Full Reviewed Transcription

Temenos Group

Q4 2021 Results Conference Call and Live Webcast

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COMPANY REPRESENTATIVES

Max Chuard, Chief Executive Officer
Takis Spiliopoulos, Chief Financial Officer

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PRESENTATION

Operator

Ladies and Gentlemen, welcome to the Temenos Q4 2021 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, operator. Good morning, 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'm calling from one of our office in the US. So I hope you can all hear me well. We have a lot to cover in this call, including our move away from license to subscription, which is a game-changer for us. So let's get started.

So starting on Slide 7, before we look at the quarter, I'd like to look at our growth trajectory. We are accelerating out of the pandemic, and we do this through our leadership position in a growing market. Across all our KPIs, we are forecasting a strong acceleration in growth. Client across all tiers are increasing their spend, and we are very well positioned to capture this growing demand.

We focused ARR, Annual Recurring Revenues, to grow around 19% at our guidance midpoint this year, up from 12% last year. And then, it'll accelerate to around 25% from 2022 to 2025. Similarly, we expect total software licensing growth of 17% at our guidance midpoint this year, and then an acceleration to more than 19% CAGR from 2022 to 2025. EBIT will also exceed to more than 15% CAGR from 2022 to 2025. We will achieve this through our move to subscription and by taking market share in a growing market.

Moving to Slide 8, disruptive technologies and changing customer demands have led to an unbundling of the banking value chain. Cloud APIs and DevOps have already been widely adopted. And these technologies, as well as, AI and big data mutually reinforce each other.

Embedded finance and BaaS means banking is becoming a journey, an experience. It doesn't need to happen within a bank.

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Banking is now taking place everywhere, creating opportunities for thousands of new entrants with innovative business models. So now alongside traditional banks, we are also working with FinTechs, neobanks, platform and BaaS players, and this is creating a huge range of new opportunities for us.

Moving to Slide 9, we've been the market leader in traditional banks for many years now, proven in massive multiyear transformation projects for incumbents. And now, I'm very proud that we've proven our success in penetrating the non-incumbent market as well. We are helping them to build Greenfield businesses, and scale very rapidly. We've shown we can deliver extremely fast go to market for non-incumbent in just a few months. It resulted in some of our clients achieving exponential growth. And in fact, our win rate with no incumbent is even higher than with traditional players and you can see some of them on the slide.

Turning to next slide, Slide 10. Our success across incumbents and incumbents is down to our focus on innovation. We are investing in the way technologies that are disrupting the banking value chain, including cloud, SaaS, micro services, DevOps, with big data, AI and machine learning, embedded across our platform.

We consistently evolved our platform with the highest R&D investment in our industry, over 20% of our revenues growth into R&D. We've made more than 2.5 billion Dollars of cumulative investment, and we expect to invest another 1 billion Dollars over the next few years. So, we've got the technology. We've got the highest amount of references with all the Swiss banks worldwide. We are passionate about innovation, and no one else can come close to matching us. And this is why we continue to gain market share and will sustain our position as market leader.

Moving to Slide 11, now I'd like to talk about something that is a game changer for us. We are changing our business model this year. We are moving from a license model to a subscription one. Obviously, we will continue to offer our very fast growing SaaS solution.

We see demand in the market for this across all clients. With subscription, we can capture greater value and accelerate our growth and our shift to a highly predictable recurring revenue. We expect to transform the financial profile of our business. ARR will grow 20% to 25% every year to 2025. And by then, it will be more than 85% of the revenue mix. That's compared to 65% on our old model.

Moving to Slide 12. The shift to subscription will also accelerate our total software licensing.

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And in addition to that, TSL will also benefit from SaaS revenue, matching ACV much more closely than in the past. And with most of the heavy investment in SaaS and cloud already completed, in the next 12 months we expect to see the acceleration in EBIT from 2023 onwards. With SaaS gross margin improving, EBIT will ultimately grow at the same rate as TSL.

