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SUSE S.A. – Analyst Conference Call Q2 2022 Results

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PRESENTATION

00:00:03 Operator

Dear ladies and gentlemen, welcome to the conference call of Suse SA. At our customers request this conference will be recorded. As a reminder, all participants will be in a listen-only mode. After the presentation, there will be an opportunity to ask questions. If any participant has difficulties during conference, please press star key followed by a zero on the telephone for operator system. May now hand you over to Jonathan Atack who will lead you through this conference. Please go ahead, sir.

00:00:33 Jonathan Atack (Director IR)

Thank you, operator. Good morning, and welcome to our presentation of Suse's results for the second quarter of the 2022 financial year. I'm Jonathan Atack, Head of Investor Relations at Sousa. I will shortly hand you over to our CEO Melissa Di Donato and our CFO, Andy Myers, who are going to take you through a few prepared remarks before we open up to Q&A. Before I do that, can I remind you of the disclaimer on page two of the presentation, which contains important notices on the information provided in the following presentation. Thank you, and Melissa, over to you.

00:01:09 Melissa Di Donato (CEO)

Thank you, Jonathan. Hello, everybody. I am very pleased to speak to you today and share the details of Suse's second quarter, which represented another strong quarter for the business. Starting with a reminder of our business, of course, and that is the important strengths that make our business model so resilient. The results that were reporting today demonstrate the momentum and our mission critical infrastructure solutions business. And it represents our ability to grow relationships with our existing customers, but at the same time, being able to attract new ones. The megatrends which are driving growth in our markets, including the cloud transformation, and the shift to edge solutions remain unchanged. They are the underpinning of the continuous demand for our products. We have diversified enterprise customer base, with multiyear contracts where our customers pay for those contracts upfront. This powered our high net retention ratio of around 110% and enables us to remain confident in our long term, our long term with a sustainable growth, with high profit margins, and a high cash conversion. Now obviously, this is particularly relevant at a time when there is a great deal of economic uncertainty, but it is also why we have been able to deliver such a strong growth delivery in Q2.

Moving first to our second quarter financial highlights. We are reporting 18% growth in adjusted revenue, and that is 19% at constant currency, and a 36% adjusted EBITDA margin. ACV grew 28% in Q2, 32% at constant currency, supported by pricing improvements and by emerging ACV growth of a strong 79%. While being impacted by timing of customer billings, cash generation remains strong, with a conversion rate of 64%. We expect our results for the full year to be broadly in line with our guidance, although FX movements and rate changes and the wider macro-economic environment are impacting our reported numbers. Andy is going to cover this in a bit of greater detail later on in this presentation. But these results were underpinned by continued momentum and customer wins, both through cross selling, which supports our high NRR, and by consistently expanding our presence across industries and geographies. This short list includes four examples of new business one in Q2, reinforcing Suse's strong value proposition around the world. For the first, a fortune 500 US tech giant strengthens its long-term relationship with Suse by choosing our enterprise grade, reliable and stable Linux product set. This large value win demonstrates further expansion into this global leader in the semiconductor software and services industry. A prestigious and globally renowned NGO responsible for shaping the global economic agenda chose Suse Rancher for flexibility, lack of vendor lock-in, and ease of use. This net new win enabled a small internal DevOps team to be highly productive and scale effectively. We had another net new win for Suse Rancher for the global leader in Infotech and research, which leveraged our market-leading container management technology, and our flexible business model to support cost effective scalability. We also signed a tenfold ACV expansion with a Forbes Global 2000 banking leader who chose Suse Linux Enterprise Server, desktop, and support for secure and stable, custom-built OS image for ATMs, and branch office desktops.

We at Sousa are absolutely staying focused, and we are continuing to deliver against our strategy for our customers and for our shareholders. Our strategy embraces these five growth levers. You know already a lot about our commercial excellence, and that is across our organization, and recently where we implemented a new structure to fulfill our role as a fast-growing global multinational company. Previously, we had one person running engineering and we had one person running our sales functions. But today, we have brought together engineering and product management under three new general managers for business-critical Linux, enterprise container management and edge solutions, each of which provide a single point of accountability for end-to-end product management, ensuring that our products remain best in class and that our customers extract the maximum lifetime value from their Suse products. Additionally, we have split sales into three functions, recognizing that we need to separate teams to retain our existing customers from those that need to attract new ones. Our new sales leaders are managing our demanding recruitment programs. These will ensure that we have adequate resources to deliver on our growth trajectory and growth plans in what we would qualify as a tough market for technology with higher-than-normal churn rates throughout the industry. This solution-based organizational structural change enhances our ability to cross sell, to upsell and to form partnerships across all product lines.

I would like to take this opportunity to say a personal thank you to Xiang Liang, who today announced that he will be transitioning from our leadership team to our supervisory board now that our new GM structure is safely in place. Suse will continue to benefit from his technical expertise, and his strategic leadership. I very much look forward to working with Xiang in his new role.

