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SGE.L - Q3 2017 Sage Group PLC Trading Statement Call and Acquisition of Intacct

EVENT DATE/TIME: JULY 25, 2017 / 4:30PM GMT

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PRESENTATION

Operator

Ladies and gentlemen, welcome. Stephen Kelly, CEO; and Steve Hare, CFO, are our speakers on today's call. At this time, I would like to turn the conference over to Steve Hare, CFO. Please go ahead, sir.

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

Thank you very much, and welcome, everyone, and thank you for joining the call, particularly at the short notice. You'll have seen the release of the Sage Q3 FY '17 trading statement as well as the announcement of the acquisition of Intacct. So I'm going to begin with some comments on the Q3 update before handing over to Stephen, who will lay out the context for the Intacct acquisition and talk through the strategic rationale. And then, as usual, we'll finish up with some Q&A.

So let's start with Q3. In Q3, the organic revenue growth increased by 6.3% to deliver growth of 6.4% for the first 9 months ending 30th of June. If we include the North American Payments business, the organic revenue increased by 5.6% in Q3 or 5.7% for the period through the end of June. The revenue growth in the first 9 months was underpinned by a recurring revenue growth of 9.3%, within which the subscription revenue growth was over 30%.

We continue to remain confident of achieving the full year guidance of at least 6% organic revenue growth and then underlying operating margin of at least 27%. To be clear, organic revenue guidance includes the contribution from the North American Payments business through to the completion of disposal, which we expect to happen within weeks. And the operating margin guidance includes any investments that we make into the current year acquisitions, i.e. Sage People, Compass and Intacct.

Now at the half, we called out that the U.S. and France were growing more slowly than the rest of the group. So to give you an update, the U.S. has now started to show some encouraging signs of recovery, led by X3 and also the cloud-enabled version of the Sage 50 and Sage 200 families.

It's worth noting that if you exclude France from the results, the remainder of the group shows recurring revenue growth of just over 11% and total organic revenue growth of 7.6% for the 9 months. In France, our performance was flat. We continue to see the impact of the first year premium charged in prior years, and we also have a renewed focus on driving new customer acquisition through the partners with plans in place to encourage growth through this channel with our cloud solutions.

So in summary, performance for the year-to-date continues to be in line with our expectations. As we said at the first half, 7 out of 9 countries, representing 95% of the revenue, are growing in excess of the group growth rate. We have still got some work to do in France, but it is stable, and we are encouraged with the progress we've made in North America. And therefore, we remain confident of building on this performance in Q4 and exiting the year with accelerating momentum.

So with that, I'm just going to hand over to Stephen to talk a bit about the acquisition of Intacct.

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

Thanks, Steve, and just before we get on to the details, I want to draw everybody's attention to the safe harbor statement on Slide 2.

If we go on Slide 3, let us remind ourselves of the strategy for growth with specific reference to the strategic pillars of Customer for Life and winning in the market driven by new customer acquisition.

So let's start with Customers for Life. As you know, the transformation has been about reducing overhead costs and reinvesting these savings to drive increased quality of revenue. We've improved the quality of our revenue growth, increasing retention rates from 84% to 86% over the last 18 months and improving Net Promoter Scores over the last 8 quarters. We've also created a lean up organization. We're on track for annualized savings of over GBP 50 million in FY '17, delivering this for a second year in a row. We invested in savings into our go-to-market functions to fuel better quality, sustainable growth as well as reducing our G&A ratio down to 15% from 19% of revenue. And encouragingly, our Winning in the Market strategy and new customer acquisition is really starting to take hold.

We've hired a top management (inaudible) across the board, with field experience in high-growth technology companies. We've launched a fleet of award-winning cloud-first products, which are being rolled out throughout FY '17 to allow us to win new customers at scale.

I'm pleased that, in total, we have now passed over 0.5 million cloud contracts. And our net new recurring contract number has increased by over 25% in FY '15, proof that our new customer acquisition strategy is working.

Sage of today is a very different company from 3 years ago. We are more aligned, driving innovation and efficiency, and we're now prime for accelerating growth, while maintaining our financial discipline. This discipline meant no material M&A was undertaken in the first phases of our transformation, whilst we carried out the important restructuring to achieve the simplification and efficiency needed to allow us to start to win new customers at scale.

Targeting growth organically remains our #1 priority. As we shared with you at the Capital Markets Day in 2015 and as we've said since, we will enhance this growth through bolt-on acquisitions. Throughout FY '17, we have (inaudible) bolt-on M&A, including the acquisitions of Fairsail, now Sage People, the ACV solution in the cloud; and Compass, the collective intelligence and benchmarking platform, which have strengthened Sage's commitments to cloud and the golden triangle.

