Final Transcript
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Corporate Participants

David Arnott

CEO - Temenos

Max Chuard

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Presentation

Operator

Thank you for standing by, and welcome to the Temenos Q3 2012 results conference call. At this time all participants are in a listen-only mode. There will be a presentation followed by question and answer session, at which time, if you wish to ask a question, you will need to press * 1 on your telephone. I must also advise you that this conference is being recorded today, on Tuesday the 23rd of October, 2012. I would now like to hand the conference over to your first speaker today, David Arnott. Please go ahead.

David Arnott

Thank you operator. Hello everybody, and thank you for joining the call this evening. This is my first full quarter as CEO, and Max's first quarter as CFO. I am pleased with the steady progress we've made in the quarter in terms of right-sizing the cost base and also in terms of improving our sales execution. There's still much to do, especially regarding sales execution, but I believe that we're heading in the right direction.

The organisation as a whole is more focused, and better aligned than before. In addition, I think we're better at tracking deals, and the quality of the pipeline has improved. Lastly, when I permit myself to look beyond the day to day execution, I feel very confident. Revenue trends are improving at the same time as costs are coming down, and the company has better software and assets than at any point in our history, assets that match the market's needs, and which will underpin our future growth.
Turning now to slide five, I’d like to talk about our market trends. Within our market, we continue to see diverging trends. Emerging markets continue to be much more buoyant than Europe, where conditions remain depressed, and the activity in emerging markets is helping us to partly offset the weakness in Europe. As regards to product set, we see stronger demand for the products and solutions that offer a shorter time to value, so this is the case with business intelligence, for example, and this is the trend that is underpinning the strong growth in sales to existing customers. In addition, we see much more activity from the private wealth market than the traditional universal banking market, with banks in this segment making replacement decisions, especially around the front end, as well as a lot of activity from banks trying to get into the space.

Capitalising on another strong market trend, we’re seeing a good build up in our pipeline for channel offerings, so for example mobile and Internet. It’s clear that the banks are falling behind general retailers in giving customers a rich and interactive user experience, particularly as regards smartphones and tablets, and we see strong interest from banks in Temenos’ new user experience platform, which we’ve called Edge Connect. Lastly, and potentially the most important over the medium term, we’re starting to see the first signs of the pickup of activity in the (broader?) core replacement market, particularly for component based solutions build around progressive renovation rollouts.

So in summary, the demand has shifted somewhat from Europe to emerging markets, from new to existing customers, from traditional universal banking core replacement to business intelligence, channels and private wealth management. But I’m pleased to say that we’ve got the product set to capitalise on this change.

If you look across on slide six, we’ve tried to capture here the dynamics of the banking software market, so excluding treasury capital markets and insurance. In this diagram, the size of the bubble equates to the size of the market. The X axis shows growth of the market over a year period, starting in 2012, and the Y axis relates to competitive intensity. Essentially, the bigger the bubble, and further towards the top right the better.

What you notice first of all when you look at this slide is how well we now have this space covered, standalone lending being the obvious exception. The second thing you notice is what I was mentioning in my opening slide, the clearly diverging trends within the market. The traditional T24 markets of retail, corporate and universal remain relatively subdued, even if this remains the largest medium term opportunity, whereas all of the channels, BI, and wealth management are growing much faster.
In addition, within wealth management and channels especially, the market is not so heavily contested, and we believe we have an unbeatable proposition. In BWM (?) we can offer the banks the best of front and back office applications, decoupled, and therefore able to be implemented separately, offering the best time to value, and the lowest risk to value. In channels, we now have the best, and market leading user experience platform, which when put together with our banking capabilities, gives us a fully integrated, rich and interactive customer experience.

In BI, although a more competitive space, we believe our solution Insight is well-differentiated given its integration into core banking products. It’s built exclusively for banks. It’s built on Microsoft technology, and so it’s fully integrated within the Microsoft suite of desktop applications, and is more competitively priced. It’s a great entry point into new banks, and is a quick win for them, followed by a roadmap to rollout of other Temenos products.

Turning to slide seven, although licence revenues were down, the trend is reversing, and that’s very important, and against as tough comparative in Q3. From Q4, the comparatives become much easier, with Q4 2011 down 33%. Our execution was better in the quarter, helping us to control our revenues, costs, and cash flow. We saw seven go-lives in the quarter, taking the total to 31 go-lives year to date. We continue to lead the way in taking core banking into the Cloud, helping Fountain Credit Services to become the first institution in Kenya, and the second in Africa, to be running core banking services through the Azure Cloud. We won nine new customers in the quarter, slightly down on the year before, but materially up on Q2.

