TeamViewer AG

Transcript - Q2 2020 Results Webcast

04 August 2020

PRESENTATION

00:04 Operator

Dear ladies and gentlemen, welcome to TeamViewer's conference call for the Q2 2020 results. At our customer's request, this conference will be recorded. As a reminder, all participants will be in a listen-only mode. After the presentation, there will be the opportunity to ask questions. If any participant has difficulties during the conference, please press * followed by 0 on your telephone for operator assistance. May I now hand you over to Carsten Keller, Head of Investor Relations and Capital Market. Please go ahead.

00:38 Carsten Keller (Head of IR & Capital Markets)

Good afternoon, and welcome to the TeamViewer Q2 half-year 2020 results call. Before we start with the presentation delivered by Oliver and Stefan. I'd like to remind you quickly on the note on forward-looking statements that you can find on Page 2 of the presentation. Without much further ado, I'd like to hand over to Oliver.

00:57 Oliver Steil (CEO)

Thank you, Carsten. Good afternoon to you all. Thanks for joining. As always, before Stefan is going to present the financials in quite some detail, I would like to take you through the highlights of the second quarter and also beginning of the third quarter. Generally speaking, we continue to see very strong profitable growth, also in Q2, amid a global crisis. Clearly, strong organic performance continued. That has been translated into a significant subscriber growth – 45% year-over-year subscriber growth – to 544,000, in combination also with a high net retention rate – 105% – that led to a billings increase of 45% in the second quarter to EUR 105.9 million in billings. Naturally, a good portion of the additional billings also fell through to adjusted EBITDA. Adjusted EBITDA was EUR 57.3 million, with a 60% year-over-year growth, also translating into a high free cash flow of more than EUR 44 million, which then in turn led to the fact that we have achieved our net leverage target earlier than originally planned, with 1.9x adjusted EBITDA.

We have been continuing to expand into the enterprise segment, both organically and inorganically. We have announced the acquisition of Ubimax, which I'm going to cover in the next slide in more detail. But I think it's important to know that we continue with use case discovery, more use cases, more innovation around customers. We have continued to have a very high NPS score of 47. We are seeing continued traction in the enterprise in EMEA, and also more and more in the Americas. Then, we've added Ubimax, both due to their presence in enterprise but also due to their presence in augmented reality solutions for workflow improvements.

I'd like to walk you through the Ubimax acquisition on the next page. Again, what we've tried to build is a global leader in industrial workplace technology. What does it really mean? There's many industrial sectors, be it in logistics, production, services, and so forth, where companies really try to enable their enable their works – shop floor workers, blue-collar workers – by enhanced IT technology to improve the workflow, to help these workers perform their tasks in a more efficient way, and also collect data around how different tasks are performed, analyze the data with data science and AI, and out of that, develop recommendations on how to improve the workflows going forward. All of these, Ubimax is active in. Ubimax has a very interesting solution suite called Frontline, which will become the TeamViewer Frontline solutions suite, with dedicated solutions for manufacturing, inspection, servicing and picking logistics. So very interesting sectors where, traditionally, we, as TeamViewer, have been less present. Or if we were present, we had provided the basic connectivity across all those devices, but the workflow knowledge, the business process modeling knowledge and the data analytics knowledge is not something where we were strong. And we're adding this to our solution stack, so to say. Clearly, we believe that the Frontline solution suite for many companies has become business-critical. It's a deep integration into their workflow. It has most of the time connections to the back-end systems, like the ERP systems. And it allows for efficiency gains across the entire value chain. So a very attractive place. It's high growth in subscription. We will integrate the SaaS offering into our solution suite, the hardware offering that Ubimax is, in part, providing – this is not own hardware, just to be clear. This is third-party hardware. I think in the life cycle of augmented reality, it's quite natural that players who want to be successful and win larger projects need to make sure that the solution works end-to-end. And in that respect, Ubimax is also providing the configuration and the management of hardware. We believe that over time, this will be phased out, as this industry segment is growing to maturity. There will be more plug-and-play hardware. The standard operating systems will become more capable. And therefore, the need to control and manage hardware will be less important.

That's why we believe, if we look at the Ubimax numbers, the estimated billings for 2020 of EUR 11.2 million, out of which EUR 6 million is subscription, and there is a portion of EUR 2 million of hardware. We believe that a reasonable expectation in the midterm will be that it will be 80% software-as-a-service subscription and 20% services, which is also good because it shows the embeddedness of these solutions into customers. It helps customers to create value out of very modern and very innovative deployment. The growth rate going forward, we would see as Ubimax stand-alone, at 45% to 50% CAGR. But of course, we will strive for a full integration.