On Slide 13, our subscription model will have great benefit for both Temenos and our clients. It means our clients can spread the payment terms over a number of years, and move from the IT spend from CAPEX to OPEX, reducing the upfront costs. It also makes it easier for them to scale the IT spend as business grows, and simplify the path to SaaS is the choose to move in the future. It means Temenos can achieve higher contract values through incremental growth and higher margin. This will drive our revenue acceleration with more upsell opportunities, higher customer retention, and higher recurring and more predictable revenues.

So now on Slide 14, let's look at Q4 2021 performance. We had great momentum in the business this quarter. SaaS continued to outperform with ACV up 52% and SaaS revenues up 33% in Q4. We had a good level of signings across license and SaaS, driving total bookings growth of 10% in the quarter and 37% for the full year. This means we have a strong backlog and good visibility on revenue going forward. We continue to make significant investments in the business, in particular sales and R&D to maintain our leadership position and take market share. And we are very well positioned for a strong growth in 2022.

Turning to Slide 15, total bookings grew 10% this quarter, driven by demand across all client tiers. Remember, in 2020, there was very little demand for the first 3 quarters of the year and most of the pent up spend came in the fourth quarter as banks return to spending. So I'm pleased with our 10% growth in total bookings this quarter against that strong comparator.

Our bookings have now grown 37% in 2021, reaching nearly 740 million Dollars, and giving us, as I said, great visibility into 2022 and beyond. And our bookings this year, even in 2021 even grew on 2019, our strongest year ever. We saw broad-based demand across product for both license and SaaS, and there was an increase in the average tenure compared to 2020.

On Slide 16, we generated 17 million Dollars of SaaS ACV this quarter. That's up 52% on Q4 2020. And with a total of 57 million Dollar of ACV for the full year, we are up 65% on full year 2020. Q4 was particularly strong last quarter with a good mix of new business and consumption growth with existing clients.

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The US and Europe continued to be the largest contributor to our ACV, where we are having great success with non-incumbent players. And we see increasing demand for SaaS from small and mid-tier banks. Our SaaS revenue grew 33% in the quarter and 27% for the full year. And going forward, we expect SaaS revenue to match ACV much more closely which will help accelerate our TSL growth.

Moving to Slide 17, the sales environment continued to improve through the quarter in all regions. The US performed particularly well this quarter as we continue our expansion there. And I was particularly pleased to see the strong sequential improvement in Europe across license and SaaS and strong pipeline build for 2022.

Tier 1 and Tier 2 banks generated 41% of our total software licensing this quarter, with many of them pushing ahead with the strategic transformations. And we had 19 new client wins this quarter, and a total of 63 new client wins for the full year. Our market leadership position means we do very well with new business has been consistently gaining market share across incumbents and non-incumbents.

Moving to Slide 18, our US operations continue to perform very well. SaaS ACV from US clients was particularly strong in the quarter, and we expect this to continue in 2022. I'm also very pleased to say that Commerzbank went live, which is helping to grow our reference customer base with domestic US clients.

We have a strong pipeline of deals in the US, including several marquees' names and our strategic partnerships with the likes of DXC and Salesforce continue to make progress. I would hope to see the first deals from this partnership in 2022. To continue our US expansion, we are investing in the region, in particular, in sales and marketing to ensure we've got good coverage across all key segments.

Finally, on Slide 19, the outlook for 2022 is strong with third party spend accelerating to 10% growth, and demand for SaaS in particular is accelerating with both non-incumbent and some small and midsized banks looking for SaaS solution. The spend with non-income is only a minority, a small part of the market today, but it is growing very fast at nearly 30% every year. And in response, we see Tier 1 and Tier 2 banks increasing the spend to ensure they remain competitive with new business models, and can meet changing customer expectations. Our open composable banking platform caters very well for the needs of those larger banks.

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From a geography perspective, we see the US and Europe as the main drivers of growth for us this year. And our new subscription model will accelerate our ARR and total software licensing in 2022. With the investment we are making in the business, I'm confident we are very well positioned to accelerate our growth in 2022.

I will now hand over to Takis to talk us through the numbers for the quarter.

Takis Spiliopoulos
Thank you, Max. Starting on Slide 21, we show our performance versus our 2021 guidance. We overachieved on SaaS ACV which grew 65% driven by strong demand from non-incumbents. We achieved our guidance for both ARR and TSL with total revenue coming in slightly below guidance driven by lower than expected services revenue with a shift to partners continuing. EBIT came in slightly below guidance as we continue to invest heavily in the business.