A critical measure of the success of these acquisitions has been the fact that they have both grown faster since they joined the Sage family. Sage People's new annual contract value has accelerated by 70% on the prior quarter, and Compass has had similar success, accelerating their growth within Sage.

Today's acquisition of Intacct represents another logical step of our strategy, and we are thrilled at the opportunity this provides us to enhance our ability to grow at scale.

Delivery of the transformation work to date, combined with our M&A, has strengthened our investment case, increasing our ability to grow our high-quality recurring revenue, funding investments in our high-growth acquisition through cost savings, to maintain or even enhance our operating margins, while still providing strong free cash flow and a progressive dividend.

In the midterm, we have talked about trending towards double-digit revenue growth and margins trending upwards, and the strategic acquisition of Intacct reinforces this commitment, positioning Sage for accelerated cloud momentum.

We go to Slide 4 and have a little more on Intacct. Intacct is the leading provider of cloud financial management solutions based in San Jose, California with thousands of customers in North America. It's the largest independent cloud financial management solutions provider and has won multiple awards, including a Gartner Visionary for the Magic Quadrant in their field. The solution is sophisticated and powerful, targeting growing business looking at process automation, rich financial operational insight, seamless integration with their existing applications ecosystem and cutting-edge features for great user experience. And they have an impressive track record of growth and high-quality revenue.

Now over to Steve for more details on the numbers.

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

Thanks, Stephen. So a detail of the transaction is in the [RNS] and the presentation. But I just wanted to call out some key numbers from Slide 5. So the total consideration is $850 million, which is in cash and rolled over options on Sage shares. This will be funded from a mixture of cash on hand, an existing revolving credit facility and a new term loan. Now we said at the first half that if we identify an attractive acquisition opportunity, we would be prepared to temporarily increase our leverage position of 1x, and we'd be comfortable within the range of 1 to 2x. So our pro forma leverage position will therefore increase following the closure of this transaction, but we will remain within that 1 to 2x range. The consideration paid represents multiple annualized recurring revenue of 8.8x, which is very much in line with the investment opportunity of acquiring a leading high-growth cloud solutions provider.

Now assessing our return on investment for a high-growth [iron] company is very different from the acquisitions that Sage has made in the past. This acquisition delivers an internal rate of return that significantly exceeds the cost of capital. But in the early years, it will remain loss-making as we invest for growth.

Now if you look at Slide 6, you can see that Intacct's revenue growth has consistently exceeded 30% per year, and this is supported by a strong subscription base, representing in excess of 90% of revenues. Our net renewal rates on a value basis in excess of 107% and an annualized recurring revenue as at the end of June of $96 million. Now as I said earlier, the guidance remains in line with the update that we gave at the first half.

This acquisition, together with the previous acquisition of Fairsail, now known as Sage People, is expected to add in the region of GBP 20 million to reported revenue throughout the rest of the year, assuming that this transaction closes in August. And as we said, we're committed to funding any investments in Intacct and, indeed, in Sage People and in Compass through our cost saving initiatives, and therefore expect our underlying margin to remain at least 27% for the full year.

So I'm going to hand back to Stephen now to give a bit more strategic rationale.

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

Thanks, Steve. And now, if we turn to Slide 7, I want to share with you the compelling logic of the acquisition of Intacct. Whilst we've only announced the acquisition today, Intacct has been a target for a long time, and talks started with management of Intacct over a year ago. In that time, we've developed a great relationship and a deep respect for the Intacct management team. And we see a great cultural fit and good chemistry with Intacct and Sage, as evidenced by the extremely positive interactions we've had at every level during discussions and due diligence.

Prior to their discussions with us, the Intacct team have been considering and preparing for an IPO. We're delighted that we managed to convince them of the strong strategic rationale for building a better business together with Sage.

The data is compelling. First of all, the market. IDC predicts that by 2020, over 50% of financial software will be in the cloud, and the rate of growth in the U.S.A. particularly is large. In FY '18 alone, it is expected to grow by $400 million, more than the entire value of the U.K. cloud financial management market. However, the market remains fragmented with many legacy on-premise vendors. The time to act is now. There's also a shift away from large monolithic, hard-to-implement ERP systems as we discussed way back to 2015, towards best-grade cloud integrated solutions, such as Sage Intacct and Sage Live. The acquisition represents an amazing opportunity to capitalize on both of these market trends.

Next, the fit of the solution within the Sage Business Cloud, the suite of integrated solutions we continue to develop to enhance our critical mass in the cloud. There's more to come on this in the future.

The Intacct solution fits just above Sage Live and just below Sage X3. At this level in the market, it's all about vertical business requirements and functionality, and the solution complements our suite of cloud offerings perfectly with actually very little overlap. This enhances Sage's ability as the first and last cloud financial management solution that the customer will need.