The other interesting piece, apart from the use cases and the technology, is clearly the logos that Ubimax has been able to acquire: 200-plus real enterprise customers, household names like DHL, Siemens, Schlumberger, Coca-Cola, Airbus, BMW, and so forth, with very different use cases in their core processes. So that was the other attraction; we felt it is something which would be a perfect fit with TeamViewer. Hence, we embarked on this acquisition. We are starting now the integration planning. Our view is that it will be a full integration of the solution portfolio, and also of the organization. Clearly, it helps that the cultures of the two companies are very similar – on the one hand – and also the locations, headquartered in Northern Germany, will make it relatively easy to integrate, which was an important part of the decision for this first acquisition, apart from the size and the product fit.

When you turn to Page 6, I'd like to talk a little bit about enterprise, as we've always discussed that. We want to show you the traction that we're having in enterprise. Now this is clearly without Ubimax. And you can see a deeper and broader penetration of the enterprise segment is paying off, really, as it has become a meaningful billings contributor. The first KPI that we like to report is the number of customers with an annual contract value of more than EUR 10,000. This has increased compared to the same period last year by 181%. It has also significantly increased in the second quarter as compared to end of Q1, which shows you that despite or apart from the demand spike that we saw in the first quarter of the year, also the second quarter showed nice development. Why is that? There's a much broader routing now of selling these larger ticket items across our inside sales and also our reseller sales force across the globe. And hence, we see this very strong growth in this segment, ticket size above EUR 10,000.

The other KPI that we'd like to report, because it shows the real upper end of our deals, is the contribution of the top 50 deals and the accumulative contract value of those. This has grown to EUR 6.3 million in the second quarter, which is a 133% increase compared with the end of Q2 2019. So, also very strong traction there. I think we have mentioned a few of the larger deals in the first quarter, but we continue to see good traction in this segment also in the second quarter, which is clearly very promising because, as we know, we are embarking on the rollout of our enterprise sales force. We've started this initiative in Europe some time ago. We are now in good rollout speed in the Americas, specifically U.S. and Canada. And we're also investing a bit more in selected markets in APAC.

Talking about the deals, if you go to the next page, there's an illustration of our diversified customer base and the deal flow. The table here contains a selection of Q2 transactions with existing and new clients located around the globe. Again, we've seen demand from sectors, including media, industrial, consumer and retail, as well as medical technologies and pharma. Also, clients in the education and public sector have requested remote management and access solutions to support their staff or enable working from home and also manage a wide range of devices. So you see here Tensor. You see Pilot. You see Remote Management, clearly, as a representation of our product portfolio. As you can see, TeamViewer is really used to address the variety of use cases across the IT space, but also the OT space – the operational technology landscape – which is very, very important for us, as it is a key growth driver.

To take an example, there's a Canadian broadcasting organization running multiple television radio stations. They use TeamViewer Tensor to remotely access more than 50 different on-premise systems and provide a comprehensive working-from-home solution to its employees independent of the device or the operating system. So that's a very common use case. The IT department there, they can set up and manage the user account centrally and remotely without any configuration of a typical VPN that you would normally see. The customers also conduct online remote trainings of employees all over the country, which has, of course, resulted in a drastic reduction of travel cost, which is necessary given the corona pandemic. And the key reasons why this customer has chosen TeamViewer Tensor were, on the one hand, enhanced security and the full auditability of remote sessions; very rapid and easy deployment, with the single sign-on integrations that we provide; and seamless remote sessions, even for CPU-intensive graphics and media tasks. So the performance of the connectivity that we provide, even if there's a lot of imagery and data flowing, is very strong. And that performance was also a key driver.

Other interesting examples of TeamViewer deployments include medtech and pharma customers. They enable their technicians to remotely support installed devices or scientists to connect to lab equipment, as well as a media company connecting high-performance cameras in stadiums around the world to record sporting events with 3D technologies – so a very wide array that we're providing here. And as you know, Tensor provides the connectivity backbone, so to say, for the enterprise customers. What we see is that the Pilot solution – so, the augmented reality solution – has become increasingly popular. Where enterprise customers try to improve their support processes, support of service technician processes, they found that Pilot is actually a very easy plug-and-play solution that helps them to improve the processes with devices, which are anyway present in the organization, i.e., tablets and phones based on either ARKit or ARCore for Apple and Google.

Just to give you an example here as well, a global provider of precision instruments for laboratory and manufacturing, they have added Pilot to its Tensor license as a plug-in, to enable their service technicians to conduct the troubleshooting on the customer side. Pilot connects the technician with an expert engineer who is then providing repair instructions. At the same time, the details of the technical failure that the field technician sees on-site are also directly documented. And they use Pilot for remote product demonstrations when on-site presentations are not possible or when there are any travel restrictions. Again, a pretty obvious use case in corona lockdown times. That customer has chosen Pilot because it's a perfect integration into Tensor. So everything you do with Pilot, the entire account logic management console is fully integrated into Tensor and has the same security standards that people are expecting from Tensor.