Moving to Slide 22, I'll give an overview of our financial performance. All figures are in constant currency unless otherwise stated. SaaS revenue accelerated to 33% growth in Q4 '21 driven by several strong quarters of ACV growth. It rose 27% for the full year. Going forward, we expect SaaS revenue to match ACV much more closely as the negative impact on revenues from non-core and legacy products are fading off. We also had strong license growth, which together with SaaS drove TSL growth of 11% for the quarter and 17% for the full year. We delivered strong growth in our pipeline in the quarter, which gives us confidence in the outlook for 2022.

As previously indicated, maintenance growth in Q4 '21 accelerated to 7% driven by strong license signings. Total revenue grew 7% for both the quarter and the full year. EBIT was up 2% in the quarter and 10% for the full year with the full year margin up 100 basis points. We generated 473 million of operating cash in 2021, up 16%, and 358 million of free cash, up 21%. DSOs ended the year at 117. We ended the year with 821 million of net debt and leverage at 1.8 times, which is within our target run rate of 1.5 to 2 times. This means we have now fully deleveraged in two years after the Kony acquisition. We are also proposing a dividend of 1 Swissy for 2021.

Moving to Slide 23. Our strong ACV growth of the last few quarters drove an acceleration of SaaS revenue growth to 33%, and we expect to maintain SaaS revenue growth of 30% plus going forward. With good license growth in Q4, total software licensing grew 11% in the quarter and 17% for the full year. As expected, maintenance growth accelerated to 7% in the quarter, and we delivered 4% in the full year. For 2022, maintenance should see an acceleration towards mid to high single-digit growth.

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Services revenue was again down 8% this quarter with more services work being performed by our partner network. This contributed to total revenue growing 7% for the quarter, and also for the full year. Operating costs were up 6% year-on-year with ongoing investments and hiring across the business. EBIT moved up by 10%, demonstrating good operating leverage.

Next, on Slide 24, we have like-for-like revenues and costs, adjusting for the impact of M&A and FX. The figures are all organic and therefore in line with our constant currency growth rates. In terms of FX, the Euro continued to weaken against the Dollar, and the Sterling strengthened against the Dollar, creating an EBIT headwind of around 2 million.

Turning on Slide 25, net profit was down 1% in the quarter driven by a combination of an increasing tax rate and FX impact. EPS grew 1% in the quarter and 7% for the full year. Our tax rate was 16.3% for the quarter and we are guiding for our 2022 tax rate of 18% to 20%.

On Slide 26, our 2021 cash conversion was 124%, well above our target of converting at least 100% of IFRS EBITDA into operating cash. We also expect our cash conversion to be at least 100% for 2022.

Next, on Slide 27, we show the key changes to the group liquidity over the year. We generated total operating cash of 473 million, paid out 71 million in dividend and executed a 200 million share buyback program. We ended the year with 139 million cash on balance sheet and net borrowings of 821 million. Our leverage was at 1.8 times at the year-end, and we expect leverage to decline further in 2022 subject to no M&A.

Moving to Slide 28, ARR continues its strong growth, up 12% in the quarter driven by the acceleration in SaaS revenue and maintenance. With our shift to subscription, we will now have an additional driver for ARR growth, which is expected to accelerate further to reach our full year guidance of 18% to 20%, and we expect continued momentum in ARR into 2023 and beyond. Our deferred revenue also grew strongly at 11% with good advanced cash collection and free cash flow was up 18% in the quarter.

On Slide 29, some comments on the outlook for 2022. Banks are under increasing pressure from competition, and customers demanding better products and services, non-incumbents are seeing exponential growth, which drives rising demand for SaaS. Incumbents are being forced to respond to the competitive threat, which is driving spend by Tier 1 and Tier 2 banks with smaller and mid-tier banks also feeling pressure to innovate and digitally transform.

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Our move to subscription this year will also enable us to capture greater value and accelerate growth. We expect sales to our installed base to remain strong, and we see SaaS core and digital as the key demand drivers for 2022.