I’m also pleased to say that Temenos continues to be regarded by industry analysts as a leader in our market, and we advanced within the leaders’ category of the Gartner Magic Quadrant for retail banking systems. It’s the first year, for example, that we’ve been placed above Oracle.

Lastly, we’ve made the organisational changes which I signalled on the Q2 conference call. Essentially, we’ve moved to place much more emphasis on the regions. The regions are now responsible for their full P&L, and present a single face to the client across sales, implementations and support. This is the same model that worked so well in the past, and already we’re seeing the change bringing greater focus, accountability and execution. In addition, I’ve made significant progress in the sale and execution issues I talked about in July. Excessive layers of management have (made?) qualification criteria for deals, and our best people too far removed from the actual sales process. This has all been reversed, and we have a much more accountable and focused sales organisation.
The changes to the organisational structure come with changes to the composition of the executive committee. Mark Winterburn becomes a member of the executive committee, Mark Cullinane takes on the role of corporate development, taking over the M&A function as well as the broader remit of strategic partnerships, and Mike Davis joins the executive committee as head of services. All three of these are industry veterans, with a strong track record of success in our industry. In view of the changing structure, Bernd-Michael Rumpf and Temenos have agreed to terminate our relationship at the end of Q1 2013. We thank Bernd-Michael for his valuable contribution to Temenos over the past year.

Turning now to slide eight, I wanted to include a slide on partners for a couple of reasons. Firstly because I wanted to update you on the progress we’ve made with the programme. We continue to take up the number of partner consultants in the ecosystem, and more importantly, the knowledge of these consultants continues to improve. We measure this to the level of certification of the consultants, but more anecdotally, we know knowledge improves as partners take on more and more projects. At present, partners are involved in over 80 projects in more than 50 countries. In many instances, it’s the partner running the whole project, with Temenos just acting in an oversight capacity.

The second reason for including the partner slide is to signal that we are re-invigorating the programme. Temenos has remained committed to the programme, but I believe it’s status and importance became subjugated to the improvement in the Temenos services business. The two go hand in hand. Temenos is never going to have the scale to run projects all over the world. Nor is it our core competence. It is critically important that we make a clear demarcation between our role, which we see as increasingly around governance and expert services, and partners, who should do all the other work, including writing customer bespoke applications where applicable.

Looking now at slide nine, a year on year licence decline of 20% in the quarter represents an improvement in the trend seen every quarter for the last four quarters. And even though the comparatives were down marginally, Q3 2010 was an extremely strong quarter for us, up 38%. In other words, we’ve had two very, very strong third quarters, compared to any of the years before that, and you need to put the movement in the third quarter in perspective. Maintenance was resilient, growing at 6% on a constant currency basis, as would be expected given our very high renewal rates, and growth initiatives such as premium and on-site support are now starting to gain traction. Services continues to move towards our target model, as we continue to refocus on high value-add offerings like training and expert services, which are sold
into the base, and which make the business less dependent on new licence sales, as well as to improve margins and leave the majority of the business to partners.

We’re also making good progress with our cost cutting programme, with 80% of the 20 million targeted already locked in for next year. Max will update you on this in a minute. Consequently, we’re beginning to see the profit trend improve, with adjusted EBITDA falling 14% in the quarter, compared to 32% in the last 12 months. Lastly, we saw an operating cash flow of $11.4 million in the quarter, in what is normally a seasonally weak quarter for cash, helping to take our cash conversion, on an LTM (?) basis, to 164% of EBITDA. In summary, all of our key performance indicators are showing an improvement, which gives us great confidence in reiterating our outlook for the full year.

Turning now to slide ten, at the end of last month we announced the acquisition of edge IPK. This acquisition is now closed, and we will now consolidate the numbers for the fourth quarter. The effect here is immaterial, and so it will have no impact on earnings. This wasn’t a large acquisition compared to, say, Odyssey or Viveo, but it is very exciting and strategic for us. The market for software to help banks manage their channels is hot today. As with any retail business, bank customers want to consume products and services over their smartphones and tablets, and they want rich, compelling user experiences.

But banks are struggling, today, to offer this. The multiplicity of front and back office systems they use have made it difficult to keep up with the advances in multiple access devices, and to offer a rich and consistent experience. User experience platforms are the answer to the industry’s issues. UXPs are a completely new way for banks to go about developing user experience applications, introducing a presentation layer that allows the channel applications to be developed independently of other systems. As a result, it allows for much faster deployment, and a much more consistent experience, but without compromising security.

