Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q3 Trading Update Call for The Sage Group plc. Your presenter today will be Jonathan Howell, Chief Financial Officer, who is joined by James Sandford, Head of Investor Relations.

(Operator Instructions) For your information, the conference is being recorded.

Now I would like to hand the conference over to your speaker today, Jonathan Howell. Please go ahead, sir.

Jonathan Anton George Howell  The Sage Group plc - CFO & Director

Thank you very much, and welcome, everyone, to Sage’s Q3 Trading Update. First, I’ll take you through the key numbers and the performance of the business. And after that, we can open for Q&A. Just as a reminder, all numbers in the trading statement are on an organic basis.

Recurring revenue for the first 9 months is up 9% to GBP 1.2 billion. This reflects a resilient performance in Q3 and was underpinned by growth in software subscription of around 23%. This strength in recurring revenue reflects good momentum carried into the period, together with new customer acquisition and the migration of existing customers to Sage Business Cloud.

Our 2 largest regions have continued to perform well. North America delivered growth in recurring revenue of over 11% to GBP 474 million. This was driven by continued growth in both cloud connected solutions and Sage Intacct. And in Northern Europe, recurring revenue grew by just under 11% to GBP 281 million. This reflects new cloud connected contracts as well as good momentum carried into the period.

Recurring revenue for the Future Sage Business Cloud Opportunity increased by almost 11% to GBP 1.1 billion. This demonstrates our continued focus on delivering growth in line with our strategy. Recurring revenue in the other portfolio was down by 2%, which was in line with our expectations.

Now looking at the third quarter. Recurring revenue grew 6.5% to GBP 421 million. This reflects a resilient performance against more challenging trading conditions. Whilst this led to a reduction in new customer acquisition and a slight increase in customer churn, our trading performance gradually improved as the quarter progressed.

Now turning to other revenue. This declined by almost 25% to GBP 148 million in the first 9 months. This reflects our transition to subscription revenue and the move away from licenses and low-margin professional services. As expected, this decline accelerated in the third quarter due to COVID-19. And the impact of all this is total revenue growth of 4.1% to GBP 1.4 billion in the period.

For Q3, total revenue growth was 1.1% to GBP 460 million. The group's balance sheet remains strong. And as at 30 June, we had cash and available liquidity of GBP 1.2 billion and net debt of GBP 226 million.

Now moving on to the outlook. Given the resilient performance in Q3, we now expect recurring revenue growth to be in the region of 7%
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to 8% for FY '20. We also expect the decline in other revenue to continue for the remainder of the year. And reflecting the overall performance of the business, the operating margin is now expected to be around 22%.

Going forward, we remain cautious, given the continuing economic uncertainties and the risks to our small and medium customers. Overall, this has been a resilient performance, and we've achieved good results in the first 9 months.

Thank you. And now let's open for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We are now taking our first question from the line of Stefan Slowinski from Exane BNP.

Stefan Julien Henri Slowinski Exane BNP Paribas, Research Division - Research Analyst

Just, I guess, 2, if I can. Can you talk about whether or not you may have seen any impact from the work-from-home move over the past 3 to 4 months? Do you think that stimulated any extra demand for the cloud connect product, maybe pulled forward some demand there?

And then secondly, I know it's early, but as we look out to 2021 with some of the unemployment benefits ending in September, October, you've now got some more difficult comps going into next year. Do you think you can grow recurring revenue next year?

Jonathan Anton George Howell The Sage Group plc - CFO & Director

Yes. So just -- thanks for the questions. If I take the second part of the question first. In terms of looking at FY '21, we've only had 1 quarter of trading so far in the COVID environment. And therefore, at this stage, we really think it's too early for us to imply or infer too much from that 1 quarter's trading about the following financial year, FY '21. What we can say is that you've seen a good set of results for the first 9 months, a resilient performance in Q3, but we do remain cautious about next year, particularly with regards to risks to the SME customer base that we have as government support measures either cease or taper off.