Now moving to Slide 30, I'd like to explain the impact of moving to a subscription model. I'll run you through the impact of a subscription contract on P&L, cash and ARR. From a P&L and reporting perspective, we will recognize the license element of a subscription contract in our new revenue line, called subscription license. We will then also recognize the maintenance portion of the subscription contract as usual in the maintenance P&L line. This is in line with IFRS 15, and we had the same impact on our existing fund administration subscription contracts when we adopted the standard in 2018. At the renewal point after 5 years, there will be another subscription license revenue recognition.

In terms of cash, we are moving away from larger upfront cash collections linked to traditional licenses with the cash linked to subscription, collected pro rata over the life of the contract. ARR will similarly mirror cash with a subscription license and maintenance revenue, recognized pro rata over the life of the contract, which is considered best practice in the software industry.

On Slide 31, before discussing our 2022 and medium term guidance, I'd like to show you how the disclosure regarding TSL and ARR will be. We are adding a new reporting line called subscription where the revenue linked to subscription license will be reported. Subscription will also be included in total software licensing, one of the key metrics we guide on. And for ARR, as I outlined before, subscription will be included, and it will be a material contributor over the next 4 years.

Turning to Slide 32. We will continue to provide disclosure on a broader range of metrics. However, we are focusing our annual and medium term guidance on a selected number of KPIs, which are best suited to reflect the financial performance of Temenos. Annual guidance will include ARR, total software licensing, total revenue, EBIT growth and operating cash conversion.

Our 2025 targets will include the same, with the addition of free cash flow instead of operating cash conversion, while we retain our EBIT margin target. We believe these are the best metrics with which to track the performance and health of the business over the short and medium term.

On Slide 33, we show our 2022 guidance metrics. These are non-IFRS, and in constant currency. We are guiding for ARR growth of 18% to 20% as we benefit from the move to subscription, and also from accelerating SaaS and maintenance growth.

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We are guiding for total software licensing growth of 16% to 18% and total revenue growth of at least 10%. We expect our EBIT to grow 9% to 11% and our cash conversion to remain at over 100% of EBITDA into operating cash. Lastly, we expect the 2022 tax rate of between 18% and 20%.

Now turning to Slide 34, we now move to our 2025 targets. Aside from 2 key changes, we reconfirm all other targets we presented last year. Firstly, we have substantially increased the ARR growth target CAGR to 20% to 25%, up from 15% plus to reflect the growing contribution from subscription and the acceleration of ARR on the back of this. This converts to 1.3 billion of ARR by 2025, meaning that at least 85% of our total revenues will be ARR. We see our free cash flow growing at 10% to 15% CAGR, and reaching more than 600 million of free cash flow by 2026, which again reflects the impact of subscription in the earlier years as there will be less cash collected upfront on the subscription contract. However, we see our free cash flow growth substantially accelerating to at least 25% in the years 2023 to 2026.

Lastly, on Slide 35, I'd like to walk you through the impact on our EBIT in 2022. Improving SaaS gross margin and strong maintenance growth will be the largest drivers of our EBIT growth in 2022, with a smaller contribution from term and subscription license growth. 2022 is a year of investments for us given the strong market growth. And with wage inflation across the sector, these will be headwinds for our EBIT margin. We still expect to end the year with a broadly unchanged EBIT margin at the midpoint around 36.8%. Looking further forward, we would then expect our margin to continue expanding in '23 to '25 by 130 to 150 basis points per annum. Please note that our SaaS maintenance and subscription contracts have our CPI protection building. We would also expect to have wage inflation offset by price increases, which we have not built into our guidance.

With that, I hand back to Max to conclude.

Max Chuard

Thanks, Takis. Turning now to Slide 37. I'd like to invite you all to join us tomorrow for our Capital Market Day. We have some great presentation and even demos on the evolution of our open platform, and you will hear more about our strategic initiatives on how to accelerate our growth in 2022, and in the medium terms. It starts at 2:00 p.m. CET. And if you have not yet registered, you can join through the link in the slide or from our website.

And so in conclusion, on Slide 38, we had strong momentum in the fourth quarter. The sales environment continued to improve with very strong momentum in our SaaS business and in our US operations.

