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CORPORATE PARTICIPANTS

Jonathan A. G. Howell *The Sage Group plc - CFO & Director*
Stephen Hare *The Sage Group plc - CEO, Interim COO & Executive Director*

CONFERENCE CALL PARTICIPANTS

Adam Dennis Wood *Morgan Stanley, Research Division - European Technology Equity Analyst*
Alexander William Tout *Deutsche Bank AG, Research Division - Research Analyst*
Amit B. Harchandani *Citigroup Inc, Research Division - VP and Analyst*
James Arthur Goodman *Barclays Bank PLC, Research Division - Research Analyst*
John Peter King *BofA Merrill Lynch, Research Division - Research Analyst*
Michael Briest *UBS Investment Bank, Research Division - MD of Global Technology Research Group & Head of the European Technology Research*
Mohammed Essaji Moawalla *Goldman Sachs Group Inc., Research Division - Equity Analyst*
Paul Kratz *Jefferies LLC, Research Division - Equity Associate*

PRESENTATION

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Good morning. Hello, everyone. I'm Steve Hare. I'm the CEO of Sage, and I'd like to welcome you all to Sage's First Half FY '19 Results. Thanks to all of those of you in the room, those of you on the phones and also everyone on the webcast.

I'm really happy to welcome Jonathan Howell, who's presenting here for the first time, as Sage Group CFO. And I have to say it's absolutely fantastic to only be doing one job as CEO this time.

Now before we begin, please note the safe harbor statement, which you can find on the screen behind me and also in your packs.

The agenda for this morning's presentation is detailed on the screen behind me. And I'm going to make some opening remarks before handing over to Jonathan for the financial review, and then I'll come back and give an update based on the strategic execution and also on the outlook.

But I want to set off by talking about the purpose, the vision and the strategy because this sets the stage for today's presentation. I'm also going to summarize what I see as the key things that have been different in the first half and, therefore, why I think we've created some momentum in the business.

Now our purpose is the reason that we exist as a business, if you like. It's what gets us out of bed in the morning. And our purpose is to transform the way people think and work, so their organizations can thrive. Our vision is how we serve that purpose. And as I outlined at the FY '18 results announcement, our vision is to become a great SaaS company for customers and colleagues alike.

And we achieve this vision by focusing on the 3 key strategic lenses; customer success, colleague success and innovation. And what I'm going to talk about today pulls together the purpose, the vision and the strategy.

Now I've been CEO for 6 months now, and I use this slide a lot, particularly internally, so that we can continue to use it to focus on what's really important. I've also been looking at the wider Sage culture and how I want the company to operate. This means continuing to embed the right values and leadership behaviors as a major priority. And it has to start at the top.

We have great talent at Sage, and I want to ensure we continue to build an environment to support our people and enable them to thrive.

So what's been different in the last 6 months? I've spent time building my leadership team and making sure that we're working in a way that mirrors the values and behaviors that I want to drive in the business. This means pulling together as one team and focusing on the quality of performance instead of just the end result.

How we achieve success matters.

In a SaaS company, you must perform every day for your customers. Success is not about closing all of your orders on the last day of the quarter. And we're already starting to see success in this area, as evidenced by the sequential month-by-month recurring revenue growth.

And you must do it in the right way. I do not want to create a business that achieves short-term boosts to results at the expense of long-term value creation. So as a company, we're focused on the quality of the performance, driving the right behaviors and delivering everything through the lenses of customers, colleagues and innovation.

Now it's early days, but we are starting to see results.

And linked to that, these are the 3 key messages for the first half. Firstly, we've shown focus on the right areas of the business. Secondly, this has resulted in successful strategic execution. And the output of that, amongst other things, is the acceleration and high-quality recurring revenue growth.

Now I'm going to come back to these themes later in the presentation, but for now, I'm going to hand over to Jonathan to cover the financial review.

Jonathan A. G. Howell ***The Sage Group plc - CFO & Director***

Thank you, Steve, and -- for that introduction. And welcome to you all here this morning. I'm very pleased indeed to be presenting Sage's results today. To start with, I'll run through the 3 key messages I want you to take away. They're very much linked to Steve's key points and focused on strategic execution which, in turn, leads to improving quality of revenue.

So my key messages. First of all, high-quality recurring revenue growth. Sage's own good strategic execution in the first half. We've just given strong growth in recurring revenue of 10.2%. Secondly, strong cash conversion. Cash conversion has been particularly strong in the period due to a number of factors which I will explain. However, even without one-off effects, long-term cash conversion remains a core strength of Sage. And thirdly, on-target margin. Organic operating margins are in line with our targets, reflecting good performance in the business and ongoing investment.