Edge Connect is the market leader of UXPs, and has a number of unique characteristics, such as the ability to develop an application once, and deploy across multiple devices. Banks using Edge Connect report a fivefold improvement in productivity. If you think of the possibilities of combining Edge Connect with the banking capabilities of Temenos software, the proposition becomes even more exciting. We’ve got very high expectations for this acquisition, which we believe will continue to contribute materially to revenues in 2013.

So with that, I’d like to pass you over to Max, to update you on the financials.
Max Chuard

Thank you, David, and thanks to everyone on the call for joining us tonight. Let me walk you through the finance updates for the quarter.

Looking at the slide 12, we show the different (working?) lines, and the profit metrics for the quarter for the last 12 months. I won't go through all of the numbers, but I will discuss some of the key figures. The main takeaway from this slide is that we are seeing an improvement in a numbers of key trends in our business. Licence renewals down 21%, an improvement from a decline of 38% in the prior quarter. In the quarter, the growth in the Middle East and Africa, as well as the Americas, was not sufficient to cover for weaknesses in Europe, and a strong comparative in Asia.

But you can see that the trend is clearly improving. The quarter is down 21% compared to a decline of 29% in the last 12 months. Our existing business is holding up well, and is growing by approximately 10% over the last 12 months. And as David mentioned, Q3 was the last difficult comparative, and from Q4 the comparatives get much easier.

Maintenance revenue was at 50.2 million in the quarter, up 1% on a reported basis, weighted down by currency movements. Maintenance revenue reached almost 12 million in the last 12 months. I'll discuss maintenance further on the next slide. Services revenue was down 10% in the quarter, compared to 21% drop in licence revenues, and down 7% in the last 12 months, compared to 29% drop in licensing that same period of time. These two present a solid result in Q3. I am sure that we are continuing to reduce the level of dependency of services revenues on new licences. We have been successfully upselling additional services into our client base, such as upgrades, extra services, and training, which is a trend we expect to continue and which will have, on the time, much improvement in the business. Adjusted operating costs are down 8%, as the effects of the cost cutting start to be seen. We will look at the cost in greater details on the coming slides.

Profit metrics are improving as well, the adjusted EBIT margin is down one percentage point, which compares to being down five percentage points over the past 12 months, as revenue trends begin to improve, and as we continue to take out costs. And finally, adjusted EBITDA margin in Q3 12 increased by .6 percentage points, driven by lower cash costs, which demonstrate our focus on taking cash costs out of the business.
On slide 13 now, we show the underlying business performance for both revenues and costs by adjusting for the impact of foreign exchange movements. Like for like total revenues decreased by 5% in the quarter, with costs down by 3%. With the (unclear) proportion of our licences being in US dollars, there’s little difference between the reported decline in licence revenues and the like for like numbers. However, there is a greater swing in both like for like maintenance and services, with a higher proportion of these revenues billed in euro, and the weak euro impacting the results on the reported base.

As a result, maintenance revenue actually grew 6% on a like for like basis, as we would expect, given renewal rates in excess of 97%, highlighting once again the resilience of the cash flow from this business. Costs declined 3% on a like for like basis, as we begin to see the benefit of our cost efficiencies plan announced last quarter. I will take you through this now on slide 14 and 15.

You will recognise slide 14, which we presented at Q2, and which gives details of our cost savings plan, which we generate 20 million in savings, but which will not impact our ability to scale for growth. I’m pleased to report that we are making progress on all the areas that we identified. In Q3 we incurred a restructuring cost of 5.4 million, and we now believe that with the costs of the restructure in 2012, we’ll be at the higher end of the range previously communicated of between five to ten million, as we are talking a larger proportion of costs out of the western Europe, which tends to be more expensive.

Turning to next slide, slide 15, I’ve broken down the 2013 cost base to explain how to bridge to our reconfirmed cost base for 2013 of $250 million, or now $360 million, including the costs related to Asia. I’ve calculated this by taking the starting cost base for 2013, taking off cost savings, and adding back in variable costs and costs related to Edge. I will now take you through each of these in turn.

