Full Regular Transcription

Temenos Group

Temenos - Q2 2022 Results

2022-07-21 at 6:30 pm CET

Duration: 76 minutes

COMPANY REPRESENTATIVES

Max Chuard, Chief Executive Officer

Takis Spiliopoulos, Chief Financial Officer

PRESENTATION

Operator

Ladies and Gentlemen, welcome to the Temenos, Q2 2022 Results Conference Call and Live Webcast. I am Moira, 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.

Max Chuard

Thank you, operator. Good afternoon. Thank you for joining today's call to run through our Q2 results. The results presentation for this call is available on our website. I will start with an overview of our business performance, and then Takis will go on through the financials.

Starting with Slide 7, I'll give an overview of the quarter. We launched our new subscription pricing model for term license at the start of the year, and the ban has been ahead of our expectations. We signed 31 million Dollars of subscription license in the quarter, which represents, in fact 50% of our license business and this has contributed to 16% growth in ARR, up from 14% last quarter and 12% in Q4.

I know that there is a lot of focus on the macro environment at the moment and so far the demand environment has been supportive. We haven't seen any change in client behavior or impact on sales cycle at this point. And this is reflected on our total bookings, which grew 12%, which is a measure of all new business signed in the quarter. That being said, our total software licensing grew by 8%, which is below our full year 2022 guidance of 16% to 18%. This was due to a large Tier 1 European deal that moved to Q3 and which is expected to close shortly.

On the SaaS side, we signed 11 million Dollar of ACV, which was in line with our expectations and which came largely from new business signed in the quarter. Our EBIT declined by 9%. Our focus on cost management allowed us to limit the impact of the slower total software licensing growth in the quarter. Free cash flow declined by 42%, which was expected with the move to subscript pricing and finally, we are reconfirming our full year guidance.

Turning to Slide 8, ARR, which is a key KPI for us, actuated again this quarter to 16% growth up from 14% in Q1. We see good demand for subscription and SaaS, and we are confident in achieving our full year guidance of 18% to 20% ARR growth. In fact, I do expect a sequential improvement in Q3, similar to what we saw the last few quarters. Total bookings also saw healthy growth at 12%. I'd like to call out Europe in particular, which had double-digit growth in bookings this quarter. We are seeing increasing demand for SaaS in Europe and this was a strong contributor to booking for growth... booking growth in the region. This will be visible in the P&L in the coming quarters, given the timing gap between SaaS ACV signings and the revenue flowing through the P&L.

Slide 9, we had 11 million Dollars of SaaS ACV this quarter which was, as I said, almost entirely from new signings. We had a strong comparative in Q2 2021, which included a large volume of additional consumption from existing clients. As you can see on the chart, SaaS ACV can be volatile between quarters depending on timing of increased consumption from existing clients. We are confident in our SaaS ACV for H2 as we've got good visibility on new SaaS signings and on additional consumption from existing clients. And finally, our SaaS revenue grew 36% this quarter and our SaaS revenue for the year is now largely locked in.

Moving to Slide 10, I will give you a sales review of Q2. We see accelerating demand for subscription pricing across tiers and geographies. Activity in the US remains high, and I'm particularly pleased that we won a top 20 US bank for core replacement, which is a significant milestone for us. Europe also continues to recover, reflected in double-digit total bookings growth in the region. However, as I said, Europe was impacted by the slippage of a large Tier 1 deal, now expected to close very shortly. APAC had a very strong quarter with a number of new signings, including some partner deals. In fact, we had strong sales activity with partners overall in Q2, and we will continue to build the partner channel going forward. Sales to the installed base remain strong, contributing to 55% of license revenue, and we had 16 new clients wins mainly for core banking.

Moving to Slide 11, we've seen strong demand for the subscription pricing model we introduced at the start of the year. And as I said, this is ahead of our expectations. Already in this quarter, subscription licensing made up 50% of the term licensing we signed. Just to remind you, we are moving from a term license model to a subscription and obviously, we continue to offer our SaaS solution.

Subscription pricing captures greater value and exceeds our shift to a highly predictable recurring revenue.

We saw this in our ARR, which accelerated to 16% growth in the quarter, and which we expect to reach 18% to 20% growth for the full year, reaching a share circa 650 million Dollars. We expect this new model to transform the financial profile of our business, with ARR growing between 20% to 25% every year through 2025, and by then, this will represent more than 85% ARR of the revenue mix. So the goal is really to create a much more predictable and recurring revenue model.

Moving to Slide 12, I'd like to highlight our momentum in the US. Our US business has performed very well over the last couple of years and this momentum is continuing. We had strong level of activity in Q2, and I'd like to focus on 1 significant milestone in particular. I'm very pleased to announce that we won a Top 20 US domestic bank for core replacement. We were shortlisted with one of the US incumbent vendors, and we were able to win the deal on the quality of our proven technology stack, our proven scalability, our ability to fully comply with US compliance and regulations, and because of some fantastic references that we've got in the US. Now, we are in the final contractual negotiation and we expect the deal to close in the second half of the year. This win really builds on our success with Commerzbank, which went live earlier this year and which is a great reference for us. And I will add that we have a number of other deals in the pipeline with US Tier 1 and Tier 2 institutions.