So turning now to the P&L. Total revenue for the first half is up 6.2% to GBP 941 million. Recurring revenue is up 10.2% to GBP 779 million. The organic operating profit is GBP 218 million at a margin of 23.2%. This margin is in line with expectations and reflects good performance in the business, offset by increased investment to support customer success, colleague success and innovation.

The underlying operating profit for H1 is GBP 218 million. And a quick word on tax. The underlying effective tax rate was 26%, and we expect the effective tax rate to remain broadly in the range of 25% to 27% going forward.

Overall underlying EPS is 13.93p, which is 2.2% less than last year. And we've increased the interim dividend by 2.5% to 5.79p. This is consistent with our dividend policy to maintain the dividend in real terms. Finally, you can see that ARR has increased by 10.2% to some GBP 1.5 billion, in line with recurring revenue of the business.

So now looking at revenue categories. As you can see from the chart, we've delivered strong recurring revenue growth of over 10% to GBP 779 million for the first 6 months. This is underpinned by the 28% increase in software subscription to GBP 485 million as the business transitions to subscription and the cloud. The decline in other recurring of 10% to GBP 294 million reflects the substitution effect as customers migrate to subscription contracts. The SSRS decline of 12% to GBP 137 million reflects the planned decline in licenses as the business transitions towards subscription. This is further impacted by underperformance in the U.S. and France. It's encouraging to see that 83% of total revenue is now recurring, and software subscription penetration is now at 52%, up from 43% in H1 '18.

Now turning to the portfolio view of revenue. Growth in Sage Business Cloud for H1 has been driven by a number of factors: firstly, acquisition of new customers and reactivation of off-plan customers onto cloud native and cloud connected solutions; secondly, migration of customers from their existing Sage products to a cloud connected or cloud native solution; and thirdly, migration of a product set to Sage Business Cloud as the product develops cloud functionality.

This type of migration started happening for the first time in H1 and included Sage 50 cloud payroll.

The impact of this type of product migration is a net GBP 40 million movement into cloud connected revenue, mainly in Northern Europe.

So looking now at the growth rate of the portfolios. Overall, the future Sage Business Cloud opportunity continues to show strong performance with recurring revenue growth of 12%. Importantly, cloud native solutions have delivered recurring growth of some 27%, and the growth in cloud connected recurring revenue of 124% to GBP 210 million includes the GBP 40 million product migration I just outlined. Even without this, the cloud connected solutions delivered 82% growth. This is principally driven by our major territories of North America, Northern Europe and France. And the impact of all this is Sage Business Cloud penetration is now at 44%. Finally, the flat recurring revenue and decline of 3% of total revenue in the other portfolio is in line with expectations. So overall, strong progress in Sage Business Cloud.

Turning now to the regions. And here I'll focus on our most important regions and countries. There is more information on the slides.

North America delivered total revenue growth of 10% to GBP 311 million and recurring revenue growth of 12% to GBP 276 million. North America has the highest Sage Business Cloud penetration of all our regions with nearly 2/3 of recurring revenue now coming from a cloud solution, up from about half last year. Cloud connected has continued to be very strong in North America with the U.S. now approaching full penetration on 50 cloud connected. The Sage 200 family in the region and Sage 50 in Canada are now driving the next wave of growth. Cloud native growth in North America is driven by Sage Intacct, which reported growth in recurring revenue of 29% in the first half.

Northern Europe, that is U.K. & Ireland, delivered total revenue growth of 4% to GBP 197 million, and recurring revenue growth of 14% to GBP 163 million. Again, I just want to call out Sage Business Cloud penetration here which is now at 59%.

We have seen strong performance in Sage 50 cloud connected. This has come from migration, but also new customer acquisition and reactivation, which has been helped by Making Tax Digital.

Also, as you're aware, recurring revenue has been held by a weak comparator in the prior year and renewed focus on recurring revenue this year. Total revenue reflects the drop of 44% in SSRS due to strong license in services sales in the prior year, which drove an increase in SSRS at the expense of recurring revenue.

Central and Southern Europe delivered total revenue growth of 3% to GBP 304 million and recurring revenue growth of 6% to GBP 241 million. Sage Business Cloud penetration is much lower in this region, but the cloud connected solutions are now becoming more significant.

France delivered recurring growth of 5% to GBP 119 million, continuing to improve recurring revenue, largely driven by cloud connected migrations, and there is still a significant runway on cloud connected in France. Total revenue growth in France reflects the decline in SSRS due to the continued transition to subscription and underperformance of services revenue.

And finally, the international region. Here we delivered total revenue growth of 6% to GBP 129 million and recurring revenue growth of 8% to GBP 99 million. Africa and Middle East, which represents over half of the international region's revenue, delivered recurring revenue growth of 12%. Growth in the region is driven by local products and a smaller amount of cloud native solutions.