Let me explain. From startup with Sage One, scale up to services companies with Sage Live, Intacct from upper scale up to lower enterprise companies of technology, services and not-for-profit companies, and Sage X3 in the Enterprise space, ideally suited for manufacturing and verticals by pharmaceuticals and food and beverage.

The breadth of these solutions in the marketplace can be seen by their variant characteristics. Sage One and Sage Live are marketed towards the entrepreneur, with a typical ACV, annual contract value, of between $150 and $300 for Sage One and $3,000 to $7,000 for Sage Live. And these products are literally ready to go in a matter of hours.

Sage Intacct is targeted at the CFO, who will understand the power of financial management solution, and is typically live within a few months. Sage X3 goes to the larger enterprises, in particular, with complex supply chains. All of Sage's solutions have rapid time-to-value unlike a traditional ERP system, which can take significantly longer and cost tens of millions of dollars.

So now if we move to the strategic rationale in Slide 8. The Sage Intacct solution is hugely popular in the North America market, growing at 33%, well in excess of the market rate. The management team who will be remaining to run the business are very experienced and have a track record of winning new customers at scale.

At Sage, as we mentioned on the Q3 FY '17 update, we started to see a significant turnaround in our performance in North America through the divestment of the Payments business, the leadership of Nancy Harris and the progress we're making with our partners.

Steve highlighted the progress made in the U.S.A. in Q3, and we are confident of continued recovery. The acquisition of Intacct will build on this momentum in the U.S.A. and provide us a platform to emerge as the market leader in North America for cloud financial management solution, which represents over 50% of our total addressable market. And whilst the solution is currently only available in North America, once we've integrated and established the business within Sage in the U.S.A, in the medium term, we have plans to deploy Sage Intacct across our other major English-speaking geographies, strengthening our ability to emerge as a true category market leader.

Finally, there are significant cross-selling opportunities with this solution. For instance, it's a very compelling complementary solution with Sage People. The cross-selling opportunities strengthen our golden triangle of cloud offerings across accounting, people and payroll, and payments and banking.

To summarize the compelling logic for the acquisition, firstly, winning in the U.S.A. is core to accelerating our strategy. Secondly, this makes Sage the partner with the most complete cloud portfolio of solutions for the target market to deliver the Sage business cloud. The acquisition accelerates Sage's market leadership position in North America as a cloud leader in the scale up to Enterprise market. Thirdly, this is a further catalyst of winning in the market and new customer acquisition.

So if we turn to Slide 9, you can see some of the testimonials how Sage Intacct has delivered results for its customers, and we're delighted to welcome these customers to the Sage family. We are also excited to engage Intacct into our Sage partners. From recent Sage Summits in both Atlanta and Toronto, where we had 8,000 entrepreneurs registered, I was lucky enough to meet some of the top Sage partners personally, and they provided me with feedback that they had considered competitive products in the past as a partner some 3 years ago has doubted Sage's committed to the cloud. The Sage partners doubt this commitment no more and, in fact, suggested that Sage is moving ahead in the market. The partners are excited to keep up with this growth and expand and grow their implementation teams. The partners have been very encouraged and excited about the Sage business cloud. This acquisition will further endorse Sage's credentials as the leader in the cloud enterprise accounting space.

If we turn to Slide 10, I'd like to summarize with our strategic pillars. Clearly, this acquisition accelerates our ability to win in the market, and the Intacct management team has a track record of beating the competition. We're very excited at the momentum that we bring to our strategy to acquire new customers at scale.

Through One Sage, we're committed to fully integrating the acquisition to continue to further position Sage as the first and last cloud financial management solution a business will ever need from startup to enterprise. In terms of Capacity for Growth, we are committed to funding any additional investments in the acquisition with existing cost savings, enabling the solution to grow at rates significantly in excess of the market rates, and importantly, allowing us to maintain and enhance our current margins as we achieve operating leverage.

The acquisition also enhances our commitment to Customers for Life. The Intacct solution attracts retention rates by value of over 107%, a market-leading statistic. And finally, Sage Intacct is committed to revolutionizing the business, aligned to Sage's X3 cloud vision, with a track record of innovation, classified as a Visionary in the Gartner Magic Quadrant.

So what does this mean for our M&A agenda going forward? We want to be absolutely clear that any further M&A will remain completely aligned to the execution of the strategy, with bolt-on acquisitions complementary technology that will enhance our golden triangle and commitment to the cloud. And crucially, financial discipline will remain of utmost importance to us, ensuring the management team is aligned to the interest of our shareholders.