Moving to Slide 13, we once again have topped the league tables for both IBS and Forrester, which are the reference in our segment of the market. For Forrester, we led for new named deals and are the only global power seller for 2021 with 19 new named deals in 2021, more than double the number of deals of the next vendor. And in fact, this is our 16th year as global power sellers. And in fact, for the first time, we were the only vendor at the top of all the 3 Forrester pyramids for new name combined and extended business.

For IBS, we were the number 1 core banking vendor for the 17th year running, and the only major vendor to increase our market share year-on-year. We were also ranked first in numerous other categories, including digital banking and channels retail payments, risk management and digital and new one challenger banks, which reflects the strength of our solution.

And lastly, we continue to focus on integrating ESG into every aspect of our business from our people agenda to cyber and information security and measuring and reducing our carbon emission footprint. We are working to continuously improve our disclosure around this as well, and our efforts have been recognized by many of the leading ESG analysts and indices.

So on Slide 14, the demand environment so far has remained supportive. Remember, high interest rates are positive for banks, on the transition of our business model to subscription is accelerating, which is driving ARR growth. We clearly also benefit from a value uplift from the subscription pricing model, which ultimately help us de-risk our full year guidance. We also see increased demand for SaaS, which is also contributing to ARR growth. We see wealth management as a major demand driver globally. And we currently have a large number of deals with Tier 1 and Tier 2 banks in the pipeline.

Now it can be hard to predict the timing for closing these deals as we saw this quarter, but there are good indication of increased demand in the market. From a geography perspective, the US and Europe will drive the majority of our growth this year. And we are having good success with partner deals and expect this to drive incremental demand. We are focusing our investment in the business to ensure we capture market growth, but at the same time, managing our cost base to ensure we achieve our EBIT guidance. Finally, our strong H2 pipeline supports our full year guidance.

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

Takis Spiliopoulos
Thank you, Max. Moving to Slide 16, I'll give you an overview of our financial performance. All figures are in constant currency unless otherwise stated. We signed nearly 31 million of subscription licenses in the quarter, and as Max said, demand is clearly ahead of our initial expectations.

SaaS revenue contributed its growth trajectory up 36% in the quarter driven by our strong ACV growth in prior quarters. Overall, total software licensing was up 8% in the quarter with some headwind from the large deals that slipped and is expected to sign shortly.

Maintenance grew 3% as expected and we still expect maintenance to accelerate in Q3 2022 and further in Q4 2022. Total revenue grew 4% in the quarter dragged down by total software licensing and services with EBIT down 9% because of this. We generated 87 million of operating cash and 50 million of free cash down 42% year-on-year and 5% LTM. This was in line with our internal expectations. DSOs ended the quarter at 114 days down one sequentially, and we reported 793 million of net debt at the end of the quarter with leverage standing at 1.8 times.

Moving to Slide 17, subscription was a bright start in the quarter with 31 million of subscription licenses signed.

Going forward we expect most of the on-premise license deals in our pipeline to move to subscription. As we move through this transitional period, our traditional term license will continue to show negative growth offset by very high growth rates in our subscription line. SaaS revenue growth was again also very strong this quarter.

Operating costs were up 11% with investments now largely concluded and with cost management focused on mitigating some of the impact of the 8% total software licensing growth. We will maintain this cost discipline going forward, while we still enabled selected gross-oriented investment.

Services revenue continued to decline as expected following the same trend as the last few quarters as we continue to hand more work to partners and with a number of projects with increased costs and less revenue milestones. We expect this to normalize from Q3 2022 onwards and for services to grow for the full year. Lastly, we delivered 78 million of EBIT for the quarter and our EBIT margin declined 4 percentage points.

Next on Slide 18, we have like-for-like revenues and costs adjusting for the impact of M&A and FX, although we have not done any M&A since 2019. The figures are all organic and therefore in line with our constant currency growth rate. Our cost base continued to grow due to post-COVID normalization and investments made in prior quarters. We also had some cost benefit from cutoff, which will normalize in Q3 2022. However, we remain highly disciplined around our cost base as we have proven in the past. In terms of FX, it was a similar trend to the last quarters, with weakening euro having a negative impact on revenues, which was offset by some benefit on costs saw a neutral impact at EBIT from FX this quarter.

On Slide 19, net profit was down 8% in the quarter in line with the EBIT decline. We had slightly lower financing charges and the small FX gain and taxes were broadly in line year-on-year. EPS was down 7% in the quarter. We continue to guide for a tax rate of 18% to 20% for 2022.

Now on Slide 20, our Q2 2022 LTM cash conversion was 116% still 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 the full year 2022. As I mentioned earlier, operating cash and free cash declined this quarter as expected with a move to subscription.

On Slide 21, we are presenting a bridge to show moving parts of our free cash flow in the year.

Clearly, the revenue growth we expect is more than offset by the impact of the move to subscription. However, with a positive impact from deferred revenue growth and DSO improvement on licenses and services, we can mitigate this somewhat, and expect free cash flow to end the year around 10% to 15% down on 2021, slightly more than previously due to the acceleration in subscriptions.

Next on Slide 22, we show the key changes to the group liquidity over the quarter. We generated total operating cash of 87 million and paid 74 million of dividends in the quarter. We ended the quarter with 106 million cash on balance sheet, and net borrowings of 899 million. Our leverage was at 1.8 times at quarter end, and this will continue to improve throughout 2022, subject to no further M&A.