Looking first at the top left box, Q3 saw fixed cost of approximately 84 million, and by multiplying this by four, we get to the starting point for the 2013 cost base of 334 million, illustrated in the left hand bar on the chart on the right. If we now look at the table on the bottom left of the page, we’ve already realised, in Q3, savings of 1.5 million, being six million of savings on an annualised basis. There is a further 14 million to come, as shown in the second bar on the right hand chart. Ten million of this 14 million is already locked in, which means that they have been already communicated to the employee. Taking the realised and locked-in figures together means that we’ll deliver a total of 16 out of the 20 planned savings, 80% in total. We expect to have the remaining four million locked in by the end of the year.
We will expect around 30 million of variable costs in 2013, shown as the third bar on the right hand chart. Add to this an additional ten million of costs relating to Edge IPK, which wasn’t included in our previous cost target, which is shown on the fourth bar. This then takes you to our projected cost base of 360 million for 2013. This significantly lower cost base should leave us well-positioned to deliver growth in profitability and cash for next year, even in a challenging environment.

Now turning to the next slide, slide 16, Q3 saw a strong operating cash inflow of 11.4 million compared to 2.3 inflow in the same period in 2011. This strong cash inflow, joined by tight control of the net working capital, have led to a cash conversion of 164% for the past 12 months. We are competent in achieving our full year outlook of 100% stated EBITDA conversion, which we’ve delivered for the last three years. You can take comfort in this by taking the year to date operating cash flow for 2012, and then Q4 implied EBITDA, and then I think the reversal of the Q4 deferred revenue movement which happens every year as we collect the majority of our maintenance in the fourth quarter. For reference, last year in Q4 we collected (unclear) million of maintenance.

Finally, slide 17 now shows our net debt at the end of Q3, or 131 million including treasury shares. By the end of 2012, following the strong maintenance related cash inflows in Q4, our net debt will be less than one times EBITDA. That’s the end to the financial update part of the presentation, I’d like now to hand it back to David to discuss the outlook.

David Arnott

Thank you Max. If you turn now to slide 19, since starting as CEO I’ve conducted a thorough and deep review of the fourth quarter pipeline. The quality of the pipeline is improving, in all geographies, and across all products, giving additional confidence that we’ll be able to deliver our forecasts. To give you some colour on this, over half our pipeline in the fourth quarter is our installed base, and the biggest components are deals coming from business intelligence, private wealth, the Middle East and Asia. Combining these things together gives me great confidence in meeting our outlook for the full year.

Finally, if you turn to slide 20, let’s remind ourselves of the full year outlook, which we’re reiterating tonight. We still expect constant currency revenues of between minus 5% and plus 1% compared to 2011, which equates to a slightly higher range of 438 to US$466 million. We’re still guiding to an adjusted EBIT margin of 19 to 22%, which now equates to a range of 83 to $103
million. And lastly, as Max has said, we still expect to convert at least 100% of EBITDA into operating cash flow for the year.

So, to summarise, we’re seeing reversing licensing trends, we’re executing better, we’re right-sizing the cost base, and we’re still generating great cash flow. The sales organisation is being realigned with the new strategy, being heavily simplified, and much more focused. If you combine all that with the strength of our pipeline, we feel confident, today, in reconfirming our outlook for the full year.

So with that, Operator, that ends the formal part of the presentation. I’d like to open up the call for Q&A please.

Questions and Answers

Operator

Thank you. As a reminder, if you would like to ask a question, please press * 1 on your telephone and wait for your name to be announced. If you would like to cancel your request, please press the # key. Your first question comes from Takis Spiliperos (?). Please ask your question.

Takis Spiliperos

Thanks for taking the question. David and Max, the first one would be I was surprised that you mentioned that you saw a pickup in activity in core replacement markets. Could you elaborate a bit more on that, you know, a bit more specific in terms of regions or, you know, which, which tier banks would go this way? And the second one, an update on the service margin target, now that I would say the former head is on his leave out, what is the target, let’s say, for the medium term, 2013 and 2014, in terms of profitability? Thanks.

David Arnott

Thank you Takis, I was beginning to worry we weren’t going to get a single question there, so thank you for that. Listen, on the core replacement cycle, there’s a couple of data points. First of all, two organisations, Gartner and Boston Consulting Group have both signalled in the past
couple of weeks that they’re seeing very, very early signs of activity, largely in the tier one space, they’re being engaged by a number of banks to talk about the landscape, what systems are available, and we’re starting -- I carefully say starting, to see some very early signs of banks looking at component based solutions around areas like payment, but I hasten to add this is very, very early, and not something we should, any of us, take into our numbers at this stage.

Max Chuard

Hi Takis, it's Max, this is taking the second one. Mid-term service margin still remains at under 10%, as we’ve committed in the past, and clearly we need to spend much more time on that during the investor day, but the main driver, twofold, first is the change of composition of the services revenues, which is much more with high end services like upgrade training, and specialised services people. And secondly, as well, the action that we are taking on the cost side, which basically puts an infrastructure which is much more competitive from a cost point of view. So those two drivers together clearly will drive margin improvement then on services for the medium term.