So to summarize, this acquisition will significantly enhance our ability to win in the U.S.A. and win in the cloud. The bolt-on acquisitions we've made in FY '17 have been successfully integrated with accelerating growth since they have joined the Sage family, proving our commitment to discipline and successful integration of these acquisitions and acceleration of our strategy.

The acquisition of Intacct is the next logical step in this execution, allowing accelerated growth whilst maintaining and enhancing margins, reinforcing our investment case of high-quality recurring revenue, superior operating margins, strong free cash flow and a progressive dividend.

So with that, Steve and I would love to open up to your questions. Thank you very much. (inaudible). Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is coming from James Goodman from Barclays.

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

First is on the positioning of Intacct. You've explained that it's going to be addressing the higher end of your existing addressable market, nearing X3. Can you talk a bit about, first of all, the data architecture and how that also overlaps with the rest of your business? And I'm thinking in terms of what can you do to actually scale some of this technology down in time towards more of the Sage 50 end of the market, that would be great. And then the second is just a clarification on the guidance, please. The drag from payments, I think, has been about 70 basis points throughout the year. Are you effectively saying that, for the full year, therefore, you're going to do 6.7% plus in terms of growth, and if that's the case, what's driving the acceleration in the last quarter?

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

Okay, James. Maybe I'll take the first one and then pass to Steve for the second question. In terms of market position, I think it's very clear, and one of the slides highlight this. Sage 50, that you referenced, and Sage One is a really powerful startup product and just moves into the lower end of the scale-up market, and we used employee numbers as a proxy here. So when we talk about startup, it's typically 0 to 10 employees and then 10 to 200 for the scale-up, and then 200 and above for the enterprise. So just come back to that, what we have here, when you get above typically about 200 employees, you tend to find that the compelling business need is vertically driven. The decision-maker at these levels tend to be the CFO, and this is a perfect solution and very successful in demonstrating the customer [reference-ability], the 107% renewals and the win rate that Sage Intacct has, particularly in verticals like not for profit, for services companies, for technology companies, software companies, actually, financial services and the health care marketplace. So they're the sort of verticals that this is a really perfect solution for and where they're very, very successful. Then if you go up into the sort of next level, you get into complex businesses with complex supply chains. Typically, therefore, manufacturing (inaudible) and process, you get into companies like food and beverage companies and pharmaceuticals, and that's where Sage X3 is a very strong player. So I think what this does is give us a real -- well, fundamental credibility and solutions in the cloud for the startup, the scale-up and the enterprise, and we use this phrase this is the first and last cloud accounting solution you need to buy with Sage because you can grow your business and scale your business. And throughout your business life, you know that Sage is the best-of-breed partner of choice in the cloud and can offer you the full range of the cloud business services. So I think it's very clear and very complementary to what we're doing in terms of the market position. And Steve, do you want to do with the...

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

Yes, on the guidance, James, you're right. To date, the drag has been about 70 basis points. For the full year, hopefully, we'll complete the transaction, as I say, in the coming weeks. So we'll probably end up consolidating about 10 months' worth of results of the North American Payments business. So for the year-end, you're probably looking more like 50, 60 basis points rather than 70, but nevertheless, your point is absolutely correct. And the acceleration in growth really is coming -- there's a little bit in terms of the recovery in the U.S.A. But also, we've consistently said throughout the year that we expected to exit Q4 with accelerated momentum. And that's really coming from the focus on driving the cloud C-line versions of the Sage 50 and the Sage 200 family. And also, we are starting to get a little bit of contribution from Sage One. We said at the half year that the annualized recurring revenue is now in excess of GBP 20 million. We've also now exceeded 1,000 subscribers on Sage Live. So we're starting to get some little but meaningful contributions from the whole range of our cloud products, which will give us a little bit of a tick-up as we exit Q4.

Operator

Our next question is coming from Mohammed Moawalla from Goldman Sachs.

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

Just on Intacct, first of all, can you sort of quantify any numbers on sort of the losses of this business or the cash burn rate? And as we sort of think about 2018, calendar '18, how we should think about the calendar impact at sort of the EBIT level? And then tied to that, any other kind of additional investments you may look to make? And then on the top line side, you sort of alluded to accelerating what's already a pretty high growth rate, kind of 30%. So what is the sort of growth rate you expect you can sort of accelerate Intacct to under your ownership? And lastly, just how does this sort of impact, if it has any, on sort of Sage Live? I know this is closer to X3s and Live, but does this create any issues around kind of the force.com platform in the positioning of live as a very distinct product and market segment?

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

Thanks, Mo. Maybe I'll start with answering a couple of the questions and then ask Steve on the financial side. So first of all, on the acceleration, our cases -- we have evidence, obviously, with Sage People and Compass, within the Sage family since they joined, that the growth has accelerated, and I called out one of the data points, about 70% growth acceleration quarter-on-quarter of Sage People. We are, obviously, I think, conservative.