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I was pleased with the sequential improvement in Europe this quarter, and we have a strong pipeline in the region for 2022. And we see clearly increased activity with Tier 1 and Tier 2 clients, which give us increased confidence for 2022. We continue to invest heavily in the business, and our game changing move to a subscription model will let us capture greater value and accelerate our growth. We are very well positioned for strong growth in 2022 and an acceleration in the medium term.

And 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 the 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 handset 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. Maybe first, if we could dig a little bit more into the strategic rationale around the transition in the on-premise business to subscription. So I guess what's really prompting you to make this change in model right now, I mean, there was a pretty comprehensive review of the cloud subscription transition this time a year ago. So, just curious as to what's really driving the strategic shift? And, I guess, I appreciate... thank you Takis, the explanation on the IFRS 15 unbundling and the limited P&L impact, but maybe you can talk a little bit about value uplift potential or pricing and as a result of this. And whether you're going to effectively enforce the subscription or you'll remain agnostic from a client perspective? And will you continue to offer both options?

And then secondly, I just wanted to ask you about the cost development next year, specifically on the share based compensation, you are guiding to 5% of sales for 2022, a bit up from where we were previously, I think, 3% to 4%.

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Just wondered if you could take us through the puts and takes for thinking on the share-based compensation. Is there some ongoing impact from the Q3 one-off that we had? And how do we think about the right level there in the 2025 targets now? Thank you.

Max Chuard

Okay. Takis, maybe let me... I start with the first part of the question. Why the move to subscription? And now, I'd say, James, that we see increasing demand from all our clients across all tiers for subscription. And that's why you know, basically we are deciding to do this move now. We believe it will allow us to capture more value... greater value to accelerate our growth. And as I said, to accelerate a shift to highly predictable recurring revenue model, as we said, by 2025 to be at more than 85% of revenues coming from ARR. So I think this is the driver of why we are doing it now.

Maybe, Takis, you want to take the rest of the questions?

Takis Spiliopoulos

Yes. Thank you, James. Clearly, on the uplift, which we expect on a total contract value, we haven't disclosed this, but we'll go with something which is, you know, I would say, quite material to the market. We'll see how much we'll basically get done. But if you look at what enterprise software peers have been able to generate on the back of such a move, you know, it's somewhere 40% or more. Now, what we have basically reflected in our guidance, this is obviously something we cannot disclose. But I think maybe some data points since we have this announced internally, the initial feedback from our sales teams has been very positive. And we clearly see that there is a pricing benefit. Temenos can derive from this.

Now on what deals we're going to force this upon, clearly some of the deals in late stages, you know, for Q1 and probably also into Q2 are probably a bit late to transition to the subscription model. But Q2 onwards, clearly, this is something we're going to do for all deals. Now, if you have clients which, you know, wanted all cost to stick to our license model, clearly, we're not going to force them into this. But clearly, it will be the de facto standard for our contracting.

On IFRS 2, you were spot on. Clearly, the one off program we announced in Q3 was one off in nature, and different to the existing other programs. However, it involves cost spread across 3 years, as we had said at that time. So the impact of this program will also be felt in '22 and '23. So we would expect, you know, I think, the 5% is probably something a good measure, and then it will trend back maybe in the outer years, '24 to '25. But I think for the next years, this is probably the right measure.

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James Goodman

Okay. Thank you.

Operator

The next question comes from Varun Rajwanshi from JP Morgan. Please go ahead.

Varun Rajwanshi

Hi, Max. Hi, Takis. I have couple of questions. Firstly, on the topic of license to SaaS migration, I mean, I get the point on faster growth in non-incumbent spending, but are you now assuming a higher cannibalization from SaaS to your total license revenue growth going forward? There seems to be some implied downgrade to your 25 revenue targets?

The second question is on margin expansion of 130 to 150 basis points per annum from 2023. What gives you the confidence on the inflection in margin profile from next year, given increased competition from well-funded cloud-native vendors? Could you also clarify where your SaaS gross margins are at, at the moment?

And lastly, on the recovery in the European business, total software licensing sales is still down 45% plus from 2019 levels. So are you losing market share in this region or is this more related to timing of large bank deals or deal closures? Thanks.