Turning now to cash flow. Underlying cash flow from operating activities was GBP 330 million. Cash conversion of 151% is strong and reflects an improvement to the receivables collections process, the continued transition away from license deals and low levels of FY '18 bonus payouts in H1 '19. And this has led to free cash flow generation of GBP 257 million, some GBP 100 million higher than the last year. However, we do expect cash conversion to trend down in the second half. Net debt has reduced to GBP 448 million, and net debt to EBITDA leverage is now at 0.8x.

Finally, I want to outline our capital allocation policy. As you can see from this slide, Sage's primary focus remains organic investment in order to move to a SaaS company. Second, the group may consider bolt-on acquisitions of complementary technology that will drive strategy. Thirdly, Sage will continue to maintain the dividend in real terms going forward, and the interim dividend has increased by 2.5%, as I mentioned earlier. And then if there are surplus capital, we will consider making additional returns to shareholders. Finally, underpinning this capital allocation, Sage plans to operate in a broad range of 1x to 2x net debt to EBITDA in the medium term. We will maintain the flexibility to move slightly outside this range as the business needs require.

So to summarize. Firstly, Sage has shown good execution, which has resulted in high-quality recurring revenue growth of 10.2%. Secondly, we've had strong cash conversion of 151%. And as I called out, there've been a number of one-off factors. But even excluding these, cash conversion remains a core strength. And thirdly, on target margin, with organic operating margin of 23.2%, in line with our full year target of 23% to 25%.

Sage has continued to invest in the business to accelerate the strategy, and we are satisfied with current margin progression.

Thank you very much, and I'll hand back to Steve.

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Thank you very much, Jonathan. So as I've said, the vision for Sage is to become a great SaaS company for customers and colleagues alike. And I just want to remind us all why this is the goal that we're striving for.

As we outlined at the FY '18 results, we believe that driving an accelerated transition to subscription and the cloud is critical to unlocking the potential for significant value creation at Sage. This is not an overnight change, but the price is worth the hard work and the patience.

Moving to a true SaaS model, we'll transform Sage's relationship with both existing and new customers. The mutual benefit of this relationship results in higher contract values and higher retention rates. Over time, it also reduces the cost to acquire and the cost to serve our customers. And put together, customer lifetime value increases significantly, but so does customers satisfaction, as we deliver more of what the customer needs and help make their lives easier.

So that's the price, and how we achieve it matters. The headline indicator of success is recurring revenue, but the other KPIs that we will report on every 6 months externally reinforce both the quality of the performance, i.e., how we achieve the results, but also provide evidence of progress on strategic execution. And we have shown strong progress, as evidenced by these strategic KPIs.

We now have over GBP 1.5 billion of ARR with growth of 10%, reflecting strong momentum and achieving sequential progression.

Software subscription is now over half of total revenue. This is a big milestone and is being underpinned by Sage Business Cloud penetration, which is now 44%.

We've also seen continued strength in renewal by value of 100%, and I just want to explain this a little bit further because this metric tracks the growth of existing contracts over the period, including churn, but excluding new customer acquisition.

100% renewal by value demonstrates the strength of the existing customer base, meaning that Sage can compensate for churn by driving growth through existing customers even if we didn't do any new customer acquisition. But of course, we are attracting new customers and reactivating more of those who were previously off-plan. This is happening through increasing the awareness of our Sage Business Cloud solutions.

Customers are seeing the benefit of always being up-to-date and compliant with local legislation and being able to access the latest functionality.

Now taking all of these KPIs together is proof of a good first half and demonstrates the quality of the performance, but the journey to becoming a great SaaS company is a multiyear transition. And whilst this is an encouraging start, we are focused on the long-term performance of the business, so we do not necessarily expect all of these metrics to track upwardly in a consistent linear fashion. We're also not complacent by this early success, and we must continue to focus and invest where necessary.

And that's what I'm going to talk about now, where have we been focusing and investing in the first 6 months of the year?

Now you'll recall from the FY '18 results. We've allocated extra investment into the business. This is to focus on customer success, colleague success and innovation. We remain committed to investing in these areas both in FY '19 and in future years, with investment weighted towards innovation.

I'm going to spend a bit of time outlining the projects that we've been investing in and how they're contributing to achieving our vision, starting with customer success.

In a subscription business, the value comes from the long-term ongoing relationship with our customer, not just from the initial sale. That means that you need a deep understanding of your customers to provide solutions that solve their pain points, enabling them to be more successful. That's why customer success must start with existing customers. Happy customers stay longer, buy more, leading to higher lifetime values. In turn, this helps you to acquire new customers because in a business-to-business context, reputation, recommendations and advocacy can heavily sway the buying journey while most of the research happens online before you even hear from a potential customer.

