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SGE.L - Full Year 2017 Sage Group PLC Earnings Call

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PRESENTATION

Stephen Kelly *- The Sage Group plc - CEO & Executive Director*

We're good. Let's make a start. So hello, and welcome to everyone here for Sage's FY '17 results, to those of you who are in the room and those of you who are on the phones.

Please note, first of all, the safe harbor statement, which you can find on the screen behind me and in your packs.

The agenda for this morning's presentation is outlined on the screen. So firstly, I'll provide a brief overview of Sage's performance. And then I'll hand over to our Chief Financial Officer, Steve Hare, who will talk you through the business performance. Then I'll update you on the progress against our plans and close off with our outlook for FY '17 before opening for questions.

I think, today, before we dive into FY '17, I think it will be useful to step back and reflect on what we've achieved together since we announced the transformation plan at the Capital Markets Day in June 2015. When Steve and I started our journey together, our immediate task, obviously, was to run the parallel tracks of delivering the commitments to the public markets whilst conducting a root-and-branch review of the business, which helped us map out the plans for the future. Back in 2015, we found that Sage had been slow to innovate and failed to engage closely with customers and the market.

The organization, as many of you know, was fragmented, misaligned and inefficient, in part due to the dozens of acquisitions that had not been integrated. The leadership probably lacked the relevant experience for sustainable cloud-based growth ahead. It was clear that a major overhaul of all parts of Sage's business was needed, and we set about sequencing carefully the transformation. As a result of this appraisal, our mission became very clear.

Firstly, we had to reconnect with our existing customers and attract new customers with best-in-class cloud solutions and, as I've said before, rediscover our technology mojo. Secondly, we had to create simplicity and efficiency in the organization with systems and processes fit for the businesses and as a platform for future acquisitions. And thirdly, we needed to create a high-performance, customer-obsessed leadership team, culture and company. And it was evident that we needed to address these issues to seize the opportunity in front of us, which was to become category leader in a market worth $27 billion and to truly win in the cloud, where over 50% of financial solutions are set to be by 2020.

So what did we do? In the first phase of the transformation, in FY '16 and FY '17, our first steps were to integrate what were decentralized functions into one unified operating model, what we called at the time One Sage, to create strong supporting functions for our market and customer-facing colleagues in each country. Alignment of all our Sage colleagues will be critical to our success, so we undertook a significant rationalization program to reduce costs from the back office and to reinvest in for growth and accelerate the move to subscription. During this phase, we were very deliberate to consider no significant M&A, as we shared with you at the time, also that we wrapped the go-to-market functions in cotton wool to protect the customer experience.

The transformation, the whole program was carefully thought through, created, sequenced and executed with great care. With Phase 1 progressing well and the Sage internal platforms considered fit for purpose, we were ready to embark on Phase 2 in October 2016. And throughout FY '17, we continued the progress we made in Phase 1. With the appointment of Blair Crump as President, we also started to improve in the go-to-market organization, which makes up 60% of our headcount, to address the inefficiencies in this area.

In FY '17, we also commenced selective M&A activities with the acquisition of Sage Intacct, Sage People and Sage Compass. These acquisitions again were thoughtfully selected to accelerate the strategy and have allowed Sage to emerge from Phase 2 with the most complete portfolio of cloud products now unified by the Sage Business Cloud, and more to come on this later.

So let's just put into context what the transformation has delivered against the original objective we set for ourselves. Since June 2005, we've consistently achieved at least 6% organic revenue growth and at least 27% underlying operating margin. This has been achieved whilst restructuring the business and transitioning to subscription, avoiding the double dip in revenue and margins that many software companies have experienced. And whilst we have achieved this growth in profitability, under the surface, we've strengthened the Sage business model, creating the efficiency and simplicity that we targeted. Now you could call it building the plane whilst flying it.

Let me share some of these highlights. Firstly, in the transition to subscription. Our recurring revenue now stands at 78% of total revenue, with software subscription revenue now representing 37% of total revenue, up from 22% 3 years ago. The focus on customer obsession has resulted in much improved Net Promoter Scores, NPS, the measure of customer advocacy, which has risen from a neutral score at the start of FY '15 to a high of plus 25 in the final quarter of FY '17. In the cost transformation, we've identified over GBP 100 million of annualized cost savings and reduced our G&A expense as a proportion of revenue from 19% to under 14%. We've reinvested those savings to drive further growth.

We've invested in technology, winning now host of awards and joining forces with the best-in-class strategic technology partners, including Amazon, Microsoft, Salesforce and Stripe. From virtually no cloud presence for FY '14, we now have a comprehensive suite of cloud products in all our major geographies. These products are unified under the Sage Business Cloud, with GBP 300 million of cloud annualized recurring revenue in FY '17 growing at over 80%.

We've strengthened our position as the market leader in the scaleup and enterprise market through the organic growth and the acquisitions of Sage Intacct and Sage People. And lastly, our focus on developing the senior management has resulted in a high-performing, driven leadership team, focused on executing on our accelerated growth plans for the future.

So as we close the door on Phase 2, we now have the leadership, organizational alignment, efficiency and a comprehensive suite of innovative cloud platforms to accelerate momentum in our markets. And I'm pleased to confirm that the transformation we outlined and announced in FY '15 is now complete. The strategy is clearly working, and the path to accelerated growth and superior margins is emerging, powered by the Sage Business Cloud and strengthened by the acquisitions of Sage Intacct and Sage People.

We will continue the progress we've made to the shift to the subscription model and the cloud, combined with relentless drive for efficiency and simplification. To be clear, though, there will be no further exceptional charges from the transformation we announced at the Capital Markets Day in 2015.

Now I'll give you some color on the strategic progress we've made shortly, but I'd like to hand over to Steve Hare for the financial and operating performance review. Steve?

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

Thanks, Stephen, and I'd like to add my welcome to today's results presentation. The opening message for me today is the same as last year. We've done what we said we would do. Our guidance was that we would deliver 6% organic revenue growth, including the North American Payments business for the period that we owned it and that we would deliver a 27% underlying margin, including the impact of any acquisitions and disposals and, therefore, including Sage Intacct, Sage People and Sage Compass. We have delivered both the 6% organic revenue growth and the 27% underlying operating margin.

In addition, the level of exceptional charge is below where we indicated, at GBP 73 million, and we've delivered an improved payback with annualized cost savings relating to the transformation of GBP 59 million. We've also maintained strong free cash flow, finishing the year at a leverage of 1.6x, well within the 1x to 2x range.

We are one of the only companies in the FTSE 100 to have had a progressive dividend every year since 1999. And we have again, this year, increased the dividend by 9%. Stephen and I have always been known for being completely transparent, so before I go through the details of the results, I do want to spend just a little bit of time on definitions.

So I'll start first with FY '17, the period that we are reporting. The organic revenue definition for FY '17 neutralizes the impact of foreign currency translations, i.e., it's at constant exchange rates. It excludes the contribution from current and prior period acquisitions, any discontinued operations, disposals or assets held for sale. The underlying revenue definition for FY '17 also neutralizes the impact of foreign currency, but underlying includes, rather than excludes, the contribution from current and prior year acquisitions, discontinued operations, disposals and assets held for sale.