Now on Slide 23, we reiterate our 2022 guidance metric. 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. We had sequential increases of 200 basis points in ARR growth for each quarter this year and we would expect a similar evolution for Q3 2022. At this point in the year most of our SaaS revenue growth is already locked in given the one quarter delay between SaaS ACV and SaaS revenue recognized in the P&L.

We are guiding for full year total software licensing growth of 16% to 18% and total revenue growth of at least 10%. Given the large number of Tier 1 and Tier 2 deals in the pipeline, the closing of which can be hard to time. We are currently assuming Q3 2022 total software licensing growth in line with full year guidance, and then an acceleration in total software licensing for Q4. 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 2022 tax rate of between 18% to 20%.

Turning to Slide 24, we also reconfirm our 2025 targets. There are 2 key metrics, I would like to highlight. Firstly, we have an ARR growth target CAGR of 20% to 25% which reflects 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 and there will be less cash collected upfront on the subscription contracts. However, we see our free cash flow growth substantially accelerating at least 25% over the 2023 to 2026 period.

Moving to Slide 25, this is a slide, I showed last quarter, but it's an important one, so I'd like to run you through it again. Next year's EBIT growth is strongly correlated with this year's ARR growth. We already have a high blended gross margin for ARR and this will continue to rise as we improve our SaaS gross margin from greater automation, improved unit economics with the hyper-scalers and scaling our SaaS business on an optimized cost base. We will of course, continue to make the necessary investments in sales and R&D to drive our growth going forward. After these investments we would expect EBIT growth to track around 75% of the prior year ARR growth. So as ARR is expected to grow at the CAGR of circa 25% from 2022 to 2025, EBIT is expected to accelerate to more than 15% CAGR over the same period.

And lastly on Slide 26, I'd like to walk you through the impact on our EBIT and margin in 2022. Improving SaaS gross margin and strong maintenance growth will be the largest drivers of our EBIT in 2022 with a smaller contribution from term and subscription license growth.

In terms of costs we have around 12 million of post-COVID normalization, which is linked in particular to increased travel and the return to in-person events. Once these costs are reflected in the 2022 cost base this will no longer be a headwind in 2023. On top of this and given the strong market growth, we have invested in H1 '22 and we also face wage inflation as does the whole sector. We expect to end the year with an EBIT margin of around 37.5% at the midpoint.

Looking further forward, we will then expect our margin to continue expanding in 2023 to 2025 by 130 to 150 basis points per annum, having absorbed the impact of COVID normalization and having made significant investments in our SaaS and cloud capabilities and in sales and marketing in 2022 in prior years. Please note that our SaaS, maintenance and subscription contracts as our CPI protection clause is building.

With that, I will hand back to Max to conclude.

Max Chuard

Thank you, Takis. And so in conclusion on Slide 28, we've had a supportive demand environment this quarter which drove total bookings growth of 12%. And we see increase demand for subscription which is accelerating our ARR growth. Total software licensing this quarter grew below our full year target with a Tier 1 deal slipping to Q3 and expected to close shortly.

We have multiple drivers to deliver our full year guidance, including a large number of Tier 1 and Tier 2 opportunities, strong activity in the wealth space and incremental demands to our partner channel. And in addition, we also benefit from value uplift from our subscription business, which helps to de-risk our full year guidance. Overall, our pipeline activity, total bookings and ARR growth give me confidence in achieving our full year guidance.

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 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 or a comment may press * and 1 at this time.

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

James Goodman
Good evening. Thanks very much. Just firstly on the... outlook, you've been very clear, that you're not seeing a sort of specific macro softening. But I just wondered, if you could clarify, whether the one slip deal is purely that one, or you've seen a little bit of a lengthening of sort of sales cycles, more broadly, because at the same time it feels like, you're being a little bit of cautious around the timing of some larger deals in Q3. And I'm wondering what's giving you the confidence that those don't in turn slip beyond Q4, given I think (not audible) saying you impacted any sort of broader macro softening into the guidance?

And then I mean doing in on the deal itself, very encouraging to see you win this large deal. I wondered if you could elaborate a little bit on the nature of the deal, you know, subscription or traditional license, anything you can say around this sort of timing of revenue recognition and perhaps more importantly, competitively you know, was this against also cloud native providers, if you could help us with the competitive process that would be very useful. Thank you.

Max Chuard

Hi James. Listen the... regarding the macro environment and I tried to make the point in doing my... when I started the presentation, we don't see if you want any changing... changes from an environment perspective. We don't see at least today a lengthening change of the sales cycle. We don't see a customer behavior which is changing. I think... so that we don't see. And what happened in Q2 is really a very large Tier 1 bank, which, you know, the process to closing those deals are more complicated with more complex approval within the bank. So that's really what happened.

And you know, back to the second question, which is great to see more activity with those Tier 1 banks. And I have to say, it's now many years. I've not seen such amount of activity with Tier 1, Tier 2 banks. So it does show that there is something happening in the market. I would say, most of the activity is mainly coming on the core banking side with I will say a focus on reducing TCOs, focus on bringing more efficiencies, simplifying a very complex legacy infrastructure. So that's really what happened in Q2. And as I said this deal that did not close on time is expected now to close you know, extremely shortly.