If you delight your existing customers, they become advocates and help you win new ones.

So what are we doing to improve customer success? Well, again, starting with existing customers, we're on a journey from what was previously a transactional relationship with inconsistency in customer interactions across sales and service. We're now building a consistent ongoing 2-way dialogue with a focus on the entire customer journey and enhancing the Sage Business Cloud value proposition for all of our customers.

Now to do that, we need to make sure we have the right systems in place to serve our customers, and we have continued to invest in enhancing and in integrating the sales and services systems. We now have Enterprise Management solutions and the lead management process on a single CRM in all our major geographies with more to come.

In services, we've continued to digitize, supplementing phone conversations with web chat, AI, online forums and communities. Now these investments in sales and services systems will allow us to improve the quality of data, and so enable us to gain more customer insights to build our relationships, increase interaction levels and improve customer experience. Again, we will continue to invest in these areas.

In the first half, customer interaction levels have increased by 16% over prior year, as customers have access to more means of communication, but critically with forums and communities proving particularly popular.

And linked to what I said about reputation and advocacy driving new customer acquisition, we've harnessed the power of customer testimonials and success stories in our marketing.

Our recent campaign in the U.K. was particularly successful because we showcased customers like Bremont watches, who've gained insights and competitive advantage through using Sage solutions. This customer-led marketing approach, combined with recent compliance changes, particularly in the U.K., has led to significant inbound interest from new customers and reactivation of customers who've gone off-plan.

So how do we track customers success? Well, as well as the strategic KPIs we're disclosing externally, we also track other metrics internally to drive our business and check the quality of performance. So in addition to renewal by value, we monitor Net Promoter Score and customer churn.

Turning now to colleague success. Colleague success at Sage means building a culture that fosters collaboration, openness dialogue and where colleagues feel connected to the vision, putting customers at the heart of everything we do, so by creating a safe environment that embraces diversity in all of its forms and promotes curiosity and innovation as a norm. And of course, supporting and motivating our colleagues, in turn, helps create happy and successful customers.

Sage has 12,500 colleagues around the world. And as I've said previously, what unites them is they care. Sage is a great place to work, and we want to do more to continue to support our colleagues now and into the future. And this is where, in my first 6 months as CEO, I have focused more of my attention.

How I view what I need to do with colleague success is actually quite similar to customer success. It's about building a continuous 2-way relationship, where we really understand our colleagues.

I outlined at the year-end that we've moved from a formal performance management process and replaced this with a lead feedback system, which promotes continuous conversations, which are much more focused on development. And we've had really positive feedback from our colleagues on this.

Linked to what I said earlier about leadership, the top 40 leaders has been engaged in a development program, delivered in partnership with London Business School, to enhance the effectiveness of the leadership team.

We've also changed company-wide broadcasts with content now being driven by our people. Prepared scripts and slides are being replaced by more interactive broadcasts, where colleagues ask me and other leaders questions on topics that are important to them, and we give direct answers in the moment.

So in terms of how we track results on colleague success, we carry out regular, company-wide pulse surveys. And a crucial indicator of colleague morale is engagement. Demotivated colleagues often switch off and stop engaging, so I'm very encouraged by the latest pulse survey which we literally just had the result in the last week, and we've had our biggest ever response rate. 84% of our colleagues responded to the survey. 12 months ago, in the same survey, the response rate was 54%.

Sage Foundation volunteering days are also up 26% on the same period in the prior year, another proof point that colleagues are engaging and aligning to what we think is important at Sage.

I'm also personally delighted to add, in the first half, we completed the Sage Foundation million-dollar challenge, raising $1 million for charitable causes. But we're not stopping there. We've set a new challenge, $2 million by 2022.

Now, again, I've shared our external strategic KPIs, but other metrics that we track internally for colleague success include voluntary attrition, level of internal promotions and other external metrics such as Glassdoor.

So I'm going to talk a bit about innovation. Constant customer-led innovation is a core part of a SaaS business model. We are developing a culture which embraces experimentation. We know we have great products that our customers love, knowing that they can trust Sage to keep them safe and compliant.

We also have very talented product and development colleagues, but the technology world never stays still and neither will we.

Now the first thing I wanted to get right was to ensure that I had a strong technology and SaaS leadership team to execute on our technology strategy. So I've made some changes recently to strengthen my executive committee, including the promotion of Lee Perkins to Chief Product Officer and Sage Intacct CTO, Aaron Harris to be Sage Group CTO, with the incumbent CTO, Klaus-Michael Vogelberg, remaining on the executive committee as Chief Architect and Technology Advisor.

