Sage Full Year Results 2021

Wednesday, 17th November 2021

Overview

Steve Hare

CEO, Sage Group PLC

Hello and a warm welcome to Sage's 2021 full-year results. Now, before I hand over to Jonathan for the financial review, I'd like to start with an overview of our key messages for today, starting with our performance during the year.

Performance

Sage performed strongly in FY21, and I'm really pleased with what we have achieved. Having decided to invest more in the business, we accelerated growth, building momentum in all regions. We grew recurring revenue by over 5% and annualised recurring revenue by almost 8% and, importantly, this was driven by cloud native ARR growth of 44%, the fastest it's been since 2017.

We've added £140 million of ARR from new customers and that's more than 50% higher than FY20 and supported by a continued strong performance in cloud connected, Sage Business Cloud revenue has now reached £1 billion, up 19% on last year.

Progress

On our strategic progress, we've continued to transform the group over the last three years. We've invested in our people, our customer experience, and our technology, to build a strong platform for sustainable growth, and I'd really like to thank all of our colleagues and partners for their hard work in serving our customers and supporting each other over this last year.

Priorities

And finally, onto our priorities. The market opportunity for Sage is growing. Small and mid-sized businesses are investing more in digital technology to enhance their resilience, flexibility, and productivity. And as we build on our progress to capture this opportunity, we've refreshed our strategic priorities to drive Sage forward into its next phase of growth.

Now, I'll come back to talk about our progress and our priorities later in the presentation, but for now I'm going to hand over to Jonathan for the financial review.

Financial Review

Jonathan Howell

CFO, Sage Group PLC

Thanks Steve and good morning, everyone. I'm pleased to share with you today our full-year results. In summary, we've executed well in FY21 and made good strategic progress in line with our plans.

FY21 financial highlights

So starting with the highlights, it's been another strong year for Sage, with performance ahead of expectations at the start of the year.

Firstly, we've delivered recurring revenue growth of 5.4%, in line with our guidance. This was driven by strong levels of new customer acquisition across Sage Business Cloud, with particular strength in cloud native.

Secondly, operating margin was 19.3%, as expected. This is almost 300 basis points lower than FY20, as we increased the level of investment to accelerate growth.

And finally, cash conversion has remained strong, at 126%. This is now the third consecutive year above 100%.

Growth drivers

Adding some colour to our growth drivers gives us a sense of the level of progress we have made in the year. ARR grew by 8%, up from 5% in FY20, reflecting the accelerating momentum from Sage Business Cloud.

In addition, as Steve said, we saw particularly strong cloud native ARR growth of 44%, up from 26% last year. Renewal rate by value was 99%, with churn slightly below pre-COVID levels. Cross-sell and up-sell also increased during the year, supported by our growing digital network.

Sage added £140 million of ARR from new customers, up from £90 million in the prior year, demonstrating the impact of the increased investment we have made. This indicates growth is well balanced between existing and new customers, and this success creates strong momentum as we enter FY22.

P&L summary

Turning now to the P&L, and as usual, all numbers are on an organic basis. Total revenue growth was just over 3% for the year, driven by recurring revenue growth of 5%, to £1.6 billion.

Organic operating profit is £343 million, at a margin of 19.3%, reflecting our planned investment, whilst underlying operating profit is £358 million, leading to an underlying EPS of 23.09 pence.

And our final dividend, of 11.63 pence, is up 2.7%. This takes the full-year dividend to 17.68 pence, an increase of 2.5%, in line with our policy.

Revenue growth drivers

Let's now look at the full-year performance in more detail, starting with the drivers of revenue growth.

Our focus remains on growing Sage Business Cloud and in line with this growth was some £162 million, or 19%, in the year. Both cloud native and cloud connected have delivered a strong performance, growing by £74 million and £88 million, respectively.

Importantly, a large proportion of this growth has been driven by significant levels of new customer acquisition. Migrations also continue to drive growth, mainly in our cloud connected solutions. Accordingly, revenue to be migrated decreased by £56 million.

The impact of all this is Sage Business Cloud penetration, which is now 67%. This is up from 60% last year, with an increasing number of customers in Sage's digital network.

Revenue categories

Turning to the revenue categories, as you can see, both recurring revenue and subscription penetration have continued to trend upwards. Recurring revenue penetration is now at 92%, while subscription penetration has reached 70%, up from 65% in FY20. This is driven by the growth in recurring revenue of 5%, with 11% growth in software subscription to £1.2 billion.

As a result, other recurring revenue and non-recurring revenue continue to decline, by 10% and 18%, respectively. This demonstrates the growing quality in our revenue base as we progress through our transition.

Portfolio view of recurring revenue

Looking at the portfolio view of revenue, the future Sage Business Cloud opportunity continues to show a strong performance, with recurring growth of 8%. And as I mentioned, Sage Business Cloud penetration is now at 67%.