Now in FY '18, we will include inorganic revenue, the acquired businesses from the beginning of the financial year following their date of acquisition. This is to support full alignment between the internal measures and our external guidance. For this purpose, we will therefore make adjustments to the comparative period to present the acquired businesses as though they had been part of the group throughout the period. These businesses that we acquired in FY '17, i.e., Sage People and Sage Intacct, are all an integral part of the Sage Business Cloud. So again, for clarity, FY '18 organic revenue will include Sage Intacct and Sage People, but the underlying margin will also include the investments that we will continue to make in these businesses.

So let's now have a look at the FY '17 numbers. As we said, we achieved 6.6% organic revenue growth in the year, and half of the 8 regions delivered double-digit revenue growth. We saw an acceleration in Q4 in revenue growth to cover to over 7%, and this was largely driven by the expected recovery in North America where Q4 revenue growth was in line with group rate.

We also saw stabilization in France after what's been a challenging year. And excluding France, organic revenue growth was 7.8%. Organic adjustments of GBP 24 million include GBP 20 million from the acquired businesses, as we guided, and a further GBP 4 million from subsidiaries either disposed of in the year or currently held for sale. The GBP 5 million adjustment on the recurring line is the fair value adjustment of the deferred income in Sage Intacct.

As we continue to deliver on cost savings, I am pleased to say we achieved an organic operating margin of 28%, which meant that we could fund the investments in Sage Intacct, Sage People and Sage Compass and still achieve the 27% underlying operating margin.

So turning now to the financial summary. I've already covered the story on revenue and operating margin, but a few words on earnings per share. The underlying earnings per share growth is 3.5%. However, if you adjust to exclude the impact of the acquisitions and disposals and, therefore, look on a like-for-like or continuing basis, the growth is 7.4%, reflecting the enhanced organic operating margin. The nonrecurring item of GBP 70 million is the exceptional relating to the transformation of GBP 73 million, offset by the gain on the sale of a small German subsidiary that we disposed of during the year.

The recurring item of GBP 49 million relates to the amortization of intangible assets and other acquisition-related costs. And the organic adjustment is the losses in the acquired businesses. Consistent with the last 2 years, I've shown the organic EBITDA margin, which this year has exceeded 30%.

Just a quick word on tax. The effective underlying tax rate is 26%, in line with where we expect it to be. This is higher than the U.K. corporation tax rate as we continue to derive more of our profits from other countries where the tax rate is higher and in which we operate and pay taxes. We would expect to maintain an effective underlying tax rate in the medium term in the range of 25% to 27%.

So let's turn now to the strong capital metrics. Starting with the first column, the underlying cash flow of GBP 470 million represents a cash conversion of 95%, but this is after net CapEx of GBP 52 million. As I flagged last year, we continue to overinvest in both IT systems and facilities, and we will continue to do this in FY '18. But we are remain -- we remain committed to driving strong cash conversion just as we've always done. Excluding the impacts of overinvestment in capital expenditure, we will continue to deliver an operating cash conversion in the region of 100%.

Free cash flow as a percentage of revenue was again 15%, as last year, within the 15% to 20% range, and this is after we've absorbed the exceptional cash outflow of GBP 72 million. As indicated in H1, we remain committed to delivering a strong return on the capital we invest in our business. And in FY '17, we achieved a healthy return on capital employed of 27%, and this despite spending over $1 billion on acquired businesses. Going forward, we'll continue to report on this long-term metric, a clear signpost of our focus on efficient capital allocation. And moving to the final column, the closing net debt is 1.6x trailing EBITDA, which is, I said, well within the range of 1x to 2x.

So let's take a look at the sources of revenue. Recurring revenue grew 9% and annualized recurring revenue, nearly 10%. This was underpinned by software subscription growth of more than 30%. Recurring revenue growth is slightly down, largely due to sales mix, specifically the strong new customer acquisition in Enterprise led by Sage X3 revenue growth, which has a large nonrecurring element. And we also saw a weaker performance in France. This is the second year running that we've grown software subscription in excess of 30%. As Stephen said, recurring revenue is now 78% of total group revenue, and software subscription is 37% of total group revenue.

SSRS revenue this year is approximately GBP 300 million and declined more slowly. In line with plan, non-X3 licenses, which are now less than 1/3 of this category, are now still declining double digit. However, this increase was partially offset by new customer acquisition driven through Sage X3 where we achieved great success growing revenue in excess of 20% and adding over 400 new customers.

In addition, professional services also had a strong year. Processing growth of 2% was driven by Sage Pay, particularly in the U.K. market where the shift to online commerce remains a key theme, and this was offset by a slower year in U.S. payroll processing. So we're continuing to see the migration of our installed base customers to subscription. And we've also seen some good success in new customer acquisition with Sage X3 and Sage One. And overall, we continue to increase the proportion of the revenue that is coming from recurring.

So let's turn now to a key metric, which is the growth in annualized subscriber base. In line with last year, we've continued to see strong growth of 32% to GBP 705 million, with almost 70% of this growth coming from Sage Business Cloud. You can see on this slide the success of the cloud-enabled version of Sage 50 and Sage 200, which combined have added GBP 93 million of annualized growth. Regionally, this has been driven by Northern Europe, U.S.A. and Canada. And in FY '18, we will have these products available in 12 further countries all in local languages.

It's also very encouraging to see Sage One at GBP 22 million of growth. Last year, on this slide, that number was GBP 4 million. And as we seek to improve the revenue quality, we have achieved an increase in the Sage One average annual contract value of over 34% to exceed GBP 80. Just a note on X3, which is a relatively small number on here because most of the Sage X3 revenue is on perpetual license. In H1 in FY '17, we successfully launched Sage Live on the same day in 3 more European countries, introducing multi-language, locally compliant accounting on one global platform. In H2, we then expanded Sage Live into Australia and South Africa, whilst also focusing our efforts on better positioning this product and, as a result, seeing customers better suited to this higher-value, functionally rich product.

Sage Business Cloud was launched in October this year, and I just want to put some numbers into the context following on from what Stephen said. We have gone from having virtually no cloud presence in FY '14, just GBP 2 million of revenue, to a comprehensive and unified suite of cloud products. As you can see from this chart, this is driving an annualized recurring revenue of GBP 300 million and this year has grown in excess of 80%.

Now I want to be clear, Sage Business Cloud revenue only includes revenue from Sage One, Sage Live, the cloud version of Sage X3 and the cloud-enabled versions of Sage 50 and Sage 200. Both Sage People and Sage Intacct are also included here, and these 2 businesses contribute just over GBP 90 million of the ARR and grew this year at over 40%.

Whilst I'm talking about the 2 acquired businesses, I wanted to provide an update on how they're performing. Both Sage People and Sage Intacct have continued to perform strongly since joining the Sage family. Sage Intacct has continued to grow in excess of 30% and achieved this year an ARR in excess of $100 million for the first time, further strengthening our position as market leader in this scaleup segment in North America. Sage People's ACV has continued to increase, recording the highest ever ACV in the fourth quarter and signing our largest ever contract for GBP 300,000. Sage Compass is also continuing to make significant progress in providing market insights to customers with total users increasing by 65%. So clear evidence that the benefits we anticipated at the time of the acquisitions are coming through.