In parallel, we are continuing on our path of rapid innovation, and in the past six months, we have delivered major new updates to Suse products across the whole infrastructure stack, all with a very clear focus on security enhancements. I am going to cover these in greater detail on the next slide.

We will continue to invest in geographic markets with great opportunities for growth, such as demonstrated by our growth rates in North America and LatAm in this quarter. Finally, as you would expect, we are continuously assessing

M&A opportunities to leverage our current market position and our global customer base while successfully integrating our new platforms, programs, and innovation.

On the next slide, you can see what we have built, and we have built the industry's most secure open-source infrastructure, from the operating system all the way up to developer services. Rapid innovation has delivered major new enhancements to Suse products across the entire infrastructure solution in the past six months, all with a very clear focus on security capabilities. To highlight just a few of these, this May, we announced the release of Sousa New Vector 5.0, the first major release of our container security platform since we open-sourced new vector in January of this year. Suse New Vector 5.0 is integrated with Suse Rancher and works with all major Kubernetes platforms, including Amazon EKS, Google, GKE, and even Microsoft AKS. At the same time, we announced the release of Suse Rancher 2.6.5. As part of that release, users can manage through the new vector directly through the Rancher console. By giving our customers and our communities better visibility, access and risk management controls across their entire multi-cluster and multi-cloud Kubernetes environments, we at Souza are taking significant steps to establishing Rancher as the industry's most secure container management platform. In June, we launched major enhancements to Suse Linux Enterprise Server 15, in a service pack that is called Service Pack 4, allowing Souza customers to operate the latest and the most secure version of our product without any disruption to their operations.

To that end, Suse Linux Enterprise is currently the world's most secure and compliant Enterprise Linux distribution. Our extensive list of certifications and security capabilities puts us well ahead of the competition in delivering a secure infrastructure solution for our customers. This is another important differentiator for Suse alongside our interoperability, and our industry-leading customer service. But we are not stopping with our existing product set. We are continuously expanding both organically, working to the open-source community, and inorganically through acquisitions.

As you well know, ESG is at the very heart of our business, and our plans for a sustainable growth. We continue to deliver on our ESG roadmap with some great progress across our key commitments for FY22. First, on climate action: we are on track to set near-term emissions targets and our commitment to setting these have been recognized by the science-based targets initiative. In information security we have made notable progress towards strengthening our information security and data privacy, in line with ISO 27000k standards, enhancing our policies following our first internal audit, which occurred in May. Under the disclosure banner, we have improved the quality of data collection and metrics across our focus areas. And we are preparing for the next annual disclosure in line with GRI standards and EU directives. Finally, on external assessments, we are preparing for a sustainability assessment with EcoVadis, an independent rating agency, to evaluate our material ESG impact. With that, I will hand it over to Andy, our CFO who will now take you through the details of a strong quarter and our financial performance. Andy

00:12:48 Andy Myers (CFO)

Thanks, Melissa. Good morning, and good afternoon to you all. Q2 was another strong quarter for Suse, demonstrating the momentum in our mission critical business. ACV was up 28% and 32% on a constant currency basis. We reported 18% growth in adjusted revenue, 19% on constant currency, Group ARR was 15% year on year, and NRR remained strong at 109%. We have continued to deliver high profitability and cash generation with a 36% adjusted EBITDA margin and a cash conversion of 64%. I will now take you through our KPI starting with ACV.

Group ACV grew by 28% with a 32% on constant currency basis. Core ACV for Q2 was 114 million with growth of 20% at actual FX rates, and 23% on constant currency. This growth was driven by end user product upsell and renewals and by continued growth in our cloud service provider route to market. Emerging ACV for Q2 was 26 million, with growth of 79% at actual FX rates and 84% at constant currency. Renewals in emerging more than doubled from the prior year benefiting from the increased customer base. As you can see, our emerging ACV is growing rapidly, and this is driven primarily by new contracts. The current macroeconomic environment has however led to slower purchase decisions from our customers on contracts.

Moving to performance by our geographic regions, Amir and APJ ATV growth of 18% and 17% respectively, were driven by upselling, primarily to end user customers, and growth in consumption through the cloud service providers. North American growth of 34% was driven by Rancher renewals on a growing customer base and higher sales to embedded customers. Latin America delivered exceptional growth of 197%, underpinned by pricing strategies, which started to take effect in the quarter.

Now let us look at our performance by route to market. End user ACV, including the cloud route to market grew 28% in Q2, driven primarily by upsell and renewals across both core and emerging product lines. Independent hardware vendor and embedded ACV grew 27%, driven by strong sales to embedded customers who shipped devices with Suse software built in. Sales to hardware vendors continued to decline due to hardware shortages, and a shift to selling to the same end customers through other routes to market, primarily through cloud providers.