James Goodman

Thank you Max. Can you say anything about whom do you want the deal against the nature of the competitive process?

Max Chuard

Listen it was competitive, I think, we came up as the winner quite quickly. Our references, our credibility, our infrastructure but you can take through that the usual suspects were part of that process. It's a Tier 1, so Tier 1s they do on structure and detailed process. But we came first quite quickly and that's great.

James Goodman

Thank you.

Operator

The next question is from Chandra Sriraman from Stifel. Please go ahead.

Chandra Sriraman

Yes. Hi Max, hi Takis. Thanks for taking my question. Just a couple of questions from my side. Sorry, to come back on this large deal in the US.

Just trying to understand how this impacts your guidance as such, typically I would assume large deals are not part of the guidance. I just want to get a sense of how comfortable you are with your guidance given that you are likely going to sign this deal. And also can you just comment if it was one of those DXC led deals, are you seeing some momentum built up there given that it's been a while since you had signed this partnership?

The second question is on Europe. You're still seeing weakness in Europe. It still contributes less than APAC in terms of total software licensing. I'm just wondering what is the risk that... given that we are entering into a slowdown you see sustained weakness in Europe? Are you seeing some clear signals that this slowdown in Europe is genuine and there's going to be a bounce in the geography? Thanks.

Max Chuard
Hi, Chandra. So if we start with the deal in the US this is, as I said it's an exciting moment for us in the US as it clearly shows the hard work and the commitment that we've made to that part of the world where after winning Commerz, after winning PayPal. Now, this is for me clearly a next milestone. This is a bank, which is probably 4 times the size of Commerz. So it's really taking us to a next level, which is also opening up quite a number of opportunities for us. It's also a deal where we were competing against the, you know, incumbent and we were able to win, because of our strength, the architecture, the scale, and also all the regulatory that we've gained you know, with our experience with Commerz. So I think that's great. And as I said we expect this to be done in H2.

Now to the question about DXC. Listen, we continue to work with DXC, and I would say more globally we see... and as you know, we've been trying to do more with partners and trying to accelerate growth. And I have to say, we start to make progress clearly one of those you know, is DXC. But we see more and more of activity with various partners across the globe, and we had some successes in Asia and hopefully, we'll be able to announce them at some stage. And we see more and more of those opportunities. And I think this, as I said before, will be an incremental way to accelerate growth.

Regarding Europe, Europe for me is clearly on the recovery path. If... yes, we had this deal into Q2 that did not close in time, but the level of activity is definitely there. I expect Europe to grow strongly this year. Also, my comments about Europe was quite some business is also going to SaaS in Europe. I think you know, the traditional way to look at the license performance does not capture the full story.

So in Europe, we see more and more activity on SaaS either with non-incumbents or with smaller banks. So there is, I will say, more and more activity in that part of the market. So, I am confident that we will see strong growth in Europe this year. And I think as I said, it's about time, because Europe, as you know, took time to recover from COVID, but definitely this is the year where Europe will recover from that.

Takis Spiliopoulos
Chandra, let me take... let me be a bit more precise on guidance. Clearly, what we have always said is you know, those large transformational deals, you know, the Nordea open bank type of deals, are not included in the guidance. I would say, normal large deals, which are part of our business, especially with Tier 1 and Tier 2 are included and are a material part of our guidance and we expect this to be the case also this year.

Now what is specific, and Max mentioned this is, we have a you know, very large number of large deals, which makes the kind of timing or get the timing right a bit difficult as we have just seen with Q2. So this is why we're saying you know, for total software licensing growth in Q3 we'd like to be prudent, and let's assume you know, the current full year guidance run rate, if it comes better, we'll see. We just come off a quarter when we reached our own target. So we'd like to be prudent on this.

On this US deal, you know, again, what's the timing and what we can say is definitely H2. And hopefully, we will also be able to announce the name. I think that will be a strong message to the market, and clearly then we'll also book the revenue.

Chandra Sriraman
Great, thank you.

Operator
The next question is from Josh Levin from Autonomous Research. Please go ahead.

Josh Levin
Hi. Good evening. 2 questions. Just I understand you on the US deal, I think you said, you won the deal, but you're still negotiating the contract. Just, I guess, how do we have comfort that that is definitely gonna close?

And then the second question is, there have been multiple stories in the media about Temenos being sold to private equity or strategic buyer. I know you can't comment on specific stories, but given where the start price is right now and your outlook for the company and the change you're navigating with the subscription model. I guess, when it comes to creating shareholder value, how do you weigh the trade-offs between selling the companies and continuing to go it alone?

Max Chuard

Hi, it's Max. Listen regarding the US deal, it is very well advanced. And you know, we won it and we are now finalizing the detail of the agreement. In fact we signed some agreements and there are some more to be signed, to be precise. I mentioned it today, because I felt it's significant and material if you want a milestone for Temenos. And that's why, you know, I wanted to share that with the market, because it is opening up new doors. It is going to position Temenos differently in that market. And as you know it's a market that we've made significant investments of the year and it's great to see now that you know, we are starting to see the benefit of those investments.