So let's move to the regions now. We have grouped the regions together into 3, as last year, but I will make comments on the 8 subregions, these being Northern Europe, Central Europe, France, Iberia, North America, Africa and Middle East, Asia and Australia, and Brazil. And as I said earlier, half of these 8 regions are this year growing their revenue double digit.

So let's start with Europe. Although the recurring revenue penetration has remained constant in Europe at 78%, the subscription -- software subscription penetration has increased to 37%. Both Central Europe and Iberia achieved double-digit revenue growth this year, with Northern Europe at 7%. Sage 50 and Sage 200 drove growth across Europe with an 86% growth in Sage 50 cloud in Northern Europe being a particular highlight. In Northern Europe, which is essentially U.K. & Ireland, we now have GBP 61 million of annualized recurring revenue from Sage Business Cloud, which this year in UKI grew at 78%.

As previously indicated, it was a difficult year in France with revenue growth of 1%. The impact of first-year premiums when customers were migrated to subscription continues to have an impact. But we do expect to see signs of recovery later in FY '18. Both Sage One and Sage X3 delivered strong growth as new customer acquisition picked up. In FY '17, in Europe, we recorded over 30 Sage X3 deals in excess of GBP 100,000. There were also 26 product releases in Europe in FY '17, with the first sales of Sage Live being achieved in Germany, Spain and France.

Software subscription penetration ranges across Europe, starting at 16% in Spain, increasing to 37% in Northern Europe and with France reporting the highest penetration rate at 56%. So there remains much opportunity for subscription growth in FY '18 in Europe as we focus on driving further growth through Sage Business Cloud and through our new leadership in France, where we will focus on the partner channel and accelerating growth in France.

So moving now to North America, which now has the highest recurring revenue penetration of all of our 3 regions. And I do want to make a specific call-out for the Canadian team because this year, they achieved both double-digit overall revenue growth and double-digit recurring revenue growth.

The success in North America's recurring revenue penetration has historically been achieved through maintenance and support. And despite the significant increase in software subscription penetration this year, from 14% to 25%, there remains a considerable growth opportunity in FY '18. We have clear momentum already showing in the Sage 50 cloud and Sage 200 cloud products, which fueled software subscription growth in North America of 97%.

Now in the past, we've called out the Sage 200 family in North America as being on the watch list. It's been an area that's been slow to switch to both cloud-enabled products and subscription as these products are sold predominantly through the partner channel. And I'm pleased to say we now have 10,000 cloud-enabled Sage 200 family customers in North America driving GBP 30 million of revenue. This strong growth in both the Sage 200 family and also in Sage Intacct in North America reflects the complementary nature of these solutions.

The momentum I talked to in the second half of last year in Sage X3 in North America has continued to strengthen. In FY '17, Sage X3 grew at 20% compared to 7% in FY '16. So in FY '18 in North America, we will focus on driving growth with Sage Business Cloud and, in particular, in the scaleup and enterprise. We will also focus on driving growth through our partner channel.

And finally, International. We achieved double-digit revenue growth in International and delivered a further increase in software subscription penetration to 56%. Brazil, Africa and Middle East, all grew double digit. With Sage One and Sage X3 growth, we're seeing further evidence of new customer acquisition in this region. We also won our first Sage Live customer in South Africa as well as growing Sage One revenues in South Africa by 66%.

In Brazil, the team did well to grow the business by 12% in what can only be described as very difficult economic conditions. We do have some continuing headwinds in Brazil due to slower paying customers defaulting on payment, which may impact FY '18, as you would expect in any country recovering from recession. As in other regions in FY '18, we'll continue to focus on winning with Sage Business Cloud.

So moving now to what you all know is my favorite subject, financial discipline. In FY '17, we successfully managed our portfolio. We tidied up the underlying business through disposing of operations that were not a core fit to the strategy, as evidenced by the disposal of the North American Payments business and other smaller subsidiaries throughout the year. We then identified value-accretive investments complementary to the strategy, acquiring Sage Intacct, Sage People and Sage Compass, which collectively have added GBP 91 million of ARR in FY '17. Despite investing $1 billion on these acquired assets, we have also funded all the losses and investments in the acquired businesses and delivered a return on capital employed of 27% and an underlying operating margin of 27%.

Throughout the year, we have continued to act in a disciplined manner and, for the second year in a row, have generated annualized savings in excess of GBP 50 million as an improved payback. This was done through a combination of driving efficiencies in our shared service centers as well as areas like procurement and productivity in the go-to-market functions. Overall, our organic headcount declined, as we planned. And general and administrative expenses as a percentage of revenue is now 13.8%, and this will continue to reduce through driving efficiencies and discipline across both our back-office and go-to-market teams.

So if we have a look at the profile of the operating margin. In FY '16, the G&A saving was 220 basis points. In FY '17, we have achieved a saving of 360 basis points. Now as I've said, going forward, you can expect this to continue to trend towards low double digit as a percentage of revenue.

This year, the reinvestment is very similar with both product and go-to-market benefiting. In products, we have significantly increased our cloud product investment, delivering 52 country releases of our cloud products. But it isn't just a case of making the savings and just handing them over to the go-to-market team. We take a data-driven approach to allocating the investments, and I want to give you a specific example of how this has paid off.

In FY '14, Iberia was growing at 2%, operating as a stand-alone business, often overlooked with little or no investments in the region and no new product launches since 2010. Under the leadership of Luis Pardo, who was appointed in FY '14, we have made significant progress through focused investments in both marketing and product, supported by a strong leadership team and an alignment of operations to strategy. In the last 2 years, we have invested marketing spend to support 8 product launches. In FY '17, we took Sage Summit to Spain, delivering the biggest event for SMEs in this region with 2,500 people attending. We've also rolled out smaller marketing campaigns to better engage the local market, such as the recent activity in response to a local VAT change that delivered revenue in excess of EUR 3 million and engaged over 9,000 customers. So Iberia is a good example of how we've been putting our marketing and wider investment to good work; the payback, of course, being the progressive growth achieved to finish FY '17 with Iberia growing their revenue double digit.

So in summary, I wanted to finish by making 3 points. Firstly, this is the third year in a row that we have achieved or exceeded guidance. Secondly, we have continued to demonstrate financial discipline and focus on capital allocation, as evidenced by both our return on capital employed and our underlying operating margin both being 27%. We've also delivered, for the second year in a row, savings in excess of GBP 50 million and in FY '17 delivering GBP 59 million of savings with an improved payback. And finally, in the last 2 years, we have seen annualized software subscriber base grow from GBP 381 million to in excess of GBP 700 million in FY '17, therefore, providing us with strong revenue momentum.

So with that, I'd like to thank you, and hand back to Stephen.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Thanks, Steve. And actually, just if there's some folks at the back, there are some seats at the front if you want to come forward; more comfortable, hopefully.

So a strong set of results in FY '17, giving us a platform for acceleration as we move towards the next phase of our growth story. The strategic pillars that we shared with you back when we met at the Capital Markets Day, I just want to take you through now and update you on where we are with progress.

