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Q3 2024 Trading Update

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COMPANY REPRESENTATIVES

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PRESENTATION

Engvall Anna

Good morning, and thank you to everyone for joining SoftwareOne's Q3 2024 trading update. I'm Anna Engvall, Head of Investor Relations at SoftwareOne. Joining me today are Raphael Erb, our CEO, and Rodolfo Savitzky, CFO. In terms of agenda, Raphael will kick off with his initial perspectives and priorities as new CEO of SoftwareOne and a summary of Q3 2024's trading. Rodolfo will then take us through our financial performance. We will finish the session with Q&A, as usual. Before handing over to Raphael, please let me draw your attention to the disclaimer regarding forward-looking statements and non-IFRS measures on slide three. With that, I'll hand over to Raphael.

Erb Raphael

Good morning, everyone, and thank you for joining the call. Before diving into the Q3 numbers, which are fully in line with our pre-announcement last week, let me start with my initial perspectives and near-term priorities. I joined SoftwareOne 25 years ago as its fourth employee, and I very much care for this business. I had leadership positions in both of our divisions and in several important markets. I built our business in Asia-Pacific, which has consistently been our fastest-growing region. It grew 24% in Q3.

SoftwareOne clearly has a large market opportunity and a very solid foundation. We have an unparalleled global presence, strong recurring revenue streams, and deep partner relationships. But recently, we have lost customer focus, as demonstrated by the mismanaged implementation of our new GTM model, which led to sales execution issues and disappointing results. We have identified the key issues, and we will implement a plan around three key priorities.

Firstly, we will resolve the execution issues related to the GTM, a model which I fully endorse because it means enhanced focus on client needs. In markets where it has not yet been implemented, we will adopt a phased approach. This will lead to an approximately six-month delay versus original plans. Secondly, we will make changes to ensure that, as a company, we put customers at the centre. SoftwareOne is a value-added reseller and service provider. However, we have recently developed more towards a top-heavy product-like organisation. That was the wrong direction.

For one thing, we cannot afford it, and it reduces the speed and agility that are essential to our business.

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Our customer engagements are mainly happening in our 60-plus country organisations, hence we are going to empower them while we hold them accountable for the P&L within their markets. And we are going to simplify some of our processes towards the customers.

Thirdly, and this is related to the intended changes I just explained, we will execute on a 50 million saving programme. We will start at the top, reducing the executive board costs by half in 2025 versus 2024. We are going to reduce management layers, keeping corporate and overhead spend lean, focused mainly on governing our organisation. And we are going to focus our investments into sales and service delivery capabilities, which are needed to serve our customers with excellence. Addressing these issues is critical to our success. We have identified 17 million in annualised savings that will be realised already in Q4 2024. Rodolfo will go into more detail later on. I am confident these actions will put us back on the right trajectory.

Let's now go to the next slide and look at our performance in the third quarter. We delivered 3% revenue growth in Q3, below our own and market expectations, in a challenging environment. Contribution margin grew 5%, demonstrating strong progress in our core operations. The adjusted EBITDA margin was 16.6%, down four percentage points compared to prior year, mainly reflecting the lower-than-expected growth.

The underperformance in Q3 was driven by a combination of factors. The rushed implementation of our new GTM model from July 1st led to challenges with sales execution. Mainly due to this disruption, but also due to the macro environment in certain markets, we did not effectively respond to the shift in incentives as done in the past. We are taking decisive action to address these issues, which I will go through shortly, but first, let me dive deeper into what happened in each of our regions.

It's a mixed picture. APAC continued to deliver great results with 24% growth. We have excellent teams in the region, and we will continue to invest there. Our recent acquisition of Medalsoft in China, a leading Microsoft AI Copilot partner, will help us accelerate and deliver business outcomes to our clients and further strengthen our partnership with Microsoft. In APAC, we did not rush into the GTM transformation, deciding to do it gradually instead, with the aim of having it fully implemented by the end of 2025. DACH grew by 11%, supported by several key client wins in the large enterprise and public sector segment at the end of the quarter.

