Q1 2023 Trading Update

Wednesday, 17th May 2023

Introduction

Anna Engvall

Head of Investor Relations, SoftwareOne

Good morning, and thank you to everyone for joining SoftwareOne's Q1 2023 Trading Update. My name is Anna Engvall, Head of Investor Relations at SoftwareOne, and joining me today are Brian Duffy, our CEO, and Rodolfo Savitzky, CFO. Brian will kick off by saying a few words on his first impressions and priorities after ten days at SoftwareOne. The presentation of the results and Q&A will then be hosted by Rodolfo.

Disclaimer

Before handing over to Brian, please let me draw your attention to the usual disclaimer regarding forward-looking statements and non-IFRS measures on slide two.

With that, I will hand over to Brian.

Message from the CEO

Brian Duffy

Chief Executive Officer, SoftwareOne

Welcome

Good morning. I am pleased to welcome everyone to our Q1 2023 Trading update. It is a great pleasure to be here today for my first call with you as CEO of SoftwareOne, and I will use this occasion to share a few of my very first impressions and priorities.

Since joining ten days ago, I have taken the opportunity to spend time with my team and the Executive Board here in Switzerland, and to meet new colleagues across the company. I will soon be leaving for a five-week Global Connect tour to meet with local teams around the world as well as clients and partners. It is still very much early days, but I am pleased to say my conversations so far have confirmed my initial impression of SoftwareOne.

Firstly, there is an incredible team of talented men and women here at SoftwareOne, and a huge amount of passion within the organisation which I could feel immediately. In prior roles, I have been part of driving large transformations, and these are rarely easy. However, I can see that SoftwareOne has the right people and culture to continue embracing change and this will inevitably be a part of our future in the technology sector.

The long-term opportunity in cloud is massive for us at SoftwareOne. Customers deciding that approximately 30% of their workload have moved to the cloud only so far. At SoftwareOne, we have a powerful global Software & Cloud solutions platform and there is still untapped potential to fully capitalise on this opportunity.

To get there, we have to put the customer at the centre of everything we do to ensure their journey to the cloud is successful. Enhancing our partner relationships will also be a priority for me. Our independence, our global reach, our local presence and expertise create a unique value proposition. We have much to offer both old and new partners as we build strong and mutually beneficial relationships. I am also convinced that embedding operational excellence across the organisation in our go-to market, delivery, and support function will bring significant value and make us stronger and more scalable for the future.

Now, to conclude, I would add that I am incredibly excited to lead SoftwareOne's next chapter together with the team. I look forward to reporting back to you soon again on our progress, and I will now hand over to Rodolfo to take you through the business development and financial performance in Q1. Rodolfo?

Q1 2023 Highlights

Rodolfo Savitzky

Chief Financial Officer, SoftwareOne

Solid start to 2023 with revenue growth of 9%

Thank you, Brian. A warm welcome from my side as well to our Q1 trading update.

We have had a solid start to the year. We continue to see healthy demand as our clients remain focused on cloud-first digital transformation. Q1 revenue for the Group grew by nearly 9% year-on-year in constant currency to CHF 239 million, with both business lines contributing to growth. Our core service lines, Cloud Application and SAP Services, continue to show particularly strong momentum. In Marketplace, underlying demand was strong across both our Microsoft Business and ISV portfolio.

Adjusted EBITDA was nearly CHF 40 million with a margin of 16.6%, down 1.8 percentage points compared to prior year, but in line with our expectations. With this solid performance, we remain confident in our full-year 2023 outlook, as communicated in March, to deliver double-digit revenue growth and an adjusted EBITDA margin of 24-25% of revenue.

Before moving on, I would also like to welcome the team from Beniva Consulting, an acquisition announced today, and I will come back to the details later on.

Resilient performance across regions

By region, EMEA delivered a solid quarter with revenue up 9%, driven primarily by strength in large enterprises in the DACH countries. APAC remained very dynamic, up 23%, as a result of strong results in key markets such as China, Singapore, Malaysia. Meanwhile, NORAM saw revenue decline of 3% on the back of more cautious customer spending and soft results in Microsoft. Finally, LATAM was up nearly 4%, driven by good momentum in services, partially offset by softer Microsoft revenue in Colombia, Brazil and Mexico.