Now these changes, combined with the earlier additions that I'd already made of Sage Intacct Head, Rob Reid; and Chief Strategy

Officer, Keith Robinson, reinforce the focus on innovation and SaaS. With this team in place, we are now focused on accelerating our technology strategy and investing in innovation to build out Sage Business Cloud.

Now this includes investing behind the latest technology such as automating manual repetitive processes, developing tools to automatically capture and code paper-based transactions like invoices and bank statements; leveraging machine learning to incorporate continuous transaction verification and testing, assuring confidence in information accuracy; and building powerful AI insights into our products, so customers can make data-driven decisions to improve performance with tools like intelligent cash flow forecasting.

We are using the innovation investment to fund all these areas, hiring AI engineers and data scientists as well as funding an emerging technology incubator on the West Coast of the U.S. And we continue to invest in Sage Business Cloud, buying, building and partnering as required.

We also continue to invest in the service fabric, which is a critical component of Sage Business Cloud, the glue which holds it all together. And this can enable commonly required capabilities like bank feeds, payments and VAT into any of our cloud native and cloud connected solutions. We build it only once and deploy it across all of our solutions, meaning our products stay current and compliant with minimal additional development.

Service fabric has also allowed us to accelerate the product development on Sage Intacct ahead of its internalization. This is a key component of building out native cloud capability. The project is progressing well, and we will have Intacct in Australia and the U.K. before the end of 2019 with other major geographies to follow in due course.

Now I just want to focus on cloud connected solutions for a moment. Over time, we've worked on switching on cloud functionality to features that were once entirely on-premise. A good example of this is our Sage U.K. Payroll Solution, which almost half of private U.K. companies use, which has now become cloud connected, so users can access online self-service. And we will continue to add in the latest technology that I've just outlined using the power of service fabric.

This process of updating cloud connected functionality is ongoing. And eventually, these solutions will look and feel very similar to a native cloud solution. This will ensure that we can continue to improve retention and upsell on these solutions, holding on to our customers for longer and embracing a closer relationship with them.

Now of course, I think, in the future, we will need a cloud native solution for all of our customers, and that is where a good proportion of our investment is focused. And I will share more on our plans on this with you in due course. But today, cloud connected solutions continue to drive significant performance in the business. And Jonathan's already talked about how this is translated into improving recurring revenue growth.

So the KPIs that we use to track innovation include the externally published KPI, Sage Business Cloud penetration and, internally, availability of native cloud solutions and customer churn.

So let's turn now to outlook. After a strong performance in the first half due to early success with the implementation of our strategy, and noting a somewhat softer recurring revenue comparator in the first half of FY '18, we expect FY '19 organic recurring revenue growth to be at the top end or slightly exceed the guided range of 8% to 9%.

We expect SSRS and processing revenue to be at the lower end or maybe below the guided range of flat to mid-single-digit decline. And therefore, overall, expectations for full year FY '19 total revenue remain unchanged, and the group maintains its organic operating profit margin guidance of 23% to 25%.

Now just to reiterate what we said at Q1. The journey to become a great SaaS company is a multiyear transition. We've had a good first half, and we're confident of a strong full year in terms of recurring revenue growth. But we are focused on the quality of the performance and long-term results over several years rather than just the short term.

So to recap on my 3 messages. In the first half, we've shown focus on the right areas of the business. This has resulted in successful strategic execution, and the outputs of that, amongst other things, is acceleration in high-quality recurring revenue.

So that concludes today's presentation, and Jonathan and I would now be delighted to take questions.

QUESTIONS AND ANSWERS

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Now as usual, I have a roving mic, so if you could state your name, the institution the you represent. And as always, we'll try as hard as we possibly can to keep you to one question each. So let's start in the front row.

Adam Dennis Wood ***Morgan Stanley, Research Division - European Technology Equity Analyst***

It's Adam Wood from Morgan Stanley. I just wanted to -- Steve, you made a lot of focus on the shift in culture in the business towards subscription SaaS recurring revenue. I imagine as you shift the employees' focus on to those, it makes it a little bit harder to predict what's going to happen on the SSRS side, and we did see a little bit weaker SSRS in the second quarter. Could you just maybe talk a little bit about how you managed that transition and the confidence you have on the visibility of SSRS, so that weakness we saw in the second quarter doesn't continue into the second half and put the kind of top end of your revenue guide at risk?