Our results in other regions were disappointing. NorAm was down 15%, following the Big Bang approach to the GTM implementation.

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A large part of our sales force transitioned into new roles or left the organisation, and client accounts were reshuffled. We had similar GTM issues in the UK and Mexico, which impacted results for the rest of EMEA and LatAm.

Turning to our business lines, software and cloud marketplace revenue was broadly flat in Q3, with lower Microsoft revenue offset by growth in other ISVs. Microsoft billings grew nearly 7%, while revenue declined as we did not effectively respond to the incentive shifts, as previously explained. We added another 120,000 Copilot users, and also maintained good momentum on the services side. In other ISVs, we delivered double-digit growth in Q3, driven by an increased focus on our prioritised partners. Services delivered over 6% revenue growth in Q3, driven by cloud services. This continues good progress on AWS, where we grow close to 50%, year to date. SAP services grew by over 50%, driven by a number of large deals.

Now, let me elaborate more around the evolution of Microsoft and its channel incentive programme, which has recently been the subject of attention. As the quote from David Smith, VP of Global Channel Sales at Microsoft, underlines, we have a strong and trusted relationship with Microsoft, spanning over 30 years. We are one of Microsoft's largest commercial partners, both in terms of revenue and customer base. We are one of their leading CSP partners, as well as managed Azure cloud content consumption partners.

Microsoft reduced their partner incentive programme on a yearly basis and aligned it towards their priorities. This is nothing new, and something we are used to managing. Overall, it's important to note that Microsoft keeps investing and even increasing the overall incentive pool to the channel.

As you can see in the graph, it's public information that, in 2024 and going into 2025, Microsoft has reduced incentives related to enterprise agreements. Meanwhile, Microsoft is shifting attention and increased fundings towards the cloud consumption-based vehicle, CSP, and pre-post [?] sales-related services activities. This plays to our strengths as we have strong value-added services and CSP solutions offerings which we can scale across the world, given our unparalleled global presence and global sales force. Hence, we are confident this represents a continuous growth opportunity for us.

For 2025, given our exposure on enterprise agreements, we see a potential negative growth impact by two to three percentage points of total revenue, after which it will be bottomed out. As mentioned, there is an opportunity to mitigate this impact, as we have done in the past. We will continue to pivot towards CSP, gain market share, and drive the cross and upsell motion.

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Fundamentally, it's all in our hands, and all comes down to sales execution, agility, and successfully landing our GTM transformation.

We need to improve sales velocity and gain customer closeness. This is the purpose of our GTM transformation. Given we have a very diverse client base, the foundation of the GTM model is having dedicated sales teams focusing on each of our client segments. As you can see on the slides, they are enterprise, corporates and SMEs, along with a dedicated vertical for public sector. Public sector is around 14% of our overall business, growing nicely, and a vertical where we see lots of potential and further growth opportunities.

This coverage model is the right approach, simply because an enterprise client often has different requirements compared to, for example, an SME client. Our overall portfolio includes services and solutions specifically tailored towards enterprise clients, and others for corporate accounts and for SMEs. Therefore, having dedicated teams, knowledgeable and focused on addressing the unique needs of each client segment, is both logical and beneficial. This strategy will significantly support our overall mission to regain client-centricity.

The transformation is the right thing to do, but the Big Bang approach taken in implementing the new model in many markets was not. It was done too fast, without appropriate transitions. Within a very short period of time, we had redefined roles, transitioned employees, and reshuffled many client accounts.

So what have we done to resolve the issues? First and foremost, we are taking all the learnings to ensure we don't make the same mistakes for the remaining markets. Now, we are taking a phased approach, with clear accountabilities during the transition, as we are executing in APAC. Safeguarding client relationships is our priority. In the countries negatively impacted by the implementation, we are committed to closely engaging with our customers, ensuring we have the right people in the right place to service them successfully. We are focused on revitalising our sales efforts and generating new pipeline opportunities. We have also implemented a business management cadence to review progress action changes where necessary, and ensure we are moving in the right direction. Unfortunately, it will take some time to fully get back on track. Our estimates indicate it will take up to approximately six months.

