Full Reviewed Transcription

Temenos Group

Temenos - Q4 2022 Results

2023-02-20 at 6:30 PM CET

Duration: 64 minutes

COMPANY REPRESENTATIVES

Andreas Andreades, Executive Chairman, Acting CEO

Takis Spiliopoulos, CFO

PRESENTATION

Operator

Ladies and Gentlemen, welcome to the Temenos Q4 2022 Results Conference Call and Live Webcast. I am Alice, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode, and the Conference is being recorded. The presentation will be followed by a Q&A session. You can register for questions at any time by pressing * and 1 on your telephone. For operator assistance, please press * and 0. The Conference must not be recorded for publication or broadcast.

At this time, it is my pleasure to hand over to Andreas Andreades, Executive Chairman and Acting CEO. Please go ahead, Sir.

Andreas Andreades

Thank you, operator. Good evening, good morning, where you are, and thank you for joining today's call to run through our Q4 results. You can find the presentation on our website. Now, as this is my first results call for quite a few years, I'd like to change the format a little bit. I'll focus my comments on key developments in the quarter and the outlook for 2023, before handing over to Takis to run through the financials as usual. Now all the usual disclosure is, of course, available in the presentation, but I will not be going slide-by-slide.

So starting with the quarter. Firstly, I'm pleased that we were able to meet our revised guidance and indeed, exceed the revised guidance for free cash flow, in particular. The changes we made to our sales organization early in Q4 had the desired impact and with a return to predictable sales execution.

We've flagged for several quarters now that activity with Tier 1 banks is increasing, and we really see this... we really saw this in Q4 with a number of Tier 1 deals signed across regions. This includes in the U.S., where a leading U.S. bank extended its relationship with us to include its international private banking operations and it includes a deal with the European Tier 1 as well. Overall, we saw the revenue mix from Tier 1s and 2s return to 2019 levels.

We are seeing growing demand for cloud, and this is benefiting not only our SaaS business, but also the growth in subscription revenue. And let me explain that. We have a number of Tier 1 and 2 banks implementing cloud-native solutions and running the software themselves and this is driving subscription revenue.

On top of this, there is continued strong demand for SaaS, where we run the software on behalf of the client. The growth in SaaS is being driven by new customers and contracts. We've had almost no existing terminals on-premise customers switching to SaaS yet. So this is not a SaaS transition given the SaaS demand is almost entirely from new business. I'll talk much more about this during our Capital Markets Day tomorrow.

Now looking at North America, We continue to make consistent progress, in particular in the U.S. North America was 37% of total software licensing in 2022, and this is the highest ever contribution from this region. We are competing and winning against domestic vendors, with a selection by a Top 20 bank to migrate deposits business to Temenos Banking Cloud, confirming that as well as a number of other similar deals in the pipeline already. More broadly, we've maintained strong win rates against our competitors globally, both traditional vendors as well as new vendors. We'll provide some interesting competitive win rates against key competitors at our Capital Markets Day tomorrow.

Subscription transition continues at pace, and the realized value premium is within the expected range. Now both our SaaS and subscription revenue growth is driving growth in ARR, and our cash flows are benefiting from the positive working capital dynamics of the SaaS business, which minimizes the impact of the shift from the license term to subscription. Cash was a key measure of our performance in Q4.

Looking forward, I expect the sales environment to remain stable this year, with some banks still cautious around their IT spend on uncertain 2023 macros. Our pipeline is developing positively, with increasing demand for SaaS and cloud and a number of Tier 1 deals still in the pipeline. I also expect our subscription transition to be largely complete by the end of the year.

We flagged the headwind from customized development licenses in Q3 2022, and we have now entirely absorbed this headwind. Our partners are doing most of the client-specific work, and this enables us to focus our R&D on innovation that can be used across all our clients. We made significant investments in 2022 across both R&D and sales, and this gives us a solid platform for growth in 2023.

I would also like to flag that we already have reached the minimum cash flow point from the subscription transition with a positive working capital impact of the SaaS business more than offsetting the remaining negative working capital from the subscription transition. As such, I expect our free cash flow to accelerate.

We said we would look to simplify our financial communication and so have focused on ARR as our primary KPI going forward. This is appropriate given the critical mass of recurring revenue in our P&L, with ARR expected to reach more than 70% of total revenue this year and more than 80% of our product revenue. Our strong growth in ARR is also driving increasing visibility on profit and free cash flow, of course.

With this, I'd like to hand over to Takis to take us through the numbers for the quarter.

Takis Spiliopoulos

Thank you, Andreas. Moving to Slide 15, I'll give you an overview of our financial performance. All figures are in constant currency, unless otherwise stated. Subscription revenue was 47.3 million this quarter and a total of 105.7 for the full year. I am pleased with the progress we've made on the subscription transition and expected to continue at pace this year.

