Axway
Half-Year Results 2017

Summary

Introduction

Jean-Marc LAZZARI
CEO, Axway

I want to start the presentation with the traditional reminder that this is a public conference; as such, everything that we say here will be recorded, and we will strictly stick with the framework of legacy environment that is required. Also important is that this is my fourth analyst conference, and I will chair it like the first three with my colleague Patrick Donovan as the CFO, and Patrick Gouffran will join me too to take the questions and answers that we intentionally for this specific conference allocated a little more room, so we will have a little longer Q&A session at the end of the presentation.

This is the agenda that we are going to cover this afternoon. The first thing is that I will give you key highlights and key figures on the first half of 2017. That will be followed by a deep dive into the financial and accounting results that Patrick Donovan will do. I will then give you some insights on the mid-term and perspective that we have assembled and give a few comments and insights on the financial numbers. Then Patrick and I will conclude with an outlook on the rest of the year.

Highlights

I) Key Figures

As most of you have seen, we did issue a press release on 18 July as an early statement of our revenue and range for our profit. Here are the final results for the first half, both revenue and profit. The revenue is what was written in the press release and we are in the range of the early statement around the profit. We did EUR 142.8 million in revenue in the first half of 2017, which is a flattish situation year on year. This revenue is made of two major trends and two major elements. The first one is a drop in our licence revenue at the end of Q1 and Q2. The other important element is that this revenue consolidates four months of revenue of the newly-acquired Syncplicity company, where the acquisition was made in February. We did account for EUR 6 million of ROA and EUR 2.6 million in net revenue, both a decrease from 16.3 and 11 last year.

II) Revenue by Activity

Looking at the revenue breakdown and the drop in the licence revenue, I will pause and give you a little background on that minus 34%. We reached a total for the licence revenue in H1 of 25 million, dropping pretty significantly from the number last year. There are basically four reasons behind that drop – the first one is a difficult year-on-year comparison. You may remember that in H1 2016 we had two major deals, the first one of them being a multimillion deal in the US and the other in Europe; that makes the comparison difficult. The second reason behind that drop in the licences was difficult execution in sales, and specifically in the last mile of the sales when we closed Q1 and Q4. We have experienced major slippage in some of the deals in both quarters. We saw that trend coming out of Q4 already, but the two last weeks of the quarter were pretty difficult.

There are climatic reasons behind that. Specifically, when you speak about the licence revenue, the business is getting extremely complex in the last mile of the decision with our customers. Complexity has increased pretty significantly with our customers with the now operational functions like the CDOs and CTOs. We see a lot of new stakeholders in the decision taking tasks for the customers. The chief security officer is becoming extremely influential on the way decisions are taken, specifically in the way he deals with the architecture of the IT, and it did trigger some uncertainty in the last weeks of the signature.

The last trend that I would underpin there is that on the licence revenue we have also seen a pretty deep acceleration of the trend to cloud, the trend to subscription, which obviously comes as a pretty tough decision when it deals with where you want your software, your investment to run. Therefore, all those reasons have triggered that number.

We had a very positive H1 result on our cloud business. Remember I mentioned the acquisition of Syncplicity, so that number is both a combination of the organic growth of the legacy Axway cloud business and also four months' consolidation for Syncplicity, with 14.8% growth. We are satisfied with this and also see encouraging signs on the bookings.

Our maintenance and services revenue were according to plan and anticipated to be solid for maintenance with 3.7% growth. You know that our transformation of the service is focusing on getting a better and improved margin, which we did, for the first half of the year, and the revenue is minus 4% year on year.

III) Revenue by Region

Another way to look at that 142.8 number is to look at the geographical breakdown of that number. Obviously, the licence shortfall that we have experienced has happened everywhere on the planet with the exception of two little countries, Belgium and the Netherlands where we did find some pretty significant deals, but everywhere the licence was difficult to close in the last miles of the quarter.

Therefore, it does have a major impact on our big geographies, the US, the Americas and France. We went down roughly 12% in our French business and about 9.6% in our US and Americas business. The rest of Europe is up 8.7%, mainly triggered by the deals I mentioned, which were the significant deals we had in Belgium and Luxembourg. Asia-Pacific was flat, and we still experience a pretty interesting situation in Asia-Pacific, with a lot of new logos going to our offers in digital.