Clearly, these are only a few examples. You can see the ACVs. You can see the regions. You can see the use cases. So we're really getting a broad traction here. And what is also important is that in these enterprise discussions, we are often asked for integrations with other players – so, whether we are integrated with, for example, ITSM, like ServiceNow and so forth. And very often, the answer is yes. Therefore, we are successful in winning these projects.

We have been asked quite a bit about what we are developing. What are new innovations? How do we compete? How do we keep our competitive edge? And what are the key partnerships that we think of? If you go to Page 8, you see some examples here for our different product modules. And you can see examples of what we develop. I'm not going to read all of that. And you see the logos of new or existing integrations, which are very important. So for example, yesterday, we announced the universal Android add-on that enables remote access with active control and keyboard input on all Android smartphones running Version 7 or higher. That's important, of course, that we are able to connect the full range of devices, as we always said, for private and business customers. Other improvements of our core Tensor license will include a feature upgrade to the Tensor remote access bundle for working-from-home use case, so that you can really plug that in quite nicely, as well as browser-based TeamViewer version that will enable remote support without the need to install a client. So, also very important. On IoT, we will focus on advanced data analytics and facilitating advanced customization by IoT integrators via custom edge modules and also additional support, including attended IoT scenarios as the link to our expanded augmented reality offering with Pilot and Ubimax Frontline. So there's really a nice convergence of what we do on IoT in terms of data collection, edge computing, edge visualization, combined with the augmented reality solution suite that we now get through Ubimax and also have through Pilot. We really try to combine that or integrate that as much as possible, to make sure that customers can leverage both the access to the device and the data they can collect from the device, but also the augmented reality features to help remote workforce. So, very important.

If we talk about augmented reality, we have already communicated that we have enhanced the augmented reality via Apple's LiDAR technology and also Google Depth API. We do have OCR for text enhancement, so that you can use your phone and use ACR and then you get additional information into the session. We're working on live content sharing and enhanced guided workflows that you can put into the Pilot session to allow for certain downloads and manuals that are part of the session. And of course, we're trying to move more and more into the data analytics field, where also Ubimax will be an important addition for us.

Remote management: we focus on patch management, backup and protection improvements. And we will do an easy web monitoring, which will come out soon. Remote scripting, very important. So significant enhancement of our offerings there to have a full bundle available remote management for medium-sized and large customers. Especially for large customers, we need to have the multi-tenancy. It's also something we are actively progressing, to have something available for next year. So, significant effort and investment into our own product road map, putting Ubimax and other partnerships aside. And then the other part of the equation is that we make sure that TeamViewer is very nicely integrated into important other players. Salesforce, we talked about a lot. ServiceNow as well. We're also discussing now intensely with SAP. We have an integration into Microsoft Teams. Atlassian integrations into Jira, enhancement there, IBM Maximo – so, really, the big players with their very successful platforms. We are trying to have back end integrations such that there's a seamless user experience between the application that is used by our customers and then the move into remote sessions powered by TeamViewer, be it classical access session or a Pilot session using augmented reality. So, quite busy.

You also heard before that this is a year of significant investment into our R&D force. We enjoy very significant hiring speed there. Clearly, the IPO last year and also the very peculiar circumstances during the pandemic helped us to win over interesting talent in all areas of the business. Therefore, we are progressing well in our hirings into R&D as well. We're growing our Greek location, and also our Stuttgart location. We're now also getting additional development capacity with Ubimax. So we feel very good about our road map and our ability to keep our competitive edge in the fields that we're most active in. And with this view on products, partnerships and large enterprise deals, I'd like to hand over to Stefan for a more detailed look into the overall financials.

20:53 Stefan Gaiser (CFO)

Thank you, Oliver, and hi, everyone. Let me take you through Q2 and H1 on Page 10. Obviously, a very strong quarter, which we partially announced already mid-July together with the Ubimax acquisition. Very good growth across all key metrics. Second quarter billings up 45%, close to EUR 106 million. And together with the exceptional first quarter, this results in overall billings growth of 59% to EUR 225 million. Clearly, the best ever six-month period in our history. At the same time, Q2 adjusted EBITDA grew by 60% year-over-year from EUR 35.8 million to EUR 57.3 million, which actually nicely demonstrates the scale effects inherent in our business model. And this actually resulted in a very significant margin increase from 49% to 54%. This margin increase was actually even more pronounced if you compare H1 2019 versus H1 2020, with an increase of more than 6 percentage points.

So what's behind that billings and adjusted EBITDA growth? I'd say, the exceptional and immediate demand for working-from-home and remote access solutions, which we saw in March and the first weeks in Q2, has normalized, as we announced. Enterprises have largely taken the immediately required steps to prepare themselves to operate under those circumstances. So clearly, we are very pleased with this result, as they show that we have a strong solution portfolio, which clearly stands to benefit from the underlying market dynamics, which are, in our opinion, here to stay.