Now, regarding the ownership structure of the company, clearly you know, as management team we've got... we are extremely focused on delivering the year, delivering our Strategic Plan. So, this is you know, our focus. And clearly the board is taking you know, the assessment of what's best for the company. So that's, if you want the governance which is in place. So clearly, our focus is on delivering what I think is a very exciting plan. Yes, we are going through a transition and maybe a transition sometimes you know, is not easily understood by everyone, because there are different KPIs, and those KPIs does not reflect immediately on the P&L. So, that's our job to try to explain the value proposition why we believe this transition makes sense. And the fact that we are seeing significant acceleration of our ARR gives me great comfort that what we are doing is right, and that you know, there will be significant value to be created through that transition. So, I hope I have answered your question.

Josh Levin

Thank you very much.

Operator

The next question is from Justin Forsythe from Credit Suisse. Please go ahead. The connection with the questioner has been lost. The next question is from Varun Rajwanshi from JP Morgan. Please go ahead.

Varun Rajwanshi

Hi good evening Max and Takis. Thanks for taking my question. Firstly, just a clarification. So, would your total software licensing revenue growth be in the 16% to 18% range including the Tier 1 deal that slipped into Q3?

And then secondly you know, you've maintained your full year EBIT growth guidance, which implies quite a step-up in H2 higher than what we've seen in prior years. So, what is driving your confidence in terms of hitting this target?

And then lastly, you know, given your first half performance and visibility into the second half, what is your expectation for subscription revenue for full year 2022, I think you had previously indicated 60% of non-SaaS total software licensing revenue to be subscription based. Is there an update to that expectation? Thanks.

Takis Spiliopoulos

Hi, Varun. Let me take this one. So, yes the Q3 TSL guidance, as I mentioned, we want to be prudent. So it includes the deal Max just discussed, so the slip deal which we expect to sign in shortly. So that's included yes.

On EBIT, I think it's a fair question. Clearly, we have seen Q2 cost being probably a bit lower than expected. Some of that was driven by you know, accruals on the variable side being lower and also some... that's the... we were a bit conservative, so costs which were planned and down now gonna hit us in Q3. However, if you look at the trajectory there are 2 elements in H2, which is gonna help us you know, accelerate EBIT growth substantially. One is the investments we wanted to do, which we started basically second half last year and continued early this year have been largely concluded. So this is something where you have seen the impact fully reflected. So, second half you will see you know, much less in terms of cost growth.

The second one is like all companies probably in this environment where there could be a potential uncertainty, which we don't see today. Clearly, there has been a stronger focus on cost control, which also becomes visible in H2. So if you couple this with you know, the acceleration of the top line growth, yes you get to a substantial double-digit EBIT growth, especially in Q4, but we are confident to deliver that. So Q3, yes there will be you know, we're targeting flat to slightly down, EBIT growth. But clearly, Q4 we'll see then the acceleration.

And your third question on subscription. So yes, we have seen better or faster impact or faster transition, subscription has been ahead to what we internally projected for Q3, it should be 50 million plus and the rest then for the full year. So I would expect and this is also having an impact... a slight negative impact on our free cash flow guidance. I would expect the you know, subscription to come probably a bit higher than those 60% we initially said.

Varun Rajwanshi

That's clear. Thank you, Takis.

Operator

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

Laurent Daure

Yes. Thank you. Good evening Gentlemen. I have 3, first question for you. The first is back to your guidance and the explanation you gave on gross in EBIT in the second part of the year. Another way to ask the question is, what are your hypothesis regarding your closing rate on, I think, you probably have 5 or 6 important deals to close. Have you taken a 50% conversion or any granularity on the hypothesis you have taken on those important deals will be helpful.

My second question is back on the cost base. I think you had roughly 5% or 6% staff inflation. Do you start to see that easing with macro deteriorating significantly or do you believe it's gonna take a bit more time and that's not going to help you in the second part of the year?

And my final question is on ACV you know, compared to the consensus the second quarter was on the low end. Could you confirm that in the second half you are more likely to come back to numbers every quarter at 15 million plus? Thank you.

Max Chuard

Hi, Laurent, it's Max. Let me start with the last one. On the ACV and you know, on purpose we've put a chart where you saw... you can see different quarters so that you see the volatility. And the volatility on the ACV side is really driven by when there is increased consumption from existing customers and that was clearly the case a year ago and it was not the case this quarter. The visibility on increased consumption, we do get a good assessment on a yearly basis, because we understand increased volumes from our customers. But the timing of those are very difficult to predict.

So we do expect strong consumption from existing customers in the second half of the year. I think that's one thing that give us you know, the comfort on the full year. And then if you were to look of the growth from our new signing activity so far in the year, it has been very, very strong, so you may... a multiple of what we had last year. And we continue to see very strong momentum on new SaaS ACV activity. So when you combine this for the second half of the year, we feel confident that we can achieve significant growth, which will sustain more than 30% tax revenue growth which we want to deliver.

Takis Spiliopoulos
Hi, Laurent. Let me take the other 2. First on wage inflation which we had said was baked in at around 5% to 6% growth for the full year. So clearly we see this as sufficient. I think this is, if you won't locked in and clearly given that attrition over the last 2 months, especially has clearly slowed down substantially, we feel comfortable with this wage inflation. We don't think that will deteriorate.

Also in terms of you know, hiring, it was probably a bit easier. The last 2 months, where we still did some hiring.