Takis Spiliopoulos

Okay, medium term meaning two to three years, or rather on a two years basis, or what about (overtalking)…

Max Chuard

Medium term for us is three years, Takis.

Takis Spiliopoulos

Okay, thanks.
Michael Bryst

Great, thank you. Just going back to Bernd-Michael’s departure, I mean, I thought he was doing a good job on the services, from what we heard at the analysts meeting. I mean, what are the regional changes or structural changes that mean he couldn’t continue in that role? And then secondly, just on the cost savings in Q4, obviously you’re sort of hammering down the cost basis for 2013, I’m just wondering if there was good demand and strong licence growth, what sort of further investments you’d have to make in sales capacity to support that, because, you know, if licences bounce back 20% next year, I’d be surprised if you could support that growth on that sort of cost base. Thanks.

David Arnott

Michael, thank you. It’s David, I’ll take those. So regarding Bernd-Michael and the services story, let’s not forget, under Guy’s model, Bernd-Michael was brought in with a remit to run global services, global reusable development, and global maintenance, which was approximately half of Temenos today. I believe fundamentally it’s important to move back to a regional model. If you go back to Oracle, one of our board members is on the board of Oracle, sorry, was a senior member of Oracle management in Europe, he said that Oracle was a $5 billion business before they moved away from a regional model.

The benefit of a single unit operating as one in front of the customer, able to position services, support, sales, account management, has huge value, whereas operating on a silo basis, at this stage of our evolution, I fundamentally believe is the wrong structure. What this means is the significant authority goes back into the regions, and the corporate roles very much become the support roles, for example services is about ensuring adherence to methodologies, it’s around building expert services.

We have very, very strong people in the regions, all of our regional services directors, manage, maintenance directors have been long in the industry, they’re more than capable as delivering as part of a region, but from Bernd-Michael’s point of view, the role changes. Bernd-Michael has
added a huge amount of value, for which we’re very grateful, in the year, but I can understand why this role, this change of role would be a challenge, and the model we’re moving to today has great strength in the regions, it’s already adding a lot of value, it proved very, very nimble, very scalable, until we changed it 18 months ago, and let’s not forget that from Bernd-Michael, and from the people we have running services and maintenance division today, we have very, very strong people.

Mike Davis has been in the industry for 26 years, he has turned around Temenos services since taking over, he has been mentored a lot by Bernd-Michael, and we bring with him and his organisation, which includes a number of ex-Oracle people, some very, very heavyweight services people, there to support a regional model. So nothing changes about our strategy. The regional model is the way to go. We need stronger support than we had before, I would say the central support, last time we had a regional model, wasn’t as strong as it could have been, and we’ve learned from that, and we’ve strengthened it.

So I wouldn’t say the pendulum was going back all the other way, we’re trying to find a balance which, in today’s environment, meets the demand from customers to operate as a single unit that also has some strong centralisation. So nothing has changed about the services. One thing I did try to highlight was the importance of our partner channel. As a company, and this has been a corporate direction over the last 18 months, we have, I would say, not focused on the partner channel as much as we could have done, in building services into a profitable standalone business, we ostracised, a little bit, the partners who’d been investing heavily in T24 and other product skills, and if you look forward today, key to our ability to scale on the services side is the use of the partner channel, and looking beyond that, key to leveraging sales is engaging the partners for lead generation.

So you have to look beyond turning services into a profitable business, into the overall picture of Temenos to put services back in perspective, if you like, and I think as a company, and as a management team, we lost sight of that a little bit in the last two years. So I think there’s a lot greater clarity of the organisation now, there’s a lot greater clarity of go to market, and we’ve learned a lot over the last, I would say, two and a half years, in terms of fine tuning the balance between regional and corporate.

The second part of your question, I think, was related to our ability to scale on the sales side. If you look today, we, I would say, Temenos has gone through two shifts. In 2001 we were really a private banking vendor. We saw a shift, straight after IPO in 2002, when the market moved towards universal banking. It took us 12 months to understand and react to that, when we had
basically a sales organisation that were really focused on selling to private banks. Then we went through eight, nine years of very steady growth in universal banking, and I believe what we’re seeing now, what we’ve seen in the last 12 months, is another shift, a similar shift to what we saw eight years ago.

Banks today don’t want two to three projects with four to five year paybacks. They understand the structural need for it, the regulatory pressures are there, the competitive pressure is there, but in the short term, they just can’t sign off on those type of budgets. And with such a long payback, especially in regions like Europe. So whilst emerging markets is good because of the growth drivers, a large part of our business has moved away from our core area, if you like, into quicker projects, quicker wins, new front ends, new channels, business intelligence that allows the CEO, CFO to drill down quickly. And our sales organisation needs realigning towards that model.

