. All regions delivered double-digit growth in the quarter, with the U.S. in particular, having another very strong performance. The U.S. was again, the largest contributor to total software licensing.

In Europe, we are seeing a recovery that is following the trajectory of the U.S., with a short time lag. Our European deal pipeline is building up very nicely, and we expect strong sales growth in the second half of the year. Activity with Tier 1 and Tier 2 banks is also increasing across all regions, and in fact, we are strengthening our sales organization to address this. We had 16 new clients win in the quarter, and our services teams and partners delivered 15 implementation go-lives.

On slide 12, I'm very proud that we again topped the sales league tables for the year. With IBS, we were ranked number 1 seller for core banking, for 16 years in a row, which is an amazing achievement. We were also the number 1 seller for digital banking and channels, retail payments and risk management. This year IBS introduced a new category for sales, to neo-banks and challenger banks, which is a very fast growing segment, targeted by a number of neo-vendors. We have invested heavily in our SaaS and cloud capabilities over the past few years, to ensure we are highly competitive in this segment, and being ranked number 1 in this new category is a strong statement of our capabilities, our competitive positioning and the investments we've made so far.

With Forrester, we were the top global power seller for the 15th year, and in fact this year we were the only vendor to be ranked as a global power seller with a 20% increase in new named deals, and with 3 times as many deals as the next vendor in the ranking, so that's quite impressive. I'm very pleased with this confirmation of our market leadership, and the efforts of all our product, sales and marketing teams, who fully deserve the credit for this success.

Moving now to slide 13, I'd like to give a quick update on the 2 strategic partnerships announced earlier this year. In our partnership with Salesforce, as you know, we are combining Salesforce CRM capabilities with transactional capabilities from Temenos Infinity, the product integration is nearly complete, and sales activity have already commenced with strong level of interest. The second partnership was a strategic agreement with DXC, to offer the bank's clients a digital transformation path for core banking. We have a number of workshops and early stage sales processes on the way, and are looking to potentially expand the relationship to offer all the products into the U.S. market.

Turning to slide 14, our U.S. business continues to perform very well, and was the largest contributor to our total software licensing, with strong growth in both license and SaaS. We had a number of new U.S. logos signed in the quarter, and looking forward, it is the largest contributor to our global ACV pipeline this year. We have continued investing in our sales team in the U.S., which is translating into pipeline growth, and we expect our strategic partnerships, as I mentioned, with Salesforce and DXC to also contribute to future growth. And finally sales activity with large U.S. clients is also increasing.

Finally turning to slide 15, we are seeing increased activity with Tier 1 and Tier 2 banks in the market. And therefore, we are proactively responding to this and have announced two expanded roles in our Executive Committee to strengthen our global sales leadership.

First, Philip Barnett is taking the role of President of Global Accounts in addition to his Strategic Partner responsibilities. He is building a dedicated sales team focusing on strategic and complex Tier 1 and Tier 2 accounts to capture the increased demand we see in this market. And I think this is very exciting.

Jean-Paul Mergeai is being promoted to President International Sales with responsibility for sales across Europe, Middle East and Africa as well as Asia PAC. Jean-Paul took over responsibility for Asia earlier this year and has already had great success. And we are very confident he will replicate this in Europe. Jacqueline will continue as President of the America with responsibility for sales both across North and South America.

On that, I will now hand over to Takis to talk through the numbers for the quarter.

Takis Spiliopoulos
Yes, thank you, Max, and hello, everyone, from my side as well. On slide 17, I'll start with an overview of the quarterly financial performance. All figures are in constant currency unless otherwise stated.

SaaS revenue was up 24% in Q2, ‘21 driven by strong ACV growth in prior quarters, but offset by the impact of HCL. Total software licensing grew a strong 16% and maintenance grew 3% in line with guidance and in line with Q1,‘21 giving total revenue growth of 8%. EBIT grew 16% and the EBIT margin expanded by 300 basis points to 36.2% driven by the operational leverage in our business model.

We had another very strong cash quarter with operating cash flow of 112 million, up 19% and free cash flow of 87 million, up 24%. DSOs ended the quarter at 106 days, down 1 day year-on-year and also down 1 day sequentially. Our net debt is now just above 1 billion and our leverage is at 2.3 times having paid out the 2020 dividend and executed 194 million of the 200 million share buyback program. With our strongest cash quarter ahead in Q4 ‘21, we expect our leverage to be around 2.1 times by year end, therefore unchanged year-on-year.