IV) Balanced and Resilient Business Model

Regarding the relative weight and size of our different geographical business, you have to note here that the US is still the biggest business that we have got and is growing year on year. I presented the same slide last year – the US represented 43%, now 44% of our total revenue. The rest of Europe was probably also driven by that good performance on the licence, now at 24%, it used to be 22%. The French business went down to 27% of our business.

Looking at business lines, you have here the same relative weight of the different business lines. What must be noted is the strong increase in our recurrent business, with 5.6% organic growth, as well as a significant improvement in the size of that specific type of business, up to 63% of our current revenue, and this is obviously made by combining organic growth and 12% in our cloud business, which you remember was 6% last year. The Syncplicity acquisition waited for the four months that we approved. Therefore, there was a significant increase in the proportion of our recurrent business. Our licence is also explained by the shortfall we have had at only 18% of our revenue, and services is staying basically stable at 19% of that same revenue.

V) Headcount

I also wanted to give you some key highlights on those numbers before Patrick deep dives into the financial and accounting. The headcount of Axway at the end of June was 1 941 people, and in that number you have two major effects: the first one is that the legacy Axway has decreased, and of course the acquisition of Syncplicity has added about 70 people.

Also to be noted is the way that Syncplicity have decided to work with the R&D more specifically was to handle the core of product management and R&D direction at the centre and then have 203 subcontractors playing the developer's hand, so you would not see in that specific 70 number the fact that we are still using some of the contractors.

VI) Axway Licence Pipeline

What is a key insight into the business is the remaining pipeline for the full year 2017. We normally do not communicate the value of that pipeline, but I can give a few insights. The first thing which is important to note is that the digital pipeline accounts for 57% of our pipeline today; it used to be 53% in the past. Our two big geographies are proportionally well represented in the pipeline. You also have to note that we consider that pipeline, both in terms of quality and quantity, sufficient for us to close the rest of the year and to provide the guidance that we gave in the press release.

I will come back to those insights after Patrick has made his presentation, but for now let us dive into the numbers.

Accounting and Financial Results

Patrick DONOVAN

CFO, Axway

I) Income Statement

Thanks, Jean-Marc, and thank you all for coming today. I will go into more detail on the financials that were presented in the press release earlier today. Our revenue, as Jean-Marc said, dropped 1.3% in total, finishing at EUR 142.8 million for the first half of 2017. This was a 6% organic drop from the first half of 2016 of EUR 144.47 million. This reflects the changing business mix, with a drop in licence but the improving cloud business.

Our cost of sales tells a mixed story. We finished with a gross margin of 67% for H1 2017, down from the gross margin of 69% for H1 2016. The total drop from 69% to 67% was directly tied to the drop in our licence revenue, but we saw a nice improvement in two areas. The margin in our cloud business improved from 28% in 2016 H1 and finished at 38% in H1 2017. This is a nice improvement and we hope to see this trend continuing and growing year after year.

Regarding our services business, when we came out with our strategy a few years ago, we wanted to focus on our core services around our product and not so much on the non-core service activities, so the drop in service revenue does not come as much of a surprise to us, but we wanted to focus on margin. Our margin was up to 13% versus 9% last year.

Just as a reminder, this is the first presentation we are doing breaking out the cloud and the cloud margin separately, so in prior years the cloud, the service revenue and margin were combined, and as you could see from our results, in prior years our cloud growth was really contributing to the service growth that we are presenting and holding up our margin.

One other point is that, as Jean-Marc mentioned, we include four months of Syncplicity in both our revenues and costs for H1 2017, so our operating expenses increased to roughly EUR 90 million from the EUR 84 million last year, and the growth was mostly in the R&D expenses. These are for R&D contractors coming from Syncplicity, and so almost all of our growth in our cost base, when you compare H1 to H1, is coming from the acquisition of Syncplicity.

Our profit on operating activities finished H1 2017 at EUR 6 million or 4.2% of our revenues, versus the EUR 16.3 million or 11.3% of our revenues. You will notice our amortisation of our intangible assets increased slightly in H1 2017, and that is just with the amortisation of the Syncplicity assets, intangible assets added. Our profit from recurring operations finished at EUR 1 million for H1 2017 or almost 1%, versus 12.3 or 8.5% in H1 2016.

Regarding 2017 and 2016, our other income and expenses is related to one-time charges from the acquisitions of Syncplicity and the Appcelerator in 2016. Our net profit finished for H1 2017 at EUR 2.6 million or 1.8% versus EUR 11 million or 7.5%.