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Yes. So internally, I'm absolutely crystal clear that the focus is on recurring revenue. Now we have a small part of our business now 17% of revenue, which is not recurring, and that's a mixture of license and services revenue. Now I wouldn't go as far as to say I don't care about that revenue because it's revenue, and it's important we focus on those customers. But we should be crystal clear that my focus is to move all of that revenue to recurring revenue. I'm not interested in driving license sales. I want to move the business to recurring revenue. We have some parts of our business, mainly X3, where we still do licenses. We will always maintain services, so we have a better visibility of that services. But to some degree, and you've seen it in the first half, the more successful we are at switching Enterprise Management or X3 customers to recurring revenue, we may see a greater decline in SSRS. But the flip side is you see stronger recurring. So in the first half, we're above guidance on recurring, and we're slightly below on SSRS. And part of that is the trade-off, and that's a good thing.

Jonathan A. G. Howell ***The Sage Group plc - CFO & Director***

So I just add as well. But if you look at the first half performance, we've called this out before, there was a strong comparator in SSRS as well. Notwithstanding that, we have guided that down towards the bottom end of the range that we started the year with.

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

Michael Briest at UBS. I've got one question for you, Steve, and one for you, Jonathan. So Steve, good performance on subscription here. Clearly, on the cloud business, the growth rate is strong, but driven very much by Intacct and Sage People, it looks like Sage One is -- or Sage Accounting is certainly dragging down the cloud growth. Sage Live, you're announcing today, is being put into the sort of noncore business. What is the strategy for getting more of the portfolio into SaaS? One of your competitors is pushing upmarket QuickBooks advances going into the line 50 space. So I think we really need to know what's going to be used to address that threat. And then, Jonathan, it's just on IFRS 16. I think you say in there there's about GBP 27 million of lease expense, which will move around. I'm just wondering what the impact on margin is of that.

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Yes. So I would take the first one. First of all, on cloud native, the overall cloud native growth was 27%. That does include the drag from financials because, obviously, we've announced that we're not continuing to develop financials. We don't disclose accounting separately. But, I mean, to give you some context on the slide, it said that Sage Intacct's recurring revenue growth was 29%. Accounting wasn't far off that. So Accounting, although we're kind of deemphasizing selling direct to the smaller customers, we are continuing to sell Accounting through accountants, and it is continuing to grow at a similar level to the other cloud native products.

The other thing as well is I will remind everyone that cloud connected is an integral part of our strategy and is an integral part of Sage

Business Cloud. So if you look at the growth of Sage Business Cloud in total, we are growing as quickly, if not quicker, than our competitors. It is an integral part of our strategy to continue to migrate our customers to cloud connected, and then, as I said, ultimately to have cloud native solutions for all of our customers. I think we've shown, particularly in the U.K. in the first half, that not only are we able to do that with our existing customers, but we've seen a significant increase in both new customer acquisition and reactivation of off-plan customers with Sage 50 cloud, and that remains a product that we're very proud of.

Jonathan A. G. Howell ***The Sage Group plc - CFO & Director***

Yes, IFRS 16, good question. In terms of -- we've started our preparatory work internally in line with the introduction of IFRS 16. We'll be giving more disclosure at the year-end. Our initial work at this stage demonstrates to us that we don't think there will be a material effect on margin for us. And we do not have a substantial number of leases that will change the shape of the balance sheet materially either, but we'll give you more detail at the year-end.

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Okay. We go to the middle of the room.

James Arthur Goodman ***Barclays Bank PLC, Research Division - Research Analyst***

It's James Goodman at Barclays. My question, just on the phasing of the investment and how your deployment of that investment has been going to date. If I look at the margin year-on-year in the first half, clearly, there's less of a drop than the full year guidance would imply. Is the right interpretation there that the investment is taking some time to go into the business and will pick up in the second half and annualize into next year?

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Yes. So I think if you take the 3 lenses, in some ways, it's easier to get going faster in some of the things that we're doing in customers and colleagues in the investing and systems and some of the other things we've been doing, things we can deploy faster. The area that takes more time is product development, because although we're looking to see where we can partner, in the end, ramping up product development requires us to hire more people which we have been doing. And therefore, yes, it's a perfectly accurate observation that the pace at which we will deploy our money will pick up in the second half, particularly in the area of product development.

James Arthur Goodman ***Barclays Bank PLC, Research Division - Research Analyst***

A quick clarification, if you like, on the revenue growth in the period. I remember a couple of years ago, we talked about price or inflation giving you about 3% revenue growth. Is that still an element of inflation in the numbers today? And can you quantify that?

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

There is an element of inflation. I think there is considerably around the world. The other thing we have been doing, as an extra incentive to move customers to subscription and to cloud versions, is we are putting price increases through our maintenance and support contracts. So it differs a lot by territory, but some level of price along those lines is probably not a million miles away. Do you want to...