Moving to slide 18, SaaS revenue grew a strong 24% despite the HCL headwind. We have had several from quarters of ACV growth and with most of the HCL headwinds behind us, I expect a sequential improvement in SaaS revenue of 2 million to 3 million in Q3 ‘21 and an even stronger sequential improvement in Q4 ‘21 as the ACV growth is reflected in the P&L.

Total software licensing grew 16% on the back of strong sales momentum and then improving environment in most regions.

Maintenance continues to recover as expected growing 3% in the quarter. We expect maintenance to grow at a similar rate in Q3 ‘21 and then accelerate in Q4 ‘21 to give full year maintenance growth of around 4% driven by the license growth in the first half of the year. After 2021, we expect our maintenance growth to accelerate in 2022 and beyond as license growth is rebounding.

Service revenue was slightly up in the quarter and I expect service revenue to accelerate in the second half to also yield around 4% growth for the full year.

Looking at the cost base, our operating costs were up 3% year-on-year. Our fixed cost base continued to grow with hiring in R&D and sales in particular and we had some limited increase in travel costs.

On slide 19, we have provided the Q2 ‘21 impact of the Kony non-banking clients moving off from the Temenos P&L to HCL. HCL paid us an annual license fee in Q2 ‘20 and this repeated again in Q2 ’21, so there was no impact from the HCL license fee on our year-on-year growth rates. The headwind comes from lost revenue across licensing SaaS as well as services and a bit of maintenance as non-banking client's move from Temenos to HCL which also impacts EBIT. In Q2 ‘21 this created a 4% headwind on SaaS revenue, 9% on total software licensing, and 4% on total revenue. There was also a 10% impact on EBIT. The large majority of the HCL impact is now behind us and the rest will gradually phased out in H2 ‘21 and become negligible in 2022.

The strong ACV performance in the recent quarters will become more visible in the SaaS growth acceleration in Q3 ‘21 in Q4 ’21. We have now visibility on most of our forecast 2021 SaaS revenue given the sake of 3 months’ time lag between SaaS deal signing and SaaS revenue starts.

Now on slide 20, we show like-for-like revenues and costs adjusting for the impact of M&A and FX. The Q2 ‘21 figures are all organic and therefore in line with our constant currency growth rates. In terms of FX, the trends from Q1 ‘21 continued with a stronger Euro having a positive impact on revenues, but more than offset by cost increases in all major currencies, in particular the British Pound and the Aussie Dollar. Taking into account all currency movements and hedging FX had a negative impact of about 2.5 million on EBIT in the quarter.

Turning to slide 21, net profit grew 11% with higher taxes driving most of the difference versus EBIT, and EPS grew 11%. Our tax rate was 17.5% for the quarter and we continue to guide for the 2021 tax rate at 16% to 18%.

Moving to slide 22. Our DSOs reached 106 days at the end of the quarter, down 1 day sequentially and also down 1 day versus 1 year ago. We had strong cash collection in H1 ‘21 which was reflected in the operating and free cash flow growth. And we expect this trend to continue going forward. We are confident in getting DSOs to below 105 days by year end. Beyond 2021, we expect DSOs to continue on their downward trend towards 85 days by 2025 driven by continued improvement in licenses and services cash collection and then increasing contribution from SaaS in the P&L which typically have lower DSOs, more in line with maintenance.

On slide 23, our Q2 ‘21 LTM cash conversion was 107%, well above our target of converting at least 100% of IFRS EBITDA into operating cash. We expect our cash conversion to be at least 100% for 2021 driven by strong growth in recurring revenue, which we have continued to deliver for the last few quarters.

Now on slide 24, we show the key changes to the Group liquidity since Q1 ‘21. In Q2 ‘21, we generated 112 million of operating cash flow and the other main movements were the share buyback of 105 million and net positive inflow from borrowings and a 71 million dividend payment. Our cash on balance sheet at the end of the quarter was 88 million with our net leverage reaching 2.3 times. We expect our net leverage to be around 2.1 times at the year-end 2021 after share buyback and with strong free cash flow generation. This is unchanged versus the end of 2020.