SaaS revenue was up 36%, and with the SaaS ACV signed in 2022, we already have around 10 percentage points of total software licensing growth locked in for 2023. Maintenance grew 3% as expected and 4% for the full year, while total revenue was down 1% year-on-year. The combined effect of lower subscription licenses, the macro impact in H2 '22 and increased costs driven by targeted growth investments and higher expenses in services drove our EBIT down 28% and our EBIT margin to 33.8%. Operating cash was 135 million, down 38% year-on-year, and we maintained cash conversion at 105%. Free cash flow was down 43% year-on-year and 46% for the full year, which exceeded the revised guidance we had given at the Q3 results.

DSOs ended the quarter at 129 days, up 12 days sequentially, driven by the impact of the subscription transition. We ended the quarter with 751 million of net debt and leverage stood at 2 timers, and our leverage should trend down through the course of 2023. We have also announced a dividend of 1.10 Swiss Francs for 2022, which will be voted on at the AGM. This is up 10% year-on-year and reflecting the expected acceleration in free cash flow growth.

Now on Slide 16, SaaS revenue continues to perform very well, and we expect this to continue in 2023 and the medium term. As Andreas mentioned, our subscription transition is also progressing well, and our subscription revenue is benefiting from the rising demand for cloud. By the end of 2023, I would expect subscription to make up the significant majority of the combined subscription and term licenses.

Operating costs were up 22% this quarter, driven by continued targeted investments in sales, product and cloud and also higher service costs linked to partner-led implementations, which I had flagged at Q3 results. I expect services cost to trend down through 2023.

Our cost base was up 17% in 2022. And while it will grow in 2023, the growth will be significantly less than last year. We made a lot of investments in 2022, which serves as a good platform for growth for this year. Lastly, we delivered 94 million of EBIT in the quarter and our EBIT margin declined 12 percentage points in constant currency, and our EBIT margin for the full year was 38.4%.

Now on Slide 17, 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 rates. I have already outlined the main impact on revenue and cost this quarter.

In terms of FX in Q4, we saw a continuation of the trends from Q3, with the strength of the U.S. Dollar having a negative impact on revenues, while the weakening British Pound and Indian Rupee generated some benefit on costs. Overall, we had a small positive impact at EBIT from FX this quarter of around 2 million.

On Slide 18, net profit was down 30% in the quarter and 26% for the full year. Higher financing costs in the quarter were offset by lower taxes. EPS for the quarter and year were down in line with net profit.

On Slide 19, our 2022 cash conversion was up 105%, still well above our target of converting at least 100% of IFRS EBITDA into operating cash, but we also expect our cash conversion to be at least 100% for 2023.

On Slide 20, we have provided a free cash flow bridge for 2022. We had headwinds from higher investments and wage inflation as well as from services. We saw the negative impact from the decline in term license. However, it is worth noting, and as Andreas has already highlighted, that the net effect from the negative impact from the transition to subscription and the positive impact from the growth in SaaS and maintenance deferred revenues was slightly positive. This is quite remarkable and evidence that we have already reached the trough in 2022. I'll get to 2023 in a minute.

On Slide 21, we show the key changes to the group liquidity over the year. We generated total operating cash of 317 million and ended the year with 90 million of cash on balance sheet and net borrowings of 751 million. Our leverage was at 2 times and are expected to trend down from here through 2023.

On Slide 22, we have our 2023 guidance metrics, which are non-IFRS and in constant currency. We are guiding for ARR growth of at least 12%, driven by the move to subscription and also from strong SaaS growth. We start the year with a significant majority of our ARR locked in through committed SaaS revenue, subscription and maintenance. We are guiding for 2023 total software licensing of at least 6%. This combined subscription, term license and SaaS revenue and we already have approximately 10 percentage points of total software licensing growth locked in from SaaS ACV signed in 2022 and early 2023.

I would also flag that the headwind from the decline in customized development licenses is now behind us, and this alone acted a circa 4% headwind on total software licensing in 2022. In particular, we have a high level of confidence in our SaaS revenue growth, driven by several elements. We had more than 85% growth in SaaS ACV from new logos in 2022 and continue to have a strong pipeline of new logos.

As we have progressed over the last 2 years, we have now a better understanding of our customer base and therefore, improved visibility on consumption. Finally, we benefit from newly introduced over-hedged revenues. This means we have started charging customers for consumption over the contracted volumes at the premium until they commit to more incremental ACV.