On large deals, I think the number you're quoting is probably a bit low. We're working on a much larger number of large deals. Now, the way we forecast this is clearly that we don't need all of them or 3.25 of them or any large percentages to close, given the unpredictability in terms of timing and also if all those large banks, all those large banks execute on those deals. So let's assume, you know, we need a conversion ratio in line with what we have seen, you know, over the last 4 quarters to make our numbers.

Laurent Daure
Thank you very much. Very clear.

Operator
The next question is from Michael Briest from UBS. Please go ahead.

Michael Briest
Yes. Thanks. Good evening. And nice to speak to you again. Just in terms of the US deal, I think you mentioned Max it's 4 times bigger than Commerzbank. Should we be thinking in terms of the value of the deal that could be a similar quantum? And I think James asked around the structure of the deal? Is this going to be a subscription deal?

Is it likely to be a single event... license event or subscription event, or is it going to be broken up and delivered over many years? And then Takis, just on the balance sheet, while since I've looked at it. I'm just curious as to why the income tax payable is over 100 million, it seems to just be growing sequentially. Why isn't that being paid down at all? Thanks.

Max Chuard

Hi, Michael, listen, it’s a very good question. And I am glad you asked, because maybe my comment was not very clear. So when I said this is 4 times bigger than Commerz, I meant that the bank is 4 times bigger than Commerz. So I wanted to say... I'm clearly not going to comment on the deal size as such. I wanted to say this is a significant next step for us in terms of going to an institution that is significantly larger than what we've achieved so far in the US. And I'm saying it is... if you were to look at the deposits for instance, so any of those KPIs this one will be four times bigger. So, it's a significant step up for us in the US. That was my comment. So I'm glad that you asked the question, so I could correct the point.

I was not going to comment on the deal side as such. So, it's really... it's a different level of institution. It opens up a new market for us. It gives us the credibility to go after those largest banks in the US. and that was the point I was trying to make.

Michael Briest

But I thought Commerzbank was only deposit and loans. So is this a full core banking replacement as it says, or is it more gradual than that? (Not audible).

Max Chuard

It is... I would say it will follow probably a similar path than what Commerz did. But my comment again was to say this is an institution that is much larger than Commerz which is the largest domestic business (unit) that we are making today in the US. So that's what my comment was. This is a significant step-up for us. We are now talking to a top 20 US Bank, so it's really a significant milestone for us.

Michael Briest

Yeah. Thank you.

Takis Spiliopoulos

Hi Michael, on the tax liabilities, if you look at the number of this corresponds to let's say a bit more than 2 year's basically of taxes to be paid.

Now, as you know, we have a large part of our IP is in Switzerland and also in Luxembourg. And clearly the way it is done there and we have the impact on cash taxes this year, it can take a very long time sometimes as long as 4, 5 years until basically you have to really pay the cash taxes on these deals.

So it's more a timing thing. We had very low cash taxes last year. Some of that will reverse. And we had said it's gonna be quite a bit higher this year. So this you should expect to converge maybe to one year or so over the next period, but it's always gonna be a mismatch because of when the tax authorities ultimately give you a definitive tax (royalty).

Michael Briest
Okay. So it will be flattish from here on or around these levels?

Takis Spiliopoulos
We would actually expect this to be flattish or actually come down over the next years.

Michael Briest
Okay. Thank you.

Operator
The next question is from Justin Forsythe from Credit Suisse. Please go ahead.

Justin Forsythe
Thank you so much, guys, filling back in, I had a technical difficulty there. I have a few questions for you. So, first, I want to ask you a question about neo bank. So you've talked in the past about how non-incumbents are growing third-party software spend nearly 3 times the size of the market. We've heard several neo bank closures, potential issues with accounts, money running out et cetera. Given the level of growth that has been expected from these providers, do you believe the estimate needs to be revised down at all? And can you remind us, how much of growth from non-incumbents is assumed in your medium-term guidance.

And sorry to belabor the point, just wanted to touch upon the TSL point again. And so, walking through the steps there, you're guiding for TSL to be in line with consensus in 3Q and then accelerating in the 4Q. I just wanna make sure I fully understand the impact given the miss was in 2Q due to the deal lagging into 3Q and that deal was expected to be closed in 3Q.

If it closes, are there other material deals in process which could move the needle hence the conservatism, or is there something else that we should be thinking about when we think about the cadence there? Thank you very much.

Max Chuard

Let me take the first one on neo banks. We, as a company, we focus on... even most of our SaaS business today comes from neo banks, even though we see more and more our sales activity from banks. But the majority of what we do is with some challenger banks, neo banks or fintechs.

Now, we've focused ourselves I would say probably on the high end of that market in a sense that, we are extremely focused on the profitability of those deals, because with neo banks, depending on which size you go, I believe you cannot make money as a provider because all the cost of the hosting and so on is too high. And hence we've been very strict on which deals we've engaged. And hence probably I think even the economic environment is probably protecting us in a sense that I think we've got some of the strongest of those fintechs on the OPEX. So, I would say that that's the main element.

Now, regarding the future, what we said was, we expect our SaaS business, our ACV business to be growing around 30% and that is largely delivered by non-incumbent banks. But within that, there is two elements, there is new signings and there is more consumption from some of our customers. But also, as I said before, we see more and more, so I would say low end of the market, smaller banks coming as SaaS. So, we feel we feel very confident that we can continue to grow our ACV business by at least 30% per year.