Now let us turn to revenue. Total revenue in the quarter was up 18% to 161 million, 19% at constant currency. This strong consistent growth reflects the ongoing delivery of our strategy. We are benefiting from the migration to the cloud, the investments we have made in our sales force, and the high demands for our products. Core was up 10%, driven by continued growth of sales through cloud service providers and renewals with upsell. Emerging was up 78% in Q2, with upsell and renewals from existing customers and significant growth in consulting services. Both ARR and NRR metrics include new vector contribution since acquisition in October 2021. Group ARR reached 619 million in Q2, up 15% year on year, driven by continued demand for our subscription-based products and services. NRR was 109%, broadly the same as last year and the previous quarter, demonstrating our ability to consistently expand existing customer relationships. In Q2 22, we updated our ARR methodology as part of a stringent focus on this metric to track the performance of the business. The methodology now reflects a more complete view of our recurring bookings. All quarters in 2021, and the first quarter and 2022 have been restated on this basis. This has led to a small increase in the reported numbers, but the growth rates remain broadly the same. You can find more details on this in the appendix.

A strong revenue performance has allowed us to continue to invest in growth. As can be seen on the next slide. We continue to have a resilient and high gross margin of 92%, in line with the prior year. Sales, marketing, and operation costs increased by 29%, as we invest in our salesforce. This investment was focused on sales development representatives who are responsible for the qualifying pipeline links, and on our customer service managers to strengthen our customer retention capabilities. In addition, we continue to invest in marketing and in partner and customer relationships as COVID restrictions lifted, enabling face to face meetings and events. Research and development costs increased by 21%, driven by continued investment in Suse's R&D headcount. These investments enable our continuous product innovation, demonstrated by recent enhancements to Suse Rancher, Suse New Vector, and Suse Linux products. General Administration costs decreased by 18% to 16 million in Q2. Suse insourced several key roles in cyber security, business applications, and IT operations in the quarter and invested in roles to support Suse's position as a public company. This cost increase was more than offset by a favorable realized foreign exchange impact and timing differences in spending versus prior year. Adjusted EBITDA grew 22% to 59 million in Q2, as Suse's revenue growth was further enhanced by margin expansion. In March, shares were granted to employees as part of our ongoing incentive programs in the form of restrictive stock units, vesting in equal tranches over three years, and share options, vesting over two and three years. The total number of unvested RSUs and options outstanding is now around 4 million. In H2, we expect our non-cash P&L charge to be circa 17 million per quarter due to grants to new hires in the first half of the year. And we take about 60% of the total grant cost in the first year. Next year, we expect to return to an ongoing charge of around 15 million per quarter.

Now let us look at how our high levels of profitability, profits, have converted into cash. The change in deferred revenue was a strong 58 million in H1, as our customers continue to sign significant long-term contracts and pay up front. The increase in EBITDA and positive change in deferred revenue led to adjusted cash EBITDA of 76 million in the quarter, up 40%, and 169 million in H1, up 5%. Adjusted unlevered, free cash flow for Q2 was 38 million, and in H1 was 82 million, down from 67 million and 106 million respectively in the prior year. This was despite higher adjusted cash EBITDA, which was more than offset by a working capital outflow in Q2 due to the timing of customer buildings and receipts. Gross capex increased as we invested in a datacenter move to ensure a future-proofed IT infrastructure. Due to this one-off investment, we expect elevated capex of mid-teens millions this year, and we will return to our expected run rate of circa 10 million per year in the medium term. Cash conversion was 64% for the quarter and 74% for H1, below our guidance for the full year primarily due to the working capital outflow in the half.

Now let us look at our evolution of our leverage. In Q2, we continue to deliver the business. Net debt at the end of the second quarter was 655 million, significantly below the prior year figure, which was pre-IPO. Compared to the first quarter, net debt reduced by 35 million due to our strong cash flow. As a result, our leverage ratio, calculated as the net debt divided by the last 12 months adjusted cash EBITDA, was 2.3 times, down from 2.6 times at the end of the first quarter, and well within our commitment to keep leverage below 3.5 times.

Let us now move on and look at our LTM KPIs, demonstrating the robustness and stability of our business model. Due to both seasonality and the lumpy nature of our contract wins, ACV and revenue can be volatile in any given quarter. These charts show our key metrics on a last 12-month basis, demonstrating our track record and providing a consistent picture of steady growth over time. Out last 12 months ATV continues to show progress, having grown 23% from Q2 21 to Q2 22. Weighted average contract length, on the last 12 months basis, remained stable versus the prior quarter at 20 months, supported by multiyear subscriptions on emerging contracts. We have consistently grown our ARR and our NRR that remained stable at a high and value added 109%. This is a key foundational block of our future growth. Note that our ARR numbers here are on our new methodology that I mentioned earlier.