So firstly, Customers for Life. We've continued to migrate our customers to subscription, and this has been a strong growth driver, more now than ever with the introduction of cloud-enabled solutions in the Sage 50 and Sage 200 families. These solutions give our customers the flexibility of the cloud, combined with the functionality and the familiarity of the desktop, and give customers access to data from Sage through Microsoft Office 365, as an example. From here, customers can see client contact details, check credit scores and even raise invoices from the palm of their hands. So it's no surprise that these solutions have proven incredibly popular with our customers. From their launch in FY '16, revenue from these solutions is now GBP 133 million, almost 8% of our total organic revenue, growing 140%. And almost all of this revenue comes from Northern Europe and North America where the solutions were first launched. We have another 12 country launches of cloud-enabled solutions planned for FY '18, so expect this revenue stream to continue to be a strong growth driver in the future, both directly and through our partner channel.

The transition to cloud-enabled solution continues to increase our software subscription revenues. Software subscription as a proportion of total revenues is now 37%, up from 22% 3 years ago. Now this shows us that we made strong progress in the Customer for Life strategy, but also that there's plenty of room to continue the growth, both by migrating the installed base to subscription and the cloud and by reactivating off-plan customers who don't currently use a recurring contract. Throughout the transformation, we've also built a strong culture of customer obsession as we transition towards a software as a service, getting to know our customers better and creating a community of real advocates for the Sage brand.

Now we've given our customers the choice between digital, phone or self-service, and unifying the team to meet areas of peak demand for customer service. We also now use artificial intelligence within our own customer services. For example, at tax year-end, we've trained Pegg, our smart assistant, to answer the 3,000 questions that are asked 95% of the time by customers, making the process smoother and more efficient for all our customers to receive the right answer.

So this has resulted in the significant improvement in our Net Promoter Scores, from a neutral score at the start of FY '15 to a high of plus 25 in Q4 FY ' 17. This is up 11 points since FY '16. In terms of the focus on FY '18, the rollout of the cloud-enabled solutions as part of the Sage Business Cloud into further geographies will be a continuing priority, as well as the relentless focus on customer obsession.

So now onto the second strategic pillar, Winning in the Market, new customer acquisition, led again by our President, Blair Crump, who heads up all our go-to-market functions, including all customer functions. This year, we've had 2 priorities here: firstly, to drive successful execution in our go-to-market functions; and secondly, to win in the cloud.

In terms of go-to-market execution, we appointed Blair in April -- I'm sorry, August 2016, and I want to show you some of the progress that Blair has made. Prior to Blair's arrival, our sales function had been fragmented, disparate and operating towards different measures. Blair has made progress here with a focus on raising the standards of leadership. He's replaced 5 out of the top 8 country leaders in the past 15 months. And actually, since Steve and I joined together, all top leaders in the subregions have been replaced. Now this leadership team is highly experienced, competent and highly effective, and we're confident that we have the right team to drive forward the revenue acceleration we strive for as well as maintain and enhancing our margins.

Now another big area of focus for Blair has been to align and simplify our go-to-market functions. Throughout our many regions, there was still significant fragmentation and inefficiencies. Just one example, there was a headcount of 900 nonquota-bearing colleagues within the sales function. Blair has now started cutting through and reducing the complexity, so our sales teams can start focusing on customers and winning. Now there's still more to do here, as I'm sure you'd appreciate, but we're making good progress.

Within every function, we become much better at tracking our return on investment. We'll only continue investing in those areas that drive a return. A great example is the local marketing campaign we delivered in September 2017 right here in London. You may have seen us paint Waterloo and other London stations Sage green, as you can see on the screen behind me now. This campaign raised awareness of Sage in London by 11%, increased web sessions to sage.co.uk by 33% and reached 8 million people with the Sage stories #celebratingourcustomerssuccess. The return on investment led us to invest further in local marketing into FY '18.

Let's move on to our second priority for Winning in the Market, the rollout of our cloud products. So we've shared this slide with you before, in fact, last year, and it shows how far we've come; from virtually no cloud presence in FY '14 with only GBP 2 million of revenues in the cloud to rolling out our cloud solutions across the globe, driving GBP 300 million of annualized recurring revenues in FY '17. As we continue this rollout and improve the functionality, user experience and in broadly ecosystem, our cloud revenue will continue to grow. Sage X3, which grew at over 20% in the year with more than 50 contracts signed at over GBP 100,000. Sage Live's average ACV has risen from under GBP 1,000 to GBP 3,900 in the year. And Sage One's average ACV has risen by 34% on the prior year to GBP 81 with ARR increasing by 76%. This solution now has expanded its market reach as well and is suitable for businesses with up to 50 employees.

These solutions are all part of the Sage Business Cloud, which is now the primary engine to win and drive new customer acquisition in the cloud. As we continue driving out market, the scaleup and lower enterprise segments remains our largest area of revenue generation, providing the sweet spot of strong profitability against fragmented competition where Sage is a clear market leader. The acquisition of Intacct significantly enhances our position in the upper scaleup and lower enterprise as we now have a cloud-first solution in the space to win in the U.S.A, which represents over 50% of the total addressable market. We also continue our focus on the start-up market as well as driving higher contract values, we have strengthened our routes to market with renewed focus on our accountant channel and also our new e-commerce website.

So important work completed to Winning the Market this year. And I would appreciate there's certainly more to do, but we are very clear of some great signs of progress. 4 out of our top 8 geographies are growing at in excess of 10%. These mid-sized regions: Iberia, Central Europe, Brazil, and Africa and the Middle East, where the comparatively smaller size makes it easier to embed operational and cultural change. Now in our larger regions, the transformation took longer, but we're now confident we have the pathway with the right people, the leadership, the processes and the products through the Sage Business Cloud.

So let's take a proper look at Sage Business Cloud, which we launched in October 2017, the one and only cloud business management platform that customers will ever need, from start-up to enterprise. Sage Business Cloud unifies our portfolio of cloud products to provide the most comprehensive suite of cloud solutions in the market. It's perfectly aligned to our customer requirements across the golden triangle of Accounting, People & Payroll, Payments & Banking.

Supporting these core solutions, we have been developing a thriving ecosystem with marketplace apps, powered by developer platforms for application program interfaces, APIs. We also offer the latest platform services, including artificial intelligence and the Pegg framework. So you may wonder what differentiates us from other cloud platforms. Quite simply, there is no competitor who offers the sheer breadth of cloud products that Sage does, products that are global, products that are multilingual, that adapt to local legislation, that can serve a sole trader in her kitchen -- on her kitchen table as easy as they can serve multinational international corporations. Simply put, no one else can do this.

Now new and existing customers can join the Sage Business Cloud at any stage of their business journey and carry on growing with Sage. There is no more expensive, hard-to-implement, monolithic ERP systems. Sage Business Cloud is flexible and completely customizable as the customer's business grows.

A big part of our work around in the Sage Business Cloud has been to develop our ecosystem of partners, and our Payments business has particularly seen exciting developments here. We talked about the updated payment strategy at H1 FY '17. We announced the disposal of the North American Payments business in June 2017. We continue to leverage the power of Sage Pay here in the U.K., and a huge focus in this year has been building our global partnerships.

Following our payment strategy update in May, we now have partnerships with the best Fintech providers in the world, companies like Stripe and Go Cardless, and we are together helping to revolutionize the services we can offer our mutual customers.

So imagine an entrepreneur starting their very first business, a process that could be fraught with administration and red tape. Our technology, through the cloud, simplifies this first step for an entrepreneur. Within Sage Business Cloud, the customer can access a custom-fit solution, a suite of solutions to start trading straightaway.