On a different note, and before handing over to Rodolfo, I would like to mention one important appointment we have announced today.

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Oliver Berchtold will be taking on the role of President of Software and Cloud and Member of the Executive Board. Oliver joined SoftwareOne in 2004, and is currently Regional Service Lead DACH. At the same time, on behalf of the entire Executive Board and Board of Directors, I would like to thank Bernd Schlotter. Bernd has been instrumental in scaling out our services business and driving efficiencies in our delivery network, and we wish him all the best. With that, I hand over to Rodolfo, who will take us through our financial performance in Q3.

Savitzky Rodolfo

Thank you, Raphael. I'd like to start by extending a warm welcome to everyone joining us today. Let me first provide an overview of our financial performance at the group level. In general, our Q3 results fell short of both our internal targets and market expectations. Revenue grew by 3.1% year over year, on a constant currency basis, with mixed results across the regions, as Raphael explained.

With our ongoing efforts to streamline delivery costs, we overcompensated for portfolio mix changes and increased our contribution margin ahead of revenue growth, reaching 64.9% in Q3, with 1.4 percentage points above prior year. As the expenses rose by 15.2% in Q3, mainly driven by higher sales costs, our adjusted EBITDA margin was 16.6% for the quarter, a decline of four percentage points compared to the same period last year, largely due to slower-than-anticipated growth. I will go into further detail on the EBITDA building blocks on the next slide.

Foreign exchange fluctuations, particularly the appreciation of the Swiss franc against the euro, US dollar and Brazilian real, led to a negative forex translation impact of 1.7 percentage points on group revenue. Thanks to our natural hedge with similar forex exposures in expenses, the impact on the adjusted EBITDA margin was once again minimal.

These slides provide a detailed view of the year-on-year changes in adjusted EBIT. Marketplace delivery costs improve compared to prior year. In services, delivery costs remained almost flat, despite the higher volumes. Service delivery has benefited from insourcing of resources and optimisation of our global footprint, while marketplace delivery has continued to optimise its processes. Increased sales in marketing expenses reflect our investments in the new Go To Market model across all regions. In addition, admin costs also increased, driven by a combination of one-off costs, including some legal provisions, and the build-up of new teams over the last 18 months.

Moving on to the business line view. In marketplace, revenue grew by 0.4% in Q3, and 4.4% for the first nine months.

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Revenue growth in other ISVs remained double-digit for Q3 2024, offsetting the decline in Microsoft revenue. Increased efficiency in our delivery operations contributed to an improvement in contribution margin, reaching 87.3% for Q3 and 88% for the nine months, up by 1.2 and 1.7 percentage points respectively, year on year.

The adjusted EBITDA margin for the quarter was 43.8%, down 8.4 percentage points from the prior year, reflecting increased sales specialists and the overall increase in sales results as detailed in the prior slide. And this is part of the Go To Market model. Allocations also had a negative impact on marketplace for the quarter. May I remind you that, as highlighted in previous earnings calls, business line adjusted EBITDA margins fluctuate quarter to quarter, due to the allocation of some savings in admin costs based on a combination of contribution margin and revenue.

In services, Q3 growth was primarily driven by AWS Cloud and SAP services. We achieved a notable increase in contribution margin, reaching 41.9% in Q3 and 43.1% for the nine months, an improvement of 2.8 and 4.1 percentage points respectively, year over year. SG&A increased at a lower rate than contribution margin for the nine months, mainly reflecting a reduction in sales specialist resources as part of the GTM model. Allocations were also favourable, resulting in an adjusted EBITDA margin of 6.4% for the nine months, four percentage points up from last year.

I would now like to provide more detail on the 50 million cost reduction programme we are implementing. As mentioned by Raphael, the purpose of the program is to restore client-centricity and drive sustainable, profitable growth. To achieve this, we are reducing corporate costs and eliminating unnecessary management layers in our commercial teams to drive sales productivity.