Strong growth of core services in S&C Services

Moving on to our business lines. Software & Cloud Services delivered over 11% revenue growth. Our core service lines, Cloud Application and SAP Services, grew by over 20%, partially offsetting the expected decline in certain legacy services. xSimples grew 20% in Q1, down from over 70% last year, reflecting that we have reached the end of the shift to pay-as-you-go from existing multiyear agreements. Growth in xSimples was also impacted by changes to Microsoft's Cloud Service Provider or CSP platform.

Continued momentum in S&C Marketplace ISV portfolio

Moving on to Software & Cloud Marketplace, which grew by over 6% in the quarter. Microsoft billing grew 13%, reaching $4.2 billion in quarter one, up from $3.7 billion last year, with solid momentum across customer segments. As flagged in our quarter four results call, Microsoft revenue was negatively impacted by the shift from legacy CSP to New Commerce Experience. After a transition period with lowered incentives on the legacy CSP platform, the NCE model comes with higher pricing, more favourable incentives and longer-term subscriptions.

Our portfolio of ISVs continue to show strong growth momentum with revenue growth of approximately 30%, driven mainly by our hyper-scale portfolio and strong demand for IT security and visualisation solutions.

Expansion into IT Service management via acquisition of Beniva Consulting

As I mentioned at the beginning, we have today announced the exciting news that we will acquire Beniva Consulting, an Elite ServiceNow partner with around 75 experts in North America. Beniva is a provider of professional services and brings deep capabilities and know-how around ServiceNow, a preferred vendor for IT workflow management solutions in enterprises moving to the cloud.

The strategic rationale for this acquisition is compelling. It expands our item service line from a $2 billion addressable market to over $7 billion IT service management market within the broader IT operations management space. Complementing our existing item[?] practice, it will enhance our ability to help clients reduce costs by improving their IT operations.

In terms of financial impact, Beniva has an excellent growth track record and its attractive margins will be immediately accretive to our Services business line.

Financial Performance

Solid revenue and margin performance

Now, let us move on to the detail around the numbers. As I have already shared with you the headline numbers, let me characterise the quarter first. The Q1 results are fully in line with our expectations and are consistent with our plan for an acceleration of growth through the year, particularly in the second half. As a result of the strong Swiss Franc, forex headwinds had a significant impact of approximately four percentage points on revenue growth. However, given our natural hedge with similar exposures on OPEX, the forex impact on adjusted EBITDA was again minimum.

Contribution margin increased by 2.3 percentage points, reflecting optimisation of delivery costs, compensating for the continued shift in business mix towards services, and SG&A expenses grew by 19%, and the adjusted EBITDA margin was 16.6% of revenue, 1.8 percentage points below prior year.

Adjusted EBITDA impacted by wage inflation and normalisation of commercial activities

The year-on-year development of adjusted EBITDA is shown in the bridge. While revenue growth and slightly lower delivery cost had a positive impact, SG&A increased faster than revenue due to a normalisation of commercial activities as well as increased headcount and wage inflation of around 5%. The normalisation reflects a planned higher level of travel and sales marketing activities compared to prior year, which was partially impacted by COVID and also included one-off co-marketing investments from strategic partners.

Improved contribution margin across both business

Moving on to the business line view. Before diving into the numbers, it is important to explain certain adjustments to the allocation of sales expenses, which have been implemented in the context of our operational excellence programme. Specialised sales resources are now assigned to their respective business lines, while key account managers continue to be allocated based on contribution margin.

The contribution margin in services was 36.4% of revenue in Q1, comparing favourably to peers, and up 4.1 percentage points versus prior year, driven by the operational excellence initiative. SG&A grew at a materially lower rate than top line, translating into an adjusted EBITDA of CHF 2.3 million. The margin in Q1 was 2%, partially reflecting seasonality, but this year-on-year improvement yet again confirms that we are on track to meet our 15% target.