Turning to slide 25, we had an acceleration in ARR versus Q1 ‘21 with ARR growing 8%. HCL was still a considerable headwind in this quarter, but most of this is behind us now and underlying attrition on ARR remains in line with historic rates. ARR growth will continue to move upwards in Q3 ’21 on the back of higher SaaS growth before considerably accelerating in Q4 ’21, as both SaaS growth and maintenance growth reach normalized levels.

We had very strong growth in deferred revenue, which was up 17% after already growing 28% in Q1 ’21. This is driven by a combination of strong cash collection on maintenance and the growing contribution from SaaS. Free cash flow was therefore up 24% year-on-year to reach 87 million and our net cap debt was 5.4 million, flat on Q1,‘21 and still expected to be at or below 2020 levels for the full year assuming no further M&A.

Moving to slide 26, I have kept this slide in here to remind you of the new KPIs we introduced in February: total bookings and ARR. Most of you will be familiar with these by now, so I will not spend time going through them. But if you have any questions, please let us know. We've also put slides in the appendix with tables showing SaaS ACV, ARR, total bookings and free cash flow by quarter.

On slide 27, we have revised our 2021 non-IFRS guidance specifically increasing our expected SaaS ACV growth to 50% to 60%, up from previously 40% to 50%. Keep in mind, there is a one quarter delay between ACV and SaaS revenue growth, so most of this will impact the 2022 P&L. With a Dollar of SaaS ACV equivalent to around 2.5 Dollars of license, if this has been licenses, we would be raising total software licensing guidance by 2.3% for the full-year 2021. This is why reporting our new KPIs of ACV total bookings and ARR are so important. They provide visibility on the future growth trajectory of our business, given the acceleration in SaaS and its increasing contribution to the P&L line.

We have reconfirmed or other guidance items for 2021. The guidance is on a non-IFRS basis and in constant currencies. You can find the FX rate assumptions in the appendix. For ARR, we guide for 10% to 15% growth, driven by committed SaaS revenue from the ACV we have booked and the reacceleration in our maintenance growth during the year. We expect to grow total software licensing by 14% to 18% as licenses continue to grow, as already seen in the first 2 quarters and driven by the sustained growth in SaaS.

Total revenue growth is forecast at 8% to 10%, with the impact of slower growth in maintenance and services on the back of lower license growth last year. We expect both of these to accelerate throughout the year and in 2022 and beyond. We are guiding for EBIT growth of 12% to 14% to 362 to 369 million implying an EBIT margin expansion of 130 basis points from 35.9% to 37.2%. We have maintained our target of converting over 100% of EBITDA into operating cash and expect DSOs to be below 105 days by year end 2021. We expect a tax rate of 16% to 18% for 2021, and our net leverage to be around 2.1 times by the end of the year.

On slide 28, I'd like to reconfirm also our 2025 targets which we presented at our Capital Markets Day in February. These targets are organic growth rates per annum. We expect total software licensing to grow 15% to 20%. SaaS will clearly grow significantly faster at around 30% plus and licenses are expected to grow at 10% plus per annum. This will drive total revenue growth of 10% to 15% per annum. We expect to expand the EBIT margin to around 41% by 2025, driven by strong growth in license and maintenance improving our SaaS gross margin and leveraging R&D and G&A, while still growing R&D on an absolute basis by 7% to 8% per annum.

We expect total bookings to grow 17% to 22% per annum with ARR to grow at least 15%. ARR in particular will drive free cash flow growth of at least 15% to reach more than 600 million by 2025.

Next on slide 29, this is a slide we showed during the last couple of quarters, but I wanted to give you a quick run through of our non-IFRS EBIT and margin expansion in 2021. Our EBIT growth will be driven in particular by our growth in recurring revenue as well as licenses while we continue to invest in R&D and sales and marketing and with greater variable cost accrual compared to 2020. As such, we expect to deliver an EBIT margin expansion of around 130 basis points in 2021.

Lastly, on slide 30, we have so far completed 194 million of the 200 million share buyback we launched in February.

With that, I hand back to Max.

Max Chuard
Thank you, Takis. Turning to slide 32, we are operating in a very large market, 63 billion Dollar with well over 70% of the spend still being done in-house, so we've got a huge opportunity in front of us for sustainable growth in the long-term.

COVID-19 has accelerated the structural pressures on banks with traditional business models and legacy technology stacks. Demand for our products and technology continues to accelerate in particular for SaaS, and this is driven by our pipeline growth. The acceleration in SaaS is largely incremental, as we discussed and our growth in total booking is increasing our backlog and long-term visibility.