Max Chuard

Okay. Let me take the first one and the last one. Takis, I'll leave you the 2 in the middle. Listen, we are not talking at all about higher cannibalization. So we see our SaaS business being extremely successful, growing very fast and based on being able to gain new customers and as well to extend our relationship with our existing customer. So we are not positioning an increase of cannibalization in that side. We've been talking about our move to subscription, which is mainly for traditional on-prem license business. But from a SaaS point of view, we see this performing very fast, very strongly, but not really increase in cannibalization. So it's mainly incremental as we've said it in the past.

Now, to the question about Europe. Clearly, Europe, as we said, has been a market that has been most impacted by the pandemic and that took longer to come back. And I was pleased with the improvement that we saw sequentially in Q4. And that improvement came from I would say, 2 parts, I would say the traditional business, midsized type of business. We saw also quite some activity on the SaaS side. But also, we started to see larger banks coming back to market.

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And I think that was clearly, I would say a very encouraging element. And when I look at our pipeline for 2022, we do see large Tier 1, Tier 2 banks coming back you know, significantly to the market. I think this will be one of the key driver of our growth in Europe in 2022. So clearly, we continue to gain market share. And I'm confident that this would be the case as well in 2022.

Takis, maybe you want to take the other 2 questions?

Takis Spiliopoulos

Yes, hi. So let me take those ones. Clearly, on SaaS gross margin, and I think we have been quite transparent already last year, and there will be again this year. We've seen quite some strong margin improvement also in 2021 and expect this to continue. Clearly, we have also done some investments which will help us get to the 80% plus target we have for 2025, some investments will be done early in terms of cloud operations. However, if we look today, if we just look at the non-legacy products, we're at a run rate of around 67%. So you see that it's not far away to get to the 80% over the next years. This is across various level... levers we have here, whether it's on better terms with the hyperscalers with more volume, simply running more volume across our operations, do a lot more in terms of automation. So this is the trajectory.

Now getting from you know, the 37% EBIT margin to the 41%, a large part of this incremental growth... a large part of this incremental growth is coming from the SaaS gross margin expansion. That alone would already deliver more than this 400 basis points. Then on top, we clearly have still TSL growth, also providing some good operating leverage, which will give us the ample of leeway to invest across sales, marketing, what is required. We still have also G&A, which will provide some operational leverage. So we feel very confident in this EBIT margin bridge, and this is why we also invest a bit more in 2022 to get not only the margin progression, but the growth acceleration as well.

Varun Rajwanshi

Thank you.

Operator

The next question comes from Josh Levin from Autonomous. Please go ahead.

Josh Levin

Thank you, and good evening. Just a few questions from my end. So from Temenos' perspective, how do the economic benefits of the new on-prem subscription model differ from the traditional sales SaaS model?

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I think you said last year that over a 10 year period, SaaS generates maybe 2 times the revenue of a traditional on-prem sale. I mean, how does that look at the new subscription model versus a SaaS versus on-prem or alternatively ask, all things equal, would you prefer to make an on-prem subscription sale or a SaaS sale? And then, given the choice between a traditional on-prem license sale, and an on-prem sale under the new subscription model, I think you said you prefer clients to do the new subscription model. If so, why... wouldn't you prefer to collect all the cash upfront as opposed to spreading it out over many years?

Max Chuard
Josh, let me take the second part of your question. First, we... our view is, we can, as I said, change greater value by moving to subscription. And so, I think that's the first thing. We provide more flexibility to the customer. We are moving from CAPEX to an OPEX model. We can... it's easier for us to cross sell into that customer base. And also, as I said, it will be an easier move towards SaaS. So we do see clearly value uplift from moving license model to a subscription model. I think that's one thing.

The second benefit of this is moving to subscription will create a much more recurring, much more predictable business model. And we said by moving to subscription, we expect by 2025 to be more than 85% of our revenues to be coming... be recurring in nature compared to around 65% with the old model. So I think this is also, I think, something which is very important for us considering to move into subscription.

Maybe the first part of the question about the equation between SaaS and subscription, I'll leave it to Takis to answer.