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

No, nothing really to add. I mean, but I think the thing that we must have a look is we've mentioned is we are seeing reactivations in NCA as well as alongside migrations and upsell in pricing. And that's very, very important. And I think the portfolio view of recurring revenue that we're giving there for you, you can see that move from those products and those revenue streams that are waiting to move into the business cloud and that first transition into cloud connected and then ultimately to native cloud. And as you can see, 124% increase in native cloud products in the Sage Business Cloud, that's driving a considerable amount of the revenue uptake that we see.

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

It's John King from Bank of America. I've got 2 questions, though. I'm going to crowbar them into one. So basically, you talked about moving the business entirely to cloud native. And I know there's -- there are work that's still ongoing there, but can you talk about kind of whether that is likely to mean a further hike in investment in the operating business or whether you think that's a material acquisition that you might need to make?

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Sure. So I think as I said, the strategy is to build partner and buy as appropriate. I think what's clear to me is that the level of sort of how we're upticking our -- the amount we spend on R&D -- so the amount we spend on R&D as a percentage of sales is likely to run at a higher level than it has been in the past. It's obviously then a question of how we fund that, and we're not here today to give medium term guidance, but we will be definitely continuing to invest more on developments, and then we'll figure out how we fund that.

The second thing is, yes, I think there are areas where we will continue to acquire technology to integrate into Sage Business Cloud. And so as Jonathan put up on the capital allocation slide, I think that will be an integral part of what we do. We've actually done a couple of very small acquisitions in the first half, so millions of dollars each, where we bought certain types of technology to integrate both into Sage Intacct and then into the widest Sage Business Cloud platform. And we'll also continue to look to how we can partner. I think it's a big ecosystem, and we need to be open to the most effective way to deliver the best solutions to our customers. Do you want to go over to Mo?

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

Steve, you sold apparel business back in February. Can you give us an update on the portfolio of products where you don't see kind of a clear past the kind of migration to Sage Business Cloud and what your thinking is and timing around some of the disposals?

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Sure. So, look, portfolio management, both acquisitions and disposals, is an integral part of the strategy, and we will continue to look at that group of revenue for which we see no path to Sage Business Cloud. It is likely that there will be, therefore, some further disposals, which we'll obviously announce once we've done them, and we will continue to evaluate the -- whether we can find paths to take those assets and sort of reintegrate them into Sage Business Cloud or, alternatively, how we can most effectively run them for value. So we have made decisions internally about how we're focusing on those different parts, and we're getting on executing. And as I say, some of -- there will be some disposals, but we'll announce them when we do.

Alexander William Tout ***Deutsche Bank AG, Research Division - Research Analyst***

It's Alex Tout from Deutsche Bank. On the maintenance base, can you give us an idea of how much of that relates to Sage 200 at the moment as opposed to -- perhaps to Enterprise Management and any other large chunks? And what's your rough time line on converting the Sage 200 maintenance base over to subscription? And do you still see the kind of uplift on conversion of about 10% to 20% in the case of Sage 200 as you did more in the case of Sage 50 in the past?

Jonathan A. G. Howell ***The Sage Group plc - CFO & Director***

Yes. I mean as we -- as I've said in the presentation earlier that if you look at North America, in the U.S., Sage 50 migration is substantially done. But for the whole of North America, we've got Sage 200 migrations that are only just started, and we've got Sage 50 migrations in Canada within North America as well. And then when you look at Central and Southern Europe, Sage 50 and Sage 200, those migrations are only just beginning as well. So as we said earlier, there is still significant runway in terms of that migration program. And you can also see that from the extent of the revenue that is waiting to move into the Sage Business Cloud, but is already being identified now, has a very clear pathway to Sage Business Cloud.

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

The other thing I'd add is, I think, as Jonathan was going through the regional slides, yes, you can see there's a very, very marked contrast in terms of Sage Business Cloud penetration across the regions. So the 2 kind of bigger regions, North America or the U.S. and the U.K., there's still more to be done, as Jonathan says, particularly on the Sage 200, but they are the sort of 2 most cloud-adoptive regions in which we operate.

If you go to the other end of the scale and look at Southern Europe, particularly areas like Iberia, the level of cloud adoption is relatively low. So there's still quite a lot of runway to go. We've only got 44% penetration. So we've got over half to go. In the bigger countries like the U.S. and the U.K., what we're going to see there is probably a greater acceleration towards migrating to native cloud solutions, obviously, using solutions like Sage Intacct. And we're going to see an increase in the level of cross-sell and upsell because, obviously, we're at a much higher penetration levels.

Unidentified Analyst

Could you talk about the issue of new customer acquisition? And you've done well in the U.K. You talked about that may well be Making Tax Digital helping sort of perhaps a bit of a one-off effect. And obviously, products like Intacct and native cloud products and connect are doing well. But do you think, as a whole, it will depend on you getting to these native cloud products before you can really accelerate that new customer acquisition?