On slide 33, our strong SaaS performance is built on years of investment in our SaaS and cloud capabilities. We were the first vendor to run a bank in the cloud a decade ago, and since then we've invested in our product and architecture to ensure we have the market-leading SaaS and cloud platform. We use a single code base and the same product is delivered on-premise or in the cloud. This means our clients are not forced to choose between different products with different capabilities. They simply choose Temenos and then decide how they want to implement and run the software. It also means we can leverage a single product and sales and marketing organization to drive our growth profitably going forward. We are very well positioned for the future growth in demand for SaaS and cloud and will continue to invest heavily in R&D to ensure we stay well ahead of the competition.

So finally on slide 34 to conclude, we had strong momentum in the second quarter with substantial growth in SaaS ACV, which will drive our SaaS revenue over the coming quarters. We had excellent growth in total bookings, up on Q2 2019, as the sales environment continues to improve and we maintain our market leadership across products and regions.

Our revenue growth continue to drive our EBIT and the operation leverage in our business model is driving margin expansion, and we remain very focused on cash with strong operating and free cash flow generation in the quarter. Finally, we've raised our 2021 SaaS ACV guidance to reflect the momentum in our SaaS business. And I'm confident we will have a very strong second half of the year.

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

QUESTION & ANSWER

Operator
We'll now begin the Question and Answer Session. Anyone who wish to ask a question may press * and 1 on their touchtone telephone. You'll 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. Questioners on the phone are requested to use only handsets. Anyone who has a question may press * and 1 at this time.

The first question comes from the line of Sven Merkt from Barclays. Please go ahead.

Sven Merkt
Good evening. Thank you very much for taking my questions and congratulations on a good quarter. Clearly, if we adjust for the different accounting treatments between SaaS and on premise, you're already tracking ahead of the 2019 level, but on the other hand, you know, Q4 remains an important quarter. Could we, therefore, maybe comment on the visibility you currently have for Q4 and how pipeline coverage and pipeline conversion have developed versus your initial expectations so far this year.

And then secondly, SaaS ACV was clearly very strong and I'm just wondering to what extent this was driven by licensed substitution or customers that decided in the end to go for SaaS solution rather than for the on-premise solution. Thank you very much.

Max Chuard

Thanks for the question. Let me take the first one. And listen, yes, we are very pleased with the quarter, pleased with the first half. Clearly, as you know, the second half of the year is where a lot of activity still has to happen. What I can tell you is we've seen quarter-after-quarter the improvement in the environment which is extremely positive across the regions. Clearly, we said the U.S. is ahead, but we see now Europe as well coming back with a time lag of potentially 6 to 9 months. So I expect the second half of the year to be also very strong now in Europe.

And I will say what is also very exciting is I think I've been mentioning these now for a few quarters is the fact that we see some large Tier 1 and Tier 2 banks coming back to the market. And as we discussed, we've structured and we... for the organization to ensure, we can take the full potential of all that.

Now, what we've seen since the start of the year is clearly an environment which is much more predictable. So the ability to... forecast accurately clearly is almost back to the 2019 levels, so that's why as we said, we feel confident for the balance of the year.

Takis Spiliopoulos

Hi Sven, let me take the ACV question. So I can here confirm that we have seen also in Q2 same as in Q1, no cannibalization, i.e. no license deal shifting to a SaaS deal. And with the visibility we have in our forecast and our pipeline, this is also not something we see coming. So that's maybe the first part of the answer.

The other one, the way to look at the ACV number is really... it's not just incremental, you know, meaning we win a lot of new clients. It's also what we call basically surfing the wave, i.e. if you are... if you have clients, which are successful with their business models on the cloud, these challenger banks and FinTechs, you know, just to give you one example, PayPal as we have mentioned a couple of times and they are successful, you know, clearly you ride this wave and they come back by more and more. So the ACV number is driven by both new names, and new logos we bring, but also incremental additional business with existing clients. So this is why you know, you see the strong performance and clearly there is no cannibalization or any business shifting from license to that.

Sven Merkt

Yes, great, and very helpful. Thank you.

Operator
The next question is from the line of Chandra Sriraman from Stifel. Please go ahead.