Let me give you a couple of examples. Our partnership with Stripe means the entrepreneur can set up and receive card payments instantly with easy reconciliation. With Go Cardless, the entrepreneur can seamlessly set up direct debits to ensure payments in and out are frictionless, automated and always on time. In partnership with Liberis, we have piloted new ways for the entrepreneur to get easier access to funding via Sage Pay Business Finance.

Now with our new bank and API, we've enabled new bank account information feeds with the leading banks in the U.S. and the U.K., making the arduous process of bank account reconciliation much, much, much easier, giving back precious time to our customers, the entrepreneurs. So Sage is not just providing compliance and allowing access of backward-looking accounts. It's helping entrepreneurs run their business smarter, more efficiently, looking always ahead from the palm of their hands. And as the business grows, the power and the ecosystem of the Sage Business Cloud will continue with them, allowing the business to scale and expand across the golden triangle.

Now Steve earlier touched on the work we've done to achieve annualized cost savings, reaching our targets and reducing our G&A margin as a proportion of revenue to 13.8%, 360 basis points below FY '16. Now there's still more to do here, and this focus on efficiencies and simplification will continue beyond the transformation and is now considered business as usual at Sage.

Let's turn our attention to One Sage. Ensuring that we have the best talent is absolutely critical to our success. We've invested in our leadership, and we now have a highly talented, highly competent, technology-driven leadership team; our top 150 leaders, over 20% of whom come from top tech companies like Google, SAP, Salesforce and Oracle. Another key element to succeeding in our strategy is making sure we embed a culture where our customers feel -- our colleagues feel empowered to make a difference and give back to our communities.

Sage Foundation is now a beating heart of our business at Sage. In FY '17, we donated almost GBP 2 million in grants to small charities, and Sage colleagues spent 23,000 days paid volunteering in their communities. The Sage Foundation helps us attract and retain the right talent, particularly Millennials. It's also the right way to do business, and it's something that makes us very proud.

So moving on to outlook for FY '18. The organic revenue definition for FY '18 will include acquired businesses from the beginning of the financial year following the date of the acquisition. During FY '17, Sage acquired Sage People and Sage Intacct, which will now form part of organic revenue and, combined, are expected to add around 1% of revenue in FY '18. On this basis, management expects organic revenue growth for FY '18 to be around 8%.

We expect to continue to achieve cost efficiencies that will be more than sufficient to absorb losses as we continue to invest in these businesses as they scale. We are, therefore, confident of delivering an organic operating margin of around 27.5% in FY '18. Now you know we provide guidance on an annual basis. However, in the spirit of transparency and particularly keeping investors and analysts informed of the progress, we will continue with quarterly updates. We started FY '18 investing heavily in sales training and ensuring we're set up for success through the year. Therefore, we'd expect a similar phasing to prior financial years as we accelerate momentum through the year towards our strongest performance in Q4. Our guidance today, on any basis, our organic revenue margins -- sorry, our organic revenue and our operating margin targets are raised.

So to summarize, the strategy is working and the transformation we announced at the 2015 Capital Markets Day is complete. Throughout this period, we maintained a compelling investment case of higher quality, recurring revenue, superior operating margins, strong free cash flow and a progressive dividend. The work we have done organically and through acquisitions has strengthened our position as the market leader in the scaleup and lower enterprise. And we now have the leadership, the organizational alignment, the brand and a comprehensive suite of cloud products unified through Sage Business Cloud to accelerate momentum in the market. Today, Sage is stronger than ever, supported by the rise in our guided organic revenue and operating margin targets and our 9% increase in the full year ordinary dividend to 15.42p.

As a reminder, we'll be holding the Capital Markets Day on 25th of January 2018, here in London, and we'll be excited to give you much more color on Sage's future accelerated growth story. We look forward to seeing you all there.

And with that, I'd love to open to Q&A. (Operator Instructions) So let's start. Steve, come down. Thanks.

QUESTIONS AND ANSWERS

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

We'll start. Mo, do you want to kick off? There's a roving mic coming around for everybody.

Mohammed Essaji Moawalla - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Stephen, can you maybe give us some more color on kind of the assumptions around the sort of 8% organic growth guidance? I mean, geographically, France, obviously was a little soft. What are these -- are you planning any kind of bounce back in France there and then, specifically, U.K.? Some other companies have talked about some sort of macro concerns. Can you maybe isolate the macro versus some of the kind of product cycle and underlying structural drivers around that acceleration, where the risks in the guidance are?

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Well, there's about 3 or 4 questions in there, but I'll do my best. So at the macro level, we see the continuing acceleration with ARR, obviously, around the Sage Business Cloud. In terms of geographically, I think it's important to say we have a plan. We've got new leadership. Laurent Dechaux joined at the start of the month in France. What we shared with you before in terms of the challenge in France last year was around, effectively, the way we priced for subscription and also the partner channel in France. I think we've got our arms around the issues. And with new leadership, we certainly see more stability in the first half and then momentum in France for the second half. Geographically, actually, we would certainly see broadly continuing momentum in all geographies, and 4 obviously out of the 8 subregions are growing at double digit. And then your last question relates, I guess, to the U.K. and the environment in the U.K. Actually, we, like our customers, are confident we're getting on with running our business. And we, despite Brexit and all the noise, we're just focused on getting up every morning running our business, and the outlook for our U.K. business is continuing growth. Last year, we grew at 7%. You saw Steve broke out the Sage Business Cloud growth in the U.K., which is a lot of momentum. We see that continuing across the board. And do you want to add, Steve?

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

Yes, I think -- I mean, in the U.K., we -- despite it being our home market and we've done well in the U.K., we still only have 37% subscription penetration in the U.K. We have a very large installed base of customers who we think will continue to upgrade to the cloud-enabled version, particularly Sage 50. And we've also seen strong Sage X3 growth in the U.K. So I think we have momentum both in the installed base, but also with new customer acquisition.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Good. Who's holding the mic? Do you want to try, Stacy, just mix it up a bit? Otherwise, what we'll do is take all the questions in the future from the front to incentivize you all to come to the front of the room. Go with it, Stacy.

Stacy Elizabeth Pollard - *JP Morgan Chase & Co, Research Division - Head of Software and IT Equity Research*

Only one question, right?

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Yes.

Stacy Elizabeth Pollard - *JP Morgan Chase & Co, Research Division - Head of Software and IT Equity Research*

So can Intacct be taken into new geographies where and over what time period?

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Obviously, yes, but what we'd like to do is keep a bit of powder dry because we want you to all come to the Capital Markets Day, and we'll share the plans around the internationalization of Intacct as part of that sort of future strategy. But absolutely. But obviously, today, Intacct's revenue is all in the U.S., even very little in Canada, so a fantastic product, a market-leading product. Gartner Magic Quadrant. And actually, the key part of the scaleup and lower enterprise is to complete the Sage Business Cloud. Another element I probably should share with you, we've a lot of market analysts kind of doing a deep dive on Sage Business Cloud. And their feedback after spending 1.5 days with this going really into the bowels is we're probably 2 years ahead of the competition and it's the most complete, and that's why I said the most comprehensive suite of cloud solutions products within a platform. So there's loads more to that, though, Stacy at the Capital Markets Day. Michael?