The amount we spend on sales, which is 20% of revenues, is more than enough to meet the new demands. We shouldn’t get confused between the medium term drivers, which is universal, and the probably next one to two years until the core market comes back, when there’s fantastic opportunities, with the products that we’ve got, to capitalise. So I don’t think it’s a funding constraint. We spend more than enough on sales and marketing to meet that demand, it’s more of an organisational challenge to move the sales organisation towards the products the banks want to buy today.

And that’s probably the thing I’ll update you on every quarter, so I’d say it’s a much more of an operating challenge than a financial challenge. There’s nothing around our level of sales investment today that, by recycling that same investment, with different skills, would constrain us by growing by at least whatever we guide as next year’s outlook for sales.

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**Michael Bryst**

Thanks.

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**David Arnott**

A bit long, but I hope that helps.
Michael Bryst

Yes, that's great. I mean, just a final quick one was on the DSOs (>). I mean, they had stepped up in the quarter, they've been on a nice downward trend for a few quarters now, is there anything particularly behind that, and what should we be expecting for it, at year end?

Max Chuard

Okay, I mean, this was clearly, you know, this is an item, the DSOs, and you would expect DSOs to go up in Q3. Clearly, in Q4, you see them going down, and, you know, by what we've said in the past, at around (five days?) compared to last year, so I will expect the DSOs to end up at around (97 days?). There's also some forex to take into account, around three days in the quarter, but having said that, to deliver the 1% EBITDA conversion, we expect, basically DSOs to go down by (five days?) compared to last year.

Michael Bryst

Okay.

Operator

Your next question comes from Joseph Bullery (?). Please ask your question.

Joseph Bullery

Hi, good evening, thank you very much for taking my questions. I'll ask two, if I may. The first one, just on the performance, you talked about execution issues in the last quarter, and you mentioned some slippage, and you mentioned that one of those deals had been closed by the time of the conference call, so could you give us some details in terms of the nine wins this quarter, how many were spilled over from Q2, and are there still any deals from Q2 are outstanding?
And then secondly on the partner strategy, you gave some compelling metrics in terms of the number of projects where they are involved, but could you maybe indicate what was the partners’ contribution to licence revenue in this Q3, please.

David Arnott

Okay, Joseph, so… listen, I’ve been in the job ten weeks. Sales execution has many, many aspects to it. One is simply short term, better focus, delayering, all the things I talked about. We’ve made a lot of progress on that, but the next stage obviously is upskilling, upskilling the organisation. Now, we’ve brought in some very senior heads to run two or our regions today, I’m in the process of bringing in some more, so it’s a gradual process.

I never said, or I never intended to say that execution would be perfect immediately. Yes, we did have a good start to Q3. It could have been better at the end of the third quarter, it can always be better. We’ve had a good start to the fourth quarter again, the sales cycle is still difficult to read for many banks, so… I think it’s going to take another one to maybe even third quarters to get sales execution to the point where we’re signing a good steady 70% of what we had in forecast at the end of the quarter. So we’ve made a lot of improvement, we had a good third quarter.

Just to be clear: the third quarter was in line with our expectations, it was a reversal of a trend against a very, very tough comparative, it ticked all the boxes in terms of win rates, pricing, beating competition. It’s not like we got there with one big deal in one geography that has been taking two or three quarters to close out. Solid execution across all the areas I’m looking at, but it’s not perfect. It’s frustrating that a couple of deals that signed at the start of the fourth quarter didn’t come in in Q3, but that’s life in software, unfortunately. We hope it will get better in the fourth quarter, and I would certainly hope that over the first couple of quarters of next year, as we really take the sales organisation to the next level in terms of the management capabilities, the closing skills, and more importantly the processes, that the productivity continues to improve even further.

But we’re happy with the third quarter, it ticks all the boxes, it could always be better. Let’s look forward to the fourth quarter.
Joseph Bullery

Okay, excellent. And with regards of the contribution of partners to the licensing I was talking…?

David Arnott

Sorry, okay. Listen, very little. To put in context, step one of our services partnership is really about scaling for services for implementations. That is happening very well, lots of data points around new projects in the third quarter being picked up by partners, but very firmly step two of the partnership is about them bringing leads. So very little contribution in the third quarter to partner led deals, they were mostly direct.

Joseph Bullery

Okay, thank you very much.