As you can see, the pace of growth in both cloud native and cloud connected is significantly ahead of the group as a whole. Recurring growth of 35% in cloud native, to £286 million, is driven primarily by new customers and migrations. This means cloud native solutions now represent 17% of total recurring revenue, up from 14% last year.

Cloud connected revenue has grown by 14%, to £712 million, which is underpinned by a good performance in the international region.

And recurring revenue in the non-Sage Business Cloud portfolio decreased by 12% to £150 million, in line with our expectations.

North America

We've seen growth accelerate during the year across our regions, starting with our largest region, North America. Here, we delivered recurring growth of 7%, driven by the strong performance in the medium segment.

Sage Intacct continues to be the standout performer, growing recurring revenue at 22%. This is driven by high levels of new customer acquisition, demonstrating strong win rates against our competitors in the market.

In addition, the Sage 200 franchise continues to contribute to overall growth. And the impact of all this is Sage Business Cloud penetration of 73%, up from 71% in the prior year.

Northern Europe

Northern Europe had recurring revenue growth of 4%. Growth in cloud native products has accelerated during the year, with success in the small business portfolio, particularly new customer wins in Sage Accounting.

This is supported by further growth in Sage 50 cloud connected. Sage Business Cloud penetration is now at 86%, up from 81% last year, reflecting the high levels of cloud adoption in the region.

International

And finally, the international region, which delivered recurring revenue growth of 4%. This was underpinned by particularly strong growth in Sage Business Cloud penetration, now at 47% compared to 35% last year.

The good performance in France and Germany is driven by good growth across the Sage Business Cloud. And Africa and APAC delivered strong recurring growth of 9%, with momentum in cloud native, building through Sage Accounting and Sage Payroll Cloud. This was offset by a decline of 2% in Iberia, reflecting a reduction in maintenance and support revenues.

Strategic investment to drive growth

We have continued to accelerate our strategic investment during the year. In line with our plans, the key areas of focus have been investment in sales and marketing, which is focused on driving efficient new customer acquisition in our key territories. This is now at 42% of recurring revenue, an increase of 150 basis points, and investment in product development, which grew by 120 basis points, and is now at 16% of recurring revenue. This is focused on the Sage Business Cloud digital network and our AI capabilities.

We've maintained a disciplined approach to investment. Accordingly, G&A spend is around 11% of recurring revenue and remains unchanged from last year. Importantly, while we continue to invest for success, we expect our level of spend to increase at a slower rate than revenue. As a result, margin is expected to trend upwards in FY22 and beyond.

Strong cash generation

Turning now to the cash flow, cash generation remains a core strength of the business. The group generated £451 million of cash from underlying operations, resulting in cash conversion of 126%. This is now the third consecutive year above 100%. Working capital improvements are again the key driver of this, mainly due to our growth in subscription revenue and continued strength in debtor collections. Free cash flow is £339 million, which is net of interest and tax.

Robust financial position

This in turn has driven a robust balance sheet, underpinned by cash and available liquidity of £1.2 billion, and leverage of 0.6 times. In FY21, we've executed on a number of investments and acquisitions, including Brightpearl, Task Sheriff and GoProposal.

Reflecting disposal proceeds, we're returning a total of £600 million through our share buyback programmes. Alongside this, we announced today an increase in our dividend of 2.5% for the year. Our capital allocation policy remains unchanged. Importantly, we retain significant capacity for future capital priorities to support both organic and inorganic growth. As we execute against this, we expect to move back within the target range of 1 to 2 times.

FY21 financial highlights

To recap, this has been another strong year of strategic execution for Sage. High-quality recurring revenue growth of 5% is underpinned by acceleration in Sage Business Cloud, whilst our operating margin of 19.3% reflects our additional strategic investment. And finally, another period of strong cash conversion, at 126%.

Thank you and now I'll hand back to Steve.

Strategic Update and Outlook

Steve Hare

CEO, Sage Group PLC

Thanks, Jonathan. Now, before I look forward, I want to reflect on our achievements over the last three years.

Strong strategic progress since FY18

We've made strong strategic progress since 2018. Through our investment and the decisions we've taken, we've transformed Sage into a more focused, higher-quality business.

Firstly, we've focused on the needs of our customers, moving them to the cloud, helping to solve their pain points and driving lifetime value for both the customer and Sage.

Secondly, we've invested significantly to grow through technology and innovation, increasing cloud native ARR to almost £350 million, and this growth has accelerated in FY21.

Third, we've reinvigorated our culture and colleague experience, with colleague MPS up more than 60 points over three years.

And finally, we've simplified the group. We've restructured the organisation to focus on growth areas and we've sold non-core businesses, generating sales proceeds of over £500 million. And as I said at our half-year results in May, our disposal programme is now largely complete.