You've got to know us, and therefore, we would anticipate the Intacct business continuing to grow at the rates they grow, which is 33%, so in the 30s. And we would anticipate, given the market opportunity, particularly in the U.S., that, that growth rate could continue. Obviously, in the medium-term, we highlighted some of the plans for further expansion into the English-speaking geographies where Sage obviously has a fantastic footprint. And also, the cross-selling opportunities for Sage People and, over time, Payroll in the cloud as well. So I think there's some good opportunities for us in terms of both cross-selling and geographic expansion to build on the core growth rate that we're seeing within the business. Second question really around Sage Live. Again, it's very complementary. And actually, Rob and the team from Sage Intacct have spent a lot of time looking at our solutions. I couldn't emphasize the quality of the discussions, the chemistry and the cultural fit that we have. And this is a really high-quality team. And we've spent a lot of time with them looking at Sage Live and our own products to make sure that this is a really good fit with minimum overlap, and we're very convinced that is the case. But you're right to highlight that Sage Live runs on the Sage -- sorry, Salesforce platform, force.com, as it was known. And the good news is Sage Intacct has a very strong strategic partnership also with Salesforce. So I think there's again synergies in terms of the partner network in the U.S., but also strong synergies in terms of the technology relationships that we have with Salesforce. So I think that's another big bonus associated with this. And Steve, what about in terms of losses, cash flow?

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

Yes, I mean, I think we've said in one of the footnotes in the press release that, last year, Intacct's loss before tax was around, as you just said, over $20 million. And it's probably not going to be that much different this year. I think, look, without getting sort of pulled into guidance for next year, you can assume that our commitment to funding any acquisitions that we do through our existing resources remains. So we're not going to turn up in FY '18 and start talking about the dilutive effect, and therefore, walk away from our existing commitments. So the margin will remain at least 27%. And both Stephen and I are totally committed to looking to enhance that margin. But by the same token, if we feel that we can invest in accelerating the growth of Intacct or, indeed, Sage People or, indeed, other solutions that we have, particularly within our suite of cloud solutions. And we're going to do that because we need to drive and we need to get this accelerated growth in new customer acquisition. But what we're saying to our investors is that we're totally committed to everything we've said before. So if we invest behind Intacct, you'll still get your accelerated growth. We're still committed to organic growth, and we're still committed to our margin progression and the free cash flow and everything else we've said in the past.

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

Okay. So you sort of still then stand by kind of that organic once your U.S. Payments was away. As you look at 2018, that organic growth sort of moves closer to the sort of 7% and beyond, even kind of just by virtue of kind of de-consolidation of the business and without any meaningful NCA?

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

Yes, I mean, as I said, I don't want to quite give the FY '18 guidance just now, but you are clearly heading in the right direction.

Operator

Our next question is coming from John King from Merrill Lynch.

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

The first -- a couple of follow-ups, really. First one was really on the performance of the underlying business. Obviously, Q3 was pretty much in line with the first half of the year. You are implying now acceleration more towards the 7% for Q4. I suppose the bigger question is how sustainable do you think that is. I mean, are the things that you've talked about there things that we can rely on into '18, obviously, before you get to integrating the acquisitions? That's the first one. And then the second one was around the -- just another clarification actually on the margin, the question just asked around the dilution. It seems as though you're -- the deals ain't going to give you about almost a 2% dilution. So just to confirm, you're saying that you think you can basically offset that with the underlying business performance? And then the final one. Again, if you could talk about the -- you talked about accelerating growth. Just going to ask you to kind of quantify that as much as you can in terms of where you think the pro forma business can be then it's as simple as saying, well, 5% of your revenue is now going to be growing 30%, should get you more into the kind of 8% range? Or maybe just some comments around what we can expect once you start including these deals.

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

Yes, maybe, John, I'll just start. In terms of current trade, I think Steve gave a good perspective on Q3. And at the half year, we stood up and told everybody that 7 out of the 9 geographies that represent 95% of our business revenues were growing in excess of group rates. We're very encouraged in Q3, particularly through Nancy Harris's leadership and the team that she has in place. And we've seen continued acceleration actually in the Sage 50 cloud-enabled solution franchise and also Sage 200 cloud family. So we see that continuing and continued progression in North America. So I think that's very comforting because, if you remember, 2 years ago, actually, the U.S. was on the watch list. And we're very definitely seeing significant momentum in the core business in the U.S. The area where we were essentially flat in Q3 was around France. The team there are working with Blair and working with the team to get our arms around the plan, which is in place. And we do expect some progression in France as well. So I think that speaks to our comments that Steve made and I made, actually. I think, at the half year, where we expect to be exiting this fiscal year in Q4 with accelerating momentum, and we continue to see that as the basis and the foundation for a strong performance in FY '18. But as Steve sort of said, and I think the management team are very comfortable and very transparent, but we will stand up at the end of the full year, and then that's the right time to give FY '18 guidance, and it wouldn't be appropriate to do that today. In terms of the comments I made today, certainly, we have a commitment to see our organic growth business trending upwards and trending towards that double digit. And also, you've had similar reaffirmation of that from Steve in terms of trending and certainly maintaining operating margins with a possibility of enhancing those. And then maybe I'll hand over to Steve. So that sort of deals with your first and third question. But then maybe, Steve, on margin dilution.