Chandra Sriraman
Yes, good evening Max, good evening Takis. Just a couple of questions from my side. So thanks for giving us some sense of the HCL impact on the SaaS revenues. Could you give us a sense of what is the impact in Q2, I would assume there was some impact this Q2, a number would be nice, but at least the direction in terms of what the figure was that would be very helpful?

The second question is, you've been quite positive on Tier 1, Tier 2 deals at least in terms of activity, but there was a significant drop in the contribution in licensing from Tier 1, Tier 2. Would you be able to comment on that? Thanks.

Max Chuard
Hi, Chandra. Listen, it's Max. Let me take the second. I'll leave Takis with the HCL one. Listen, I wouldn't track you know, the quarterly to take a view of the trend, and clearly my comment about the activity in Tier 1, Tier 2, clearly means what I see in the market, what is reflected in the pipeline, and clearly there is a time lag between this and those deals closing up. What is... so I would say, so positive is that there is really increased activity across the lines, across the regions on those larger more strategic deals. Now, it doesn't mean that you see this immediately, but definitely you know, you will, at some stage flow through the P&L as we close them. So my remark is much more about, if you want the opportunity that I see in front of us. Now, as well when you look at the pie chart that you refer to, you need to take into account that we do have a SaaS business, which is growing very strongly. And this will be reflected on both our, as we know, on the low end of the tiers.

Takis Spiliopoulos
Hi, Chandra. So for the HCL impact on Q3. First of all, Q2 was clearly the one quarter with the strongest impact it was even higher as you see from versus Q1. Now, for Q3, clearly beyond the... if you want the peak. So I would say on total software licensing the impact would be maybe you know, 2%, 3%, 4% lower than in Q2, and then substantially lower in Q4 again. So we're really minimal in Q4 to get to the full year number. And then on profit, clearly there was... there is a bit more impact from services in Q3, versus the previous quarter. So the profit impact will be lower, so maybe on profit, let's say 3%, 4% impact from HCL, then Q4 clearly, it's very low single-digit impact and then you arrive at the full year number.

On ARR, we have not basically given guidance on that, but it was in the previous quarter and also in the future quarters, it's about 1% to 2%, so full year impact is also then at 2% on ARR. And next year, as we said it's negligible. So I guess we'll not gonna be providing this anymore. Maybe we'll only provide Q3. And then, you know, it becomes really negligible and not meaningful to record anymore.

Chandra Sriraman
Great. Maybe, sorry, just a clarification, was there an impact on pure licenses as such?

Takis Spiliopoulos
Yes, so as you remember, ACL impacts you know, across all lines. We had the Kony non-banking business, it wasn't just pure SaaS. There was also, if you want to call it you know, annual licenses and annual maintenance. So yes, there was clearly in Q2 there was an impact, as we mentioned of 11% just on the license line. In Q3, this will be also substantially lower, maybe 6%, 7%.

Chandra Sriraman
Perfect. Thank you very much.

Operator
Next question is from the line of Josh Levin from Autonomous Research. Please go ahead.

Josh Levin
Thank you. Good evening, I have 2 questions. One, I guess, there's a lot of uncertainty around the Delta variant. How much does your ability to sell these days, depend on your ability to travel? And then number 2, you announced some new management changes today, has there been a departure of any key executives with somebody else previously President of International Sales or Chief Marketing Officer? Thank you.

Max Chuard
Hi listen, let me take both. First on the Delta variant, and which is obviously very sad what is happening on that path. But I will say from a business point of view, the banks have adapted to the situation now for quite a few quarters, and hence we don't see an impact on our ability to transact, to close this, to operate. Quite a lot of banks are still you know, operating remotely. The few that are started to go back to the office, I think now have the ability to very quickly go back to remote, if this would be the case. So we don't foresee if you want an impact from... on that side.

Now, regarding the management change. So as I said, I mentioned 2 main ones you know, both on the sales side. We did not have before someone running international sales, as it is today. However, we had someone running Europe, and that person for personal reasons, is going to depart and leave the company.

Now, internally we've got great and very seasoned executive in Europe, you know, this is really our core market. So I'm very confident about the ability to deliver on the strong expectation we've got in H2 for Europe. So that if you want for the international sales, as well you've seen, we've announced, also a new chief of... a new Chief People Officer, who has been with us now for more than 5 years, Jayde. She's really fantastic and she's taking over Monica, who is leaving for personal reasons.