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

I think there's 2 -- there's a couple of drivers at play here, I think, not just in the U.K., but more widely. I think there is a kind of starting -- customers are starting to see really the benefit of being up to date. I think if you go back even a few years, we've talked a lot about our -- a high number of customers using our products who are off-plan. I think Making Tax Digital, GDPR, probably just general uncertainty, there is no doubt that customers are having an increasing propensity to want to be up-to-date, compliant on the latest versions. And so that has, as I said, definitely resulted in greater sort of inbound inquiries, particularly around reactivations. Of course, that's how we're also directing our marketing. I talked about the Bremont watches example, but running -- we've obviously run Peter Jones campaigns in the U.K. all designed to do the same thing, which is to raise awareness around our solutions. So I think that will continue.

I think in mature -- more mature cloud markets like the U.S. and increasing in the U.K., native cloud solutions are definitely driving new customer acquisition. And that's why, strategically, it's so important to get the Sage Intacct product into the U.K. Next question. Are we -- one in the middle.

Paul Kratz ***Jefferies LLC, Research Division - Equity Associate***

Yes, it's Paul Kratz from Jefferies. Just one question I mean, on your renewal rates by value. I mean, in the past, you've disclosed where the cloud native business sits. I mean, you've been pushing price increases in your maintenance support, so where does that leave your cloud connected business in terms of renewal rates by value? I mean, it suggests it's probably underperforming 100%. And where do you see that -- or what are the initiatives that you're taking to increase that renewal rate by value over time in the cloud connected business specifically?

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Sure. I'll kick off, and then Jonathan can add. I think I would expect, over time, that the renewal rate by value will start to tick up as we put more focus on selling more value through to our existing customers. I think, at the moment, we have a -- it's a very good KPI to track, but at the group level, there is such a lot going on under the covers of that metric that actually it is going to be a little bit volatile in the short term. What we know, for sure, is as we migrate our customers to subscription and to the latest versions of cloud, we are getting higher retention rates in terms of volume. And then we see we can, when come round for the second round of renewal, that we are able to show those customers additional value that they consume. Well, remember, this is a very early stage, the way we're changing the relationship with the customer, the way we interact with the customers in its early stages. And so, at the moment, that tends to be a real focus on getting the customer to just adopt and move as opposed to really selling additional value. And I think that's contributing a little bit some softness in the renewal by value, but I think the underlying trend is upwards. And I think we're definitely going in the right direction. We'll just take one final question. Amit?

Amit B. Harchandani ***Citigroup Inc, Research Division - VP and Analyst***

Amit Harchandani from Citi. I appreciate that maybe this is not the right time for a midterm guidance, but at the end of the day, on one hand, we see recurring revenue wherein you are talking about high end of guidance potentially exceeding it. Within that, we see Sage 50 reaching penetration in the U.S. You're trying to roll out Intacct outside, in other countries. A lot of moving parts. So obviously, when we think about our long-term projections, could you at least give us comfort that this level of recurring revenue growth is seen as being sustainable beyond FY '19? And likewise, on SSRS, can we think of extrapolating the guidance that you've talked about for this year, just so that we get a feel for how the overall organic growth is likely to shape up going forward?

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

That does sound like a very friendly way of asking me to guide to the midterm.

Jonathan A. G. Howell ***The Sage Group plc - CFO & Director***

Which I'm afraid we won't be doing.

Stephen Hare ***The Sage Group plc - CEO, Interim COO & Executive Director***

Well, let me try and be helpful in terms of giving some color. I have deliberately, multiple times, said it's a multiyear journey, we're going to be linear, et cetera, et cetera. But if you sort of talk about the long-term vision and start with what we were just talking about, the renewal rate by value Sage Intacct achieves a renewal by value of 108%, as does Sage People. Now I don't think we'll get the whole of Sage of that because I think that's very much a sort of best-in-class metric, but we should be able to get our renewal by value from 100 something up towards the 105. So something in that sort of range. So you would expect that as we mature, we're able to drive that sort of growth of the existing customer base.

Then what you have to believe is that we can do something similar with new customer acquisition, right, so that we can achieve, whatever, another kind of 5%, 6% growth of new customer acquisition. And once we have a fuller suite of native cloud solutions, that should add to the confidence that we would be able to do that. So I'm not saying at this point in time that's our guidance. I'm not saying that that's what we will do. I'm painting a picture of how it could be possible. Is that helpful?

And I think that's a good note to end the morning. So thank you very much.

Jonathan A. G. Howell ***The Sage Group plc - CFO & Director***

Thank you.