So what are the underlying metrics of this billings development in Q2? Let's turn to the next slide. Breakdown of the subscriber growth and NRR. You can see that our subscriber base kept growing to more than 534,000 paying customers at the end of June, corresponding to a 45% increase since June 2019. Clearly, in Q1, we witnessed a significantly higher net addition of subscribers. That being said, subscriber churn in Q2 was relatively low, with only around 18,000 subscribers lost. So this shows that the customers who have bought in late March have mostly held on to their licenses, and associated billings have actually been very nicely converted into cash, as we will see in a minute from the very strong cash flow statement. Considering that we suspended all free-to-paid campaigning in the second quarter and effectively allowed, therefore, unlimited free usage on a global scale, we are very pleased with this subscriber growth in the second quarter.

The net retention rate, which is calculated over the last 12-month period, stayed above the 2019 levels due to an increase in upsell in Q1, as customers booked or bought additional capacities as the lockdowns were implemented. In Q2, we continue to see largely stable churn rates and almost unchanged up- and cross-sell on our annual recurring billings. The slight drop in our net retention rate over last quarter is mainly the result of a strengthening of the euro, or actually weakening of the U.S. dollar when we retranslate those billings from U.S. dollar into euro. So, the churn and net retention rate development is clearly encouraging. That being said, we continue to closely monitor our customers' payments and renewal behavior. And I think the discontinuation of government funding programs across the globe is clearly something which we need to watch out for, and that impact is hard to quantify at this point in time.

Let's take a look at the next slide, Page 12, billings by category and region. The composition of our billings. New billings increased by more than 10% year-over-year to EUR 28.1 million, benefiting from the already-mentioned subscriber growth, as well as higher Tensor sales and a significantly expanded enterprise customer base. We are also still successfully migrating the long tail of our previous perpetual license customers. So we still continue to see some migration billings here, but as expected, it’s now continuing to phase out. Renewal billings, which include additional capacity sales, is up close to 80% and is completely reflected in the high net retention rate.

If we take a look at the regions. I think we are particularly pleased by the Americas’ performance despite the ongoing challenges there posed by the COVID-19 pandemic, as well as the recessionary environment and some political unrest in the Americas. Despite that, a very strong performance, also driven by our continued traction in the enterprise segment on the back of the enlarged local sales team. You might remember that this is a relatively new motion for us, that we really moved into the enterprise segment there and we've significantly expanded our team in the Americas. Moving on to EMEA, EMEA is our largest region. It contributes still more than half of overall billings. Billings grew 40%. I'd say pretty much a well-balanced performance across all sales channels and maybe a bit of a slowness in the enterprise channel in EMEA towards the end of the second quarter. Moving on to APAC, the smallest region by billings, yet with a very large free user base. And again, as we haven't monetized any of the free users, APAC was more impacted by the suspension of active free-to-paid conversion than other regions. Despite that, APAC billings grew by 34% in the second quarter.

Let's move on to the next slide, covering the full financial performance. We had 45% top line billings growth, translating into 60% adjusted EBITDA growth, and a significant margin improvement, which I already mentioned. This is despite the fact that we continue to invest across sales, marketing, but also R&D. If you actually take a look at H1 2020 versus H1 2019, we roughly deployed EUR 20 million of additional OpEx, and more than half of that went into sales and marketing, especially around the enterprise motion and the continued geographical footprint expansion.

Moving on to cash flows, the quality of our earnings remains very high and so does our cash conversion despite higher tax payments, which are in line with our expectations. Net cash from operating activities in accordance with the IFRS more than doubled to EUR 55 million. As you can see from those slides, we slightly changed the presentation of our cash flows to have it more in line with the analyst models. So I think that should be helpful to you. And, as expected and due to the planned one-off cost related to the rollout of our new ERP system, roughly EUR 6 million in H1, and the cost for our new headquarters, EUR 2 million in H1, capital expenditures will be higher than usual, but in line with our guidance of EUR 25 million to EUR 30 million. I am glad to report that, following some corona-related delays, those projects are largely back on track. And actually, we move into the new headquarters in the coming weeks. The final lease repayments remained low, and we did not pay interest in Q2 on our outstanding loan facilities as we chose a six-month interest period at the end of Q1. So there will be interest payments in Q3 for a six-month period.

Bottom line, very strong cash. Free cash flow generation and free cash to equity increased sharply in the second quarter and for the first half, which then obviously translated into a very significant reduction in our leverage. And that you can see on the next slide, the leverage slide. We have achieved on that leverage target of below 2x already by the end of the second quarter, six months ahead of plan. Net cash, EUR 150 million. If you include interest-bearing financial debt, a total amount of EUR 612 million, of which EUR 590 million to our loan facilities and close to EUR 20 million lease liabilities. All of this up this corresponds to a net leverage reduction of more than 1 turn, from 3x adjusted EBITDA at the end of 2019 to less than 2x at the end of June. The revolving credit facility obviously remained undrawn, and interest cost on the term loans have decreased to EUR 5 million in the second quarter compared to EUR 6.4 million in Q1. As we delever, we can benefit from a margin step down triggered by the leverage reduction. Given our strong cash generation and improving credit metrics, we actually see potential for further interest cost savings in the near future.