Michael Briest - *UBS Investment Bank, Research Division - MD of Global Technology Research Group & Head of the European Technology Research*

In terms of Sage One, it was -- it added about 70,000 customers in H1 and only about 25,000 in H2. Can you talk about regional picture there? And why do you think that will accelerate? And just a cheeky follow-on in terms of the -- sorry, yes, the acquisition contribution. You're showing Intacct and Sage People at GBP 90 million. You're saying about 1% acquired growth or benefit from that, which is about GBP 20 million. And that just seems lower. It seems to imply they're growing about 20% rather than the 30% you alluded to. Can you explain?

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

So let me take that second one quickly. The GBP 90 million is ARR, so it's slightly higher than the recognized revenue. So -- and I think we've guided to about 1%. It could be a little bit more because we obviously -- what we're looking at, at the moment is where we allocate capital between the different parts of the business, and this is another reason why we want everything to -- we want every pound of revenue to be equal. If we think we can invest more into Sage Intacct and Sage People and get them to grow faster, we will. But we'll do all that within the envelope of making the 27.5% margin. So I think the important thing here is that we are treating both revenue and also costs as equal internally. And it is very important because we're selling through existing channels, particularly with Sage People, that when we're talking to the sales teams, they're not saying, well, I better go and sell this other product over here because it's organic, and I'm not selling this one because it's not organic. We need everybody to be selling the best solution for the customer. So it may be, and we'll be open. When we come and do our results, we will give you an indication of how much of the growth has come from Intacct and People. And it might be that it's more than 1%. But if it is, then that's great, but it will be because we've invested behind it. So if you look at the -- if you think about how that impacts on the margin, for example, we've disclosed that in the period, we've gained this year. We've already made losses of about GBP 8 million in People and Intacct. We haven't said how much we think that will be in '18, but you can extrapolate and you can assume that it's going to be something like 100 to 150 basis points. So by us saying we're going to make to 27.5% margin, it means, excluding those investments, we're probably making something more like 29% in the rest of the business. So you can see from that, therefore, the confidence that we have in terms of the cost drive -- the cost efficiencies and the cost savings in the rest of the business. But we think it's important that we allocate capital in the way that drives the most progress. I've forgotten the first question.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

The first question, maybe on the U.K., Sage One, I think, is what you referred to. Yes, it's, overall, 2% of our revenues. So I know that part of the market gets a lot of noise. However, we're really happy with the progress we've made on raising the ACV and also the ARR of 76%. And Actually, Steve mentioned, I think, GBP 61 million ARR in that marketplace in the U.K. And that was growing broadly similarly in line to the 75%, 76% for ARR growth in FY '17. The other things that you'll see us do more of on reference of them in terms of the local marketing campaigns here, and I just noticed, we got some of our senior management, Amanda, Vicki or Klaus-Michael, our CTO; our Head of Payments and Banking, Seamus; and Neil Morgan, who leads our marketing. You'll see us get really, really engaged in the U.K., as you started to see us in terms of, what was called, station domination, where we painted these stations green. And if you go out to Hammersmith, if you want to lighten up Hammersmith, you might look up at the sky and see Sage. So there's a lot of things in marketing. There's a big push now in the U.K. to really strongly reengage with the accountants. And we're seeing a big shift to the Sage Business Cloud for both our U.K. and North American customers that really underpins this very strong growth we saw in ARR and Sage Business Cloud. So I think there's -- number one, I think we did a -- we said to you, I think signaled for, what, 3 years ago, at that time, it was really marketing money. But we found that the businesses of quality are actually prepared to pay for the value. And there, we've seen the ACV trending up on Sage One particularly. And also, that is the same story on Sage Live. And now we feel that we've got all the elements of the product, the distribution, the marketplace in place to really drive the strategy for accountants through marketing and the move to Sage Business Cloud.

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

We did some -- I think we said a few years ago, we did some experimentation in the U.K. So we did do some deals on Sage One where we were pushing it through GBP 1 a month, so Sage -- the lower end of Sage One. We have encouraged churn at that level because, at the end of the day, if we cannot up-sell and monetize, the model doesn't really work with people paying GBP 1 a month. So we have seen significant increase in churn in Sage One in the U.K. However, the revenue has gone up because we're focused on high-quality revenue. We've also seen churn in Brazil. I mentioned in my presentation that we've seen nonpayment -- an increase in nonpayment in Brazil. And so we've started turning customers off who are not paying. So you are absolutely seeing a shift, as Stephen said. We've said a few years ago, we didn't really mind what the ARPU was in the first year or so. We're now focusing much more on -- we believe that the product is a premium product. It's the match of anybody else's, and we intend to charge appropriately for it.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Actually, one other final thing. So long answer, but 2 years ago, if you'd asked us about Sage One, it would've been 30 different code bases. Now what we talk about in terms of the U.K. version, French, Spanish, German, U.S, is a single code base. So we obviously have to do a lot. Klaus-Michael lead the project with engineering to make sure that we unify that. Now we -- I think we are the only company that has a non-English-speaking, locally compliant, totally legislative to compliant plan, which means that in the future, we can go much faster in terms of product innovation and integrating things like AI and Pegg and all those fantastic products as well. We'll go for Charlie, and then we'll come back over here.

Charles Brennan - *Crédit Suisse AG, Research Division - Research Analyst*

It's Charlie Brennan here from Credit Suisse. Can I just start with a clarification on the terminology of the guidance? We're not used to you using words like around. It's sounds surprisingly imprecise for you. Should we continue to interpret that as at least? And then just in terms of my question, can I just ask about the CapEx? GBP 50 million sounds like a big number. Can you give us any insights as to whether there's any cost capitalization within that, with R&D and sales commissions?

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

I'm sure that's 2 questions.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

(inaudible) yes.

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

So if we really want to say "at least", we would have said "at least". So we mean around. So why are we saying around? Look, because we're still going through a shift, particularly on new customer acquisition, where we're selling X3 on perpetual license. And then we're selling the other products on subscription. So being completely precise about that mix as we go through this year and as we're pushing harder and harder on new customer acquisition means that we just want a bit of flexibility. So we don't want to say that 7.9% was a failure, and 8.1% was a success. Something around 8% we think is reasonable. And the same with the 27.5%. I mean, this year, we have managed pretty much precisely to the guidance that we gave. But again, whether it's 27.4% or it's 27.7%, what we're trying to do is give you the color that we are starting to see the acceleration. And as we go through the first couple of quarters, we'll get a better sense of how that's playing out.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Second question, CapEx.

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

So on CapEx, yes, so GBP 50 million, we don't capitalize internal costs as a rule. We do actually -- we have an R&D policy which could, in certain circumstances, allow us to capitalize R&D, but we have not done so. It is IT systems. So we said before that whilst we've made progress in the back office on using our own systems like Sage X3 and Sage People, we still have a lot more work to do in terms of investing in the CRM systems. So we have salesforce across our Enterprise business, so for X3. But look, we have 3 million customers that this -- the front-end CRM reengineering is quite a big project, which is -- we're still underway with that. And also, we made a deliberate decision 2 years ago that we would rationalize our entire property portfolio. So we've halved the number of locations to around 70. But in our key sort of Tier 1, Tier 2 locations, in pretty much every case now, we have either moved to new offices or we have upgraded them, usually, by going to smaller footprints, but we are deliberately investing in very high-quality facilities because it's part of how we attract and retain talent. And every time you do that, we obviously capitalize the cost of that refurbishment. And these are decent size offices, sop that runs into the millions of British pounds. We are about to do Newcastle. So those of you who've been to Newcastle, North Park is a pretty sizable campus, 340,000 square feet. And we're going to do a refurbishment of that campus, which probably means, over the last -- next couple of years, we'll probably spend about GBP 30 million doing that. So that's where the monies go.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Vijay has a question down the front.