In Marketplace, the adjusted EBITDA margin was 42.5%, down compared to prior year, reflecting an improved contribution margin, offset by increased SG&A, partially driven by the allocation of solution consultants[?] to this business line.

Operational excellence programme fully on track

I would also like to provide an update on our operational excellence programme. As a reminder, this is an organisation-wide initiative to drive effectiveness and efficiency.

We are targeting savings of CHF 15 million this year and a full run-rate of CHF 50 million next year, with up to 50% being reinvested in innovation and growth projects. Deployment began in January and as of today, we are on track to deliver these savings and operational improvement.

In the commercial work stream, salesforce and the organisational model have been defined and implementation has started. We have also launched an exciting artificial intelligence-driven cross-selling pilot in NORAM.

In delivery, we have made great progress completing the review of spans of control and layers. Up to 80% of personnel transitions have already been implemented. Finally, in the support functions, the shift from country finance teams to shared service centres have started. And in HR, we are piloting a shared service centre in DACH.

2023 guidance reiterated

I will conclude our presentation with the full-year outlook. We have had a solid start to the year with strong underlying demand across our Microsoft Business ISV portfolio and core service line. We remain focused on implementing operational excellence across SoftwareOne to help improve our efficiency and effectiveness and to deliver the planned savings. While we recognise the uncertain macroeconomic environment, we generally see healthy demand in our market and are confident in meeting our guidance for the year.

Q&A

Kathinka de Kuyper (UBS): Hi. Thank you very much for taking my questions. A couple for me. First of all, welcome from my side, Brian, I am looking forward to working together with you.

In terms of the strategy, it is always good to get a new perspective from a new CEO, so maybe could you comment on what parts of the business are going to be a priority for you, and have you already seen some opportunities where you can take advantage of?

And then secondly, a question for Rodolfo on the margin. Especially in Marketplace, the margin was quite weak. Well, the top line actually improved if we compare it to Q4. Can you just comment on the moving parts? Is it just the sales roles which impacted that, and if so, where can the margin then get to longer term? Thank you.

Brian Duffy: Sure. I will take it, and then I will hand it over to Rodolfo. Firstly, I would say that, in terms of the organisation itself, I am extremely excited about the passion that our employees have to serve our customers; firstly.

Secondly, I would say that, we are in a unique opportunity given the independence that SoftwareOne has within the ecosystem. Customers know that they need to transition to the cloud, but the opportunity, obviously, for us is to help them, in that journey. I believe the answer of why to transform has been answered by many customers around the world. And now, our opportunity is to help them to move from A to Z[?] in a constructive manner.

Secondly, I would say that, I hope with my experience and partnerships that I have within the ecosystem, that one area we will be able to look at in time will be establishing further partnerships with new players and, in addition, deepening the partnerships that we currently have. In addition, I am ten days in, so over the next 100 days, we will be reviewing the overall strategy and coming back to you later in the year with an update specific to that.

I will turn it over to Rodolfo.

Rodolfo Savitzky: Yes, thanks, Kathinka, for the question. Look, a couple of observations here. As you know, quarter one tends to be smaller in terms of revenue across the company, but particularly Marketplace Q2 and Q4 are the bigger quarters, and here we clearly see a significant rebound on the margin. Also, with this transition in Microsoft programme for CSP, we expect a particularly strong quarter in quarter two. We see the opportunities, as I mentioned before, of higher pricing, higher margin for us, both translating into improved revenue and to an extent, a little bit of contribution margin. And yes, the relocation of sales resources did have an impact, particularly on the SG&A evolution. However, this business line, once we look at the full-year numbers, will go back into the 50%, around 50% adjusted EBITDA margin that we saw in 2022.

Knut Woller (Baader Bank): Regarding the one-off marketing invest you cited to have been basically a tailwind in Q1 2022 and hence missing in Q1 2023. Rodolfo, are there any further incremental marketing invest that have to be digested that will be missing in 2023 versus the last year?

And then looking at the cost run rate, if we strip out the acquisition of Beniva, is it fair to assume that we should have now, a pretty fair cost run rate on the back of the Q1 results?