Now let me take you through our guidance for the full year. Suse's outlook for the full year remains broadly in line with previous guidance, specifically for adjusted revenue and adjusted EBITDA margin, as profitability remains strong. Now let us address the potential impact of current macro uncertainty and foreign exchange movements. The current macroeconomic environment has led to slower purchase decisions for new contracts, primarily impacting our emerging business, which continues to grow rapidly. We expect core ACV growth to be in mid-teens and 22, prior to FX impacts. Following the strong growth in emerging ACV in Q2, we expect to exceed 60% year on year growth in H2, giving growth for the full year of around 50% prior to FX impacts, still representing a very strong growth rate.

We expect adjusted revenue will be less impacted by the macro environment as a high proportion is already booked through long term contracts and therefore, we continue to anticipate full year growth of mid to high teens percentage. We also reiterate our adjusted EBITDA margin guidance of mid-30s percentage as our adjusted unlevered free cash flow conversion guidance of stable to high, a slight increase versus last year. Phasing of our H2 results will be weighted towards quarter four, reflecting our usual sales guide cycles and available renewal pulls with Q3 comparables also impacted by a large retrospective consumption contract in Q3 2021. Overall, we expect this to lead to a slight decline in core ACV in Q3, followed by strong growth in Q4. We have provided this guidance before the impacts of FX, as we did at the start of the year. Although FX rate movements have and will impact our reported results. We have seen a significant strengthening of the US dollar versus our other major currencies. This has suppressed our ACV, which is subjected to in period exchange rates. Revenue is also suppressed, but to a lesser degree, given we carry a significant proportion of revenue into the period in US dollars of deferred revenue on the balance sheet. A strengthening of our ICV which is subjected to in period exchange rates. Sorry. The strengthening of US dollar also reduces our operating cost base, which typically offsets the revenue impact and therefore, is a small tailwind to EBITDA margin. Unlevered free cash flow is highly dependent on working capital movements and this means that FX impacts are difficult to predict, but in general, a stronger dollar reduces the value of our non-US cash we receive upfront from customers, which has a small negative impact on unlevered free cash flow.

On this slide, we have summarized the expected full year impact on FX and on our reported numbers, assuming that rates stay roughly the same as at the end of H1. And finally, we confirm our medium-term guidance, reflecting our strong net retention rate and a large renewer pool, our order pipeline, growth outlook in our markets and Suse’s competitive position. With this, I will hand you back to Melissa to close.

00:27:23 Melissa Di Donato

Thanks, Andy. In closing this session, I want to remind everyone on the call and listening in of the resilience and the strength of our Suse business. We deliver mission critical infrastructure software within rapidly growing markets. Our subscription based model and diversified customer base, ensure that we have a robust and sustainable recurring earning set over the medium and the long term, upfront payments on our multiyear contracts drive high cash conversion. Altogether, our business remains well placed to drive value creation in the years ahead. This concludes today's presentation. Thank you very much for attending and listening in. If I can, I will hand it now back to the operator who can start the Q&Q session of the call. Operator back to you.

Q&A

00:28:50 Operator

Dear ladies and gentlemen, we will now begin our question-and-answer session. If you have a question for our speakers, please dial zero and one on your telephone keypad now to enter the queue. Once your name has been announced, you can ask a question.

We have a first question is from Varun Rajwanshi of J.P. Morgan. The line is now open for you.

00:29:26 Varun Rajwanshi (J.P. Morgan)

Hi, this is Varun Rajwanshi from JPMorgan, a couple of questions from my side. Firstly, given your comments on slower customer purchasing decisions and delays in customer projects, do you think you are sufficiently biased to your ACV guidance on the full year? Can you comment on your confidence in terms of hitting that guide with the pipeline as you see it today and the conversion? Secondly, how should we think about the phasing of margins in Q3 and Q4. And then finally on your retention rate, can you comment or give some color on the split between gross churn and cross sell and upsell. Has the gross churn number gone up in Q2? Thanks.

00:30:08 Melissa Di Donato

Hi, nice to meet you. I think this is the first time that we are speaking to you since Stacey, I think it was, wasn't it, left. So nice to have you. Let me address the first question. And then I am going to hand it to Andy to address the phasing of margins, and retention and gross retention rate.

So, your comments about the slower customer purchasing decisions: let me go back to the end of the comment that you started with, which is around pipeline and conversion. We have more coverage in our pipeline than we have ever had, and we have more demand than we have ever had. And that gives us strength in the conviction to deliver on our medium-term guidance as well as the ACV as projected and promised, as part of this presentation, this quarter's earnings. Now, what we are saying is that whilst we have bigger pipeline and a bigger ratio to be able to convert, the decisions that need to be made to convert the pipeline is just slowing down a slight bit. Folks seem to be a little bit more cautious about how they spend, particularly net new. Now, it is not impacting our renewals, and it is not impacting our cross-sell opportunity into our renewed customer base. But it is delaying a bit of decision as it pertains to net new. But the pipeline is bigger than it has ever been. And the ability to convert and get coverage is better and stronger than it has ever been. It is just that the decision making is delaying things slightly and not a lot. And I say not a lot, because we can still see to the end of the year as well as the early part of next year. So, it doesn't give us any kind of concern. In fact, it does the opposite. It gives us strength in our numbers and our outlook for the year and in the medium term to be reconfirmed. Andy, if I missed anything on that regard, and then if you can just touch on the phasing of margins as well as the retention rates, that would be great.