Speaking about leverage and the payment for Ubimax once we close the transaction, the pro forma net leverage as per June would have been 2.3x EBITDA, and the transaction is expected to close before the end of August. And therefore, Ubimax will be consolidated immediately for the rest of 2020. That being said, its EBITDA contribution for 2020 will be relatively small or slightly negative. So we do expect a continued leverage reduction, therefore.

Now let's take a look at our outlook and our guidance. In summary, we experienced a significant growth acceleration in the first six months of 2020. With our extended solutions portfolio, we consider ourselves to be very well positioned to capture the market opportunities ahead of us. At the same time, we have to be mindful of the ongoing economic hardship and the recessionary environment in some key economies, especially in the SME customer space. And we do factor in some short terms of the market environment, especially during the summer months now. The enterprise pipeline continues to gain weight, and the general engagement within the segment continues to be very strong, despite the occasional hesitancy to commit to additional OpEx or CapEx investments. I would say that digitalization projects are increasingly important, and we expect the general funding for those business transformations to increase in the mid and long term.

Based on all this, and despite the recent weakening of the U.S. dollar and excluding any contribution from the Ubimax transaction, we confirm our targets for the full year 2020. That means billings of around EUR 450 million, revenue of at least EUR 450 million, adjusted EBITDA margin of around 56%, and CapEx in the region of EUR 25 million to EUR 30 million. And that concludes our presentation. I think now we would move to Q&A.

Q&A

31:58 Operator

We will now begin our question and answer session. If you have a question for our speakers, please dial 01 on your telephone keypad now to enter the queue. Once your name has been announced you can ask a question. If you find your question is answered before it is your turn to speak, you can dial 02 to cancel your question. If you are using speaker equipment today, please lift the handset before making your selection. One moment please, for the first question.

We've received the first question. It is from John King, of Bank of America. Please go ahead.

32:41 John King (BofA)

Good afternoon to both of you. Maybe I can start with Oliver. You mentioned some cautious spending in Q3 and watching how the roll-off of further schemes would impact your customer base. Perhaps you can you just talk about how Q3 has started. And then, I guess, related to that, a longer-term question. Obviously, I think you aspire to grow 30% over the medium term. How would you break that into subscription or subscriber growth and essentially ARPU and upsell, cross-sell enterprise?

33:22 Stefan Gaiser (CFO)

Why don't I get started on Q3? Very good start. I think we also should point out that we've started to monetize on the free users again, mainly in EMEA. So that clearly obviously helped with Q3 trading. But overall, very pleased with the start. Then, to your question around longer-term outlook and how billings would decompose in 2021, I think that's a bit too early to give precise guidance there. That being said, with the continued traction in the enterprise segment and our acquisition of Ubimax, I would expect that ARPU will go up probably more than in 2020 because this enterprise segment should grow significantly faster than the SMB segment. So I would expect more growth from the enterprise segment versus the SMB segment in 2021. But I think precise guidance around this will come later during the year. It also depends, frankly, a little bit on how the enterprise pipeline conversion will shape out in the second half of 2020.

34:37 John King (BofA)

Understood. And if I could just sneak one more in on the kind of cash flow side, is there anything to call out specifically that you would expect on working capital in the second half? And also in the same vein, I think you said at the time that the increase in CapEx this year would normalize in 2021. Is that still your view?

35:00 Stefan Gaiser (CFO)

Absolutely. Yes. In terms of working capital for 2020, second half, I don't expect any major changes there. I think cash conversion has been very strong despite the economic environment. Very pleased with that actually in Q2, and I expect the same to be in Q3 and Q4. So really no changes there. And CapEx in 2021 will go down. So this year, we're going to have EUR 25 million to EUR 30 million, and I'd expect it to be at least EUR 10 million lower in 2021.

35:49 Stacy Pollard (J.P. Morgan)

A few questions from me, just following up on some of the things that you said. First of all, can you give us a sense of your billings growth in May, June and July? So you sort of touched on them, but you said they normalized. And I was hoping you could give us some broad quantification there. Secondly, what percentage of your billings are OT today versus IT? And how would you expect that to be, say, in 2023? So, three years from now, just to understand how quickly that's changing. And then the third question. You said EMEA enterprise slowed towards the end of the quarter. What was the reason for that? And just to confirm, what was the pattern for enterprise in Americas and APAC?

36:31 Stefan Gaiser (CFO)

Yes. Just trying to address your questions one after the other. So billings growth, May, June, July, I don't think we provide this breakdown. Let me comment on the second quarter. Clearly, April was very strong, stronger than the rest of the quarter. And then May, June, we said billings growth has normalized, which you can kind of interpret as the usual 30% growth level. And if you add all of this up, April, May, June, that resulted in the 45% growth. Now, I mentioned that the start into July was strong, also driven by the monetization of free users. So therefore, we are happy with the start, but I wouldn't give any growth numbers for July. It’s just too early to comment on the quarter in general.