We are guiding for EBIT growth of at least 7% and EPS growth of at least 6%. We also expect our free cash flow to grow in line with ARR, so at least 12% growth for 2023 with a material contribution from growth in deferred revenues. We still expect cash conversion to remain at over 100% EBITDA into operating cash. Lastly, we expect that 2023 tax rate of between 19% and 21%.

Now on Slide 23, we have outlined the elements impacting our EBIT in 2023. This is for illustrative purposes to give a feel of relative size of contribution of the different elements. SaaS and maintenance profit growth will have a positive impact as well as the improving profitability of our services business through the year. This will be offset by our investments in selected areas of the business, some wage inflation and increased variable costs.

Finally, on Slide 24, we have outlined the moving parts for our free cash flow this year, again, for illustrative purposes. A considerable part of our free cash flow growth will be driven by the strong growth of deferred revenues from SaaS and a stronger contribution from subscription, where we now also collect the second year of cash. These tailwinds more than offset the negative impact from lower term licenses. This is the last time we have this headwind from term licenses as the transition to subscription will be largely complete by the end of this year.

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

Andreas Andreades

Thank you, Takis. Before concluding, I'd like to highlight our Capital Markets Day, which is taking place tomorrow, starting at 11 AM CET. We will be giving new disclosure on competitive positioning and how we are monetizing the demand for SaaS and cloud through our SaaS and subscription revenues. There is still time to register and join and I hope to see many of you tomorrow.

And so to give a quick summary of the picture for 2023. The sales environment is expected to remain stable and our subscription transition will be largely complete this year. Our pipeline is developing positively, in particular given by rising demand for SaaS and cloud. We have strong platform for growth from the investments we made last year and are simplifying our revenue KPI with a focus on ARR.

And with that, operator, I'd like to open the call to 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.

Our first question comes from the line of James Goodman with Barclays. Please go ahead.

James Goodman

Good evening. Thank you. I guess a couple of questions, please. First one, Andreas, a high level question with you having just taken over the CEO ship of the business, I mean, it's a pretty strategic juncture for the business. So I wondered if you could talk in broad terms about how you think about the longer-term value maximization of the business and the time frame that's perhaps needed to achieve that. And I appreciate some of that will be material for the CMD tomorrow. But specifically, you know, how do you also balance that with the potential shorter-term optionality, perhaps that you have around value creation given the third-party interest that we read about in the press for Temenos?

And the second question is around the OPEX growth for the business. I think, Takis, you mentioned sort of lowish level of OPEX growth. So certainly, that's what's implied, I think, a slightly expanding EBIT margin. So the question is, you know, how comfortable are we that the R&D growth you saw in '22 is sufficient versus the needs the business has around further product investment and is there an argument that R&D could or should be further accelerated over the coming period to maximize your competitive position? Thank you.

Andreas Andreades

Thank you for the question. I'll answer my part first. For those that know me, I've always looked at Temenos with the longer term in mind. Whatever we've done over the last 25 years has been long-term focused, even though we always have the sense of urgency. But every field counts, every quarter is important, every market is important, every implementation is important. So we clearly try to do both, and we are largely succeeding.

And the market opportunity, as you know, is quite significant. The market is a large market. It's a structural market. It predicates on making banks more efficient, more able to compete in the marketplace, it allows banks to deliver to their customers' expectations on interaction. And... the drivers are as strong as they have ever been.

At the same time, our competitive position is as strong as it has ever been. And I said that we'll share some competitive data tomorrow at our Capital Markets Day. Therefore, long-term, the business, and I'm a firm believer in that, can become, if you like, the category killer in banking software. And there is very little that, in my view can stop that, can derail that. Clearly, operating, as a responsible management team, we have always to balance and prioritize our investments. And we always go through a process of selecting where we are going to compete, where we have our best opportunities to succeed and deliver on our objectives. And always, this prioritization will be an important part of our business. But I wouldn't say that our judgment is influenced by... any other factors other than doing what is the right thing for Temenos. For Temenos, for its stakeholders, for the shareholders and for the company, really.

Takis Spiliopoulos
Hi, James.

James Goodman
Understood, thank you. Hi, Takis.

Takis Spiliopoulos
Let me take the cost one. So one thing is, yes, it looks like, you know, low single-digit growth in terms of costs. However, this is only the net impact or the net effect you see. Keep in mind, you know, we invested a lot in 2022, but also keep in mind that we had a massive costs, you know, in our services and in our delivery business, yes. So this will be, you know, substantially down and provide already a considerable double-digit number in terms of headroom. That's number 1.

number 2, Clearly, we were not just staying there and waiting for this cost to rise, but you know, when we saw that 2022 had a lot of macro impact, clearly, we also accelerated some efficiency gains across the organization. So just efficiency gains, plus much lower services cost, provide a considerable double-digit million amount of investment potential. And this is gonna go across product and clearly also some in sales and marketing and it will pay for wage inflation, which obviously we have to factor in as well.