00:31:51 Andy Myers

On the phasing of margin, Q3, and Q4, maybe a slight increase, probably a slight increase in Q4, linked just to the increasing revenue coming through. So, a slight increase in Q4 on margin, but nothing hugely significant. With regard to churn and gross retention, we are seeing no change in our churn and our retention rates. We are selling mission critical software and services and therefore we are seeing absolutely no change whatsoever. And that is a fundamental foundational block of our business and why we are seeing net retention rates of 109%. I hope that helps.

00:32:33 Varun Rajwanshi

That is useful. Thanks, Melissa, and Andy.

00:32:50 Quentin Marbach (Goldman Sachs)

Hello, this is Mo from Goldman, hey, Melissa, hey, Andy. I had a couple of questions. Firstly, just coming back to your comments on, sort of, the macro. Is there any particular kind of deal size points that are, kind of, getting impacted in terms of customer decision making? And you talked also about, sort of, increased attrition? As you think of, kind of, the emerging segment, was there, kind of, greater impact? Clearly, you've lowered the guidance there, so is there anything around, you know, kind of, the attrition playing an impact outside of the macro? And in terms of, as you think of the resiliency of, kind of, emerging versus the core? Do you believe, I know, there's a kind of slight issue in Q3 to Q4, but is there a risk around, you know, that maybe you see a bit more of an impact in the core further in as we move on? And then secondly, you made a comment around, sort of, M&A? How do you, sort of, see your M&A pipeline? Have you seen, sort of, shift in, sort of, valuations in the private market? And how do you think of the kind of probabilities of supplementing the organic growth with M&A over the next six to 12 months? Thank you.

00:34:11 Melissa Di Donato

Sure. Let me break it down a little bit and then Andy can pipe in on the first one around macro. So, the deal size, we are seeing a bit of an impact on decision making for the smaller deal size versus the larger, that is why you are not seeing a lot of risk in the business. And that is why the business continues to be strong and be able to deliver high profitability, and high levels of net retention. It is the deal size that are more on the macro side, they are being impacted on less than $100,000. Now, that is a long tail, and there are a number of deals, and those are ones that are going to be impacted. So, we are not seeing any kind of impact from a macro standpoint for the large transactions as much more for the smaller ones. The next part of that question was around the attrition rate. We did an analysis, actually this week, where we analyze the levels of attrition, particularly in the sales team, as it breaks down from core to emerging. And we have seen a turnaround in attrition, we have seen, more recently, a stabilization of the sales force staying put and staying in place. Now, we have a number of different initiatives and programs and outreaches to really be able to stabilize the sales teams, to keep them in place, because obviously, the longer they are in place, the more return and value that will get in way of productivity. So, we have seen now, finally, a real turn. And I think that you as the macro-economic environment continues to be volatile, that great resignation that we have all learned to become accustomed with in the last year, I think, in my belief, is beginning to shift. You are not going to see the great resignation continue very much anymore, but instead, you see very different outcomes. And we have a lot of technology companies where folks are beginning to really see a lot more stabilization, particularly us, we are seeing a lot more stabilization in the business. And you know, because we have gotten the innovation coming out, because we've got the strong profitability, and because we are investing a significant amount, as you have seen from our numbers, in R&D and innovation, as well as in building up and bulking up and advancing our sales team, that is an organization that people really want to stay with. So, we are seeing a real shift in attrition, and that now declining in the other direction in a much more positive way. So, I think we will see a lot more resiliency in our business, that pertains to the sales team in particular, as we begin now, going out of Q3, and into Q4, and definitely into the back end of the year. So that is less of a concern and much more of a greater opportunity for us. But you know, the emerging business, which was the other side of the coin, we had the emerging business with a sales team that came in from Rancher that looked to get acclimated, get adjusted, and feel comfortable in the new Suse methodologies and ways of selling and that also now sustained a bit of security in that business. So no, I do not worry around the risk for emerging, particularly related to attrition. I do not worry about attrition right now, because it has really shifted the other direction. So, I think the good news is that we are past that now. It is not a risk in the future. I think we have overcome it. On the M&A, Andy, did I miss anything that you want to comment on?