And finally, we got a new CMO, that is joining the ex-co and Martin, I'm sure he's going to be great. He's fully in line with open banking and this is you know, lots of initiative on what we want to do more on that side, so very excited to have Martin on board. So lots of new people joining the company, which is great. I chose you know, how exciting it is, so very pleased with those changes.

Josh Levin

Thank you.

Operator

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

Laurent Daure

Takis, I've 2 questions. I'd like to come back on the ACV number for the quarter. I was wondering, if there was a kind of a larger than usual deal, because when I look at your new guidance basically you expect the second half to be a bit softer than the exceptional performance you had in the first half in terms of bookings.

And my second question is on North America, all the wins that you had in the first part of the year. Do you see the environment changing in terms of competition between a new entrant and the U.S. improvement or you are still fighting with the same names? Thank you.

Max Chuard

Hi, Laurent. Let me take the second one and I will leave Takis with the ACV one.

So on North America, as I've been saying now for few quarters. Clearly, we are more and more established in the U.S., we are more and more I would say, credible, the... some of our, I would say high profile wins like PayPal, you know, what we've been able to achieve in less than 9 months to be going from 0 million to 20 million of loans being processed that's... I think that's quite fantastic. Or what we are doing with Varo, as well in the U.S. Our fantastic case studies, in fact Varo they're telling you know, very openly that they're able to deliver a service at 25% of the cost of an incumbent banks. So we've been able to show really some strong traction in the U.S., which clearly give much more credibility in our ability, and so we are more and more invited to join the sales processes, and clearly our technology makes a difference. At the same time, as you know, we have been investing on the sales side, so we've been... we've seen also the leadership of Jacqueline. We've been building a stronger, larger sales organization. And finally, the market is clearly there, banks are spending, both, I will say, on the neo-banks, on fintechs, but as well as on more established banks that want to go through the additional transformation and Temenos is more and more appealing to those banks.

So I think that's why you see the momentum which is, you know, building and which is... continues to build where we've got the pipeline which continues to be very exciting and I think we are better positioned than ever to capture this opportunity.

Takis Spiliopoulos

HI Laurent, yes, let me go back again to the ACV details. Clearly, if you look at the, let's say, new business... new incremental business in H1, that was already a very strong growth and then on top we had, you know, additional business with existing clients buying more volumes. Now, the way we forecast, and this is also true for the second half, is the new business or new logos acquisition has the same, if you want, seasonality as the license business. So you would see Q4 being the strongest one where most of the deals get decided and this is the way we forecast.

So if you add 29.5 million of the first half plus whatever the number is in our guidance, that will basically imply a slowdown. However, if you just look at the incremental business, so excluding the volume with existing customers, which is very difficult to predict, because you don't really know when those customers hit the next threshold and they have to come back and buy more volumes, so usually, this is not what we are able to correctly forecast. So if you want, the guidance implies, you know, largely new incremental business, so you could see on top maybe some of the existing ones also coming.

Laurent Daure

Takis, just a clarification. In terms of the ACV, the split between the new logos and additional businesses with existing clients, can you share that with us?

Takis Spiliopoulos

We are... yes, I know where you're going to. We... it took many years for, you know, the traditional license business to become predictable and then also to have some kind of time series giving additional information. Now, we had you know, 4 quarters in a row with double-digit ACV growth. Let us get to, you know, let's say a business which we can even better predict than we do it today and then maybe we will start sharing some additional color of that, but also keep in mind, we have now 70 clients in our cloud. This is compared to, you know, kind of 15 or 20 times more which we have in our traditional business.

Laurent Daure

Okay. Fair enough. Thank you.

Operator

The next question is from Stacy Pollard from JP Morgan. Please go ahead.

Stacy Pollard

Hi, thanks very much. Just a couple from me. You seem to running ahead of the curve on EBIT margins. Does this mean that you're being a little bit conservative for the full year or that maybe you won't have the same kind of level of heavy Q4 weighting on market? So is there some seasonality that we need to be aware of?

Secondly, just a quick update on M&A. How is the pipeline looking there, you know, sort of your current thoughts and valuation levels?

Takis Spiliopoulos

Hi, Stacy, let me take both. So yes, on the EBIT margin, clearly, I think there are a couple of elements to keep in mind. First of all, you know, last year, if you remember Q1 and Q2, we were hit with the impact from COVID and the cost base was basically still the 2019 or early 2020 cost base which we only after that started to take out cost. So what we have seen now in Q1 and Q2 is clearly a strong revenue growth hitting, you know, on a year-on-year comparison, a relatively low cost base, so this has clearly boosted the EBIT margin quite dramatically.