I want to remind you that H1 2016 was a strong first half for us, and so we did a lot more of our profit than normal in H1 2016, and so we have a strong basis of comparison when we try to take 2017's first half to 2016's. Comparing 2017's first-half profit of 2.6 back to 2015 and 2014, we are almost perfectly in line with those figures at the net income level.

II) Balance Sheet

We finished with total assets of EUR 572.1 million. This is up from the EUR 558 million at the end of the year. Our increase in goodwill and intangibles is coming from the goodwill and intangibles on the Syncplicity acquisition. Our trade receivables for H1 2017 are down from the end of year when you compare it to H1 2016; this is with the decrease in licence revenue coming in June 2017 and the strong licence revenue we had in the 2016 comparative period. Our cash finished at EUR 27 million versus EUR 52 million that was present at the end of 2016.

Our total shareholder equity finished at EUR 352 million for the June period versus the EUR 374 million at the end of the year. Our financial borrowings include USD 45 million which we took out to make the Syncplicity acquisition, and those are included in our financial debt, and what makes up the rest is a bunch of miscellaneous small debt we have taken advantage of outside our revolving credit facility.

Our deferred revenues finished at EUR 84.5 million, up from the EUR 74.5 million at the end of 2016, and our liabilities finished at EUR 220 million versus EUR 183 million at the end of the year.

The only notable items in the change in equity are that we paid out dividends of EUR 8.5 million in the first six months of 2017, and we took a strong change in the translation of our balance sheet from dollars to euros, as we had about a 7% weakness in the Dollar for H1 2017 versus the ending balance sheet of 12.31 in 2016.

III) Cash Flow

I will make a few comments on our cash flow statement. Our changes in operating working capital for H1 2017 or BFR finished at EUR 16.5 million versus EUR 8.7 million in H1 2016. This helped us finish our net cash from operating activities at the same level as 2016 even though we did less profit. The net cash used in investment activities is used to make both the Syncplicity and Appcelerator acquisitions in 2017 and 2016, and in 2017 we paid our dividends in the month of June, so it is reflected in our cash flow statement for 2017 that in 2016 we paid them in July, so there is a little bit of comparative imbalance in my cash.

IV) Financial Structure

Regarding our financial covenants within our revolving credit facility, we are well within the covenants for all periods. My net bank debt at the end of June 2017 was EUR 28.8 million, which is made up of the EUR 27 million of treasury offset by EUR 56 million of bank debt. My main covenant ratio is my leverage ratio, which we have to keep under three times; EBE or EBITDA is a common term in the US market, and I finished at 0.17 for H1, or at 30 June 2017.

Regarding my EUR 125 million credit line, we still have EUR 85 million left of room within the credit line, and it is extended through mid-2021. My shareholder structure remains stable over H1 2017 and we have just over 21 million shares outstanding. Summarising, we had the revenue finish at EUR 142.8 million, reflecting our shifting business model. Our profit on operating activities finished at 4.2% of our revenues, and we continue to have a strong and solid financial position with the EUR 27.7 million of cash, and borrowing capacity under RCF.

Mid-Term Status and Perspective

Jean-Marc LAZZARI
CEO, Axway

I) Business Plan Ambition and Strategy

That was H1. What is up for the remainder of that year and then for the future? I have decided to go back to some of the fundamentals of our strategy and the choices we have made. Regarding the guiding principles of our transformation, they are the results of the strategy that we put in place 18 months ago, and they will basically guide us through all the transformation we have described at length in the past. We have the firm intention to keep those strategic ambitions and every year to cross-check and find out where and how we are achieving them. This is the reflection of how well we executed the strategy we put in place 18 months ago.

When we speak about transformation, I want to be clear and give you some insight and key highlights on where we are and what is happening in the course of that transformation. First of all, notice that the transformation is a double sword transformation. The first big transformation we embarked on was a transformation that will take Axway to the digital world from a pretty solid, cornerstone, well-established business of legacy businesses that, of course, need to participate and be leveraged in that digital journey.

We discussed, as a reminder, the Haxway House, and we did restructure and totally reorganise our project management organization. We did link the two big portfolios that are now totally articulated in every offering that we bring to the market. That is the first important point in our digital journey. We have the digital foundation which is still there, remaining and solid, that is all our legacy business, the MFT leadership position we have and of course the B2B, and then we did articulate on top of that the ecosystem engagement, which is not only a growing portfolio, where we made some acquisitions in the digital, but also an improving portfolio, and I will take a specific example with API.