00:37:20 Andy Myers

Yeah, no, I would just add, just looking at core and emerging there, answering part of your question there, if we look at emerging, we have got good coverage. And again, we are still forecasting in excess of 60%, for the second half of the year, and a consistent greater than 50% in a medium-term guidance. We have got the coverage. It is just some deals are being slowed down and that is just impacting us at the moment. But we are not losing them, and we have got the coverage, it is just the timing to get to deals. On the core side, as you know, incredibly resilient, it is far less susceptible because we have got the renewal pool, we have got the strong upsell, we have got initiatives like pricing, which is leans heavily on core, being the older, more mature contracts. And it tends to be customers buying additional profit products in core. That again, is where they are making a new decision and that is where we see some impact. But it is a low impact on core.

00:38:22 Melissa Di Donato

Cool, thanks. And then M&A. Where do we see a shift as it relates to the private market? There is softening in the private market, because of the environment that we are in. I would not qualify it as a tremendous amount of softening, but there is some softening in the market for sure. And we are utilizing that softness in the best way we possibly can to our advantage. So, will we close an M&A deal in six months? Probably not. We have got a lot of opportunity in our pipeline, our pipeline, specifically focusing right now, on security. We are the default leading provider across enterprise infrastructure solutions, addressing the Linux, both the Rancher Container side, that is the most secure platform in the market today. And because of the sought-after nature of our technology innovation over the last three to six months, our focus right now really is to continue the strength in our innovation and our product set and why we are differentiating, how we are differentiating. And it is no longer just interoperability, it is interoperability in the most secure platform offered in the market today. So, we are really focusing our M&A efforts and outreach to be around that security and build security opportunity that we see in the market.

00:39:46 Quentin Marbach

Great. Thanks, Vanessa. Thanks, Andy.

00:40:03 Frederic Boulan (Bank of America)

If I can follow up on the macro question. Is there anything you can point to in terms of specific services where you are seeing some of those delays? Any specific geographies or, and the markets where you can pinpoint some specific trends. And from a timing perspective, I mean we haven’t really seen your business going through recessions in the past. I mean, if I listen to you, you are saying the demand is still very strong, it's just a question of timing in some cases. But if you can articulate a little bit how, you are saying the ACV can be sensitive to changes in macro. I mean, you've kept the 20% revenue target unchanged. So, it seems like you're very confident. But it would be interesting to what degree we should anticipate that kind of trend in slightly more depressed new bookings for several quarters, if the macro picture remains complicated. And then a quick follow up on the share base comp, I mean, your hiring comment, Melissa, seemed to point to less pressure going forward. At the same time, your share base comp is increasing to about $60 million a year. So, what can we contemplate in the long run? Should we penciled in a pretty stable percentage of sales or some duration over time, as you see some normalization in the job market? So, any comments on that would be very useful. Thank you.

00:41:44 Melissa Di Donato

Andy, do you want to start with the share base at the bottom? I guess the last question? And then, if you want to dive into a little bit of the recession resiliency that we have in the business, which then I will then pick up, and I can also cover on the macro side, delays, market geo, that sort of thing, I can wrap up on covering a little bit sprinkled in with all the questions too.

00:42:07 Andy Myers

Sure. Yes, share based conversation. We have two factors in the growth. Firstly, we have obviously had a significant increase in headcount. And within that, and you have heard Melissa talk about some of them, and you will have seen some of them today, in recent days and months, we have had a fairly significant increase, or new members of senior staff as well. So, all of that is added to the increase in cost. Clearly, as I think you know, of the whole three-year RSU package, you take 60% of that three-year cost in the first year. It is just the accounting policy for it. That is what you do. So, it is having a big impact in the next 12 months. In the long term, it will depend on the job market, quite clearly, which Melissa has spoken to, and is likely to have some suppression coming from macroeconomic impacts. And then it will be dependent clearly on our growth of headcount. So, it is quite difficult to say and give you a forecast. But if headcount grows, then that cost will effectively grow. But there are quite a few moving parts in that. When it comes to the macro impact, I would say, Fredrick, look, our changing guidance for FY22 on the ACV front is actually relatively modest in quantum. In fact, it is relatively small in quantum. Clearly, we have maintained our revenue guidance for 2022 and profit. From the ACV impact, yes, across a little bit, across core and a little bit across emerging, that does have an impact on revenue, but it is relatively small. And then yes, there will be slightly less deferred revenue flowing into 2023. But again, given the size of numbers we are talking about, it is relatively small, although technically yes, we will carry a little less deferred revenue going forwards. But if you think about the macro impact in the medium term, we do not see an impact to us against our guidance. Our growth is being driven by the megatrends, the migration to the cloud, app workloads being driven by data analytics, and the growth of edge or IoT, what you want to call it. And we do not see that abating. We are also selling mission critical software, with certification support and security, as evidenced by our NRR, our strong NRR rate. And we maintain our confidence in the growth drivers that Melissa talked to in the presentation and our growth levers. So that is why we are reconfirming, and are confident in our medium-term guidance.