In short, we've made great progress transforming the business, creating a strong platform for further sustainable growth, and our objective now is to grow both revenue and earnings in absolute terms. We've built real momentum and we're well positioned for the current market opportunity.

Customer insights and trends

Now, with about half our revenue coming from small businesses and about half from medium- or mid-sized businesses, we also have a broad footprint across multiple markets. This breadth gives us really good insights into SMB trends globally, which helps us to serve them better and champion their interests.

What we see currently are three key trends. First, digital adoption has continued to accelerate. CFOs say this will be their number-one priority for the foreseeable future. The productivity gains that technology brings are mitigating inflationary forces and are supporting growth.

Secondly, SMBs are increasingly aware of the value of their data. They know they could be learning more and growing faster with better data analytics.

Finally, SMBs increasingly think about their impact on society. Almost all SMBs tell us that having a positive social and environmental impact really matters to them and they want to work with other companies like Sage, who share these values. All this means that the opportunity for Sage just continues to increase.

Refreshed strategic framework for growth

So, building on our progress so far and reflecting these trends, we've refreshed our strategic framework. Our focus continues to be on supporting and championing SMBs, but we've evolved our purpose and ambition and we've set out more explicitly our priorities for growth.

On this slide I'm going to run through a brief overview before going into more detail on the key elements of the framework later in the presentation.

Purpose

Now as always, I'll begin with our purpose. This expresses why we do what we do. It starts with our customers. We create solutions that make their lives easier, removing friction from their organisations and delivering insights. SMBs power the economies around the world, creating two-thirds of all new jobs. By helping them thrive, we also enable them to contribute to sustainable, inclusive growth and a more balanced economy. That's why our purpose is to knock down barriers so that everyone can thrive.

Ambition

Our ambition is our what? It expresses how we serve our purpose and what we want to be, and our ambition is to be the trusted network for small and mid-sized businesses, delivering an integrated experience of digital and human connections. Sage's network will facilitate a smooth flow of work and money between organisations and everyone they need to connect with. It will offer simple, seamless, and unified ways of working. And while the foundations of the network are digital, our technology connects people. And Sage's human approach is core to what we do. We will drive our ambition through five strategic priorities, which I'll run through shortly, but these are the areas that will have the greatest impact on our growth.

Our stakeholders are front of mind for every decision we take. Their engagement is key and together we seek to create mutual success.

Values

And finally, our strategic framework is underpinned by our values, the most important of which is simply we do the right thing.

Our ambition: to be the trusted network for SMBs

So, let's turn to our ambition, to be the trusted network for small and mid-sized businesses. Sage today does more than just help businesses with their accounting, HR, and payroll. We also connect organisations, with their customers, with suppliers, accountants, regulatory bodies, employees, and banks, providing online services, including banking, payment, and compliance services over a digital network. And we continually aim to make the digital experience richer.

So for example, by introducing new features and more valuable services, we can enable customers to automate more work flows and so free up time to build their businesses. And by enabling innovative applications, we can help customers overcome challenges and benefit from better business insights, all underpinned by using verified digital identities and a shared ledger based on a centrally managed blockchain.

Our strategic flywheel

We create trust between network participants. As the experience becomes richer, we attract more customers. This means more network activity and therefore more data. Through artificial intelligence and machine learning, more data powers the insights that we need to build more innovative and compelling customer experiences. This in turn attracts more customers to the digital network.

This is our strategic flywheel, driving innovation and ultimately the growth of the group. And the reason this is such an opportunity for Sage is that we already have access to huge amounts of data. So for example, we estimate that over 10 billion invoices are sent and received by Sage customers annually. Sage Payroll and Sage HR solutions reach tens of millions of employees globally, including 25% of all employees in the UK. In Sage Intacct alone, we're managing 65 million customer records and 35 million vendor relationships, and this is growing at a rate of about 50% per annum. So, thanks to the scale of our existing customer base and our trusted relationships, we already have the components to power the flywheel.

And it's important to note, this new architecture doesn't replace SaaS. It extends, enhances, and connects SaaS products and services by creating trusted relationships between SaaS tenants. And as we continue to build out connections, the network will get better all the time.

Scale Sage Intacct

So, let's turn to our strategic priorities. Sage Intacct is central to our medium segment proposition. In FY21, we invested significantly, enhancing the product, increasing sales and marketing, and transforming distribution, adding over 20 new partners, including PwC. And as a result, momentum is growing, with Sage Intacct adding more than 2,000 new customers across the group, the most ever in a single year and more than 50% higher than last year. Outside North America, where Sage Intacct is just beginning to scale, ARR is now more than £6 million.