So at this point, we feel comfortable with you know, the EBIT growth we're putting in there. We'll show more tomorrow how much investment there will be, not just in 2023, but in the years beyond.

James Goodman
Cool, thank you.

Operator
Next question comes from the line of Chandra Sriraman with Stifel. Please go ahead.

Chandra Sriraman
Yes, hi. Thanks. Good evening Andreas, good evening Takis. Just a couple of questions from my side. So I noticed that the ACV growth for the year is just up 1% or so. Just wondering how does this impact your overall view in terms of SaaS growth for next year and the years coming? Maybe just a follow-up on that, if you can deconstruct your top line guidance for next year as SaaS revenues and subscription and maintenance whatever you can give an indication of that would be super helpful.

And my second question is on the pipeline. Last year, we had the heavy influence of Tier 1 deals, you have signed quite a few now. How does the pipeline look from a large deal perspective for '23? Thanks.

Takis Spiliopoulos
Hi, Chandra, it's me. Let me take the first one. Clearly, you know, we have been saying in the past that our ACV, and this is why we stopped guiding already more than 1 year ago will remain lumpy and will remain volatile. However, I think this is not something which worrying us because the deals, you know, whether they from one quarter or the next, there is a limited impact clearly on SaaS revenues. Now going forward, I think it will remain you know, a bit of a lumpy business. However, and I think this is what I tried to convey in my message, we have now also better visibility on the consumption you know, of the individual clients. We have clearly shown a very strong growth of new logos, which is helping also with the visibility of the existing business. And finally, we've introduced the concept of overages. So again, giving us more visibility there.

To come back to your question, we said, okay, if we deliver our ACV number, we have basically 10% locked in, in terms of SaaS revenues.

If you do this... the simple math, so this is you know, equaling around 24%, 25% of SaaS growth implied in our total software licensing guidance or at least I think is the right way to say.

Coming down to the other elements, I think maintenance growth, clearly, we delivered the 4% we had indicated. So you should expect at least... the same growth for 2023. And then finally, services, I think we are still in the final stages of you know, getting those projects over the finishing line, probably services will be flat to slightly down this year, but clearly with a much better and improved profitability. I think this is the deconstruction of your total revenue and P&L lines.

Andreas Andreades
Let me take... Chandra, let me take the second part of your question regarding larger deals. It's true that we've been... and we called it out from the beginning of last year, we had... we saw larger banks coming back to the market. And we saw a number of these deals getting done in 2022. And the pipeline does include larger deals for 2023 as well. And my way of looking at these... deals is on a portfolio basis. And to the extent that there is plenty of them and we have enough cover, we feel confident about our focus. So it's a departure in the approach we had before. So the message is, for us, for me, larger deals are like smaller deals. You need to have many of them going so you are able to predictably forecast your year. On a quarterly basis, of course, it's a different discussion, but you know, very comfortable about the year.

Chandra Sriraman
Thank you.

Operator
The next question comes from the line of Toby Ogg with JP Morgan. Please go ahead.

Toby Ogg
Yes, hi good evening and thank you for taking the question. 2 from my side, firstly just wanted to understand the term license and subscription side of the business in the revenues for '23. I think with the 24% to 25% SaaS growth that implies that the term license and subscription business in aggregate will decline in 2023, given the 6% total software licensing guide. Could you just help us understand that in a little bit more detail, you know, how we should think about conservatism... any conservatism baked into that end market growth dynamics and then market share?

And then secondly, just on the current trends, we're sort of nearly at the end of February now. So it would be good just to kind of hear sort of how things have trended year-to-date. Thank you.

Takis Spiliopoulos

Hi, Toby. Let me take this one. Yes, don't forget, we said at least in every line item. And I think you appreciate after recent experience, you know, how do we want to start the year. Now, it's correct that you know, if you put the math together, then yes, this was indicate an overall decline of our on-premise business. However, we see the trend towards subscription continuing. And as Andreas has highlighted and I've repeated that, we would say, at the end of 2023, you would have probably 75% of our overall subscription... overall license business being from subscription. There is still going to be some a stop, which will be term license. There's still going to be some customized development left, but the majority... the large majority will be on subscription.

In terms of being conservative, you know, we should at the start of the year, and we have now February 20, and there is still uncertainty out there in the market and we have, as usual, Q1 ahead of us. Seasonality, probably to be expected as in normal years, I think it's prudent and we feel good with that kind of guidance at this point in time.

Toby Ogg

Okay. Thank you.