00:45:02 Melissa Di Donato

Fredric, I would not add anything to that. I think that Andy hit on something that is important, that I think you referred to, which is that we are a bit recession resilient. And I think that is probably a very accurate description of the Suse business. And that is specifically because we focus and have always focused on mission critical workloads. You cannot shut down mission critical systems. They need to be maintained, they need to be documented, they need to be secure, and they need to be supported. In some cases, they are regulated industries, in other cases, to be able to run businesses and deliver services to end customers. So, that has never wavered. And that has allowed us to deliver strong and steady growth over the last, let's call it, 30 years since we have been in business. This September will be our 30th anniversary. As we begin to look forward about, living through a potential, recession, if there is one, we are not a business that is volatile in that kind of situation. We are much more resilient. Because of the structure, the nature, and the historical record of the kind of services we deliver of the business. So, we were very resilient, and you hit it quite well. It is a timing issue. It is not a performance issue. With the new setup of our GMs as well as our three leaders on the go to market side, we are set up to best be able to service these high value enterprise customers in a much more effective way, separating renewals from go to market and sales and net new, all the way through to our new and organized commercial agreements that we have with our customers. I think that first question you had was, is there a particular area that we are seeing a delay. On the core business, our renewal business, there are no delays in our renewals. In fact, we continue to upsell, as Andy alluded to, cloud, the movement to the cloud, hybrid and multi cloud continues to accelerate and grow, as expected. Workloads continue to expand, and our edge business continues to accelerate. Where we are seeing a delay is mostly on the net new, on the smaller contract size, rather than the large enterprise strategic. They are not decisions that are being delayed for enterprise solutions across an entire customer base, but they are small, pointed solutions that can tend to be delayed until a proof of concept is seen through, for example, on the emerging business side. But hopefully that gives you a little bit more comfort on the strength and resilience, nature of the Suse business.

00:47:29 Frederic Boulan

Great, thank you.

00:47:42 Charles Brennan (Jefferies)

Good afternoon, everyone, and thanks for taking my questions. I am going to do three, if that is possible. The first, just on the macro. We haven't seen many other European companies talking about macro weakness yet. Can you just give us some indication of when you started to feel it in your business? Was it apparent since the start of the quarter in May? Or is this something that only started to impact in June closure rates? Or is it merely just a preemptive caution as you think about closure rates in July? Secondly, can you just talk about the sales reorganization? It feels relatively unusual to get a major reorg midway through the year. Do you think that has had any impact on sales momentum through the quarter? And is there anything to read into that? And then thirdly, just a small point of detail on share base payments. It sounds like the majority of the options were issued in March. I guess the question is, why wasn't the P&L impact flagged when you gave us the Q1 outlook and what has changed since March view to give us this updated P&L impact? Thanks.

00:48:52 Melissa Di Donato

(Unclear recording) sales org first and then, Andy, you can cover the share-based payments and the flag from March. And then we can talk a little bit more about when the macro preemptive caution was delivered and when we found it. So, let me talk about the sales reorg. So, the sales reorg wasn't necessarily redone in the middle of the year. We talked about it in Q1, and the sales leaders came on board with the exception of Colin Brooks, who has just recently signed up and joined the business only four weeks ago. Imran and Adam, who are our Chief Customer Officer and Chief Revenue Officer respectively, did sign on the end of the calendar year last year. So, November and January. So, we did bring them on in Q1 and they did work with us coming out of our Q4 last year. So, while it sounds new, and we are reinvigorating and re-announcing the investments we are making in sales. These announcements were made in Q1, so it is not midway through. It sounds unusual, but it was actually implemented what amounts to be now five months ago. We are just talking a little bit more about the strength and the output of such an organizational alignment. The GMs were implemented earlier this year as well. We did not have a full reorg completed in time to be able to talk about it in Q1, but we did discuss implementing in Q1. But now we are happy to discuss how it has worked well and how the success has paid dividends for us in way of that organizational structure. The macro side, no one in Europe is mentioning it yet. I think we are the early ones because of our fiscal quarters. It is much more of a preemptive caution. We see our pipeline growing, as I said earlier, I think it was the first question, we have got better coverage than we have ever had. The coverage is not needing to grow, it actually can be decreased, we have more coverage than we have ever had. Our pipeline is growing in a more robust way, better than it ever has. We just see a slight slowdown. So, this is much more as a result of June closure and looking into July, as we head into summer of a preemptive caution. But it is not that we have had impact quite yet. But it is much more to be preemptive in our caution to the street, to make sure that we are transparent with you on what we see happening in the market today. Andy, can I hand it back to you cover the payments and the P&L flags that could have been in Q1 outlook.

00:51:22 Andy Myers

Hi, Charles. It is relatively straightforward in that people joined the business in quarter one and then they are made offers around share based compensation. They then have to go through, not they, the offers have to then go through a process which includes final approval by the Remco. And in effect, these approvals only came through after the Q1. And then that is why you then see the cost of them starting to appear in Q3.