One of Sage Intacct's strengths is its flexibility to integrate with popular third-party software vendors. So for example, RapidRatings, a US-based risk analytics business that I spoke with recently, implemented Sage Intacct after outgrowing a competitor product. They wanted it to streamline their finance operations and help them grow, and they're now benefiting from a seamless integration with Salesforce, leading to accelerated client billing and a 40% faster close process.

To drive further scale, both in North America and globally, we're investing to expand Sage Intacct's reach in existing and new industry verticals. We're doing this organically, for example in construction and real estate, and through partners such as Brightpearl in retail and e-commerce, and we're continuing to broaden our distribution channels.

Expand medium beyond financials

Our next priority also relates to the medium segment, where we have the opportunity to leverage our strong position in financial management, to expand into adjacent areas across finance, planning and HR. And one example of where we've done that is with Sage Intacct Planning, a powerful budgeting tool which boosts average contract values by up to a third. This product is about 10% penetrated across the Sage Intacct base, but it's gaining rapid traction, with sales up almost 60% in FY21.

Again, a good example is West Harbour Healthcare, a 650-employee nursing home business in Northern California. And they told us that Sage Intacct Planning has cut their budget creation time by 50% and enabled better business insights that are now improving patient service levels.

Now, our objective here it to deliver more solutions that address the broader challenges that CFOs face, such as accounts payable and accounts receivable. And this will drive cross-sell and up-sell opportunities, enhancing customer loyalty and increasing lifetime value.

Build the small business engine

Our next priority relates to the small segment, where we've focused on growing cloud native initially in the UK, investing in sales and marketing, optimising our e-commerce channel, and deepening our relationship with accountants. As a result, growth in Sage Accounting is accelerating, with new customer wins across all channels up 80% compared to last year. Sage Payroll is also accelerating, doubling new customer wins compared to last year, supported by a strong attach rate to Sage Accounting. And Sage HR and AutoEntry are also growing strongly.

But it's not just the capability of our software that's attracting new customers. The human side of Sage helps too. Foxglove Cocktails, a supplier of craft mixers in Cork, Ireland, who I spoke to recently, told me that Sage Accounting saves them two to three hours per day through the automated input of receipts, but they've also enjoyed the broader support that Sage provides through online learning via Sage University and through helpful advice on the phone when needed. This is a story I have heard repeated by many customers.

We'll continue to support customers in digital and human ways as we represent them with policy makers and invest in the next phases of making tax digital.

We're also investing in how we serve accountants. It's very important that we help accountants to run their own businesses, so we're launching a new cloud native solution for accountancy practices, and we've acquired GoProposal, a client onboarding solution. These actions will significantly upgrade the Sage experience for accountants and drive advocacy. All this has created a scalable growth engine aimed at winning and retaining small business customers. Our priority is to refine and develop our capabilities in the UK while scaling and internationalising the approach in other markets.

Scale the network

When talking about our ambition earlier, I mentioned that our strategic flywheel is driven by more customers using the Sage Business Cloud digital network, because more users mean more data and more insight, leading to more value. And this is already happening. Our digital network is expanding.

First, Sage Business Cloud is growing rapidly, with revenues up 19% to £1 billion, so more customers are able to access the digital network.

Secondly, customer engagement with our digital services is rapidly increasing, with logins to Sage ID, our identity management system for the network access, up by over 60% in FY21.

And third, our ecosystem of software partners and ISVs is expanding. This already includes integrations with around 700 ISVs across the group, extending the reach of our products and helping to grow the network.

Now, further growth will come from new digital services and from new customer wins and migrations. And so, we continue to invest in driving Sage Business Cloud penetration and growth. So for example, in International, we've launched new cloud native products across the region, including Sage Accounting in Spain and new solutions for mid-sized businesses in France and Germany. And we're delivering upgrade paths for on-premises products, including cloud connected offerings as well as Sage Partner Cloud.

We are scaling the digital network around the world and this will enable our customers to connect and capture real world benefits that save them time and enable them to focus on adding value in their own business.

Learn and disrupt

So turning now to our final strategic priority – learn and disrupt. Continuous innovation is key to the long-term success of Sage.

The Sage Business Cloud digital network – and the data and insight it generates – is a key enabler of innovation, and Sage will continue to invest in the technology and capabilities that underpin it.

And the resulting innovation from our teams, from Outlier Detection to intelligent timesheets, is delivering value to customers today. We are building on these foundations to accelerate momentum. So, for example, we've launched an enhanced digital service across multiple products, including bank reconciliations, e-invoicing and a new tax engine that processed seven million transactions on its first day.

We're working in partnership with Tide to provide accounting and compliance as a service to small business owners, and we invested in BrightPearl, which I mentioned earlier, and in CountingUp, an accounting and banking app for sole traders. Our priority is to continue to invest in our innovation capability so that we can create, learn from, and participate in future disruptive trends.