Operator

The next question comes from the line of Charles Brennan with Jefferies. Please go ahead.

Charles Brennan

Hi, great. Good evening, everyone. Just 2 questions from me, if that's okay. Firstly, in terms of the simplification of the communication around ARR, I think virtually every other software company I can think of has done that, it's been the precursor to them saying ARR has gone better than expected and the negative consequence of that is revenues being worse than expected. Should we think there's a risk of that happening at Temenos, I'm particularly asking in the context of your ARR guide that feels quite conservative, I think back at Q3, you were guiding to an acceleration in ARR here at 12%. It's a deceleration. That feels like its left the door open for ARR to do a bit better.

And then secondly, just in terms of your guidance, I think previously, you've said 75% of ARR growth should drive EBIT growth. If I take that rule of thumb and I add back 15 million to 20 million of non-repeating remedial services work, I should be an EBIT number closer to 320. I think your guide is obviously closer to 290. Where is that 30 million gone in the guidance? Thank you.

Takis Spiliopoulos

Hi, Charlie, let me take the both questions. On the first one, yes, we had guided for 17% to 18%. Ultimately, what we have seen in Q4, which obviously had a negative impact on the ARR number in Q4. And for the full year was we saw, as you've seen a bit more term license then subscription versus expectations, we had higher contribution from existing clients and also some Tier 1 deals, which drove higher term licenses versus subscription. So there was one impact. The other one was the ACV number. Yes, we had expected a bit more, which was the other impact on ARR.

Now, if we move to 2023, I think there is a couple of elements here. number 1, clearly, if we are, let's say, prudent on one item, it has to match everything we give as a guidance. So we... I think we want to stay with this for now.

Now Clearly, ARR will continue to grow strongly in 2023, but don't forget, 2022 was the first year we had subscription ARR, which ultimately rose... which ultimately drove an increase in total ARR, with much easier comps for 2022. Don't forget also that the absolute amount of ARR in 2023 will be a good level above the increase in 2022 despite the higher base. So we feel good about this you know, this at least 12%. It makes sense to start with this. Is there more in there? Let's see how this progresses. I think we always said we should be prudent at the start of the year. We saw in Q4, you had some deals ended up as term license. So I think that's the message here. I'm not sure of all of your...

Charles Brennan

Just to clarify, if we imagine a scenario where ARR growth comes in at 15%, is it logical to assume that reported revenue will be lower than expected or you think reported revenue can still match your guide even if ARR surprising on the upside?

Takis Spiliopoulos

Yes, we're... I think what we guided on is not total revenue, it's... we guided on ARR and on total software licensing. But if you do your math and ARR comes in at 15%, you would assume there is a positive impact on total revenue. So it's not... we don't try to hide anything in terms of the group revenue growth.

The reason we're not guiding on group revenues is clearly, because the services business, which we have been transferring now for a couple of years to our partners is obviously a drag and it's probably going to slightly decline.

And this is a pace which is not always very predictable as we have seen. So not trying to hide anything and ultimately, ARR and free cash flow will be the key KPIs. So we also wanted to simplify the messaging.

Now on ARR and EBIT. Okay, don't want to take away the thunder from tomorrow. But what we will show is, there is definitely a direct correlation, which is even better than what we had said before between ARR growth and EBIT growth, because we have now much faster progress in terms of how much ARR is as a percentage of product revenue for that matter. So if you see ARR growth in the future, it will ultimately have a direct link to EBIT growth.

So should it be higher than this? I don't know. Now the services you add back, I think you mentioned a number of 30 million, I think we have never provided this number, but clearly some of the benefit from the services business improving, as we mentioned before, will be used for investments.

Charles Brennan

Perfect. Good. I look forward to seeing the bridge tomorrow. We'll obviously be there in person.

Operator

The next question comes from the line of Michael Briest with UBS. Please go ahead.

Michael Briest

Yes, good evening. 2 from me as well. Firstly, Andreas, could you give us an update on the sort of CEO succession planning and progress, maybe what skills or characteristics does the person have to have a software background, a banking background and the timing. But just in relation to your own role, should we assume that you'll leave the board completely when the new CEO raise? I know you're stepping down as Executive Chairman, but do you remain on the board?

And then, Takis, just on receivables, I see the long term receivables have more than doubled to 82 million. What business are you writing where you're not expecting to be paid for 12 months or more? And is this a trend that will continue as the shift to subscription/SaaS continues as well? Thanks.

Takis Spiliopoulos

Yes. Let me take the... Michael, let me take the second one first. So clearly, long-term receivables and also seen in DSOs will continue to go up. And the simple reason is exactly our strategic shift to subscription.