Therefore, the first part of that transformation is the digital journey, and inside that transformation we of course have the double portfolio, but we also have the customer set. Axway have an extremely solid customer set, and the strategy has always been to differentiate Axway either best of breed in start-up or mega-vendors that we can still identify in the market. We want to differentiate by the fact that we are both in the traditional and legacy business and we keep our leadership position, and even the rebranding and the new positioning of the company are clearly digital, so we articulate both but we know both worlds. We are known for mission-critical applications and we are known for volume, and we have a huge customer base on which we can both upsell and cross-sell.

II) API

I want to give you highlights of our API business, and as a reminder, API was the result of an acquisition made several years ago. We did improve our API offer to probably one of the most competitive products in that specific area today. The combination of the technology that we took from the acquisition of Appcelerator early in 2016 and the improvements we have made in the core of our API now give us a full end-to-end solution that is extremely successful on the market, and again, those examples I will comment on in a minute demonstrate that our digital positioning remains among the leaders of that market.

We did improve the number of deals we did in API by over 30%, and we did that including some extensions. API works that way – customers buy a first set of potentialities and resources and then they extend it over the time. We had 17% growth in extensions. We did all those sales by upselling to existing customers at 84%. It means that we opened 16% of new logos as we sold our new API solutions. I am extremely pleased to report those three examples as major API deals, and I specifically choose FannieMae. You heard about FannieMae last year. They were a big client who made our Q2 a real success, making a multi-million acquisition of our analytics business. We are very happy that they continue to love us, and in H1, in Q2 specifically, we signed a very interesting deal in API.

That is all the clients with a new product, and that is typically a digital business. Smals is also one of the deals I mentioned in our Benelux business. This is a big deal which is a new client with a new product, purely a digital approach, and that is also a big API deal. Then BT is an extension of API.

What exactly happened? We came out earlier this year with a major release of our API, combining the technology of Appcelerator and some technology that we have improved. Not only that – remember last year we came out with Amplify, the first version was launched a year ago, and it does create a full environment for the customer to aim at that famous customer experience network that we spoke about at the year-end results. This is clearly working, and we now have a truly efficient differentiated offering in digital, used by our customer but also fighting with the best of breed.

III) New Business Model

The second part of the sword, the transformation, is obviously beyond the digital – coping with the massive transformation that is happening with the business model of the software. I have decided to show you a very simplistic view of what that does to your P&L when you are a software provider and you move from a very traditional licence business to a pure subscription business. I will not go into detail, but I will discuss the revenue Axway would do in the case of a licence sale and the subscription business. It is pretty easy to find out that when you do a licence business and a traditional licence, you basically invest in your product and decide on a market price which normally takes into account the competitiveness of your product, and then the customer makes a decision and gives you an amount of licence revenue and then starts deploying the product, or not. By the way, in terms of sales, it means you go to the customer, you sign the contract, the maintenance starts happening, and the customer lives his life with the product until you reach the point of over-usage of the product, deploying it everywhere, when you bought a licence, giving you a huge return on investment versus the price that you paid. That is the traditional licence model.

Regarding the revenue Axway would do in the case of a subscription, using the same software, and it all of a sudden changes shape. It starts small compared to the licence but it does increase over time, but there is a huge difference. It does not increase by magic. It increases because your salespeople are there helping the customer. It increased because your customer satisfaction teams help the customer deploy. That is typically the case with Syncplicity, where if you look at some of the highlights of our cloud business, Patrick and I commented on the nice 14% growth of our organic business, but we did not talk about the bookings. The bookings in the cloud are as important as the revenue growth, maybe even more so – that is what will create the future, so we are extremely happy at the positive trend of the new bookings, our new annual contractual value. This is actually the business that we should see as the reality of our revenue in a year, so the annual contractual value is basically the booking that you have taken that will be reflected in your revenue, if of course you manage to keep your revenue the same as churn. You may have heard that the churn of revenue in the cloud may compare very nicely to the maintenance revenue. There is a renewal rate that you want to keep higher than the 90% plus, like with maintenance.

Therefore, we are very happy to report that our cloud business would illustrate the second transformation of Axway. Firstly, we go to a digital portfolio customer base; secondly, we go to subscription, cloud, not licence or maintenance anymore. Therefore, I basically took three highlights on that, and the first one is a US government agency. That is a new deal we signed with our new Appcelerator colleague that represented roughly an additional 50 000 users – that is the way we count it in Syncplicity. There are two other examples, one with Seagate, which is a B2B service that we will deliver to Seagate, a new customer and a new product, and IRS, an old customer that renewed the deal with us.