Our Stakeholders

Onto our stakeholders, who are key to our success and to the creation of a sustainable, thriving business.

Customers

As I said earlier, our purpose starts with our customers as we seek to make their lives easier, knocking down barriers to their success. And we do this not just with our technology, but also through a human approach, building every experience with human insight and ingenuity.

Colleagues

For colleagues, knocking down barriers means improving their experience at Sage, creating opportunities, and enabling every colleague to do their very best work. Key to this is our focus on development and training, and on inclusion and wellbeing through our thriving colleague support networks and our new flexible working model.

Society

On society, for five years now, we've contributed directly to our communities through the Sage Foundation. In FY21, colleagues spent 22,000 days volunteering for good causes. Now, we've decided to broaden our impact by launching our Sustainability and Society strategy, which aims to tackle the digital divide, economic inequality, and the climate crisis. This includes supporting STEM skills training for disadvantaged children and helping underrepresented groups around the world to start their own business. On carbon, we've pledged to halve our emissions by 2030 and achieve net zero by 2040 across scope 1, 2 and 3. And last month we launched our Sustainability Hub, providing SMBs with advice on how they can reduce their own carbon impacts.

Shareholders

And, of course, our overriding objective through all of this is to create sustainable growth in shareholder value, but to do it the right way.

Outlook

So now let's move on to the outlook for the Group. We expect to achieve organic, recurring revenue growth in the region of 8-9% in FY22, driven by continuing strength in Sage Business Cloud and by cloud native revenues in particular. We also expect other revenue to continue to decline, in line with our strategy. And consistent with previous guidance, organic operating margin is expected to trend upwards in FY22 and beyond as we now focus on scaling the Group.

Key Messages

Performance, progress, and priorities

So, in conclusion, Sage is performing strongly. Thanks to our investment, new customer acquisition is accelerating, while renewals and revenue expansion rates among existing customers are strong. This is driving the sustainable growth and profitability of the Group. And, as Jonathan said, we enter FY22 with good momentum. We've made strong, strategic progress delivering on the goals we set out three years ago, and we've evolved our strategic framework to set out more explicitly the priorities which will drive Sage through its next phase of growth, with a core strategy based around the benefits of the network.

As I said earlier, our objective now is to grow both revenue and earnings in absolute terms, and we will do this both organically and through acquisitions. I am very confident that we have the right strategy and focus to drive the success of Sage for our shareholders and all of our stakeholders, now and in the long term. Over the coming months we intend to host a series of webinars for our investors and analysts to provide some more insight into our business and to give wider exposure to the depth and capability of our leadership team, and I really hope you'll find these helpful.

But, for now, that concludes today's presentation. Thank you very much for being with us. And Jonathan and I will be happy to take your questions, so I'm now going to hand over to the operator.

Q&A

Operator: Thank you. To ask a question, you will need to press star one on your telephone. To withdraw your question please press the pound or hash key. Please stand by while we compile the Q&A roster. Your first question comes from the line of Adam Wood from Morgan Stanley. Please ask your question.

Adam Wood (Morgan Stanley): Hi, good morning, Steve, Jonathan, thanks for taking the question and congratulations from me on a strong end to the year. I've got two, please. The first one is maybe just to dig in a little bit deeper into the acceleration you've seen during the second half of the year and, I guess, especially into Q4. Could you maybe just give us a little bit more detail around, you know, the renewal by value, where that ended up at the end of the year, what you've seen there and that mix between churn and cross- and upsell? And maybe, similarly, on the new customer activations, in terms of, you know, the mix of new customers versus reactivations and what you're seeing on that side as you came through the end of the year.

And then, secondly, it's interesting that North America is the fastest-growing market. I mean I guess that's also the most competitive market for you. Could you talk a little bit about, first of all, do you think that's market growth, or do you think that's the mix of the business being more exposed to cloud native? And to the extent it is cloud native, therefore, you know, how much of a priority and how quickly you can get more cloud-native products rolled out across the Group, and how much of a priority that is for you? Thank you.

Steve Hare: Thanks Adam, and I'll pass over to Jonathan for the first question and then I'll pick up the second. And, actually, we'll indulge you with two questions, but we would ask that generally people ask one question, so that everyone's got time. But, Jonathan, do you want to kick off?

Jonathan Howell: Yes. Look, thank you, Adam, for the question. When we set out at the beginning of this year, we guided that we thought the growth would be second half weighted and that would be driven, you know, by the additional investment that we're putting into sales and marketing, and product and R&D, and that's exactly as it's turned out. And if you recall, at the first-half stage we raised guidance slightly. Again, at Q3 we also raised guidance, and now we've landed with a 5.4% recurring revenue growth rate, which is just above, you know, where we were guiding and just above consensus. In terms of the sequential build, if you look at the ARR build, sequential growth in the first half was 3% and in the second half it was 5% on a constant currency basis, and so there's clear marked acceleration. We exit with an ARR growth rate of around 8% and we expect, you know, that sequential growth to continue into the first half of FY22.