That's the single reason there, because we... as you know, we booked basically the entire license upfront, yes, but only collect one year of ARR as cash. So which means the other 4 years of collections go into long term receivables. So that's basically the main reason. If you take a normal 10 year term license where you would get 5 million of license cash up front and 1 year of maintenance cash up front, now we get only 2 years... only 2 million of cash up front. So clearly, the rest is beyond 12 months. So this will continue until we basically have... so for another year, and then some beyond, because clearly we only collect just a portion of the cash versus the license revenue we book upfront.

Michael Briest
Okay. That's helpful. I mean, it will be useful maybe if you broke down the balance between contract assets, which are unbilled and stuff is actually invoiced anywhere just I hope.

Andreas Andreades
Okay. I'll take the first question. The board is clearly running the search for a new CEO. As we said in our press release in January, Thibault is leading that search. Yes, clearly, we are looking for software experience... in banking software experience and all of those good things. So there's nothing more to add to that.

As far as I'm concerned, I thought our communication was also very clear that I will not be seeking reelection in... at the AGM in May. So neither as a Chair nor as a Director. So I'm handing over that.

Michael Briest
Okay. Thank you.

Andreas Andreades
So no changes to the governance announcements we've made.

Operator
The next question comes from the line of Frederic Boulan with Bank of America. Please go ahead.

Frederic Boulan
Hi, good evening. Thanks for taking the question. Firstly, if you can spend a bit more time on the demand environment.

I think you flagged continued strong performance in the U.S. area the segment or geography where you see perhaps weaker demand or longer sales cycles? And then if you can spend a moment as well on the level of composition you're seeing, especially from the core U.S. competitors, also from new entrants? Thank you.

Andreas Andreades

Sure. Perhaps I can give a little bit... I can start by giving a little bit of color on what we saw in 2022, and perhaps an area where the... especially, the bigger banks were a little bit more cautious than otherwise is Europe. In the U.S., we saw actually good growth. And I'd even say that the U.S. is ahead of Europe in terms of the development of the SaaS business model. Now, so if you like, predictable dynamics in the rest of the world, good traction in Middle East, Africa and Asia Pacific. They... and consistent with the assumptions we made for the business for 2023.

In terms of competitive positioning in the United States, clearly, we do compete with the incumbents in the U.S. And today, we believe actually that we compete very effectively. We have proven that our products, run successfully large regulated financial institutions, new entrants in the market, credit unions, international banks based in the United States. And not only have we proven that our U.S., model bank, if you like, is catering for the local needs, but technologically we have an edge. Therefore, we feel that we are able to bring home deals that in the past would not have been possible, and this is showing in the numbers. Don't forget that... and we've said this also in Q3, the last 4 years, we doubled our business in the United States. So, of course, the opportunity is much bigger than this, but we feel we are in a good place

Frederic Boulan

Thank you.

Operator

The next question comes from the line of Knut Woller with Baader Bank. Please go ahead.

Knut Woller

Yes. Thank you, also 2 questions. Just getting back on the confidence that the shift to subscriptions will be finalized by the end of 2023. Andreas, I think you mentioned 75% should be subscriptions. If I remember correctly, for 2022, the target was around 60% coming from subscriptions, and we ended up 44% share. So what's providing you the confidence that the shift to subscriptions really will have seen the end already at the end of this year?

And then secondly, how should we think about Temenos growing midterm? We have the guidance for 2023. We have the old midterm targets. So what kind of growth should we expect from Temenos? Do you still feel confident to be able to achieve the previously ambition growth rates of the past? Thank you.

Andreas Andreades

Okay. I'll take the first question. I'll take the first question, first. And just to say that given... I think Takis explained the level of subscription revenues in Q4 and explained the reason they were where they were. What I wanted to say is that in our business, where sales cycle are 9 to 12 months and sometimes even longer. When you make a shift today to the business model, it takes time to work through the funnel, a deal that you find... you like to close in the next quarter or the next 2 or even the next 3 quarters. It's not easily to mid-cycle change, the pricing, the construct, the contract and move it entirely from... like a term to a subscription. And also once you provide a term price moving into subscription is challenging. Therefore, the shift is accelerating. And now, we've worked through the first 12 months of... if you like, the transition, and I expect the rate to accelerate... the right resources are available to the sales organization, the right incentives are in place. Therefore, I see no reason why we would not be substantially complete by the end of the year.

The second... your second question on midterm growth rates, tune in at our Capital Markets Day tomorrow, and we'll tell you all about it.

Knut Woller

Excellent. Thank you.

Operator

The next question comes from the line of Mohammed Moawalla with Goldman Sachs. Please go ahead.