We're also seeing, as expected, a normalization of ARR growth rate during FY '20. As you recall, we exited FY '19 off an exceptional year when ARR exit growth rate was at 12.6%, and that was driven by very rapid Sage 50 migrations in North America and Northern Europe and MTD. And then by the time we got to the first half stage, the ARR growth rate had slowed to about 9.8%. That continued in Q3, and that's entirely in line with our expectations that we had at the start of the year. So as we go into FY '21, we're a little bit more cautious.

But having said that, we've seen a resilient performance in Q3. And as you can see, we've called out that although we had a slightly increased level of churn at the beginning of the quarter, we saw that progressively improve as we went through Q3. And similarly, we started NCA down roughly at about half the level of what we would have expected on a pre-COVID environment, and that gradually also improved during the course of the quarter. So it's been very resilient indeed. And so therefore, given that we've raised our guidance to 7% to 11% recurring revenue growth for the full year, we thought it's only sensible to be slightly cautious given the unknown element of risks to the SME customer base that we have.

And then in terms of the move work-from-home, our focus has really been on customer success in the last quarter. We have put in place targeted measures of payment holidays or extended credit terms, where we think that is appropriate, in a real attempt to maintain customers, our support for customers and minimize churn. And that's exactly what we've seen. That's exactly what we've seen in this quarter.

Looking further ahead, the need to work remotely and flexibly for our customer base, I think, is going to be enhanced, and that is only going to assist us in the longer term. So I think it's very important to notice in the announcement, we are talking about continuing to invest for the long term in this business as we make this transition to a SaaS native cloud and cloud connected business.

Operator

We are now taking our next question from Will Wallis from Numis.
William Alexander Edward Wallis  
Numis Securities Limited, Research Division - Head of Research

Could I ask on the regional split of the recurring revenue growth? Looking at the differences between what you’re reporting for year-to-date and for H1, it looked like the Northern European business had slowed quite considerably, whereas North America is very similar in terms of growth rates in Q3 versus the first half. Are you able to give us any color on that? And in particular, any color on what’s happening with ARR? Has ARR sequentially in Northern Europe been shifted negatively?

Jonathan Anton George Howell  
The Sage Group plc - CFO & Director

In terms of the performance, I wouldn’t call out too much of a differential between those major territories. As you can see, in the first 9 months, they both grew at around 11% in terms of recurring revenue rate – growth rates. And that was very consistent with what we were expecting certainly at the H1 stage. What we did see was a slightly raised level of churn in Northern Europe in the first quarter principally because that’s a small segment with customers on monthly contracts. But then as we went through the third quarter, that came back and normalized almost back to levels that we would previously expected to see. So both of those 2 territories continue to perform well, certainly by the end of Q3.

And if you look at the overall growth rate of the group of about 9%, then by sort of calculation, you can see that Central and Southern Europe and the rest of the other territories in aggregate performed at a growth rate somewhere below the 9% for the whole group. But there was nothing too different in terms of the mix of growth between what we saw in Q3 and what we reported in full at H1.

Operator

We are now taking our next question from Michael Briest from UBS.

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

Jonathan, a couple for me. I mean on the ARR, can you be a bit more specific? I think you said something about continuing trend in Q3, but it looks to me as though the recurring revenues in Q3 broadly match what would be implied if ARR was flat from March onwards. And if I look at your Q4 guidance, the low end would be basically flat on Q3 run rate. Is ARR flat sequentially? Is it declining? Is it growing? And do you agree that sort of Q4, the low end of the guidance is basically flat revenue sequentially on a recurring basis? And then I’ve got a question on Sage business accounting professional.

Jonathan Anton George Howell  
The Sage Group plc - CFO & Director

I’m sorry, on Sage business accounting professional?

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

Well, just can you sort of update on where you are on general release, pricing? What countries it’s going into next and by when?

Jonathan Anton George Howell  
The Sage Group plc - CFO & Director

Yes. Look, first of all, on the ARR question. As you know, we report ARR in full at the half year and the full year, and we don’t give an update at the quarterly stage. The most critical element of what we’re seeing in ARR has been the decline, the normalization of the ARR growth rate and recurring revenue growth rate during FY ’20 after this exceptional year that we had in FY ’19. And that was driven, I think, as I said earlier, by Northern Europe, North America, those very rapid Sage 50 migrations, which was then also accelerated in Northern Europe and UKI by MTD. And we called that out at the time when we saw a 12.6% exit growth rate in ARR for last year. We anticipated a normalization of growth rates. And if you recall, at the beginning of the year, we were guiding to a 9% to 8% recurring revenue growth.