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

Maybe just positively just to emphasize. I think it's also encouraging that both Sage People, so the Fairsail acquisition, and also Compass have actually seen acceleration in their performance during our ownership. So we're very committed to driving our organic growth, but I think we're also increasingly showing that we can do these bolt-on acquisitions and we can get those businesses to flourish within our ownership. So -- and I think in terms of the sustainability, there remains, still, a number of -- a lot of runway in a number of areas, particularly in the C-line on Sage 50 and Sage 200 in terms of continuing to migrate our existing customers. So I guess, my only word of caution, which we called out in the RNS, is that whilst France is stable, it will take a little longer to recover because we do have the pullback effect of the first year premiums that we're working through the system. But if you put that to one side, I think we're very confident about the sustainability of the core business. And the very quick answer to the margin dilution is, yes, we are absolutely committed that we will deliver an underlying operating margin of at least 27% when we have absorbed one of these acquisitions that we've done.

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

Actually, John, probably worth saying, the Sage today is very different from the Sage 3 years ago. And you will be aware, the company is very fragmented then. But we're looking to align the new solutions that we've acquired within the Sage business cloud, and therefore, obviously, get these efficiencies in terms of the alignment. We have already proven, I think, over the last couple of years in terms of the G&A functions that where we are seeing the validation of this, to Steve's point, is the 2 acquisitions we've done so far, we seen acceleration. The business model, actually, is very much aligned to using and aligning within the Sage business cloud the acceleration of the companies we acquire through the distribution of Sage and the brand that we have. So it's not a model where, I guess, it was fragmented before. This is very much -- and we spent a lot of time during the due diligence in discussions with Sage Intacct to make sure they feel very special part of the family and the chemistry is very strong. And therefore, this will be only proven by time, but we would anticipate that, at the minimum, we'll continue to see the strong growth they're seeing. And if we do what we've done on the first 2 acquisitions, we'll get the benefits of the integration of the Sage business cloud and the growth of the Sage family.

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

And if I can just follow up, can you just remind us when you lap those 2 first acquisitions, I guess they start contributing to your organic growth figures?

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

Well, again, a questions -- similar question to -- similar answer to the question that Mo said, which is I think when we started out with our full year results, we've been very transparent in terms of our measurements for this year, the split between organic and we split acquisitions (inaudible) every which way. I think when we stand up for the full year, we will give clarity over the guidance that we're going to give for the year that follows, for FY '18, and we'll be clear how we are going to set out both organic and underlying measures. So we'll be able that time.

Operator

Our next question is coming from Stephen Goulden from Deutsche Bank.

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

Just firstly, could you just clarify the point you said on France in terms of premiums coming through the system? I missed that, sorry. It would be helpful if you could just clarify that slightly. Second question, just Steve was saying before that, potentially, double-digit organic revenues were possible. And I'm just keen -- I know, obviously, there's a number of things that are going well in the portfolio, but obviously, licenses is declining, you did 9.3% in recurring for the first 9 months suggesting that maintenance is slowing a bit. And obviously, a limit to how many high-growth businesses you can buy, given that you're committed to do that with cash. So I just -- it would be helpful to get a bit of a picture on how you could going to hit that low double-digit number, especially because the growth businesses are admittedly quite small, promising in the long-term, potentially, but quite small at the minute. And I suppose, the last point, if you could just clarify. On the payment for Intacct, I think you said it was cash, but also there will be rolled options. If you could just give us a bit more clarity. Apologies if that's in the deck, I haven't had time to go through it in detail yet.

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

Yes, just a few things, (inaudible), maybe and then the specifics. I think it's really important, and we've been very consistent from standing up at the Capital Markets Day and we'll continue to be consistent that the absolute priority of this management team is organic growth. So with the organic growth, obviously, I think we've made significant steps in terms of improving the quality of that organic growth since we've been together, and that's validated in the retention rates going from 84% to 86%, the NPS scores from our customers and partners improving. And we do see, within the market opportunity and our addressable market space, particularly with the 9 countries that generate 95% of our revenues, the opportunity to trend that up towards double-digit growth. And that's absolute prerequisite, and we're very explicit about that within the strategy, and that continues to be (inaudible). There should be no ambiguity about that. The priority of this management team is organic growth. Steve, do you want to talk about, maybe, France and then the organic.