Mohammed Moawalla

Great. Thank you. Hi, Andreas. Hi, Takis. A couple from me. Firstly, just on the kind of implied growth in licenses in your kind of at least 12% license plus SaaS guidance which is sort of negative. Are you baking in any of the kind of larger Tier 1 deals that are in your pipeline?

And then secondly, I just wanted to get a better handle around some of this ACV volatility you're seeing and what sort of underpins your kind of confidence on the SaaS growth, because, obviously, ACV was down substantially in Q4. And what's driving the kind of confidence around the SaaS growth in... and the sort of 10 points of contribution at least in 2023?

And then lastly, I know you sort of talked about double-digit million investments implied in the '23 sort of margin guidance. Can you help us break that apart between sort of sales and marketing and R&D? And sorry, if I could squeeze one more in, it's just on services margins. When do you expect to go back to kind of the double-digit rate you saw historically in terms of that sort of gross margin on services? Thank you.

Takis Spiliopoulos
Hi, Mo. Okay, and let me take those. First, on the ACV growth, I think we have shown, and there is a nice chart in the presentation that despite quite considerable volatility in ACV, the trajectory in terms of the SaaS revenue growth has been very consistent for the last 2 or 3 years and every quarter was higher than the previous one. And this is also something you would expect for 2023. If you think about when the ACV you sign in 1 quarter closing the revenue is usually just a matter of a few more months or less. So yes, maybe we didn't sign some deals in Q4, but they will... maybe we signed others. And again, you know, we have very good visibility on what will happen in 2023, especially on the consumption business, but also as I explained before, with the overage revenues. So I think... is it now... I mean, is it now something we're looking to change? I think this is not what we can do. But clearly, we have better visibility. And this is why we have this view for the full year on growing our SaaS business by around those. And I guess, ACV will remain volatile. Let's see where Q1 ends up, I think we're not looking at this from just year-on-year per quarter basis. But if you look at the LTM evolution, I think this is... clearly, we see the driver for the SaaS revenue.

Then, on the investment split, if I remember that one correctly, we don't want to give the exact split how we invest these funds. We can expect to have the same focus areas on the one hand, product, cloud, SaaS, these are the same areas and we're gonna talk more about that tomorrow. And the other one is sales and marketing. Clearly, given the sales cycle Andreas just explained, you need to invest ahead you know, to deliver those down the road.

On services, I'm not gonna give you a precise you know, service margin other than they will considerably improve this year already. and then even more beyond.

You know, clearly, the partner model is one which we will continue to drive. There is also an additional lever for profitability that we sell a lot more governance type of services or premium services, if you want, which carry a higher margin. Did I miss anyone?

Mohammed Moawalla

Yes. Sorry, on the... are you baking in any of the Tier 1 deals in the kind of license guidance... on-premise license guidance?

Takis Spiliopoulos

Yes. As Andreas explained, and I think we want to maintain this, we shouldn't talk and we won't talk about the individual deals. It's a portfolio of deals. And clearly, you know, as we have seen also in 2022 in the prior years, you would expect our guidance to be delivered with a fair amount of different types of deals, different sizes, different tiers. So yes, there is obviously also every year. And as you've seen, we did, I think, 43% from Tier 1 and Tier 2 deals. Yes, without Tier 1 and Tier 2 deals, you can't deliver the kind of growth.

Mohammed Moawalla

Got it. Thank you.

Operator

The next question comes from the line of Justin Forsythe with Credit Suisse. Please go ahead.

Justin Forsythe

Thank you very much. Andreas, Takis, good to hear from you. A couple from me, if you don't mind. So first, I believe and correct me if I'm wrong, you re-mentioned that 10% of 2023 TSL revenues locked in and driven by SaaS. If I recall correctly, that was the same amount you talked about in 3Q as well. So does that imply that, effectively, there are not any incremental SaaS deals locked in, in the inter-meaning by month give or take? That's question number 1.

number 2, I just wanted to dig into your U.S. strategy a little bit. And I think you discussed it a little, but looking on that one slide you have there... there's quite a few different items on there. So it seems like, first, the targeting of Tier 1 financial institutions. You've mentioned in the past a large Tier 1 in the Top 20 that you had signed... potentially signed, but also targeting subsidiaries of foreign banks. And then this investment in Mbanq providing BaaS and other embedded financial services.

And so, I guess, that does seem like you are attempting to be a bit of a jack of all trades there, maybe you could talk a little bit about what your strategy is, if there is any specific type of bank you're targeting and where your solution set fits best within the US market? And especially, you know, is there any change in any of this as a new head of North America takes over the business? Thank you very much.