And lastly, on the Microsoft price increase, you already touched a bit about it, in the previous answer on the question. The full run rate of this price increase, is it fair to assume that we should see that in the third quarter or from the third quarter onwards? Thank you.

Rodolfo Savitzky: I will take the questions in reverse order. We are seeing a very good transition to the New Commerce Experience (NCE), the new platform, already in April, and we expect further acceleration the coming months. I would say we will start seeing the pricing impact already as of Q2, but definitely I would say pretty much the full impact in quarter three.

Now, a clarification on Beniva. We announced today the acquisition, meaning the signing. Closing will still take a few weeks, and we will see the impact in our P&L most likely in the second half. This, you do not see in the current P&L.

Now, when it comes to the cost run rate, we do expect the marketing and travel partially to remain in the coming quarters; I would venture to say roughly half of that. The other half is related to the internal sales events that we normally had hosted in the past, but which we did not have in 2022, as we were under partial COVID restrictions or with COVID restrictions.

In the one-off co-marketing investments, they were particularly significant in Q1. They probably represent half of the effect for the full year, and we will see a reduced effect in Q2, and a very limited effect in the second half. They were front loaded.

I would say out of these normalisation activities, way less than half we would see in the balance of year.

Knut Woller: Great. Thank you, Rodolfo.

Joseph George (JP Morgan): Yes. Hi, good morning guys, and thanks very much for taking my questions and welcome, Brian as well. And I just have two, please.

Firstly, on the services line, you said that growth was impacted by the legacy services. Could you just give us a little bit more detail here? What specific services were the weakest, and what are you expecting through the remainder of the year here?

And then secondly, just on Beniva, could you talk around the absolute uplift that we should see to the adjusted EBITDA, through the financial year and any other financial colour that you can give on that? Thanks.

Rodolfo Savitzky: On the first, what we call legacy, these are services associated still to on-premise, to companies which have on-premise activities. And there are some, specifically, on-campus trainings[?] that we do for companies. And again, these are clearly not priority. I would almost define legacy as something that is not part of the core lines that we have flagged. And here, almost by definition, we expect a decline over the coming quarters.

Now, having said that – and this is also helped by the commercial operation excellence programme – we do expect to continue the acceleration or to ramp up the acceleration of our core services, as mentioned; as an example, Application Services, SAP Cloud Services. Even though the growth was quite healthy at 20%, we expect to take this level of growth even higher in the balance of the year.

Then, as it relates Beniva, we do mention that the growth is healthy, I would say roughly in line with our portfolio. And when it comes to the margins, they are close to what we see as the target margin for our Services line. So around 50% [inaudible] their immediate[?] equity. And again, we do not disclose the specific numbers when it comes to bolt-on, so, we will not disclose this one either. We will start seeing the effect in H2. The order of magnitude is also the typical bolt-on in the sense that it has a super big effect in terms of bringing capabilities in order to address the IT service market and IT operations market. However, from a size point of view, it is a relatively [inaudible].

Joseph George: Perfect. Thanks very much.

Ben Castillo-Bernaus (BNP Paribas Exane): Good morning. Thanks so much taking my question, and welcome to Brian as well. Two for me.

Firstly, could you just give us a sense of the impact, from the reallocation of the sales headcount from services to Marketplace? Looks to me like a mid-single-digit million amount. Is that broadly what you saw?

And then second question on the Services growth slowdown, just coming back on the legacy services, what was the quantum of the decline there, you saw? Maybe you can add some colour there. And how big are legacy services in the mix of your total services business? Thank you.

Rodolfo Savitzky: Sorry, I am not sure I got the full, so if you could repeat the first part of your second question.

Ben Castillo-Bernaus: I think you called out the decline in legacy services. I just wondered what sort of growth rate was that. Was that down five? Double-digit? That was the first part of that question.

Rodolfo Savitzky: Okay. Now, look, here the decline in legacy is relatively steep. And again, it is [inaudible] by design in a way. We were prioritising what are the key service lines, and here we are talking decline in the overall market of around 20%. But again, this is all by design. We do not disclose the revenue for the different lines, but of course, if you do the math, you realise it is enough to represent the headwind on the overall growth.