David Arnott

Okay.

Adam Wood

Hi, thanks for taking the question. Hi David, hi Max. I’ve got three smaller ones please. First of all, on the services businesses, do I understand correctly that the three years, which is a relatively long time frame to get the business back to the profitability you want, that’s basically because you
need to get the partners engaged again, and need to give them business, and that kind of slows the recovery of your own services business to enable that to happen?

Then just secondly, as we look in the change in the model in Europe, and you move more to cross-selling products into the installed base, how do you think about that from a deal-sized perspective. Is that still something that's very easily sellable with a direct sales model, or does that maybe imply some change as to how you go to market to the installed base in Europe to cross-sell what may be smaller deal sizes.

And finally, just as you think longer term, you're obviously selling into a lot of different countries, does the R&D budget enable you to keep all of those products current in all of those markets, and develop the product the way you'd like it, or do you maybe make some decisions around all of the markets you go into? Thank you.

David Arnott

Okay, thanks Adam, great questions. So three year services margin, I think the biggest constraint there, if you look at where we were two years ago, we were licence junkies. All of our services came from licensing, we would do everything on a project from data migration, user training, printing screen manuals, low-margin business, and going forward to the steady state, if you like, we're about, I would say, halfway through.

The first thing that happened is we consciously passed that business off to partners. We took it back a little bit in-house in the last 12 months, but the (unclear) that I make there is that there was less business to go around. And what has not yet caught up is building the extra type of services we should be doing. So we should not be at the point where 80% of our revenue is services driven by licensing. We should be at the point where we're able to sell expert services, education courses, training to partners, on-site support, much more high margin, much smaller scale, closer to the product, so senior technical people, for example, senior business people, and that is high margin and should probably give us time until, until (unclear) to quantify this publicly, but you should be seeing around 20% of your revenue coming from that high margin business, and it's not there yet.

So at the moment, we consciously pass business off to partners, against the declining licence number, so a lower attach, and then you have services to give to anybody, and we're not yet at the point where we're able to backfill that with the type of services we'd like to be doing. We're
making good progress on them, but we’re not there yet. So really, looking three years out, that’s what drives the margin improvement. And also, around leveraging a fixed cost base, there’s a large fixed cost component into a services business which is our size, which obviously provides a lot of natural leverage in a low margin business, just by adding a little bit of this expert services stuff.

And secondly, the selling, selling the new products, I think you specifically talked about Europe, but I think it’s also a global issue. We have a large proportion of our sales headcount focused on account management. We believe that the majority of the sales for those comes through account management, and that really goes back to one of the earlier questions, I think it was Michael’s, around having a sales organisation that is adequately able to sell different products. So I will believe that the main sales channel for these products is direct. We may use partners for some of them, certainly Edge, for example, some of the channels. But I think the biggest challenge here is, if you think about it, the front and the pricing, or the deal size for a front office system can be, and should be, as much as the whole back office system.

The challenge, I think, it’s so much of the go to market on who sells it, it’s how do you not cannibalise your price if you go in and sell the front and the back, or how do you not lead with a discounted front to get access to the back. So if we can hold our price on the front, and the BI, and the wealth, then I think there’s a massive opportunity, which is at least as big as the back, and I think primarily, certainly for the first year, 18 months, it’s going to be a direct model.

As I said earlier to, I think it was Takis, his question, there’s more than enough sales investment to go around, and my biggest challenge on the sales side, now the low hanging fruit is done on the process is, is around realigning the sales organisation to be able to sell these new products. I’m making some progress on this, I don’t want you to think it’s something I haven’t thought about yet, we’re making a lot of progress in terms of realigning the sales organisation, but we’re not there yet.

I would think it’ll probably take another two, three, maybe four quarters before our sales organisation organically can position all the new product offerings we’ve had. We might seek a bit of help in partners, but that’s not our base case.

And can you just remind me what your third question was, I can’t read my own scribbles here.

_____________________________________

Adam Wood
Yes, sure, sorry David. It was basically just about the R&D in the longer term, that you're targeting a lot of countries, it obviously implies, kind of, the regulatory updates and compliance to keep the product in compliance with all of those markets. Given the R&D budget the company has, is that something you feel is sustainable, that gives you room to do that, and develop the product in the way you’d like to, and particularly with the add-on products that you’re moving into as well?