This year, we are targeting annualised savings of 70 million, with the full cumulative annualised 50 million planned by end of the first-half 2025. The measures imply reducing our sales costs from the current level of 25% of revenue to around 22% by 2025, in line with our glide path of delivering 21.5% ratio by 2026.

As previously communicated, based on our Q3 performance and outlook for Q4, we have revised both our 2024 and mid-term guidance. We now expect 2024 full year revenue growth of 2% to 5%, down from the 7% to 9% guidance communicated with the first-half results, and an adjusted EBITDA margin of 21% to 23% of revenue, reduced from the prior 24.5% to 25.5%.

To explain this change, I'd like to outline the moving parts.

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While we anticipated a negative impact of a shift in vendor incentives, we were initially confident that our GTM transformation would accelerate revenue growth to achieve our 7% to 9% growth for the year. However, the GTM-related sales execution issues, coupled with a more challenging market environment, resulted in a slowdown in growth.

The new margin guidance of 21% to 23% for the year mainly reflects the reduction in revenue growth, partially compensated by the annualised savings of 70 million from our new cost-reduction programme. We have also adjusted our 2026 targets to double-digit revenue growth from previously mid-teens, and an adjusted EBITDA margin approaching 27%, from previously 28%. This revised guidance for 2026 reflects the delay in the full implementation of our GTM. And now, I'll hand back to Raphael for closing remarks.

Erb Raphael
Thank you, Rodolfo. So, let me briefly summarise. We are operating in a very attractive market that is growing above double-digit. And SoftwareOne, despite the recent issues, our business model is the right one, and we have the right strategy. We have what it takes, and our focus now has to be on execution, execution, execution. At the same time, we will be implementing our plan to deliver at least CHF 50 million in cost savings.

As I highlighted earlier, the approach here is not just about costs. It's about the right mindset. It's about the right balance, strengthening the customer frontline, empowering the country organisations, and realigning overhead costs to a more customer-centric organisation. Let me close by saying that I'm convinced that our mid and long-term growth and profitability prospects remain absolutely intact. With this, I'll now hand back to the operator for the Q&A session.

QUESTION & ANSWER

Operator
We will now begin the question and answer session. Anyone who wishes to ask a question may press star and one on their 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 star and two. Questioners on the phone are requested to disable the loudspeaker mode and eventually turn off the volume of the webcast while asking a question. Anyone with a question may press star and one at this time. Our first question comes from Michael Briest from UBS. Please, go ahead.

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Briest Micheal

Good morning, thank you. Rodolfo, I guess a question for you, because you were on the interim results call in August, and I think you yourself said that you expected acceleration in the business in the second half of the year. Can you sort of say what happened in September that was so dramatically different from that outlook? Because the Go To Market changes would already have been in motion at that point. And then also, in terms of the cost savings of 50 million, how much will it cost you to achieve this, the one-time expense? And what are your expectations for cash flow in the next two to three years?

And then, Raphael, just a question on chart 12. It was very useful to see that. From my eyesight, I would say that your EA exposure is more than 2% to 3% of revenues, just looking at that. Are you already assuming some sort of amelioration or mitigation of the loss of revenues within that 2% to 3%, or is that explicitly the revenues that are exposed, and the chart's just a little bit off of scale? Thank you.

Savitzky Rodolfo

So, Michael, thanks for the questions. In terms of the visibility of the reduction in growth associated with the Go To Market implementation, as mentioned when we were finished the first half results, we thought we had a clear expectation that a good implementation of this commercial model will help us accelerate growth from the 7% that we finished the first half.

Around August, when we presented the numbers, we had visibility for July, the first month of the quarter, which was an okay month. It was fine. And then as we progressed during the quarter, we had mixed results. And clearly, particularly, August was relatively soft. And then we had expectations to see a rebound in September. I have to say, when we closed the month, there was a gap, a big gap, compared to expectations, obviously. And that, together with what we were seeing around some key markets, like the ones mentioned by Raphael, NorAm, UK, Mexico, that led us to carefully assess the forecast for Q4 and led to the guidance revision.