And then, sorry, remind me, your first question then was?

Ben Castillo-Bernaus: Yes, it was just around the reallocation of the sales headcount from services into Marketplace. I was just looking for an indication of what the amount was in Swiss Francs. It looks like a mid-single-digit million amount to me. I just wondered if that was reasonable to assume.

Rodolfo Savitzky: Yes, it is even a touch lower than that. It is a good assumption. At the end of the day, it is what I flagged during the call. We have these solution specialists that we are now assigning to Marketplace. Before, they were allocated between the two lines. I would say the overall number indeed is like mid-single-digit million, but before it was partially allocated to the two lines. It is a smallish number. Of course, as part of the overall operation excellence, we have been refining roles, also the number of roles. And therefore, when you see the new SG&A allocations, it really reflects a complete new operative model, particularly for sales. And so, it is a lot of moving parts. It reflects a new reality. However, the main impact was the solution specialists, and your assumption is correct.

Ben Castillo-Bernaus: Understood. Thank you.

Andreas Muller (ZKB): Yes, good morning. Hello, Brian. I have a question to you. Since you have been responsible at SAP for bringing customers into the cloud, can you share with us, your view about the potential for SoftwareOne here? You mentioned that 30% is not on the cloud, or 30% of the publishers are yet on the cloud and there is still remaining 70%. Does this apply for SAP, for example, as well?

Brian Duffy: Sure. Thank you for the question. At the outset, I would say, I believe in the market, there is a unique opportunity for SoftwareOne, given the pent-up demand that there is across many customers in terms of moving to the cloud. And we will be taking time to review that overall strategy and ensuring that we have the correct go-to market in order to best serve our customers. And I will repeat what I said at the outset, which is, everything that we will design moving forward will be built knowing what is it that our customers are looking for. We start with our customers, we design for them, and then we come back and [inaudible].

And what I would say, in closing, is that customers for a long time would be asking, why do we need to transform, why do we need to change? Why do we need to embark on a digital transformation? I firmly believe, from my prior life and from customer conversations that I have had since I have been here at SoftwareOne, that that question has been answered by most customers. And the opportunity for SoftwareOne is to now help customers not define a 'why', instead, to look at how are we going to move them from where they currently are, to the cloud. And we are in a unique position to do that. And then we will ensure over the next 100 days that we build a strong go-to market in order to support our customers on that journey.

Andreas Muller: Okay, thanks. Then I have another question on the future integration of AI into the products of Microsoft process[?]. What does that mean to you? And also, if you can benefit from the change to Windows 11 going forward?

Brian Duffy: Firstly, specifically to Microsoft, obviously, we are the largest partner for Microsoft, so that puts us in a very unique position. As we have seen over the past couple of weeks and months, many players in the market have been making announcements specific around AI, and our customers are looking to us, in order to help them decide how they can best capitalise on the technological investments and advancements that have been made, particularly in that space. And we have kicked off an initiative internally to see how we will best support our customers moving forward, and specifically around the integration of AI into their business.

Andreas Muller: And the change to Windows 11, is that an event or not?

Brian Duffy: No, not that I am currently aware of. However, as I said, ten days in, but not that I am currently aware of.

Andreas Muller: Okay. As a last question on the efficiency programme charge, I was expecting more of a front-loaded charge here in Q1. Is there any particular reason why it is not that much that I was maybe expecting?

Rodolfo Savitzky: You mean the restructuring charge in Q1?

Andreas Muller: Exactly. Yes.

Rodolfo Savitzky: Yes. We are in the process of finalising the full restructuring provision, which we will communicate. It is definitely in magnitude in line with what we have shared so far. It will be around CHF 25 million, and we will communicate in quarter two.

Now, since the programme already started in January, you will see the impact is around CHF 4 million in quarter one. However, absolutely, you are right. I think we will see the fuller impact in the coming quarters, and the provision as such for the full year, we will communicate in quarter two.

Andreas Muller: Okay. Great. Thanks a lot.

Rodolfo Savitzky: Thank you.

Brian Duffy: Thank you.

[END OF TRANSCRIPT]