00:51:56 Charles Brennan

And then what is the share price that you have assumed in this P&L cost? If we get back to a 30 euro share price, what happens to the P&L charge?

00:52:06 Andy Myers

It set at the point when they are offered. The number of shares is set at the point of offer, so that is effectively the cost at that point in time.

00:52:20 Charles Brennan

Okay, thank you.

00:52:31 Johannes Schaller (Deutsche Bank)

Thanks for taking my questions. Hi, Melissa. Hey, Andy. I also have three, if I could. Firstly, could you maybe give us a bit of an update on the federal business? Just how that is going? I remember you were quite excited in the last quarters. But you have not talked about this that much today. The second question, Andy, you mentioned the pricing initiatives kicking in in Latin America, now this quarter. We have talked about this a few times before. My understanding was always more that the pricing initiatives needed to take a bit more time to come through. So how should we think about the other regions from here? Is there more of a sizeable impact as we go into H2, and maybe next year that we should expect from pricing. And then thirdly, we picked up a bit of color from some other software companies that are getting paid upfront, that their customers are pushing back on that now as the macro gets a bit tougher, so I just wanted to check in with you, if you have seen any of that evidence with your customers, or if nothing is really changing in terms of the payment terms. Thank you.

00:53:35 Melissa Di Donato

Hi, Johannes, let me discuss a little bit about the federal business and then I am going to cover the payment structure and allow Andy to do the same and then also cover pricing. So, federal business, we remain excited, enthusiastic, just as much as we always have. The business continues to scale and continue to grow. We have hired a full roster of the federal team, everything from marketing, finance, go to market sales, presales, services, all now fully in place and we expect that business to continue to scale. So, we are as optimistic, if not more, today with Lin's leadership as we were last quarter and six months ago. So, there is nothing going on that is unbeknownst or that we are not disclosing. In fact, we are much more optimistic about the business maybe than ever before. On the pushing back on payments, very much in the days of COVID, I braced myself as a CEO during my very first ever pandemic, thinking that customers are going to want to delay payment and they never did. We did not have any issues with bad debt. We did not have any late payments. We did not have any significant pushback at all during COVID. And it is the same now. If a customer is servicing their mission critical workloads with Suse, we are the one area that we do not have pushback in the way of payments. So no, we are not seeing anything going on with regard to payment or deferred payment terms or looking for an annual upfront fee or anything like that. Nothing has been on our customer radar at all on that regard and we continue to be highly profitable, very cash generative. In fact, the business continues to grow from strength to strength rather than, even in a macroeconomic environment, we are just not seeing the push back on payments, the payment structure. The only thing we do see is that a decision gets delayed maybe two weeks or 30 days, but not around payments. Andy, do you want to talk about, Johannes had commented that you had talked about pricing initiatives and the impacts this and going is next year, an example that we gave in last time, this quarter, are you ready to comment on that one?

00:55:45 Andy Myers

Just adding to Melissa's point there, our weighted average contract length has remained at 20 months consistently for the last two quarters. That increased the previous quarter by one month. And that despite the higher growth, then normal end user, at the higher growth of cloud, at shorter contract lengths. So that is telling you that our end users are actually, outside of cloud, assigning longer contracts than they have ever done in recent history. So, just a bit of evidence for that. Coming out to pricing, yes, we called out the (00:56:23 unclear) because 197%, it's growing well, and I think in previous quarters we have shown it is growing very well. But that growth was accelerated by a number of contracts, but particularly one contract where we noted in our paper, that was eight times increase in value, with no increase in volume. And look, that was just one call out of the contract, we are making steady progress across pricing. We are seeing better control, better control processes for discounting, we are seeing some of the initiatives we put in place, and I could think of the pricing that we changed on unlimited VMs, that is now starting to pay dividends to us. We see that coming through. We put some initiatives in place, that actually, where we decrease the price, and then will expect the volume to increase to take market share. So, we expect some of that. We see some of the impact of a lower price there, but we will expect to see the growth. I think I said once before, my expectation is, yes, this is a slow process. It is a three-year journey. And over three years, my experience is you would expect to see the order of 10% growth out of pricing over three years. And we are on that journey. So, I said that in the last quarter, we have seen green shoots. I think now we are seeing real evidence that that is helping us. But there is a lot more to come.

00:57:57 Johannes Schaller

That is super helpful. Thank you both.

00:58:02 Operator

There are no further questions and so I hand it back to you.

00:58:09 Melissa Di Donato

Thank you very much. I think we will conclude the call for this quarter, Q2 for Sousa. Thank you very much everyone for joining and for your thoughtful questions. We hope that we have been able to answer everything, and we will look forward to speaking to you again after the summer in Q3. Thank you very much for joining.

00:58:28 Operator

Thank you for attending today. This call has been concluded you may disconnect.

00:58:35 (END)