Vijay Anand Chandrasekaran - *Jefferies LLC, Research Division - Equity Analyst*

It's Vijay Anand from Jefferies. In the presentation today, you outlined the strong focus on financial discipline and return on capital employed, which I suppose is a pleasing message for investors. But on the other hand, the change in definition of organic growth might suggest to some that there's probably a greater appetite for M&A going forward. And if acquisitions are like Intacct and it's great for short-term growth, but they will dilute returns in the near term. So that feels like a confusing message to investors, so I wanted to get your thoughts on, are you telling us today that as a business, as a management team, you are going to prioritize growth over returns, or perhaps you've thought some sustainability of returns going forward?

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

Sure. So I think we're being very disciplined. I think the fact that we are including -- we're not just including the revenue, we're including the costs. I mean, remember, if we haven't had put Sage Intacct and Sage People into organic revenue, we wouldn't have put the losses into organic costs either. So we'll be standing here saying here's our revenue number, but we're now making a 29% organic revenue -- organic margin. To me, that makes no sense whatsoever. We have to have complete transparency and alignment between internal metrics and external metrics. GBP 1 pound of revenue is GBP 1 of revenue. We need to be able to say to all our people internally, drive growth. My message to investors is we're doing all of that, and we're enhancing the margin. We're funding all of this. It's not like we went out and did an equity raise. We've funded it all through debt, and the leverage is already down to 1.6. So I think we're making very effective use of our free cash flow. We are delivering to investors accelerated revenue growth, and we're funding it.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

And I think just actually, if you talk to a lot of investors, I think they are very clear that the Sage story is all about organic growth, superior margins, strong free cash flow as a platform for selective acquisitions. And we've clearly stated bolt-on acquisitions that accelerate the strategy. But the essence, and we're do much, much more about how we achieve this at Capital Markets Day, is that organic growth engine through Winning the Market with Sage Business Cloud. So that's absolutely a fundamental part of the Sage story. Do you want to go back and mix it up a bit?

Steven James Goulden - *Deutsche Bank AG, Research Division - Research Analyst*

Steve Goulden from Deutsche Bank. Just on the subscription growth, I think you've said in the past that, obviously, at the minute growing around 30% a couple of years out, maybe that starts to slow once you sort of run through the lower-hanging fruits of the Sage 50 base, and it's a tougher sell as you get into the sort of the 200 level products. I just wondered if you had a bit of an update around that and whether you still think that's going to play out. And obviously, in line with Sage One sort of slowing and customer growth slowing there, are you seeing any kind of material new customer acquisition growth outside of whatever subscribers you're getting there or maybe some subscriptions you're getting at Sage Live?

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

I think on the subscription growth, I think it's probably fair to say that if you compare how we feel today to where we where 12 months ago in terms of the sustainability of the installed base growth, we probably feel a bit more optimistic. I think the cloud-enabled versions of Sage 50, 200, which are integrated into Office 365, are proving to be very popular. I mean, we've got over globally, and by globally, I really mean the U.K., U.S. and Canada because that's the 3 countries where we've launched it so far. We already have over 170,000 customers signed up to cloud-enabled versions of Sage 50 and Sage 200. And we have an installed base in the hundreds of thousands that we can still sell that upgrade to. So I think this has got -- we deliberately quoted the software subscription penetration rates. So although they're high in places like France and South Africa, we still have a huge amount of runway both in the North America and also in Continental Europe, where the products are going to be available during FY '18. So I think there's a lot of momentum. And on new customer acquisition, both in Sage One and Sage X3, we're starting to see traction. And so it's early days. We still need to do more on new customer acquisition, but we are continuing to add the number of customers that we have. And remember, our renewal rates are 86%. So every year, 14% of our customers don't renew, and we still cover that and add more. So we are doing new customer acquisition. Stephen and I would love to see Sage having 5 million customers, never mind 3 million. But I think we're's seeing some green shoots.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Yes just another thing, and this is much kind of a little teaser maybe for Capital Markets Day, but we'll share with you on when we're moving customers to Sage 50 cloud, on subscription, Office 365. Everything I talked about in terms of payments is fundamental. So now our customer can go to Liberis and get basically within seconds effectively a facility. They can integrate Stripe. So it's not just within the Sage Business Cloud; Sage, but it's a much broader ecosystem, and that will drive momentum, and that will drive, obviously, existing customers to move to the cloud but also very attractive for new customers. And I think we've seen that, and the results actually speak for themselves in that respect. But it's -- on that, it's just the start. We've got another 12 countries this year we're rolling out the cloud-enabled solutions to. And you'll hear much more at the Capital Markets Day around Sage Business Cloud. Going to David.

David Iain Toms - *Numis Securities Limited, Research Division - Analyst*

It's David Toms from Numis. Can I just ask a quick clarification -- not a question, a clarification on your response to Charlie. You said you don't capitalize any internal costs. The notes to the accounts say that your IFRS 15 policy is capitalizing internal costs in winning long-term contracts, so can you just quantify that?

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

Yes, we haven't implemented IFRS 15 yet. So IFRS 15 is -- will be implemented from FY '19 onwards. And IFRS 15 -- I mean, I -- we've talked for hours about IFRS 15. We're obviously assessing the impacts of what that will have both from a revenue and also from a profitability perspective, but you probably all know the rules under IFRS 15 are somewhat more prescriptive. And therefore, as the CFO, I've always aired on the side that I don't like capitalizing internal costs unless we're forced to. Under IFRS 15, there are certain areas where we might be forced to. Now we don't have a lot of long-term contracts. The area where we might start to have to do something different would be an X3 implementation. So if we prime an X3 implementation, where we sell both the software and the professional services but we're the prime contractor, and let's say that implementation took over a period of time, we would be forced to match the costs to the revenue over that period of time, whereas today, we just -- we treat them as they're incurred.

David Iain Toms - *Numis Securities Limited, Research Division - Analyst*

And then just a question, sales and marketing productivity, my favorite question each year. You spent more money on sales and marketing. The recurring revenue growth rate is 140 bps lower than last year. The overall growth rate is 10 bps lower. What's the benefit of all the sales and marketing spend, and how are you tracking the productivity of it?