Takis Spiliopoulos

Hi, Justin. Yes, you were spot on with your comment. You know, we appreciate that coming out of quarter we missed and came in basically 8%, 9% below our guidance which we have pulled out in terms of the full year, clearly, we don't want to run into the same situation. And yes, there are as Max mentioned, a pretty substantial number of large deals out there planned for closing in H2. And then we don't wanna come back to you in October and say okay, there was... yes, we signed the one we slipped and then another one or two move to the Q4. So being prudent and clearly want to basically regain the confidence that we can deliver on what we see.

Operator

The next question is from Charlie Brennan from Jefferies. Please go ahead.

Charlie Brennan
Great. Good evening, guys. Thanks for taking my question. It's actually just a question about the cost base. It feels like there's a conflicting message here between your optimism about the market demand and yet at the same time you're cutting costs. It feels like if we go back to 2020, the cost actions you did there negatively impacted your momentum coming out of COVID in 2021. I'm just wondering why given this is just a timing difference you feel the need to control costs. I guess Tier-1 deals only come around every now and again. If anything, I would have thought you'd be leaning into that opportunity and investing more in sales and marketing.

And then just in terms of timing, when did it become obvious that you were missing Q2 expectations? You obviously had some visibility to have time to control costs. But I thought the message from Temenos was pretty optimistic all the way through the quarter.

Max Chuard
Listen, on the cost, I just want to clarify. We are not cutting cost. What we are saying is we are disciplined on where we invest. I think that's a very difficult, a different message here. So yes, we are recruiting, yes, we are making the right investment. But at the same time, we remain disciplined.

And I think as a company, we've always had that discipline. I think that discipline allows in a quarter where license was soft to mitigate that impact on the profit. I think that's the message we are giving. And as we continue to be disciplined on where we invest to ensure, you know, we get the best return from our investment, but we are clearly not cutting costs. That's not about cutting costs.

And if you look at the second half of the year, you would clearly see that, you know, we expect cost to be growing. So that's not... we are not talking about cutting costs here, but being very disciplined and selective of where we put our investments.

Takis Spiliopoulos
Charlie, now let me add on this. We've been always saying okay parts of the business need investment and this is what we have been doing and we'll continue to do so. But at the same time, we need to become efficient in all areas at the same time. So going forward, the focus on large deals and we did a lot of investments in the last 12 months exactly seeing that we need deal desks, we need structures to report those larger deals. And remember, we had put someone in place for global strategic accounts a while ago. So, I think this is now what you see is bearing fruit.

In terms of costs actions, I think, you know, the accruals on the variable side, I think, that's something once you see with the quarter end you can do, I think, on costs, controllers are genuinely always conservative and this is basically what gave us a bit of the upside in terms of the cost base in Q2 2022. But no mistake here, Q3 2022, we'll see a sequential increase of the cost base of, let's say, 5 million-plus. So, there is no cost restructuring or anything program planned.

Charlie Brennan

Perfect. Thank you.

Operator

The next question is from Mohammed Moawalla from Goldman Sachs. Please go ahead.

Mohammed Moawalla

Yes. Good evening, Max and Takis. I have a couple as well. Firstly, on the large deals you referred to around the second half, could you give us a framing of the size? You said they're not as big as... not big as Bank of Ireland, but just a reference point around the kind of the ticket size would be helpful.

And then secondly, obviously, is there something different around the kind of core banking or financial services space? because we typically see some signals from other software companies, so larger deals getting scaled back where you seem to be kind of having a larger part of that in your pipeline. Is it just a kind of post pandemic you know, of latest cycle kind of spend, or I'm just curious to understand, because if there's a greater proportion of larger deals in the pipeline guidance why wouldn't you kind of de-risk your guidance to a degree?

And I'd also be curious to understand what is the structure? Are they mostly on the subscription license model or the traditional model? And therefore, what is confidence then that even if you sign those deals, the cash flow would not be a potential issue for you in terms of hitting that free cash flow guidance?

And then lastly a slightly different one. Has the M&A speculation out there impacted your kind of conversations with customers in terms of the ability to kind of close and execute deals? Thank you.

Max Chuard

Hi, Mohammed. You asked quite a few questions, so I'll take a few of them myself. Maybe I'll start with the last on the M&A speculation. No, this has not, I would say, obviously, we've had questions, you know, during the sales process and what that meant, I've not had a deal where at least I'm aware of where things got postponed or lost, because of the rumors. So, I think that's the first thing.

The... what is different in financial services or with banks compared to other industries, I cannot talk about other industries, but clearly within financial services, I think, banks took longer to recover, and we do see now increased activity across the board. And as I said, I have not seen that amount of Tier 1, Tier 2 activity for quite many years.

As I said, it's mainly on the core banking, I think, core banking is there. We see a lot on wealth management. So definitely, wealth management is an (area) of which is quite where we see a lot of spending. It's about mainly modernization of core but also end-to-end back and front. So I would say, it's maybe a late cycle where banks took longer to invest. And quite a few of those discussions are on a subscription base, I would say, not only but clearly today, when we talk about term license, we go for subscription. So now license, we go for license. There is often a use of cloud, and I can see even, you know, more and more the market being more and more looking into even SaaS. So, I think that's also something that is very interesting. But subscription is probably where the majority of those deals will end up. I guess, I'll leave the rest for Takis on this side and on the free cash flow.