Renewal rate by value, absolutely critical and it shows that we're getting balanced growth now across the business. And, as you can see, in the first half we reported 97% renewal rate by value, and if you recall that had come off slightly during the COVID – you know, the 18 months of on and off lockdowns. However, we reported for the full year 99%, and therefore that implies a renewal rate by value of 100% or 101% in the second half. That gets us back to where we were pre-COVID. Just breaking that down, first of all churn. Churn has continued to reduce, gross churn has continued to reduce, and we are now operating at a lower level of churn than we were on a pre-COVID environment, so that's very pleasing. I think, also, what we've seen in the second half is a strong pick-up in upsell and cross-sell, particularly upsell in medium segment in North America, and that's principally coming through in Intacct and Sage 200.

And then, lastly, the other element I would just flag up about renewal rate by value, we said very clearly at the beginning of the lockdowns 18 months ago that we would work with our customers and that we would not be putting through price increases. We did not do that, we allowed for some discount unwinds to come through, and so this second-half performance has been driven not by price increases. Going forward into FY22, where there is a fair value exchange between us and our customer base then we will be anticipating some price increases.

So, all in all, that was, you know, a strong second half, as you say. I think also, you know, if you look at the NCA, you know, we've seen £140 million of NCA; that is a very strong performance. And just to, sort of, break that out, you know, for you, about two-thirds of that was NCA and about a third of that was reactivations across the customer base.

Steve Hare: And then just in terms of market, there's no doubt the North American market has come back strongly, continues to be very strong. I think we're also seeing the benefits of our product investment as we add functionality, particularly to Sage Intacct. And, thirdly, you know, we've also invested in the channel, adding new partners and, sort of, increasing our reach. So I think if you take those things together, you know, that's what's driven the North American performance.

Adam Wood: Thank you very much, appreciated, and thanks for letting me sneak two in there.

Steve Hare: Thanks Adam.

Operator: Your next question comes from the line of Ben Castillo-Bernaus from Exane. Please ask your question.

Ben Castillo-Bernaus (Exane): Good morning, thanks very much for taking my question. So I'll focus on one of your five strategic priorities. At number two is expanding beyond financials, broadening the value proposition. Feels like a very new avenue for Sage. What does this add to your TAM and how would you add that functionality? Is that embedded into the existing Intacct offering or is that going to be packaged as, kind of, additional, separate solutions, and I suppose if you could comment on, you know, how you intend to build out that; is that through targeted M&A or organically building these solutions yourself? Thanks.

Steve Hare: Yeah. I think the investment that we've put into the digital network is really what enables us to, you know, start to do this more widely. So, you know, some of it may be built into the Sage Intacct core base, but actually what – most of what we will do is to add functionality that is interconnected on the digital network. And so we'll do some of that organically and we'll do some of that inorganically. But as far as the customer's concerned, the aim is to deliver to them a seamless solution which is solving their wider pain points, and in this part of the market, where we're selling Sage Intacct, we're talking about selling to CFOs. So it's really about what is it that causes CFOs more work, more admin. And it tends to be around extended workflows, so things like accounts payable and things like accounts receivable, how do you integrate into payroll, HR, etc. All of these things in bigger companies tend to be overly manual, and our aim is to automate it and bring it all together so that CFOs can spend time looking forward rather than looking backward.

Ben Castillo: Got it, thanks very much.

Steve Hare: Thanks.

Operator: Your next question is from the line of James Goodman from Barclays. Please ask your question.

James Goodman (Barclays): Good morning, thank you very much. I'll ask you one around the margin outlook, please. And really, sort of, the focus of that is, I guess, historically you've talked a lot about revenue growth being the priority. Clearly, the recurring outlook's solid, 8-9%, but I had in my mind that, really, we were looking for double-digit growth before you started to meaningfully focus on the margin. So maybe you could a little bit about the trade-off there and add any colour that you can to the outlook, and I guess the sort of, topics I'm thinking about within that would include also the restructuring that you announced at the end of September and the reinvestment there, as well as any potential, sort of, wage inflation on the other side of the current inflation debate. Thank you.

Jonathan Howell: Yes, James. Look, thanks for the question and it's important as well. The – you know, when we started this year, we guided to up to 300 basis points reduction in margin to put in additional investment in those areas of the business that we needed to drive the growth rate, particularly in cloud native and particularly in Sage Business Cloud, and that's paid dividends. I mean you can see that during the course of the year, where we've seen, you know, cloud native ARR grow by 44% and Sage Business Cloud grow by 19%. The – it was more second-half loaded in terms of, you know, the rate of investment, which is exactly what we expected, and we've landed at 19.3%, which I think was more or less in line with consensus.