Takis Spiliopoulos

Hi, Justin, let me go first. Okay, maybe we were not clear. What we said at the time of Q3 results, you know, that 10% of SaaS, 10 percentage points of TSL growth for 2023 will be locked in if we deliver our ACV number for the year, yes. So clearly, you know, there was... we had an expectation in October that we would sign a specific number for Q4 ACV. And based on that, we were confident to deliver this rather roughly 40 million of increased SaaS revenue, which is what we're confirming today.

Justin Forsythe

Got it. That's clear.

Andreas Andreades

I'll take the U.S. strategic question. I'd say, okay, first of all, we are neither jack nor trade. We are quite targeted in the way we approach the U.S., market. And effectively, we have 3 target areas. And these represents the larger, if you like banks... the regional banks, where we believe we've already demonstrated the capability to be successful. We target neobanks and fintechs and within that, I would also include, if you like, our investment in Mbanq. And our entry, if you like, in the BaaS space, we do not wish to be a BaaS provider, but we wish to provide software for the embedded finance market. So that's pretty much the second area of investment and focus.

And then, the third one is credit unions. International banks have always been a part of doing business in the United States for as long as I remember it. So what, and there are a lot of other areas in the U.S. market that we do not target, such as small community banks, mortgage lenders, for example, and so on and so forth, and I could name quite a few. So, it's a targeted strategy, new management has brought in focus. It has brought in sales execution capability. And again, we'll share a lot about that tomorrow. We have a session at CMD dedicated to our U.S. progress and U.S. strategy, and I hope you can join us.

Justin Forsythe

Yes. No, I definitely will be joining you guys. I guess, just one follow-up from the conversation. I think a lot of people are asking around the TSL revenue growth algorithm for 2023. Just trying to understand that is, I mean, is that guidance just based on the fact that you have signed a lot of that SaaS ACV? I mean, is there a baseline of deals that you're expecting? Like, I think it's just... there's quite an open-ended nature to the top end of that. And so... or is there a lot of deals that have, you know, you expect to close imminently, I guess, whether large or small?

Takis Spiliopoulos

So if you look at the revenue contribution from SaaS for this year. So first of all, you know, what you have signed in 2022, especially in Q4, then you have a view, as I tried to explain on what we'll sign in terms of new logos throughout the year. How much is Q1 and Q2, because these are, I guess, the largest quarters to impact the in-year SaaS revenue, maybe a bit in Q3 as well, but definitely not Q4. So visibility on this one and then you have also what we call overage revenues is, those customers tracking above the volumes they have purchased, they also pay on top with a premium. So this is what's providing a lot of visibility on the SaaS revenues minus the expected attrition. So yes, we have a view what Q1 and Q2 would look like. And I think it's probably fair to say that you, if there was anything missed from Q4, this would imply that we would need to make this up in Q1.

Justin Forsythe

Got it. Thank you, Takis and Andreas. I appreciate. Catch you tomorrow.

Operator

Today's last question comes from the line of Gianmarco Conti with Deutsche Bank. Please go ahead.

Gianmarco Conti

Yes, hi there. Thanks for taking my questions. I guess most of it has been answered, so maybe you can walk through the, just one point about the additional consumption. Were you previously not charging customers for additional consumption? And how much uplift do you see that generating top line? And maybe if you could share some detail on that with regards to is this going to be through like all product lines or are you selecting like a few products for which you are charging additional consumption or specific clients, maybe like are you categorizing that by a Tier 1 and Tier 2 banks or what so any detail there? That would be great, thank you.

Takis Spiliopoulos

Thank, okay. What we wanted to say is, clearly, we've also seen with almost on the SaaS clients now. The business has evolved to better understand the clients' behavior over time and sometimes, clients when they sign up for an initial volume, yes, they also don't know how fast their business will evolve. Now, we have now a set of clients, large, mid, small ones, where you have good visibility and you see how the track record is in terms of evolution. So this, if you want overage, I hope it has been there in the past, but now we see more and more of those clients going above their limits. And clearly, they will not stay for long above their limits because ultimately, they will commit to higher ACV, of course, which then giving them the discounts required with the higher volumes. So it's not something new, but it's something we have seen now with a much larger base having an impact and providing additional flexibility... providing additional visibility on our business.

Going into specific customers, I don't think that would be appropriate. I think this is, as we mentioned, across larger mid-sized ones, the smaller ones you know, see that less of an issue. But clearly, some of the plans which started 2, 3 years ago are small have become mid-sized. And some of the mid-sized have become larger ones given the success of their business model.

Gianmarco Conti

Got it. Thank you.

Operator

That was the last question. Gentlemen, back to you for closing remarks.

Andreas Andreades

Thank you very much for joining us, and I really do hope you can join us tomorrow at Capital Markets Day, at 11:00 AM CET. 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 -