Takis Spiliopoulos

Yes. Hi. On deal size, I think when we talk about larger deals this is let's say 4 million or 5 million-plus okay. So this is considerable. And I think, having some are even quite a bit above that. But having that many in the forecast, and basically in the pipeline, we want to be as prudent as possible especially on the timing. Clearly, those deals, this is not just for H2, it stretches also in into 2023, which tells us you know, as of now banks are still planning ahead also for... with the larger projects.

Then the impact on free cash flow. This is reflected in the upgraded guidance. Clearly, as you remember, we have headwinds on taxes and from advance payments, we talked about. In total, that would be around 30-35 million, which would basically be a 10% decline on free cash flow. But clearly, with the acceleration we have seen and as Max mentioned, most of those large deals being on subscription, we have some headwind on free cash flow, which I have now reflected in the upgraded guidance. But other than that, I think, we're pretty happy with the way those large deals are evolving. Again, timing is the one thing, which is a bit difficult to predict on a quarterly basis.

Mohammed Moawalla

Got it. Thank you.

Operator

The next question is from Felix Remmers from zCapital. Please go ahead.

Felix Remmers

Yes. Thanks for letting me on. Three questions, if I may. Also on the large deals, I mean a couple of years ago the story was that the large deals have changed into these progressive renovation plans where banks buy piece by piece. And therefore, these larger deals are not coming through like in the real all-pay past. So, I don't understand really, why now we are back into this mode where larger deals, slippages costs and this volatility in licensing. So is... are these larger deals not like this less progressive renovation deals anymore?

Then on employee turnover, I mean, you mentioned that employee turnover has come down in the last couple of months. Do I understand that correctly? And I was wondering, if that is also true for the key management team who received quite a substantial LTIP program in Q3 last year. I'm thinking here of the share price being on a multiyear low, if that is really still, you know, worth to holding on?

And the last question... sorry, that I have 3, is on the DXC, Max. Your comments around DXC on an earlier question sounded to me quite vague. So, I just wanted to follow-up here. Is that partnership still fully in place? And is that opportunity especially in the US still fully visible? Thank you.

Max Chuard

Hi, Felix, maybe let me take the second and the third. On the ground that we gave to a selected number of employees I have to say, we achieved what we wanted out of that. So, remember it was around 350 of our top key employees that we wanted to ensure that we will retain that was below the senior management, if you want, the next to leverage mainly. And that has worked extremely well. So, we've almost not lost any of those individuals. Those are also individuals that you know, fully believe in the Temenos story that are fully convinced of the opportunity in front of us. And hence you know do believe of our ability to create value over the medium-term. So I'm not... it's not great obviously that the stock is below when we granted. But clearly, those do take a long-term view on the opportunity. So I think that's my first comment.

The second one on DXC, in fact it's true that I moved quickly to all the opportunity that we did close in the quarter. That's why I moved on. Listen, we continue discussion with DXC and it has not changed. We are engaged in quite a few discussions. Now those are long process, I have to say. That's why I don't comment on them every quarter. As I said my goal is still to have one of those closing the year. And so those are Tier 2, Tier 3 type of banks with sales cycles of anywhere 12 months to 24 months, and it takes time. And... but I do want to see a deal with DXC in the year. There are a few that are on the way. So I'm hopeful we'll get there.

But my point on partners was I can see that there are more and more activities with partners where it's somewhere in the past we've tried without success. And I can see increased momentum at this stage, where I can see partners that are willing to invest, that are willing to work with us, to open up markets where maybe we are not well established. We don't have relationship, which maybe is not the most strategic market for us, and hence we've not made the effort and the investment to go after, and we see local partners that want to leverage our IP and want to invest. And that is encouraging. I think that was the comment I tried to make. And maybe, I'll leave Takis the first question.

Takis Spiliopoulos

Yes. Hi, Felix. I think it has not really changed. The standard model is still progressive renovation. What maybe has changed in the last 12 months to 18 months, especially for European banks coming out of COVID is maybe a different approach to how much they want to do because clearly the challenges are there on the cost side. And I think this is something which has been very visible in the first half 2022. While maybe last year there was a lot, okay, what can we do in terms of the growth ambitions. It has been a lot about how fast and how quickly can we save costs. This is obviously playing nicely with Transact and having proven that there is a cost benefit if you implement this. So that's one element.

The second one is they maybe take larger chunks, larger scopes given also we have credibility in the market on scalability, on proven cost reductions. So, this is also what is driving larger deals.

The third one is it's... Europe is a main driver for this. Europe as we know too much lower than we wanted to come back. And clearly, this is substantial chunk in the pipeline.

And I think lastly what I would say is, you know, supporting us that was clearly something, which we maybe had less before. So partners also bringing more and more leads for larger deals.

And then the final one because there was much less a few years ago, definitely pre-COVID the US market, this is really a huge opportunity. We get now invited to local RFPs and these are large RFPs. So obviously that's also built into the pipeline.

Felix Remmers

Okay, Thank you.

Operator

Ladies and Gentlemen, that was today's last question. I would now like to turn the conference back over to Temenos for any closing remarks.

Max Chuard

Thank you all for taking the time to be with us this evening and we are looking forward to speaking to all of you very soon. Thank you.

Takis Spiliopoulos

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 -