The important point regarding the transformation in digital is that we have two sets of products. The typical go-to subscription model touches both the foundation product as well as the digital product. We will now go to the conclusion of the presentation by making a very short summary of the key highlights. The first is the reaction, the action plan we put in place following that difficult first half.

Key Highlights

Patrick DONOVAN

CFO, Axway

Following the last week of June and watching several of the deals that were in the forecast move out of H1, we decided immediately after closing the June revenues to do a deep dive on all our lines of revenue. First we started with the licence groups, and have asked every regional team to go back and meet with their managers and their people and go through their entire pipeline and review the deals. Those leaders from each region met with their heads and worked together for a few days to evaluate the pipeline, evaluate what they are seeing in the market, help us understand deeply what trends are impacting each of these deals, and also to look out into the forecasts for Q3 and Q4 and give us what they believe they could do with the pipeline as it exists and where it stands today around what their opportunities and risks are.

They did that process on the licence. It is not an unusual process. We meet weekly and go through the forecast and we do the forecast quarterly anyway, but we asked them to accelerate it with the drop in the last week of June, so they mapped and produced the results for Jean-Marc and I, and then we challenged the heck out of them and really dived in. They have a forecast which they are committed to, and they have signed to doing for the back half of the year. Then Jean-Marc took our forecast, which you can anticipate is a little lower than that one to give us a little buffer, because we want to be content in what we do for the second half of the year.

Then after the licence we had to go through cloud, through maintenance, through service. Maintenance is mechanical, and so based on the licence forecasts and the types of deals we are forecasting to do and some of the resignations we may be forecasting, that is just mathematical, and so we have had to do that. We had to go through some of the cloud pipeline and what we are seeing, and the opportunities we are seeing in cloud, and then also the service forecasts, where we know our largest contracts affect the revenues.

Therefore, we did that deep dive and deep re-forecasting so we could get some confidence and security within the year's revenue. Next we did a cost review, so as usual when you are looking at your forecast for the back half of the year you only have to work with the revenues that you can anticipate having. Therefore, we pulled back our cost budget and ran that back through what the teams have available to spend for the last second half of the year, and then Jean-Marc and I also kept a little bit back in reserve, so if we see some revenue movement or drifting we can also do some immediate actions to help be more prudent on the costs and try and control the margin for the year.

Jean-Marc LAZZARI

That will take us several months, and at the same time we have decided to make another deep dive in our strategic intent, and have organised a series of workshops using checkpoints looking at whether the direction we are taking is still the right one strategically as well as the roadblocks that we may encounter. That will take us until the end of the year, and that would potentially give us some acceleration or reorientation to the strategy in the different transformations we have had by early next year.

The other point that came not only after the shortfall that we have had but also those accelerations of market and business model in the market is that we are looking at accelerating our sales transformation. You understand that these are not of the same nature to cope with the two different business models as well as sales enablement. New product needs training for the salespeople, new offerings and new business models need training for the salespeople too.

Regarding the action plan, that basically gave us the outlook that we gave in the press release.

Patrick DONOVAN

Historically, we have not provided guidance, and in the licence business you often do not provide guidance because it is volatile. You start every quarter with zero, as I always say, and have to work hard to capture every licence. However, with the reset of the consensus of analysts that we did about a week ago to reset the expectations for H1 profit, we wanted to also come out to you and give the baseline that we expect. Therefore, we expect to be above 13% ROA, result operational under activity, for the year. Clearly our target would be to improve on that, but we do not see going below 13%. We expect also to be stable for the full year on revenue when compared to 2016 on an organic basis.

Jean-Marc LAZZARI

Let me try to wrap up before the Q&A and Patrick Gouffran joins us. First of all, we reiterate the transformation in the strategy and the direction that we have been taking. We are continuing the transformations that we started 18 months ago, and they are giving good results and there are no reasons why we should change that. It is the same for the strategic intention and ambition, the whole set of numbers following all those. We will absolutely keep focusing on our ambition, and basically, if you want to look at it, we are right in the middle of that transformation. We did not expect a smooth journey. Sometimes you are surprised positively; that was the case in Q2 last year with those big deals that we signed. Sometimes it is more difficult – we have been very disappointed with our shortfall in both Q1 and Q2 – but that is the life of the business.