Now, we have been investing now in this year and already started last year. So some of those investments, you know, will now follow through as originally communicated in February. So I would expect clearly to see the year-on-year margin trajectory probably not having the kind of jumps we had seen in Q1 and Q2, but there is I would say no magic behind that because in the second half, so if you compare H2 2021 to H2 2020, clearly, H2 2021 will then have a higher cost base again. So I think the margin expansion will be, you know, as guided for the full year.

But so far, yes, it's basically very good top line growth hitting a cost base which is maybe a bit slower ramping up because of, you know, the hiring process. There was still some COVID impact in the first half, but this will, you know, if you look at the exit run rate in June on the cost base, I think we are tracking well for our full year EBIT margin.

On the M&A, unfortunately nothing has changed. There is still a very elevated, if you want evaluation level. I mean if you've seen some of the recent transactions, you know, some FinTechs bought for, you know, they don't even have SaaS multiple by now. So that's clearly something very mindboggling still. We're looking at, you know, smaller bolt on acquisitions, more on the technology side. But we clearly don't see right now any larger opportunity coming on stream for us. M&A strategy is unchanged, clearly, searching the market but yes, we probably would need to see some more reasonable valuation levels.

Stacy Pollard
Thank you.

Operator
Next question is from Knut Woller from Baader Bank. Please go ahead.

Knut Woller
Yes, hi, thanks for taking my questions. It is actually 2. The first one on sales and marketing which was down sequentially which took me a bit by surprise given that license revenues have been up here in the second quarter and normally it used to always to be that sales marketing was up sequentially in normal seasonality.

So can you give some color here, what drove this development and what we should expect in the quarters to come? And then just briefly on the cash flow which was strong but benefitted from non-cash and other non-cash and non-operating items and also the trade payables.

Can you provide here some more color? In Q2, it seems to be just reversed compared to last year, while it looked I think on the longer time horizon, on the 12 months perspective, as you showed it a bit more equalized. So some more color on these 2 line items would be helpful. Thank you.

Takis Spiliopoulos

Okay. Hi Knut, thanks for the questions. On sales and marketing, again, I would not read too much into that. It has also to do with, you know some of the variable versus fixed cost evolution. Clearly, we had some lower variable costs in Q2 versus Q1 but you know, overall, I wouldn't see any change to what we have communicated. In February, sales and marketing would be clearly, you know, going forward increasing.

Now, if you look at this and maybe this is what you meant, the year-on-year drop, if you look at the IFRS number, clearly, that was, you know, mainly the... if you remember the earn-out of the Kony reversal which was booked there on the sales and marketing. So this basically explains the largest part of the drop from 50 to basically 25 million. So the year-on-year on IFRS has a special item in there.

Now, if you look at the free cash flow, yes, I would say, you know, some of the... you know, if you want strong cash flow growth was timing related, you know, payables being one of that, but I would see even if some of that will reverse in Q3, I would say maybe, you know, 5 to 8 percentage points or due to timing, but this can happen in any particular quarter. So we would still expect, you know, very solid development of free cash flow, both in Q3 and also the full year. So this is just timing, nothing specific I would say in there.

Knut Woller

Okay. Thank you very much.

Operator

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

Gautam Pillai

Great. Thanks for taking my questions. Firstly, you know, can you... excluding the HCL impact, can you comment on the underlying churn in the SaaS business and also how the maintenance churn is tracking?

Secondly, there was an announcement by Cognizant terminating a co-banking contract with the Finnish bank in which I believe Temenos was a software partner. Is there any financial liability for you in this? And also is there an impact for the other contracts you have signed with Cognizant in the region?

And then, finally, a quick clarification on share based compensation seems to be tracking slightly ahead at the half year versus your full year guidance. Anything we should be mindful in terms of the waiting of share-based compensation for the year? Thank you.

Takis Spiliopoulos
Yes. Hi, Gautam. Happy to take that one. Maybe first on, you know, on the Cognizant announcement clearly you would understand that you know, we can't comment on individual clients or individual, you know, partners. But, what we can say is if there is, you know, anyone with the relation to Temenos, you know, it would clearly not have any material impact. So I think we don't see that as an event for that.