When we got to the H1 stage, that's exactly what you saw, and we had ARR growth rate of 9.8%. And as we moved into Q3, that rate of decline continued. But in addition to that, we had a slightly increased rate of decline as a result of COVID-19. And therefore, if you look at the recurring revenue growth rate for Q3 and compare that with Q2 on a sequential basis, we were about flat. And as you can see from the guidance that we've given on recurring revenue, that is we're looking for a pretty consistent performance for that in Q4. So from that, you can see that ARR is declining, and we're guiding, therefore, for Q3 and Q4, in terms of recurring revenue, to be about the same in
So that's very consistent with what we've seen. I think the important point to make is that we've only seen 1 quarter, and we've seen a variation in that quarter as we have improved during Q3. And so therefore, calling out what the ARR growth rate could be at the year-end or indeed what we could carry into Q1, Q2 next year is really just -- is probably a bit premature.

And then looking at the native cloud products, as you know, we've rolled out Intacct and launched in the U.K. and Australia. They're probably both operating somewhere in excess of our initial expectations, and we've added about GBP 1 million of ARR in the first few months in those territories. And later on in the year, Intacct is going to be launched in South Africa.

The -- looking at SBCA, that has been launched in the U.K. with a sort of free trial basis to start off with. And the uptake is probably, again, slightly in excess of our expectations. But then the other native cloud modules and products that we've got, they are also now -- and I'm talking about AutoEntry CakeHR in the U.K. AutoEntry is now in North America as well.

So that native cloud portfolio that we talked about at H1 is now being rolled out to the English-speaking countries, is getting some traction, is probably at this early stage exceeding our expectations, but obviously, as you appreciate, at this stage, is not material to the overall numbers that we're going to be reporting over the next 18 months or so. But we will keep giving you updates at the year-end and thereafter.

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

Just to clarify, when you said ARR is declining, that's a quarter-on-quarter trend rather than a year-on-year trend?

Jonathan Anton George Howell The Sage Group plc - CFO & Director

Yes. So -- yes, so it's the rate of growth of ARR is declining, not a decline in the ARR growth rate in ARR, if you see what I mean. So yes, very much. And you can -- as I say, if you draw a picture from 12.6% to 9.8% to a slightly increased level of ARR rate of decline in the growth rate in Q3, that can lead you quite naturally to the 7% to 8% recurring revenue that we're guiding to for the full year. So yes, absolutely, the ARR was still growing during Q3.

Operator

We are now taking our next question from the line of John King from Bank of America.

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

So just to follow up actually on some of the comments you made around investment priorities as you head into next year. Obviously, the environment is uncertain. But how do you feel about essentially doubling down in order to try and reaccelerate some of the NCA? Is that on the table and scope of possibilities? And I guess, as a management team, are you prepared to accept a lower margin in the next few quarters? If that does help to drive the cloud transition, did it very much go as your maybe your #1 priority today?

Jonathan Anton George Howell The Sage Group plc - CFO & Director

Yes. And you're absolutely right, we've seen good penetration, particularly in our major territories. We reported this at H1 with regards to the migration to cloud connected and the Sage Business Cloud. And that's been a very marked trend that you've seen in the business transformation over the last 18 months to 2 years.

As the penetration of Sage Business Cloud, cloud connected products begins in some territories to get right at the top end of what we can achieve. And running parallel with that, the development and rollout of the native cloud products, that is our absolute current priority at the moment is to drive those native cloud products, the ones that I've just referred to in relation to Michael's question, and to invest in those to make sure they have absolutely comparable and indeed better functionality than the competitors and then also to invest in marketing and go-to-market. And so that is going to be a level of investment that we want to continue to make and we will continue to make over the next few years.
In terms of what that implies for margin, as you can see, we're guiding to this year for around 22% margin. At this stage, it's probably too early to be telling you what the margin is going to be for next year for a whole number of reasons. As I say, we've only had 1 quarter trading in the COVID environment. It's the -- margin is the output of many inputs, which is the recurring revenue growth rate, the decline in other revenue, the extent to which we are and how much we're going to continue to invest, which we will do, and also the extent to which we will continue with some of the cost-mitigation measures that we've taken during the course of the second half. So at this stage, we're not guiding for margin next year.