Takis Spiliopoulos
Yes, Josh. In principle, you know, our subscription is still a license and maintenance contract, which means you know, if you were to have zero uplift on a TCV basis, the NPV will basically be similar. However, we expect to get an uplift, so the NPV will be higher. So clearly, we will prefer to get the subscription contract at the expense of you know, having the cash distributed over a longer period. Now, the charge you compare, this was on a gross profit basis we had done. And clearly, this was a 10-year comparison base. And given that SaaS always includes you know, the hosting part, a subscription contract over 5 years is clearly more profitable than a SaaS contract over 5 years. So for us, you know, clearly it's a way of generating value. Yes, there is a short term impact on cash. But I think you know, given the flexibility we give to clients, and given also the demand we see from clients, I think this is the right strategic move.

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Josh Levin

Thank you.

Operator

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

Laurent Daure

Yes. Thank you. Good evening, Gentlemen. A couple of questions from me as well. The first is on the wage inflation, you mentioned 22 million, I was wondering in your existing contract support revenue or SaaS revenue for multiyear contract from one year to the other. How are they rebased? Are you able to pass on a little bit of the wage inflation or are you gonna have a timing difference?

My second point is on DXC instant base, and potentially some contracts to be announced over 2022. Have you already seen some of those contracts going to other parties or its just taking a bit more time than what you could have expected?

And my final question is on a very good ACV, you had in the fourth quarter. Could we have a little bit of granularity if it's coming mostly from new customers or is existing customers adding more capacity? Thank you

Max Chuard

Hi, Laurent, it's Max. Let me take the second and the last. So on DXC, as I said, both on DXC and Salesforce, which are the strategic partnership we announced last year. And I'm hopeful that 2022 will be the year where we see... the first successes with those partnerships. We had said at the time that added for the DXC one, those mid-size to large banks. So it will take easily 12 to 18 months, or 2022 is a year. And there are activities ongoing. I'm not aware if you want also any deal that has been done with any other vendors. So I think we're extremely well positioned for capturing those opportunities. Again, as I said, you know, the goal of that partnership with DXC is to go to that capture customer base and to position... out-position with DXC us on providing the modern technology, and them providing the integration side. So I think this makes a lot of sense. So hopefully, we'll have a success to discuss in 2022.

And then the Salesforce, we made some more announcements earlier this year on the platform being complete, being live. So now, it's really the goal of bringing the first customer (unintelligible) this fantastic joint platform that we've done with Salesforce, so more to come, I would say, in 2022 on this.

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On the ACV, yes, we had a strong performance in Q4. And I would say 2 elements: first coming from the US and from Europe, mainly Europe, we see more and more activity as well moving to SaaS, which is exciting. I will say a good mix of new names, both new names across the regions and as well continuing to benefit from some of our existing customers that are increasing consumption of the solution.

Takis, I will leave you the first question on wage inflation.

Takis Spiliopoulos

Yes, Hi Laurent, so you're again spot-on in terms of, you know, what we do. All our SaaS maintenance, and in the future subscription contracts have all CPI Close Protection LinkedIn. So clearly, this is something or partly we can pass on in terms of wage inflation. That's number 1.

Number 2, across the product portfolio and basically also across you know, SaaS licenses. We are clearly evaluating, you know, price increases and this is something clearly we have started doing late last year earlier this year. And it's something that we have not reflected in guidance as we have to see, you know, how much of this wage inflation we can pass on to customers, and clearly, the more we can pass on the more it would help us on the margin.

Laurent Daure

Okay, very clear. Thank you.

Operator

The next question comes from Knut Woller from Baader Bank. Please go ahead.

Knut Woller

Yes, hi. Thank you. Actually, 2 questions. First, on the DSOs, should we also, going forward, think about that your accelerating growth momentum is expected to be continued by rising DSOs. You haven't provided any target for 2022 and previously indicated, DSOs are expected to continue to decline?

And then secondly, given your comments on the ongoing high spend on R&D. Should we expect accelerating tailwind from that capitalized development costs? I think the growth was 10% year-over-year in 2021. That's it. Thank you.