I think as far as the restructuring costs are concerned, we expect to book around 15 million this year, and roughly around 10 million next year, associated with the 50 million savings. And then, in terms of the cash, we don't provide a three-year projection, clearly, but as you have seen in the different presentations and in the qualitative update, we typically do not cover working capital or cash, but what you have seen in the half-year and prior presentations, we have a very healthy level of cash conversion when you compare the core EBITDA to what I call operating cash, after net working capital movements and CapEx.

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So with that, we expect, and particularly as we continue to grow, improve margin and optimise many areas of the business, as described by our cost reduction programme, that we will continue to see a very healthy level of cash conversion in the coming year.

Erb Raphael

Yes, and maybe from my side, to follow up on slide 12 and your related question, I think it's important, and you understand this very well, to see that enterprise agreements is a mix of front-end margins and back-end incentives, and also, more and more, we attach services and wrap services around to the license in our enterprise agreements. So the revenues are depending on customer type and product mix as well.

And as you know, as an example, on public sector, we see continuous good growth, which helps in indirect enterprise agreements, it allows naturally to also improve front-end margins, potentially. And therefore, overall, we see, as we mentioned, an overall revenue impact of 2% to 3% going into 2025. But for me, again, very important to highlight it, essentially, it all comes down again to the sales execution and how well the upsell and cross-sell, how well we pivot towards CSP. I think this is really fundamentally where my focus is and where we need to make good progress.

Briest Micheal

Okay, I appreciate it. Thank you.

Operator

The next question comes from Balajee Tirupati from Citi. Please, go ahead.

Tirupati Balajee

Thank you. Balajee Tirupati from Citi. Two questions from my side. Firstly, if you could share additional colour on your Microsoft partnership? Given their significant share in your revenues, changes in incentive structure have caused consistent revenue disruption, so should we expect efforts towards diversifying vendor relations? And I'm also asking this question because Microsoft’s share in reselling has stayed broadly stable at around 30% over the past years.

And then second question is if you could share any additional view on your 2025 revenue growth and margin targets. While you have stated ambition of a year of growth in 2025, do you expect growth in both reselling and services? And would it be fair to assume that 2025 growth would be between growth expectations for 24 and 2026? And also, on the margin side, while mix probably would be adverse, and you'll have headwinds in the first half of next year, given cost saving

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targets, how you're thinking about margins between [?] expectations for 2024 and 2026? Thank you.

Savitzky Rodolfo

Thank you for the question. On Microsoft, first, and our partnership, as mentioned, it's a very strategic partnership between Microsoft and SoftwareOne over many years, and we have constantly been responding to these incentive changes. This is nothing new. This is happening since day one, pretty much when I started in SoftwareOne. I think what is very important to understand in today's world is that our marketplace and our services portfolio gets more and more integrated and interconnected. Our clients are not only buying the license, but are increasingly buying a service bundled with the license.

As an example, our offerings around, let's say, Microsoft CSP are all managed service offerings where we offer tailored solutions for our customers, consisting of both the license plus the service wrapped around it.

And with that, we have certain revenue streams going into the services portfolio, and certain revenue streams obviously impacting the marketplace portfolio. Very important to highlight is, as I mentioned also during the presentation, that overall we are absolutely aligned on the strategy forward with Microsoft. We see lots of opportunities around our services portfolio, where Microsoft is also investing into partners like us and increasing the incentives, as well as the CSP portfolio, which is the hero motion for Microsoft in the channel. We have a very good offering there, which we can scale globally around the world. So I think this will absolutely have a positive impact on our business and will bring us back to our growth trajectory. The challenge, short term, is the GTM. It's all about sales velocity and sales execution, as I mentioned.

Then, coming back on 2024 and 2025, I think we mentioned it, first of all, a quick update, our performance in October is in line with our full year guidance for 2024. 2025 will likely be another transitional year, but we expect positive growth for the full year with an improving margin. And as you can imagine, we will provide official guidance for 2025, together with our full year 2024 results.

Tirupati Balajee

Understood. And at this point, could you comment if, in 25 growth here, should we expect growth for both parts of the business?