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

And just a clarification, actually, on the Q3 itself. I think it sounds like NCA and churn obviously took a hit given the weaker macro. And then you said, I think, that things were improving through the course of the quarter. Does that refer to both of those? Or is one of those recovering better than the other?

Jonathan Anton George Howell The Sage Group plc - CFO & Director

No, both of them. So if you -- it's a good question. So if you recall at the H1 stage, we just had information -- we had information in relation to April, we gave you some color, which was that NCA was running at about half the level that we would have previously expected pre-COVID for that month, and churn has just slightly raised. And that was -- we thought at the H1 stage that, that was a better outcome than we probably anticipated originally, and we've seen a gradual improvement as we progressed through the month. And there's a sort of a marked step-up during the course of Q3, but still well short of what we would have expected on a pre-COVID basis.

Operator

We are now taking our next question from the line of Charlie Brennan from Crédit Suisse.

Charles Brennan Crédit Suisse AG, Research Division - Research Analyst

I was wondering if I could just ask a question around the Q3 momentum and what's implied in Q4. If you're saying that Q3 progressively improved, I guess that means that June was better than April. And yet when we look at your implied Q4 guidance, it implies a material slowdown in growth. I guess you've already got July under your belt as well. I'm just wondering if you're being too cautious around shape of Q4 and whether we should be looking at the top end or better of your range.

Jonathan Anton George Howell The Sage Group plc - CFO & Director

Really, as you sort of look at the guidance that we've given where we're giving a range, we're saying in the region of, as I say, we've had 1 quarter of performance, and we need to sort of see how it's going to evolve. I think the other thing that you should just take away also is that if you recall FY '19, and again, we sort of called this out at the time, we really exited the last 2 quarters of FY '19 in a very strong position in our 2 major territories. And if you recall the UKI, I think it exited with a recurring revenue growth rate for last year in the region of 15% or 16%. So you're right, you are running into slightly tougher around shape of Q4 and whether we should be looking at the top end or better of your range.

Charles Brennan Crédit Suisse AG, Research Division - Research Analyst

And just when we think about we've got to put some numbers out there for 2021, what part of the equation are you most concerned about? Is it cancellations? Or is it the new customer acquisition?

Jonathan Anton George Howell The Sage Group plc - CFO & Director

I think it's -- what we've seen in Q3 is those 2 almost sort of going hand in hand and also with migrations as well. And the sort of -- the tone of caution is really more to do with not what we can certainly see, but the fact that we will be moving into a different phase of economic activity in our major territories as we move into Q1 and Q2 of next year. And the element that is untested and unproven at the moment is the extent to which there may or may not be an impact on our customer base as a result of those government support schemes being lifted.

All I can say is by reference to Q3, that was resilient. That exceeded our expectations, as you can see from the guidance that we gave at H1. And so we're only putting in that caution by reference to that performance. And obviously, when you're looking at our total sort of revenue mix, it really is now all about recurring revenue and subscription revenue rather than the other revenue line, which, as you can
see in the guidance, we anticipate to continue this rate of decline as we structurally and strategically move the business to subscription in the native cloud and cloud connected and away from licenses.

And also another very important thing that we've been doing now for a year or so is moving away from low-margin professional services. So -- but look, rest assured, we will -- as soon as we get to the year-end and we've seen the full year performance, at the FY ’20 results, we'll give you an update.

Operator
Thank you. I'm afraid this is all we have time for. I will now hand back to Jonathan for closing remarks.

Jonathan Anton George Howell The Sage Group plc - CFO & Director
Yes. Look, thank you very much, indeed, for your questions and your attention as ever. If you do have any further questions, please do get in touch with either James and myself. And once again, thank you very much, indeed. Goodbye.

Operator
This concludes the conference for today. Thank you for participating. You may all disconnect. Speakers, please stand by.