Going forward, we are keen to continue to invest at pace and, however, we will make sure that the rate of growth of revenue is in excess of the rate of growth of the cost base, and that will, therefore, drive margin expansion during the course of this year. Currently, market consensus is around 50 to 100 basis points increase in margin. That feels about right at the start of the year, but we will dynamically accelerate or deaccelerate investment depending upon the growth opportunities that we see. So I think just to, sort of, give you a clear, sort of, view of where we're headed, yes, we're going to see margin expansion, yes, we're going to determine that in the context of the growth opportunities that we see, but importantly, you know, that margin will begin to expand.

And I think, just on restructuring, you touched on that. We announced in September the removal of 800 roles from the organisation. We have started that programme. You can see a one-off restructuring cost of £87 million that we put in place. That process will extend over a year or a year and a quarter but will not result in any net margin expansion. All of that, all of the savings as a result of that, is reallocating investment and headcount to those areas of the business that we need to invest in going forward, and that includes customer experience, brand, and digital marketing to continue to drive this accelerated growth that we're seeing in cloud native.

Steve Hare: And I think, just to emphasise, James, as I said in the presentation, the aim now is very much – the revenue growth does come first, if you like, but it is our intention to scale both revenue and earnings in absolute terms, right? So, you know, we've obviously had a period where we've slimmed down, we've sold non-core businesses, etc. We very much now are entering a phase where it's about scaling.

James Goodman: Very helpful, thanks for the detail.

Steve Hare: Thanks.

Operator: Your next question is from the line of Michael Briest from UBS. Please ask your question.

Michael Briest (UBS): Yes, thank you. Good morning. One from me. Just on the cost base, Jonathan, if you – helpful to give us the R&D and sales and marketing numbers. I think you gave a G&A number. I didn't quite catch it, but if I look at, sort of, the gap between total OPEX of £1,357 and R&D and S&M, you know, it's £400 million. Are there some other costs going through there; can you, sort of, tell us what those are? And I guess, related, if you hadn't reversed the £11 million of COVID provisions you would have had a bigger than 300-basis point margin decline, so can you talk about the cost progression in 2021, what meant that it was, sort of, more than you'd, sort of, initially budgeted for? Thank you. Or had you planned to reverse the £11 million?

Jonathan Howell: Yes. So just in terms of breakdown, you know, of the cost base, we've landed very much where we expected. We've got sales and marketing coming in at 42% of recurring revenue. That was up by 150 basis points and that was a critical redirection of spend.

Secondly, we've seen product and R&D come in at about 16%, probably just slightly lower than we'd initially planned, and with 120 basis-point increase, and we've kept G&A flat at about 11%. And so, therefore, the balance is effectively cost to serve, where we've seen a slight increase as we onboard all of these new customers that, you know, we're winning through the NCA success that we're having.

I think just in terms of the release of the additional COVID bad debt provision that we put in place, we put that in place 18 months ago, it was for £16 million and that was over and above the normal IFRS 9 provision. Throughout the 18-month period we have continued to test the models that support that provision. And clearly, when we got to the year-end, with the macroeconomic outlook across many of our territories improving significantly, then, you know, the modelling suggested that we should release about half of that provision.

Now, to your question, you know, have we therefore, sort of, effectively missed, you know, the margin guidance of about 19 or so if it wasn't for that release, the answer is no because, as you appreciate, there are a whole number of various provisions and accruals in the balance sheet date, and this is just one that, you know, that we chose to highlight at the time of going into the COVID lockdowns 18 months ago. So that is more than offset by other kinds of provision set ups that we made during the course of the year, so it doesn't have an impact on the underlying trend of margin.

Michael Briest: Okay. Would you expect to reverse the rest of it in H1 if, you know, things continue as is?

Jonathan Howell: To be determined. We will – you know, at each balance sheet date we will continue to run the modelling.

Michael Briest: Thank you.

Operator: Your next question is from the line of Stacy Pollard from JP Morgan. Please ask your question.

Stacy Pollard (J.P. Morgan): Hi, thank you. You've just about completed the disposal programme and you're – I guess the question would be, are you looking more aggressively at

M&A again? Is that small bowl ponds or would you consider something larger or more transformational?

Steve Hare: Yeah. Hi Stacy. So, yes, you know, the disposal programme, as I said, is largely over. I think, look, we – we're looking at similar acquisitions to what we've done in the past. So I've said before, you know, things in the kind of, potentially, hundreds of millions of purchase price. But, you know, we wouldn't rule out something a bit more transformational, if appropriate. But I think, you know, the focus at the moment is on continuing to add that additional functionality, technology into the digital network, and so, you know, you'll see us, you know, doing a number of those types of acquisitions. It's obviously very competitive at the moment; you know, to state the obvious, you know, valuations are relatively high, you know. So we will remain disciplined, but, you know, we are definitely looking.