We are reacting with the actions that Patrick and I just disclosed to you. We are looking at the transformation with optimism. We are doing more digital business than ever. Our products are more performing and competitive, and of course the transition to subscription is a little harder, but we are also going there. We have a solid customer base. That is a fantastic asset of Axway. We have the new product and we are modernising that portfolio so the transformation will continue. Thank you.

Questions and Answers

Gregory RAMIREZ Brian Garnier

I have three questions, if I may. First of all, to look at the cloud revenues, Q2 was a bit muted in terms of organic growth, which was something around 9%. Could you just give a little insight around such muted growth? Is there any product reorganisation, maybe, as the sales force was probably occupied by the integration of Syncplicity or something else?

The second question is just to come back to the gross margin of cloud. When you look at the best players, I would say, in terms of gross margin for the cloud business, you can see something around 60%, 70% or even 80%. Could you just tell us what is your roadmap to improve the gross margin and where you want to go in terms of the maximum?

Just a very last point on the cost base for H2, it looks as if you will probably invest, but it looks that you probably will not restructure the business. Could you tell us more on what you will do concretely in terms of cost-saving actions, especially the variable part of the cost?

Jean-Marc LAZZARI

We can probably share the answer and let Patrick comment on most of the financials on this. Regarding my perspective on the last one – I will take them in reverse – the cost structure of H2, it is a permanent dilemma, as the CFO and CEO of a company, to balance your investment and your savings, and it is a difficult part. What we have done when we did that cost review is to balance and protect the needed investment. That world is becoming extremely competitive and you need to provide innovation – you need to provide it via some acquisitions when you do not have the time to develop for the market, or you need to do it by R&D. Therefore, we have protected the major investments that we want to do, but as Patrick highlighted in the actions, we are also absolutely cautious and are looking at every single spending that may not contribute to the gross or the innovation to be strictly managed.

A big portion of our cost structure, of course, is about people, and the dilemma becomes a little harder when it comes to when you want to hire people and where you want to hire them, so we had to reshuffle the plans until year-end to match that dilemma.

Patrick DONOVAN

Finishing on the cost side, you asked if we are planning to do a restructuring at this point. We are not. When you are the transformational period like this, you have to protect the investments that will get you to the next phase of Axway, so we have to continue and make sure to protect those investments, and we do not see a need to do a restructuring now. We are just in the period of transforming the business.

Regarding your first question on the cloud revenue, the cloud revenues are interesting – it is a bit different. We are going to start talking differently, and we going to have to all go on the journey together to talk about cloud revenues, because no longer will we be talking about starting at zero and then finishing at whatever number we finished at, and those are all the signings of licences we did in the quarter, the half, the year. Cloud revenue is going to be made up of the ACV booking, so you saw Jean-Marc present the EUR 4.3 million of ACV booking. That means the number of contracts we signed in value annually during the period. That EUR 4.3 million becomes the revenue starting in the second half of the year, and so we take no revenue in the ACV booking, although we signed contracts just like we did for licence revenue.

The first question you had is a little complex, because we have Syncplicity and we have Axway. The Axway core business, although it is small historically and was buried in our services, made up about EUR 9.3 million or so of the total figure we did for the first half, and so that EUR 9.3 million grew about 25%, so the core Axway business in revenue grew nicely, double-digits expected. However, when you are in acquisition period, as you said, the sales team loses focus, but in this case it is not my Axway team that loses focus. It was the couple of quarters before we did the acquisition, the Syncplicity sales team, the top management that were doing the big deals were talking with me and going through due diligence and everything else. Therefore, their pipeline get a little weak, their deals close and get a little weak, which impacts our out-of-the-gate revenue.

Therefore, coming out of the acquisition, Syncplicity was down below 10%, pulling me down in total, and that makes that question you asked even more complex, because Q1 had one month where Axway at 25% weighs pretty heavy, and then in Q2 at three months, so it pulls it down into the range that we presented for Q2. That is on the revenue so it was just the effect of the acquisition and the next thing with Axway.

Regarding the margin you asked about, and rightly so, you have different players at between 60% and 80%. You will see what I called single-product multi-tenant type players. They may have single instances running, but they are multi-tenant, running many instances of their software for several customers, they will get the higher margin, so 80% or so. Syncplicity's business is about that type of model, whereas the Axway core business in the cloud is more single-instance, and the margins on single-instance do not get as high because you have the infrastructure and the team managing almost like a non-prem licence, but it is now in the cloud. Amazon Web Services is where we do a lot of it.