OT/IT split, I think a significant amount of our installed base is clearly centered around IT use cases, I would say. That being said, many of the new use cases, as Oliver also just ran you through, the customer examples are significantly more biased towards OT. So it's tough to quantify that in percentage, but I would say that OT two, three years down the road will probably contribute the majority of new billings, I would say. That would be my rough indication for the billings split going forward.

And then lastly, EMEA enterprise and how's that compared to Americas and APAC. EMEA enterprise had a fantastic Q1, with the largest deal closed ever. Then clearly, the COVID pandemic resulted in additional acceleration in the EMEA enterprise business. So, very strong Q1. I think we've been slightly disappointed by the conversion in the second quarter. Probably some pull-forward effects in Q1 and, hence, some slowness in pipeline conversion in the second quarter. So I think that's been the one disappointment. On the other hand, Americas positively surprised us, and that's a relatively new motion for us. The Americas enterprise build out a very good start in Q1, and that continued actually in the second quarter by the mid-market team. That's the sales team targeting deal size from EUR 20,000 to EUR 50,000, occasionally higher. But also the newly installed enterprise team closed the first deal. So, very good deal conversion in the Americas in the second quarter. And APAC enterprise is still a relatively young motion for us. More patchy, I would say. Only a handful of enterprise sales guys. That being said, we have very good and nice enterprise deals mainly coming from Japan, occasional enterprise deals in China, but the enterprise business in APAC is significantly lower than EMEA or the Americas.

39:41 James Goodman (Barclays)

Good afternoon. Firstly, just on the cost base, please. Specifically on R&D, you talked about the increased hiring there. I was a little surprised. It looked like the R&D expense is broadly flat, but I've been anticipating that to sort of move up in line with revenue. So is that just a more efficient deployment of R&D? Or is there something specific in there? And if I look at the implied guidance on the cost base for the second half, it looks like you have OpEx going up sequentially about EUR 8 million or so into the second half of the year. Is that some sort of catch-up on the R&D side? And then just on the second question, coming back to the top line outlook for the business and not to get into sort of the specific mechanics of 2021, but just sort of stepping back from it, it's a reasonably forecastable business. I think that's one of the key attractions of the model. And I just wondered if you could shed some light on how you're starting to think about budgeting into FY '21 given, on the one side, I guess, we do have this difficult comp of a very, very strong first half this year. But on the other side, I'm trying to get a sense for how strong the effect can be of converting the free users again actively as you move into next year. So really just gauging your comfort level around that high 20% growth rate for FY '21.

41:08 Stefan Gaiser (CFO)

Sure. So maybe first, tackling cost, R&D. The R&D buildout mainly started in Q1, Q2. So there's a little bit of a phasing impact. So you will see R&D expenses significantly going up in the second half. That being said, a significant amount of the additional headcounts have already been hired in Greece and Armenia, i.e. relatively low-cost centers for us. So the average salary we are paying for our engineers probably came down, but we continue also to hire in Germany. Now we've won 50-plus additional engineers through the Ubimax acquisition. So R&D will continue to grow quite substantially in terms of headcount, but we have a good OpEx good cost base here.

And that's also one point regarding the outlook for the full year. Yes, in R&D there's a phasing impact, i.e., R&D costs will go up in the second half, but also other cost lines, like sales and marketing, will continue to increase. Whilst not at the same pace as in Q1 and Q2, where we've hired extremely fast, we continue to hire around sales and marketing motions. So there's an underlying channel increase in our cost base as we continue to grow our business by around 38% for the full year.

Then, in terms of billings growth and outlook for 2021, a couple of points there. Clearly, as you said, we have high visibility into our billings. Churn rates remained very stable. Net retention rates remained very stable despite the lack of any price increases. That obviously gives us a high visibility into 75%, 80% of our billings. So the key questions will be around new billings dynamics, new subscriber growth. A couple of points here. It’s clearly the enterprise motion and how that will play out. I think you will just need to wait and see how Q3 and, more importantly, Q4 will play out. That's one potential, I wouldn't say, swing factor, but an important factor for us in our 2021 guidance. Then secondly, the Ubimax integration and how early we can realize potential go-to-market synergies is probably a factor which we need to take into account in 2021. That being said, we clearly feel comfortable with the guidance we gave out there, i.e., growing around 30% for as long as possible. You mentioned high 20s, 30 percentage growth, and that's totally fine.

44:04 Mohammed Moawalla (Goldman Sachs)

I had a few. Firstly, maybe could you talk about the enterprise? You talked about a strong pipeline, but to what extent do you sell mission-critical versus discretionary software? And right now, what is the gating factor? Is it simply that the customers are hesitating a little bit right now before making larger commitments? Is it to do with the quantum of the deal size? Just curious where the volatility is around conversion and when do you anticipate that to kind of improve. Are we talking 2021? Or could you see that kind of snap back in Q4?