Stacy Pollard: Thank you.

Operator: Your next question is from the line of Gautam Pillai from Goldman Sachs. Please ask your question.

Gautam Pillai (Goldman Sachs): Great, thanks for taking my question. I had one on Intacct. So the Intacct growth in North America was perhaps a bit slower than previous quarters, was there any specific reason for that? On the other hand, internationally Intacct seems to be doing quite well. So can you just comment on the BI plan you see for Intacct internationally and how the strategy's working, and how should we think about that? This is both for your growing going forward. Thank you.

Steve Hare: Yeah. I'll let Jonathan talk about the international in a minute. Just on North America, in the second half, if you look – if I look at the pipeline for North America and I look at the growth in the second half, there's two dynamics. New customer acquisition is very much back to, sort of, pre-COVID levels and above. And what happened during the pandemic was the renewal rate by value came down, i.e., we did less cross-sell and upsell to our existing customers in North America, Intacct, than we would do traditionally. But, again, as I look into the Q3/Q4 and I look at current levels of activity, that's very much coming back. So, you know, Intacct on a run rate basis is already back to the sort of growth rates that we saw pre-pandemic, which is the run rate of about 30% growth.

But, Jonathan, do you want to comment a bit about international?

Jonathan Howell: Yes. So, yes, I mean just to endorse Intacct and North America, both NCA and upsell and cross-sell off Intacct have accelerated rapidly during the course of the second half, and it's operating back on an elevated renewal rate by value, you know, way above where we've been over the last couple of years.

And then, in terms of international, if you take all of the other regions, outside of North America, we are – you know, we're reporting at this year-end a total ARR of £6 million, and that compares to £2 million 12 months ago. And, you know, in particular in the UK, you know, there's very strong and positive feedback, you know, from the new customer base and from the partner channel. So, you know, we anticipate that this should accelerate as well during FY22.

Gautam Pillai: Can I just follow up and ask who are you replacing with Intacct, especially in UK and such markets?

Steve Hare: So usually it's graduates from smaller offerings. So, you know, as companies grow and they want, you know, more sophisticated or, you know, more comprehensive systems, they tend to upgrade. So, you know, sometimes, you know, it can be a graduate from Sage's products, or it might come from Xero or Intuit, but it's typically from those – you know, coming from a smaller – and because you're growing you need a more sophisticated system.

Gautam Pillai: Got it, thank you so much.

Steve Hare: Thank you.

Operator: Your last question comes from the line of Paul Kratz from Jefferies. Please ask your question.

Paul Kratz (Jefferies): Oh, hi, thank you for letting me on. Just one question from me. I mean, when we think historically about the renewal rates by value, it's been notoriously sticky, at around this 100% to 101% pre-COVID. And I guess, you know, to what extent is it realistic that with a recovery in pricing, kind of, a structural reduction in gross churn, you actually get a rebasing of that renewal rate as we exit the pandemic, you know, to maybe a level above 101%, or maybe even to 102-103%? Any commentary on that would be helpful. Thanks.

Steve Hare: Yeah. So I think, in this context, it's important to differentiate between the smaller businesses and the more mid-size businesses. So one of the things that, if you like, holds back a little bit the renewal rate by value for smaller businesses is typically the volume churn is higher, right? So, you know, typically your volume churn, you know, is more like 15-16% per annum. Whereas with mid-size businesses your churn is often, you know, annualised, single digits, so 9-10%. So in order to get your renewal rate by value up above 100% for smaller businesses, to state the obvious, you have to work a lot harder.

I think for mid-size businesses, I mean, historically, I think we've said in the past that at its peak Intacct was managing to achieve a renewal rate by value of about 108%. And if you, sort of, go back to some of the comments I made about the digital network, over time, as we make more and more things available to our existing customers, that should give us, particularly with mid-size businesses, an opportunity to get that renewal rate by value up, but it is very, very sensitive, particularly with small business, to how the volume churn ultimately settles down.

So we tend to plan, or we tend to talk, on the basis of staying on a blended rate of around 100%, but there may well be years and there may well be periods of time where we're able to do better than that, particularly in the mid-size businesses.

Paul Kratz: That was very clear, thank you.

Steve Hare: Thanks.

Operator: There are no further questions at this time. Please continue.

Steve Hare: Okay. Well, thanks very much everyone for attending today's presentation. As always, we really appreciate you taking the time. And if you have follow-up questions, please feel free to contact James and the IR team, and we'll be happy to deal with things during the course of the day. But for now, thanks very much.

Operator: This concludes today's conference call. Thank you for participating, you may now disconnect.

[END OF TRANSCRIPT]