Therefore, with the mix we are targeting and hopefully will get above 60% longer term. It will depend on the revenue mix as to the final margin we settle at, but we are on a journey, and I think you have been at a lot of the presentations I have done. I talked about the cloud margin being so negative and pulling down our service margin, so I was having to explain why service margin was down. Now the cloud margin for the last couple of years, even for the Axway core businesses, is positive, but it is not where we want to be. It is going to grow as we get more customers, as we are able to take the core central team monitoring the service and to expand the number of customers they are monitoring. Therefore, we should expect, as they are adding more revenue, that margin to increase every year, hopefully to over 60%.

Patrick GOUFFRAN

I have a question from the web about the legacy business, the foundation business. What development do you expect for your legacy business in H2 and 2018? Are there some larger deals for you anywhere?

Jean-Marc LAZZARI

Our legacy business, the digital foundation as we call it, is essentially made of two big pillars, cornerstones of the construction of the revenue, that is MFT, where we have leadership in B2BI. The fact of coming up with the acquisition of Syncplicity has all of a sudden utilized and given a lot of energy to our existing MFT base. We see a growing pipeline of traditional legacy customers where, instead of waiting for the renewal period, embark on the connected via the Amplify platform, the new digital MFT, which is the offer we came up with by mixing the functionality of Syncplicity via the platform and our traditional MFT customer base.

Therefore, we see a kind of waking-up of that market where traditionally the growth is not real on the market, and we have seen some deal profiling on our existing customer base, which is a way to balance the legacy business and to make it digital. The reality of H1 is that we had a balance of roughly 50-50, a comparison effect to the EUR 4 million which we are accounting for, in the digital business with FannieMae. We see that same balance being a reality for the end of the year. Regarding the ELA, the big contract, traditionally the size of the contracts – whether they are pure licence contracts or even where they are cloud contracts – are bigger in the legacy and the traditional business of Axway, whereas in the digital business we normally start small. You grow, as you have seen in some of the examples of APIs, but you start smaller, so there also the cycle of renewal for those large deals are pretty well known. Those products are here to stay, they are not normally released in the same way as the digital business; it happened that 2016 as well as in 2017 were not good years for BELA renewal. We will see some showing up in 2018 and 2019, which are predicted to be good years for renewal.

Patrick GOUFFRAN

There are two other questions from the web coming back to the cloud business. The growth of the cloud for Q2 was lower than in Q1. Can you explain why, and can we expect you to come back to double-digit growth? Is it a new level of growth for the coming quarter?

Patrick DONOVAN

The first question I answered already. We do not expect the cloud revenue to be much different for the full year than the first half as far as growth goes.

Patrick GOUFFRAN

The last question is about the competitive position of Axway products. Are you losing market share against competitors?

Jean-Marc LAZZARI

When you have such a large portfolio as Axway, you lose in some areas and you win in some others, so it is very difficult to give a generic statement on whether we gained market share globally with the full portfolio. We look at it by, firstly, the big difference between the foundation business and the ecosystem engagement. We are winning market share massively in some countries, like in Australia, like even in France on API. We have a product which came out of the, as I say, new consolidation of a set of features giving us one of the most competitive products in the API, and when you combine it with the functionality of Amplify and when you open the digital access that our customers were looking for, you clearly gain and win on the market.

The competition, though, is very difficult, and the problem with the digital business is that it goes very fast. You may be leading for a quarter but then the next quarter the X or Y competitor may have a killing functionality that will force you to go and rework. It is a very different landscape, of course, when we look at the B2BI. We have had several ground-to-cloud B2BI conversions. Benteler is one of those customers with whom, earlier this quarter, Q3, we have had sales discussions and will be one example; I gave you some others. One of the realities is that the leadership in those areas is very different. It is a replacement market and the actors are very few. I do believe we will keep our leadership position in that. There is no battle at the feature level, and we spoke about huge implementation in our architectural structuring and the decisions that customers make, and I do not think we have lost any market share.

Bruno HERTZ Equigest

Could you come back on the maintenance in Q2? The organic growth was lower, but you made a comment in the press release that this was not worrying for you. Could you comment on the attrition rate and why it was lower for you in Q2 and whether you expect it to improve in H2?