Secondly, just on the churn. I know that the the unit churn kind of has been down slightly. Is that merely challenges SMBs are facing? Or are you finding that perhaps some customers who had perhaps purchased and are now sort of-- Or maybe the renewal rates are not as robust? Just curious to understand the unit dynamics around the unit churn.

And then lastly, Stefan, if I heard you correctly, I know the comps will be tough in 2021, but are you saying that you still expect it to grow even with the benefits of Ubimax at around that 30%? Or is 2021 going to be a bit more exceptional given the tough comp in 2020? Thank you.

45:42 Oliver Steil (CEO)

Maybe I'll start with the enterprise. To your first question, mission-critical versus discretionary, I think both is true. If I go through the pipeline, [we have] very different use cases. Some of them are very much customer eager to deploy and discussing and trying to find the budget because they really want to improve their business processes and are waiting for us to build certain features or to improve certain configuration options in our software. We have that, but we also have projects, which are, say, EUR 100,000, EUR 200,000, where there's a modernization of certain parts of the business which you can argue. It's mission-critical once it is implemented, but it's discretionary in timing. So whether you need to do the project now or one quarter later or first quarter next year, I think there is discretion there. And if you would talk to our enterprise people, you would see all elements of it. Clearly, what we have seen is the immediate-need sales cycles coming down to a few weeks during the peak of the crisis has now normalized again. And I think sales cycles, which we were discussing three or six months ago, are now normal again. And of course, that is just a different dynamic compared to the first quarter, and that's what we're seeing at the moment.

I think there's no underlying issue at all around the attractiveness of our solutions, the ROI, the feature set of our Tensor product or Pilot product. I think it's just a general sense that some companies take a little bit of a breather now, especially also during the summer break, which is always a tough one for enterprise. But this time, from some regions, we really hear that employees and customers took early vacation, just taking it a little bit slower and waiting for the revamp after summer. So therefore, we believe we do have a good pipeline here in EMEA for the September quarter-end closing. So let's see how this will go out. But I think from what we know now, our people are confident that there is a normalization towards the end of this quarter and then also for Q4. Having said all this, this was pretty much focused on the situation in EMEA. I think in the Americas, we don't see a slowdown. We've built our enterprise sales force. They are building pipeline, and we see good conversion on this pipeline. So it's a slightly different phase of the market, and I think normal sales cycle, normal flow.

Churn, maybe a few words on unit churn. Maybe I can hand over to Stefan. Just one comment, I think. We're very pleased to see that our net retention rate is very healthy. On our unit churn, we haven't seen many customers terminating a solution that they have bought in the middle of the crisis and then came back to us and said, "We don't need it anymore." That is really the total exception. We also don't see very elevated levels of dunning churn or payment defaults. Stefan can comment on that. All in all, relative to the peak in demand that we saw in the quarter and the concerns that might have come from that, I think we're actually doing remarkably well, and the business is very robust in that sense. Stefan?

49:32 Stefan Gaiser (CFO)

Yes. Actually, just to compare that, I think we clearly had question marks behind that peak and whether customers would actually want to return their product. That's clearly not the case. And actually, as you also can see from our cash conversion, we had a very strong cash conversion in the second quarter. Churn rates remain fairly low. No material underlying change there. That being said, I think the economic environment might be tougher in the second half – government funding programs running out or that might be discontinued. So I think there's lots of uncertainty, and that might result in some higher churn. So far, we don't see it. I would just say there's probably more uncertainty out there in the second half. But so far, so good, and no underlying changes there.

And then with regards to growth in 2021 – high 20s, early 30s – I think it's a bit too early. It depends on a lot of factors, I would say. The key one for me is enterprise pipeline conversion. Whist not material in 2020, I would say in 2021 it will be a key factor in our growth rates. And that would also include the Ubimax acquisition, in the sense of how fast we are able to realize our go-to-market synergies. And then on top of that, we have a recent U.S. dollar weakness, which might take away a couple of percentage points growth. Not sure where this will go. Obviously, there's lots of speculation, and we obviously will break out the FX impact going forward, but that might also reduce, at least, the reported billings growth. So

I think at this point in time it's just a bit too early to give precise guidance around 2021. But obviously, as we finish Q3 and head into Q4, we will have a better understanding of those market trends and dynamics

51:42 George Webb (Morgan Stanley)

Good afternoon, Oliver and Stefan. Just one question for me, please. Can you give some updated numbers around the size of the active device space and perhaps how that's grown through this year? Maybe either in terms of the monthly active devices or the annually active devices, I think the last number I've seen in a press release is somewhere around 400 million on an annual basis. Is that broadly accurate?