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Takis Spiliopoulos

Yes. Knut, let me take those ones. Yes, we have seen ultimately some acceleration in the capitalized developments in increased 10 million in 2021. Now, we have made considerable R&D investments into our, as Max explained, composable banking services architecture, and also Infinity. I wanted to basically have the net cap at the same level as 2020. It ended up 2 million higher. However, this is clearly not to be seen as trend you know, over the midterm. Clearly, we want to get delta, you know, down to much lower double-digit, and eventually basically have the delta between capitalized development additions and the amortizations to equalize in the midterm. So clearly, there will be no support from that in '22 or going forward.

On your other questions in terms of DSOs, now... we have seen that... and as you would expect, you know, there is clearly something about DSOs being linked to subscription. I think there is... we took the conscious decision that DSOs probably would not be the right metric in terms of, you know, reporting in terms of guiding going forward. It will... it is a number sensitive to the rate we shift to the subscription model. We have seen a massive reduction in DSOs over the last couple of years. We have provided now a bit more focused set of guidance metrics, which I think are best suited to track the performance of the business. So yes, depending on how fast, you know, we accelerate the shift to subscription, you would expect DSOs to rise this year.

Knut Woller

Thank you, Takis. So just a quick follow-up, given the overall license business. So why has DSOs been up so strongly then in 2021 since subscriptions are now expected just to materialize from 2022 on?

Takis Spiliopoulos

Yes. So, I think the uplift we saw in DSOs, there were a couple of elements here, which drove that, you know, we had clearly some contracts signing quite late in the quarter and basically not in time to collect the cash. So clearly, that will reverse... I think that was the main driver we saw. There were also some unusually large contracts, which boosted up the number to above what we had expected. Ultimately, it's something good if you sign big contracts but, you know, in that particular case, we had a negative impact on DSOs. So just from that, basically, that should reverse on a stand-alone basis already in Q1, assuming we don't sign subscription in Q1.

Knut Woller

Thank you, Takis.

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Operator

The last question for today's call comes from Chandramouli Sriraman from Stifel. Please go ahead.

Chandramouli Sriraman

Yes, hi Takis, hi Max. Just a couple from my side. To come back on to the move to subscriptions. So does that mean that it now supersedes the relicensing model? And from an P&L standpoint, would it be reasonable to assume that now your subscription model is a 5 year term license?

And my second question is on the large deal pipeline. Can you comment on how this has progressed, obviously, the macro is a bit more tricky. Any comments on that would be super helpful. Thanks.

Max Chuard

Hi Chandra, let me take the large deal question. So already, last year, you know, I was describing that we were seeing an increased activity from large banks, and quite across the board. And remember, we created internally some very specific skill set of people just to address and just to engage with those larger banks. We also have, I would say, the... our platform based on... our open platform based on composable services, which also, I would say, helps the transformation of those larger banks. And I can say that we've got activity with large banks across the border. So, it is...

I would say, it is really happening in North America, in Europe, in Asia, in some cases as well in the Middle East and Africa. So, we do see really large opportunities coming back. Large banks to understand you know, the... how those new vendors, FinTechs have come up with different models, much more nimble, much more agile, and the need to respond to that. And we see quite an interesting varieties of how those larger banks respond to that threat. And... but clearly, it goes with spending, and we see much more activities in our pipeline. And I'm sure we are going to see a lot of that in 2022.

Takis Spiliopoulos

Chandra, let me take the other one. Yes. So, every contract or basically every term contract, which comes up for renewal so the traditional relicensing will be, I mean, we'll try to do it, but we'll move those to 5 year subscription contracts as well. So, this is across the board, not just for new clients and new deals, but also for the existing ones.

Chandramouli Sriraman

Thank you.

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Operator

Ladies and Gentlemen, this was the last question. I would now like to turn the Conference back over to Max Chuard for any closing remarks.

Max Chuard

Thank you again for joining us today. So, I hope all of you can make it to the Capital Market Day tomorrow, where the focus will shift much more towards the medium term. You will hear a lot by different of our executives. And I'm sure it's going to be time well spent. And so, that you can understand better how we are going to transition to a business that by the end of 2025 will be 85% plus recurring and growing at between 20% and 25%. So, hopefully, you can make it. And otherwise, I'm sure we'll be talking soon. Thank you.

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.

- END -

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