Patrick DONOVAN

When we did our deep dive something came out of it. We had some struggles in North America, and it was not on resignations that can have an accounting effect. We have a lot of maintenance contracts with the US Government, and the reseller we use to be in the US Government space was not paying us, so we put them on a credit hold, which meant we were not processing renewals until we could get the relationship squared away and get them to start paying us. Therefore, we were only booking cash basis renewals, which delayed a lot of the maintenance coming from the US, and so we had the effect, and I was being conservative. I did not want to book until I knew the relationship was squared away, which is just in the stages of getting worked through, so we should see those come back into Q3.

Therefore, we are not concerned about H1; however, mechanically, as I mentioned before, when we go through the exercise on forecasting the revenues for the year, the H1 licence drop rolls through the H2 maintenance, so the H2 maintenance will be a little impacted from the licence drop here, but H1 does not worry us.

Jean-Marc LAZZARI

Putting your question on a slightly longer-term basis, we clearly see the trends of the maintenance following the trends of the licence with a certain delay, but basically those two pure software model trends are very linked, and we see them behaving the same way over time.

Patrick GOUFFRAN

There is another question from the web. How many of the postponed deals do you expect to close in your H2 planning?

Jean-Marc LAZZARI

That is a question I can always answer the same way. Regarding the strategy, the reality is that we have experienced in Q4 already, but also in Q1 and Q2, an unexpected number of deals that slipped the quarter in the last week. Given the climate of uncertainty for the customer between business model changes, between uncertainty on what kind of IT infrastructure impact it would have, the stakeholders made the decision very difficult. We have experienced all kinds of situations. There are some where the deals can be postponed if the customer is in a situation where they do not have to change because of a resource or volume problem, for anything specific, for a bug or a legacy situation, then the customer takes their time to make the right decisions which impact hugely on the future of their digital journey.

Therefore, we have experienced some who would slip quarter after quarter, and it is very frustrating, because you basically do not lose them, they are alive but nobody wants to sign anything. Some others we did sign out of the slippage from Q4, Q2 and Q1, and some others will disappear. We have a model that we permanently tune on the fact that a delayed deal and a slipping deal is never a good sign. Normally, it means that basically the deal could disappear if it slips over a quarter, so we are balancing that. Some of them will be signed, that is for sure, but some others will disappear.

Patrick GOUFFRAN

What about your longer-term ambitions in terms of size of company profitability?

Jean-Marc LAZZARI

This is short-term and you want long-term. I will take the long-term size and you take the long-term profit, Patrick. The reality is we did not abandon our goal of growing the company to a decent size. Size is not as important as it used to be, and we see a lot of startups doing extraordinary well in terms of their growth with best-of-breed products. We have a solid and a big customer base and longevity is very important for us, so we will grow to a size. That was one of the objectives that we have had. We do not focus on that, first because it is a combination of organic and inorganic growth. Inorganic is a little harder to predict, as you should be on one side very structured in matching your strategic intent, and on the other pretty opportunistic in terms of what you can see in the deals that are presenting.

Therefore, we are looking at increasing the size of the company for sure, but that is not a priority as of today.

Patrick DONOVAN

Regarding profit, I will not give any long-term guidance at this time. It would be unfair to do so as we are going through a transformation. We have our strategy, and it is changing, and the cloud business model has different drivers, and the speed to which those come into play will definitely affect our profit, so it would not be wise for us to give long-term profitability goals.

Patrick GOUFFRAN

Can you split up your cloud revenue by technology to compare it with your licence pipeline?

Jean-Marc LAZZARI

No. The answer is no, and even if I wished I probably would not, and Patrick neither. No, the current cloud revenue that we have is a building-block, and it is growing extremely fast, and as you saw, it represents now a significant portion of our revenue. It is made of combining acquisitions, and even in the Appcelerator acquisition there was some cloud revenue, so today it is made of global cloud revenue, as we reported, but it is made of very different product offerings and also ways of operating those. We go from the very high levels of subscriptions, a highly secure volume business model with Syncplicity, and they were native like that, to our ground-to-cloud, digital foundation business to the cloud, where the customer would go via a managed services approach, so it is a very different set of solutions, offerings and choices that customers make.

However, the digital transformation is truly playing with those two portfolios. The transformation to subscription touches the whole Axway portfolio, the foundation as well as the digital business.

We will conclude on that and go out to potentially have further discussion. I want to thank you for today's presentation, and we will talk to each other probably via press release on Q3 and of course in February for the full-year results. Thank you very much.