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

Yes. So on France, we talked a little bit about this at the half year. France is the only country where, historically, if you go back a few years, when they transitioned customers from maintenance and support to subscription, they charged an activation fee, which when we changed our revenue recognition again a few years ago, those upfront fees started getting amortized over the life of the committed contract, which was 1 year because they were all 1-year contracts. When those customers come to renew, you don't get to charge the activation fee again. So actually automatically again for these classification of customers, you end up with a lower second year value. Now this is something that we phased out, but it will be into FY '18 before this sort of drag disappears. Now it's not the only reason why France isn't growing as quickly as we would like, but it does have a significant impact. And then in terms of the pricing, yes, it is down in the footnotes. The $850 million includes $43 million, effectively, of rolled over options because the employees, including the management team, are part ownership of the business. So this is the rollover. So it'll be $807 million in cash and $43 million of rolled over options.

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

Yes, Steve, and the other thing, just when you get -- and I think we explained some of this at the half year, but when you look at the cloud first initiative, as part of the Sage business cloud, we're seeing the Sage Live at an ACV now of approximately GBP 3,000. When we launched that product, it was, I think, from memory, about GBP 1,200, so it actually doubled in that period; within the value of cloud contracts, increased by 20%; within X3 business growth, 17% growth. We've seen the ARR, annualized recurring revenue, of Sage One increase by 88%. So I think when you look, as we do, a very granular level, country by country of sources of revenue, particularly around the cloud first strategy, we internally think that both new customer acquisition and Customers for Life and then you see the improving retention rates, there's a lot of evidence and validation to support our aspirations.

Operator

Our next question is coming from Adam Wood from Morgan Stanley.

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

Maybe just if I could hopefully finish up on that rollover option question, does that mean that the $43 million will be Sage ads that you will issue to that management team or you buy those options out? So just a technical question on that. And then secondly, maybe just thinking about the competitive landscape more broadly. Sage obviously have this amazing dominant position in the 0 to, let's say, roughly 150 to 200 employee market. And then potentially, because of that dominant position, has maybe faced a little bit less competition. When I look at the Gartner Research that you talked about, we've got SAP Oracle, NetSuite, Workday, Microsoft, Salesforce.com, [financial force], all on there. And I'm just wondering, could you maybe give us a little bit of thought process of moving more into that market, after market? Whether there is a lot more competition, why you doubled down there rather than focusing more on that lower end market where Sage has been traditionally much more -- much stronger?

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

Yes, maybe, if you look at them, we'll do it in reverse. I'll start with market opportunity, then Steve can talk about the shares and the stock. So a couple of things, our market opportunity. We broke out the 50%, particularly in the U.S., will be cloud-based decisions around financial management. We are seeing a shift in the U.S., and we are actually probably a key catalyst of encouraging the move to the cloud. So I think the uniques that we have is, with credibly, we are the only cloud provider who can take a startup to scale-up to enterprise, so they didn't have a technology partner for live. And the other thing, particularly at the vertical market when you get into the not-for-profit services businesses, then you have huge value in this open ecosystem where they can integrate what we call the golden triangle of core accounting, integrate it with payroll, people and integrated it with banking and payments. And then typically, you'll find a business with many other vertical solution applications to run their business. So what we have, I think, is some unique aspects relative to the competition. You tend to find the people you mentioned in terms of competition. Yes, probably NetSuite would be in the U.S. The most typical name that we've come up against if we had the Sage Intacct perspective on life. But then we can, again, in reality, see NetSuite in some of the other verticals. So for our product, Sage X3, typically, from the outside, you might think that we bump into NetSuite all the time. The reality is they don't tend to be a significant competitor, even in the U.S. The guys that we see much more in the marketplace are people like Microsoft Dynamics. So I think the reality is we're very clear of our market position. I think the power with the Sage business cloud is resonating very strongly to partners and customers, and some of those partners do actually offer in the Sage portfolio competitive prices as well. And I think the opportunity for us, Adam, is the market is very, very fragmented in the early stages. And in the U.S. alone, we highlighted the growth in FY '18 is equivalent to the entire value of the cloud financial management market in the U.K. So I think there's a tremendous market opportunity, and that's why the essence of this is a great strategic fit, but it's important to actually take advantage of it now so the importance of actually doing this transaction and the execution associated with that in growth. Do you want to talk about the stock?

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

Yes, on the stock, the answer is yes. It rolls over into options to purchase Sage shares.