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Savitzky Rodolfo

No, this I cannot comment on yet.

Tirupati Balajee

Understood. Very clear. Thank you.

Operator

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

Woller Knut

Good morning, and thank you for taking my questions. Just two. The first one, looking at your Q3 results, I was a bit surprised by an 11 million revenue miss, accompanied by a 14 million EBITDA miss based on your business model. So, I understand that particularly the incentives, if they're missing, are a high-margin business for you, but can you give some more colour on how the miss breaks down on the three factors you mentioned for the miss?

And then secondly, Raphael, you mentioned that the attrition in NorAm was going up due to the new Go To Market model, can you just give us an update what attrition looked like in Q3 and what you have done to win back people that just un-deliberately left the company to ensure that the business just captures the growth potential in North America going forward again? Thank you very much.

Erb Raphael

So maybe let me start with your second question on the Go To Market in North America. Fundamentally, coming back, the implementation has been very rushed, and obviously therefore a lot of changes happened in roles and so on, and a lot of accounts get basically managed by different account managers today. So that's the challenge.

It will take a little bit of time for the new teams and the customers to gain trust and basically be aligned again. And also what we are doing is we are really ensuring that the right people are at the right place. So, it's not that all of the people have left the organisation, we still have a majority of the people with us, and so we just need to make sure they are in the right place. I think that's fundamentally important, and that's what we are working on.

Savitzky Rodolfo

Very good.

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And then I'll take the question. Look, as I mentioned in my comments, the main deviation versus plan relates to the revenue growth. So if you would assume a growth in line with our original guidance communicated in the first half, but not the revised guidance communicated in the first half, and you do the calculation, you would see that we would then be in line with the glide path to achieve the margin target for the year.

And here, I need to remind you that we have a seasonality on the margin, whereby quarter three, these quarters are relatively a lower margin. I typically say these are around 20% if you think of a margin of around 24% to 25% for the year. And then quarter four and quarter two are our high-margin quarters. So we don't know that, if you do the calculations, you would see that we would have ended the nine months ahead of the prior year in terms of margin. And this was pretty much in line with the guidance that we have communicated. So it's mainly a deviation on the revenue growth as a result of the Go To Market implementation.

Woller Knut
Okay. So just getting back to Rodolfo, just to get a better understanding of what you just said, the incentives were just a minor part in the revenue miss, if I read your comments correctly. Is that the right way to look at things?

Savitzky Rodolfo
That's correct. The incentives were relatively small. And, again, the incentives we anticipated since early in the year. As Raphael mentioned, we have this continuous shift in incentives, and we plan accordingly. The real miss was the commercial execution, which is a combination, of course, increased volume but also maximising the incentives that we have available. So it all boils down to commercial execution.

Woller Knut
Okay, got it. Thank you very much.

Operator
As a reminder, if you wish to register for a question, please press star followed by one. We have a follow-up question from Michael Briest from UBS. Please, go ahead.

Briest Micheal
Yes, just on the Copilot adoption, I think in the first half you were relatively pleased with the traction, and again, the message seemed to be in August, more of the same.

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Can you say what happened? And any sort of regional colour or customer profile colour about what was better or worse in these numbers, and maybe what you'd expect for the year? And, Raphael, are you endorsing, from memory, was it 15% adoption by the end of 2025 that Brian had set? Thank you.

Erb Raphael

Thanks, Michael. Yes, fully endorsing that. As you saw, we have 120,000 additional users in Q3. I would say, also, if you look at Q3 from a seasonality perspective, from an overall volume perspective, this is lower as compared to, let's say, Q4 or Q2 in our business. So the number appears maybe low, but it's also, I would say, mainly due to seasonality. So overall, I think it's still early days for us, but we are happy with the progress so far, having 720,000 Copilot users since launch.

Briest Micheal

Okay. Thank you.

Operator

Ladies and Gentlemen, that was the last question. I would now like to turn the conference back over to our Anna Engvall for any closing remarks.

Engvall Anna

Thanks to everyone for joining today, and speak to you soon.

- END -

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