52:08 Stefan Gaiser (CFO)

I don't think we've disclosed 400 million active devices. That number sounds unfamiliar to me, I have to say, I think the last number we disclosed was around 320 million at the end of 2019. That has gone up significantly since then. I think current numbers are somewhere in the north of 350 million range. So significantly up, and the same is with monthly active devices, but we've never been at 400 million. So 320 million end of '19. And now north of 350-ish, but we have to see now the free-to-paid campaigns, which we are running in July, which will obviously bring this number down again.

52:59 Sherri Malek (RBC Capital Markets)

Good afternoon. I have two questions, please. Firstly, on Asia. Could you provide some more color on the country performance? So which one is performing better than others? And also, how should we be thinking about the growth momentum in H2? To what degree can we expect growth to reaccelerate there? And then my second question is on the sales expenses. I believe that the original expectation was for us to see operating leverage there. It doesn't look like that may be the case, at least looking at what we could expect for the full year. So just an update on your thoughts on that cost line going forward, please, and sort of any changes to the guidance there.

53:46 Oliver Steil (CEO)

Sure. So APAC, yes, happy to give some color there. As you know, we have our Adelaide office in Australia, which is covering Australia, New Zealand and Southeast Asian countries. So, a pretty broad mix of a very mature market for us with Australia and then significantly newer markets – so, penetration markets with the Philippines, Malaysia and the likes. And then we have a dedicated team for Japan, for China and for India. I'll quickly walk you through. Japan has seen a remarkably strong performance in the first half of this year, like all other regions, also driven by corona, but I think also we have the right formula there. We have the right team, the right VP, a very ambitious woman that joined us in the second phase of the office. So we had a leader before that we then separated, and then she came on board. And since then, I think, [we've had] significant traction in enterprise reseller and our velocity business inside sales remains very strong. So Japan clearly a very positive growth outlier. Then our Adelaide office focusing on Southeast Asia, Australia, New Zealand. Australia and New Zealand, slightly slow, a little bit of a corona breather, I would say. Also the other younger markets that I mentioned before are slow. Why is that? Stefan mentioned it. In APAC markets, we are in a different stage of the life cycle. We are still in the stage where we grow the free user base very significantly, and then we monetize part of that after we understand whether it looks like personal use or business use. We have not done this monetization at all. And markets like Malaysia, Vietnam, Thailand, Philippines, they then suffer. There's just lack of conversion. And so this was weaker.

India, fine. Small numbers, frankly, small market, but contributing to the overall growth. China, we would have expected more. I really believe that we have to keep an eye on China. We do see good conversions, free-to-paid. We see initial deals in enterprise and also in reseller. Having said that, we probably would have hoped for more, but we're also investing significantly into technology means to protect our IP and to protect the product against unpaid usage. So there's a lot going on in this market, but we're not yet at the growth rates that we would want to see in the market. So, this is for the country performance.

Reacceleration in general. I think one thing that is important is if you compare the Q2 numbers this year with last year, it is a tough comparison because last year, we were actually using, in some of these markets, free-to-paid conversion campaigns, which we haven't done at all this year. And APAC is more relying on – partly, at least – some of these campaigns. That has actually increased the problem around the growth rates, if you want to call it that. Naturally, we will see a reacceleration in the third quarter because we can, in some markets at least do free-to-paid conversion. In the comparable period last year, we hadn't so much. Therefore, I would expect an increase or acceleration again in this segment. We most likely will see that for Q4, but that's maybe a little bit too early. Sales expenses, Stefan, maybe?

57:48 Stefan Gaiser (CFO)

So clearly, we accelerated our sales investments in Q1 and Q2, especially, I'd say, around the enterprise motion in the Americas. We hired more sales reps or quota carriers than we initially thought. Also, based on the results Oliver just explained, we significantly accelerated our hiring in Japan. I'm glad to report that we have now a fully-fledged sales team in Japan. It's obviously, a very large economy, and we should be adequately represented in those markets. In addition, we continue to expand enterprise and IoT. So, [we had] a significant amount of accelerated hiring in the first half. Now, I expect that pace to come down substantially in the second half. We might also want to redeploy some sales resources to faster growth areas and the like. So therefore, I would expect actually a higher sales efficiency in the second half compared to the first half. That being said, if you take a look at our sales expense as a percent of billings, they came slightly down. So despite all of those investments, we have realized some of those scale effects.

59:06 Operator

At the moment, there are no further questions. As a reminder, if you would like to ask a question please press 01.

We haven't received any further questions. So I would like to hand back to you.

59:25 Carsten Keller (Head of IR & Capital Markets)

Thank you all for joining this results call. If there are any additional questions afterwards, please don't hesitate to reach out to the IR teams, send us an e-mail, give us a call, and I'm sure we'll speak to many of the investors over the coming days. Thank you very much.

59:44 Operator

Ladies and gentlemen, thank you for your attendance. This call has been concluded. You may disconnect.