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

Yes. So I think with sales and marketing, it's why I sort of did the example I did on Iberia. We obviously have some expenditure which we sort of drive across the whole of Sage, so brand awareness. But even with things like Sage Summit, whereas last year, we had a big Sage Summit in Chicago; this year, we took Sage Summit on the road and took it to 8 different cities. So what we've been doing more of this year is focusing the investment on a country-by-country basis. And as Stephen alluded to, what we're seeing is a faster return on that in the smaller countries, so in Central Europe, in Iberia, Africa, Middle East, Latin America, et cetera, where we have more agile sort of leadership where we can make the cultural changes faster. I think in the bigger countries, what we've seen is we've put money to play in certain areas. So we've seen great success, for example, in North America on the upgrade to C-line. As I say, I'm very pleased with the Sage 300 family. It's taken a long time to get the partners to really embrace the upgrade to C-line and subscription. That all requires investment, and these things don't come for free. But what the bigger countries have to do as well as those initiatives, like driving C-line and actually driving X3, which has also been a success, we also need to manage all aspects. I mean, the bigger countries tend to have a wider, diverse source of revenue. So they have some of the older product lines that are growing slow, right? So they have some areas where they're doing well. But as a whole, their blended growth rates are not going up fast enough because they're not bringing that together and migrating customers to, for example, the Sage Business Cloud as quickly as they should. So we are being very granular about how we allocate the marketing expenditure. All these product launches that we do, they all require marketing behind them, but it takes a while for it to adopt. So the C-line product is going into 12 countries; Sage Live going into, whatever it is, 9, 10 countries; Sage One, similarly. This all requires money to support, and then it takes a while for it to set off. But we think we've put in place a lot of the building blocks, and '18 is a pivotal year.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Yes, I think it's at a good question. It's a question we ask internally. Blair's, I think, got his arms around that. It's interesting, when you look at Sage One, actually, apparently, it's the fastest product ever launched to get to 400,000 customers in that sort of comparable marketplace. So we talk about that. And it's fair to say, in the early days, you don't see the rapid adoption, but then you see the sort of hockey stick, crossing the chasm, whatever analogy you want to use. I think with Blair here at our Capital Markets Day, you'll get a real sense of a feel. We think there's a lot more we can do around sales, productivity and efficiency. And I think that one of the reassurances you can take is we clearly signaled today the transformation we announced back in 2015 is complete, no more exceptionals, but the discipline we're going to drive internally around productivity, around all functions will continue and be relentless.

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

I mean, we grew the business 7%, and the headcount declined 3%, so we're starting to make some progress in terms of the overall productivity.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Yes. And the go-to-market function, 8,000 people will be at the area of focus. Maybe a couple more questions. Yes, there, James.

James A. Goodman - *Barclays PLC, Research Division - Research Analyst*

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It's James Goodman from Barclays. I mean, you've made a few comments today about having completed the first phase of the transformation for Sage. And if we look at the guidance and step back from the 8% versus the 6% this year, that's largely a consequence of the acquisitions and the Payments disposal, where the growth slowed. My question is, why do you not have more confidence at this stage that the growth would accelerate? And not to steal your Capital Markets Day detail, but how confident are you that the organic growth of the underlying Sage business can accelerate? And when will that come through?

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

I think, James, good question. I think you probably -- you go to a lot of management team presentations. We haven't talked about Brexit. You probably, hopefully, had a very different term for this management team around confidence in the business and, obviously, raising the targets, but we want to be sensible. We never want to be a management team that kind of run before we walk, but we're very confident. And you're right with the disposal of North American Payments, it's probably 0.5%. You got 1% from the acquisitions. But it's still a statement that we're actually seeing an uptick in terms of guidance of the organic growth. And I think we'll see much more of the how, which is the fundamentally getting under the surface of how we're going to achieve this, and you'll meet a much broader range of the management team members. And you'll see the plans coming together when we meet up in January, the 25th of January. Anyone?

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

No, I think we're -- whilst we're signaling the disposal, the transformation is over, changes are constant. There's still a lot to do. We -- as Stephen said, we haven't talked about any external macro factors at all, but this is -- there's quite a bit of uncertainty around at the moment. We think we have our arms around what we're doing. But I think we need to see how the next few quarters go. We're very -- we wouldn't be guiding to 8% if we weren't confident around it, but there's still a lot of moving parts. And we still have one of our largest countries, i.e. France, which only grew 1%. That's got a new Managing Director. And these things take time, though. You can't just wave a magic wand. So that's -- as I said in my presentation, if you exclude France, the rest of the business grew 7.8%. And actually, the recurring revenue would've been 11%. So France is a considerable drag. And whilst Laurent is a very strong leader, he's going to need some time to get his arms around that. North America showed signs of strength in Q4, but again, there's still some moving parts there that need to come through. So I think it's important that we just keep it in context. This is a journey. If we've gone back 3 years, most people didn't believe we could go through this transformation and achieve 6% growth every year without having some sort of double dip. We've achieved 6% growth, we've achieved 27% margin, and we have made substantial changes to this business. But we need to keep driving that change, and I think we're signaling to you it's heading in the right direction. But there's still stuff to be done.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Right. Maybe final question? Just 2 rows back. Excellent. Thanks.

John Peter King - *BofA Merrill Lynch, Research Division - Research Analyst*

It's John King from Merrill Lynch. Maybe just a follow-up or clarification really on that. Just the visibility you have more tangibly, obviously, saying Q4 is the strongest quarter. But I guess, Sage typically feels like it has a 1- to 2-quarter visibility, so what it is that you're kind of confident that comes through really in the latter part of the year?

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

Yes, maybe I'll start, and then you wrap up. I think where -- and with Blair here, I think we have a lot more confidence. There's a lot more granular discipline, forward-looking pipeline management. There's still improvements to make. But I think when we actually sit down with the country managers, and we did a call with them last week, we got a very clear picture of the year ahead and how that kind of maps out. So I think the assurance that you can take is that when we provide guidance, it is underpinned by substance from the rollup of the country managers, and Steve's right at the center of that with Blair.

Stephen Hare - *The Sage Group plc - Group CFO & Executive Director*

So 78% of the revenue is recurring, and 37% is subscription. The subscription has higher renewal rates, so typically, 90% plus. So as the subscription -- amount of subscription increases, our visibility improves because we can see that and, as I say, renewing it at a higher rate. We do have good visibility of the remainder of the recurring revenue, i.e. the maintenance and support. But as I say, the retention rates are not as high. Now we think with the cloud-enabled products, with Sage Business Cloud and with everything we're doing on Sage 50 and Sage 200, we should be able to drive much more to those higher retention rates, and therefore, we're seeing improved visibility in terms of the installed base. More of the new customer acquisition at the moment is coming from X3 because they are bigger projects, and it's perpetual license. Although we have good order cover, visibility of the timing of those deals is more volatile, and that is one area that could be impacted by macro because CFOs become cautious when uncertainty is around. Haven't seen that yet, but that could be the case. So I think we've got a pretty good handle on the momentum and what's happening in the core of the business. But the rate of adoption in new customer acquisition is always the uncertainty. You can't predict how quickly people will adopt the new things that we're doing. We got Seamus here in the audience, who is the Head of our Payments and Banking. We're doing a lot of interesting things in that space. You saw that we signed up with Stripe. There's a lot of things that we're doing. But again, you don't know how quickly customers will adopt these solutions.

Stephen Kelly - *The Sage Group plc - CEO & Executive Director*

So thank you very much for joining us today. Also, really looking forward to seeing you on January 25. And it will give you a lot of the sort of these answers you started today and much more about the how in terms of medium term and acceleration of Sage Business Cloud and the overall business. Thank you very much.