David Arnott

Okay. First of all, we continue to spend a huge amount on R&D. That percentage won't go down in the short term. Provided you spend that money wisely, and you don’t leave pockets of expensive developers in the location where you acquire the businesses, there’s a huge amount of productivity improvement still to come out of our R&D base in terms of features and functions for the R&D spend, if you like. So we started this, and Max talked about where the R&D spend cuts come from. It’s really about offshoring and nearshoring the development of certain product offerings, whilst maintaining, obviously, our onshore capability around the core design.

And that is more than enough money to develop all of the product roadmaps that we’ve got, around BI, wealth, channels and T24.

Max Chuard

And let me just, let me add to that, Adam, that the investment has been made already in the last 15 years, (unclear) so really that, I mean, in more than ten countries. So basically we’ve built the four T24 components for those local platforms, and so if you want, an early (unclear) has been made already on that side.

Adam Wood

Maybe just a follow up, what kind of percentages are you talking about in terms of onshore versus nearshore and offshore, just to give us a feel for how much of that, how much benefit there is still to come on that side of things?
David Arnott

Okay, listen, let's do that in a structure, Adam, if we can do that in a structured way.

Adam Wood

Sure.

David Arnott

We'll have an analyst day. Maybe 20% isn't the right percentage medium term, but let us keep this up our sleeves for a couple months until we can quantify that properly. I think the bigger challenge is not so much around the core product. I think in addition to the, realigning the sales organisation, our second biggest opportunity is around working out which countries we want to focus on, from a sales coverage point of view, from a reusable country platform point of view, it's not just a case of taking the core product and installing it.

If you put a lot of effort in the services and development organisation into targeting the countries with real medium term opportunity, maybe it's structural drivers around regulatory change, or consolidation, and you really build up a rich country layer. For example, Canada now, we've got a great country platform where we can be live in half the amount of time that it took before. We did that because we believe it's a strong market. Every time you go to a bank in Canada, you can say we'll have you live in half the time that you did before. I think if we can really focus the country layer, both from a sales, services, and development point of view, around focusing on the countries with the best opportunity in the medium term, which obviously has an emerging market slant in the short term, that's much more of an opportunity on top of the R&D spend.

Adam Wood

Great, thank you very much.
David Arnott

Thank you. And the last question now from… maybe take one more question? I'm conscious that my answers have been a bit long.

Operator

Okay, your next question comes from Michael Studor (?). Please ask your question.

Michael Studor

Yes, thank you for taking my question. Just quick ones, three of them. First of all, maybe can you give us some indication on your 40 million cost cuts, where it should take place, and also why channel and admin was, let's say, rather high compared to Q2, after being some one-offs in there, termination fees. That's my first question. Then maybe on the tax rate, can you give us an indication what we should think of the tax rate for the full year 12, and also 13. And the third one, you've given us the split between existing and new customers in Q3, which is very grateful, can you give us some indication where Q4 11 was, and how you would think of Q4 12, the split between existing and new customers. Thank you.

Max Chuard

Hi Michael, it's Max. Listen, first of all, it's 20 million of cost reduction that we are going for, it's not 40 million. And as I said, 16 of that is already locked in, and by the end of the year we should have, we should be done by that. The 20 million is coming from across the board, sales and marketing, G&A (?), R&D and services, and even I spent a bit of time last quarter on that, and if you refer to slide 14 you'll see quite a bit of information. But it's around simplifying the structure obviously consolidation, and on the R&D side maybe efficiencies from our position offshoring and nearshoring of people. So if you want that, the first part of your question.

The second one, regarding the G&A cost that you see, which is an increase to Q4, it is an increase on a reported basis only, if you want in the quarter the 5.4 million of restructuring costs
are mainly related to G&A, as we had some senior members of the company that left, and the 
cost of those were part of that. So this is why the G&A is higher in Q3. You’ll see on Q4, going 
back inline with the trend.

Now, for the tax rate, the tax rate, you should expect a tax rate of 17 to 18%, going forward I 
would say for 2012, where we still have, I would say, an amount of restructuring, which is quite 
high, it does impact the full EBIT number, and that’s why, as a company, we do have a fixed, if 
you want, level of cash back, around 10 million for the year, so I would think, for you more, then I 
will guide you more a dollar amount for this year of around 12 to 14 million on the TML (?) around 
10 million on the cash basis.

Now, I’ll leave David for the last question.

David Arnott

Okay, very good, Michael, a quicker answer this time. I would expect approximately 50% of the 
fourth quarter licence revenue to come from new customers, and approximately 50 to come from 
existing customers.

So with that, thank you very much everybody for your time this evening. Hopefully that was 
useful, I look forward to speaking to you after the end of the fourth quarter. Bye bye.

Operator

That concludes the conference for today. Thank you all for participating. You may now 
disconnect.