Operator

Our next question is coming from David Toms from Numis.

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

Well done on closing the deal. Can I just ask one on trading and a couple on Intacct? In terms of trading, at the end of H2 -- or sorry, the end of H1, you said you expected Q2's strength to continue. Whereas, actually, Q3 looks like, depending on which measure you cut it on the revenue line either sort of weaker -- or second weakest quarter in the last couple of years. And if you extend out to a trailing 12 months to get away from the quarterly (inaudible) it still doesn't look like an acceleration despite all the extra sales and marketing investment. So can you comment on when you expect the sales and marketing investment to start triggering a return? And then just on Intacct, a simple one on interest costs. What do you think the incremental interest cost will be of the extra debt you've taken on and the drawdown on the revolver? And can you also talk to a product perspective about which of your existing products you see as potential migration targets if there's a kind of Sage 200 migration opportunity? I mean, it might be mainly new business you're focusing on, but is there migration in there as well?

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

Yes, David, so we'll probably do a double header again on this. In terms of H1, probably with the exception of France, we did see what we anticipated when we stood up at the half year, and we're probably more pleased with the progress we made in the U.S.A. The other countries, when we mention the 7 of the 9, continue to make good progress. So broadly, with the, actually, exception of France where we have a plan for success and momentum in Q4, I think we were where we expected to be. In terms of migrations, your third second question, I think, when we look at the customers that have been attracted to Sage Intacct, a very, very, very small percentage of those are existing Sage on-premise customers. So I think our priority #1 is very clear, it's about new customer acquisition. But medium and long term, absolutely, would we want to be within the Sage business cloud, the company that customers can trust to take for their journey from on-premise to cloud-enabled solutions, to pure cloud solutions? Absolutely. And we're already doing this with a lot of the partners. So some of the partners are referenced at Atlanta and Toronto 3 years ago who -- their business model is built on a perpetual license basis. And now, being very successful with Sage, on a subscription basis. So I think the opportunity around long-term migration is there, but the first and primary focus is really continuing to drive that new customer acquisition because of the significant market opportunity out there. And then, Steve, do you want to look at the...

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

Yes, I mean, it depends, to some degree, how successful we are in continuing to drive our kind of improvement in free cash flow. But if you just take the sort of additional leverage, we've said that at the end of June we got net debt of around GBP 400 million. We're obviously going to add something around GBP 600 million and a bit to that. So probably on a blended rate, that's going to end up with us ending up with an interest charge probably of a little GBP 10 million or slightly above over and above what we would have incurred otherwise.

Operator

So the last question will be from Neil Steer from Redburn.

Neil Steer - *Redburn (Europe) Limited, Research Division - Partner of Software and IT Services Research*

As you can imagine, most of my questions have been answered already. But just, Steve, when you talk about the margin in the future, just -- sorry to go back on this, but you keep using the phrase underlying margins. Can I just clarify, though, what you're really saying is that including the trading losses and all the investments of the Intacct business, you will still be reporting a stated margin or reported margin of 27% or above?

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

Yes, absolutely. And the (inaudible) in the phrase underlying is because of, this year, we've got a bit of a mix of trying to demonstrate that we're achieving guidance, the organic guidance, on the basis of how the business was constituted at the beginning of the year. So I want to make sure that we're transparent and that we show that, including the North American Payments business, we've hit both the organic revenue guidance and also the margin guidance. But then, yes, to answer your question, when we then consolidate in the 3 acquisitions, so Intacct, People and Compass, when you then run that calculation the margin will exceed 27%.

Neil Steer - *Redburn (Europe) Limited, Research Division - Partner of Software and IT Services Research*

Okay. And obviously, if you achieve mid-30% growth in the Intacct business next year, mathematically, that adds around about 1.5% or thereabouts to the growth of the business in 2018 on 2017 on a pro forma basis. So should we think a sort of pro forma growth of the group in 2018 on '17 moving up to sort of 8.5%, 9%. Is that the kind of level (inaudible)?

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

Sounds like another excellent attempt to have a discussion about guidance, but your math is pretty close. I mean, absolutely, that is what the arithmetic is saying.

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

(inaudible) But obviously, when we stand up for the full year, we'd be delighted to share with you the guidance for FY '18.

And just want to say thank you for your support. And also, I think today is also a step forward in terms of everything the management team is focused on is all around the organic growth, executing the strategy we talked about way back at the Capital Markets Day. But I think, today also is a step forward in terms of really a strong statement around winning in the U.S., winning the cloud with Sage business cloud and also winning the market and strengthening our new customer acquisition. So really, appreciate everybody's support and taking time out at short notice today to join us for this call. Thank you.

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

Thank you.