Now, on the churn, the maintenance churn is still tracking as we have guided in the past or around 3%, if you look at the SaaS churn, maybe it's slightly higher, you know, overall let's say 3% to 4% which basically gives you an ARR churn around the same levels. I think what is important to note on the SaaS is that the churn on Transact clearly is lower, I mean, this is more in line with the... with the on-prem license, while Infinity which clearly has also shorter sales cycles, and you know, a shorter life span has a bit higher. So on average we are, you know, on SaaS maybe slightly above the, you know, the 3% which we have on the maintenance side.

And then, finally on the share based compensation, clearly, you know, we track this very closely what is happening with the share price and, you know, when people exercise their shares. So we take assumption at the start of the year. Now, clearly there has been, you know, a good recovery in the share price. So maybe you know, some people exercised a bit ahead of expectations. But, you know, just because we are now 13 million for the half year it doesn't mean that it automatically, you know, it's just like a doubling of that number.

What we would need to add here on the share based compensation, it's usually 3 plans, which are running in parallel.

As you know, the share based compensation as always for 3 year plans, there is a number of assumptions which we had to take... not much to add there, but one reason why we, decided at the start of the year to exclude this from... our target is exactly that its very unpredictable, you know, what is happening to the share price and when people exercise how much. So this is why, you know, we have taken it out of one of the reasons.

Gautam Pillai

Got it. Thank you so much Takis.

Operator

The last question for today's conference is from Michael Foeth from Vontobel. Please go ahead.

Michael Foeth

Yes, thank you. Good evening, Gentlemen. 2 questions, from my side. The first one is the, the acceleration in SaaS ACV, and the increasing guidance. Could you maybe explain what impact that could have on your EBIT margin expansion roadmap beyond 2021, if there is any meaningful impact from the SaaS ACV, development?

And the second question would be regarding your partnership with DXC, now that we have few months in, could you maybe elaborate a little bit on what sort of potential you're seeing going forward from that partnership? I think we're sort of not fully appreciating that potential year. Thank you.

Max Chuard

Hi, Michael let me start with DXC, and this is clearly you know, one of the very exciting partnership that we signed earlier this year. We've started engaging now with a lot of the customers that are using the IP from DXC. I would say more in the U.S. than internationally even though we've done also some internationally. We've started running some processes under some and remember the customer base from DXC are mainly large banks. So... and so we do have some processes that are at early stage, but which are... that looks very interesting. So I think the relationship is clearly very strong. And in addition to that, we are accessing potentially also to extend, because the partnership is today for Transact, and it could be also extended to different products. So, we could enlarge as well this partnership. But, I have to say the engagement is very, very strong, the type of banks are really the you know, core to what we do it, and those are really large banks, mid to large banks that are running, you know, on mainframe type of application and that do need to go through a transformation.

And so, those are perfect prospects for us. And hence, you know, its progressing well and it's partially as well. While we are also structuring, you know, this team that will focus globally on global accounts is to how to better capture, how to better maximize the opportunity with those type of large banks. So very good so far, but you know, those large banks takes some time to go through the full sales process, but it's very encouraging at this stage.

Takis Spiliopoulos

Hi, Michael, let me take the SaaS margin impact. I mean, as we have guided of at least let's say 30% SaaS growth in terms of cover until 2025, this is implied in our 2025 guidance every additional million on the topline of SaaS revenue will clearly, you know, help not just improving the gross margin by simply, you know, running more volume through the... through our cost base, but also clearly help improving the EBIT margin.

Now, on the exact timing of, you know, the margin progression we have given some color back in February, if you look at the SaaS growth margin to address maybe this point it's clearly progressing very well. We intentionally don't give this on a quarterly basis because you could... you would see then where we track and then probably consider our 2025 targets not ambitious enough. So there is still, you know, some volatility in the margin evolution of SaaS, because sometimes people... sometimes clients come on board faster or there is ramp up much faster with volumes, if somebody goes live with very few clients, the gross margin is much higher than if it ramps us much faster. So there is a lot of... there are a lot of variables in there. But, clearly as a general rule of thumb, you know, every acceleration in SaaS growth in '22, and beyond is clearly beneficial to the margin.

Michael Foeth

Thank you. It's very helpful and well done thanks.

Max Chuard

Thank you everyone for joining the results presentation. So I'm sure we will speak soon and thank you again for joining this call today. Bye.

Operator

Ladies and Gentlemen, the 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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