Teradata

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Raimo Lenschow: Thank you. Hey, welcome to our next session. I'm really happy to have Claire here from Teradata. It's funny, because you are on-cycle, I kind of always start our conversation with a lot of stuff happened over the last few weeks. And I remember when you guys were reporting on-cycle, it was like, oh my God, now the off-cycle guys are reporting. Everyone was like, oh my God, we've covering, everything is great again. Which kind of might not be fully true. But to get everyone back on the same page, just maybe talk a little bit about the highlights from Q3 and then we kind of take it from there.

Claire Bramley: Yeah. Q3 was a strong quarter for us. We saw 11% total ARR growth, saw double digit total growth. We saw 63% cloud ARR growth. We saw our net expansion rate increase to 123%. And we also repurchased $140 million of shares. It was a strong financial quarter for us.

In addition though to the financials, we had a great quarter from an innovation standpoint. We completed our acquisition of Stemma, which is all about data lineage, data cataloguing, which is an enhancement to our existing product, so that was very exciting to have the team from Stemma join us at Teradata.

We also launched 2 new -- well one new product called AI Unlimited in private preview. And that kind of separated us as a service solution. It's in private preview now with a view to go general availability in 2024. Kind of showing the continued innovation, the continued investments that we're making to be able to enhance our offerings and our product.

And another one also that was launched in Q3 was our ask.ai. And that's very much about people that are using our product can use the ask.ai functionality. It can be used for writing code. It can be used for giving you results. Very much kind of focused on the ease-of-use standpoint which is something that we've been focused on as well to really make it easier for people to get in it to use our product and to get information and insights from it. It was a pretty busy quarter. Strong from a financial standpoint, but also a lot going on from an innovation and technology standpoint which is exciting.

Raimo Lenschow: How do you see -- if you think about it, we're in tough times. But you kept delivering good numbers. If you think about how the quarter played out or what you've seen so far this year, what were your observations?

Claire Bramley: We are seeing -- I think one of the things that we continue to see is that customers are making a commitment to Teradata which is great. We have good pipeline, good coverage. I think we do continue to see deals potentially elongating in their lifecycle. That's something that definitely we're watching very closely and watching as we move into Q4, which I'm sure we'll come onto shortly.

But I think the range of pipeline that we see in terms of the range of different deals, some being very large, some being very small, so that kind of barbell of different sized deals. Strong pipeline, strong coverage across our key vertical, key industries. And it's very

mixed across those 7 key industries that we play, which is great to see.

And there is a good mix between migration deals and expansion deals. As we've moved through the year, I think we've seen that strong demand, strong commitment to Teradata. But just -- and I talked a little bit about this at earnings, the deal lifecycle is potentially elongating slightly, but that doesn't mean that we're losing the deals. It just means that the decision making that is happening at the customer is a little bit longer.

Raimo Lenschow: Yeah. I can't remember, did you comment -- when you reported earnings in October, did you comment a little bit what you were seeing in October, what you saw in October? Or in the current quarter?

Claire Bramley: Yes. For the current quarter, we did have a strong October, actually both from a linearity standpoint for cloud total ARR and free cash flow. We give regular updates as you'd expect, and actually new information that we've had in the last 24 to 36 hours is that some of -- as I mentioned about elongation of deals, we've got one particular deal that potentially could be pushed out of Q4. We always have plusses and minuses, and normally we have coverage in our guide. At Q3 earnings, I talked about due to currency impact, we'll be towards the low end of our range.

I think we've got one I would say large deal which is kind of an 8-figure deal. It's kind of the low end of 8 figures, but an 8-figure deal that potentially the timing of that could get pushed out. And it's mainly, again, not competitive pressure, not issues we expect to close it, but they at the customer have -- are seeing corporate development action type activity. From a timing standpoint, they're just looking for new timing. That obviously could put us towards the low end or slightly below the range for cloud ARR that we previously gave. But the good news is that it's not a lost deal. It just rolls over into 2024. And we're still on track for our 2025 goals which is the $1 billion as well. It's good news in the sense of it's just a timing, but potentially an impact to our Q4 range that we gave.

Other than that, the usual plusses and minuses that go through the quarter. It doesn't -- I'm not seeing any issues with free cash flow, revenue, profitability, or anything like that, so a pretty isolated instance, but something that we are seeing at the moment.

Raimo Lenschow: Part of that is also -- when you joined, you probably saw it as well, I guess like it's a blessing and a curse for a vendor that is in the high end of the market because your deal sizes are --

Claire Bramley: Are huge, yeah.

Raimo Lenschow: It's big. And like 8-figures, there's not a lot of software vendors that sign 8-figure deals.

Claire Bramley: Yeah, and that's the ARR number, so you can imagine this from a TCV standpoint. These are big deals. Yes, absolutely, it's a blessing and a curse. We have been looking at -- as I said, we do have a good pipeline and a good range of deals, but if the deals are smaller, it's much easier to cover. Some move in, some move out, it's very easy to cover. If you get a couple of these very large deals, to your point, 8-figure deals, it's a very large deal. And at this point, getting this information at this point in the quarter, it's not -- there's not much time to be able to cover it unfortunately. But as its timing, it pushes to '24, which from that standpoint is good.

Raimo Lenschow: Makes '24 bigger, yeah. I just wanted to move away a little bit from current to like more

kind of what happened at Teradata over the last few years. Especially the cloud journey you guys have been on. Can you talk a little bit about when you joined, and slightly before, and the evolution of Teradata to be cloud first, a little bit what it meant from a product perspective, but also for you as the CFO. Things need to change on the operation side as well I guess.

Claire Bramley: Yeah, it's been an exciting journey actually. And a big transformation. A lot has changed at Teradata in the last 3 plus years. It instigated obviously when the new CEO came onboard in June of 2020. He fundamentally changed the strategy and the vision and to be cloud first. And to focus on partners, which we never did previously, so we were very much only focused on direct selling. But now we're focused on partners as well.

He made us cloud first and the biggest change that we made, and that we're seeing the benefits of that from an innovation and technology standpoint, is that we shifted our R&D investments to be towards the cloud. To start with, it was about 70% of our R&D investment, now it's about 80% of our R&D investments go towards our cloud product/cloud development. Now, you can still leverage across on-prem and the cloud, and we still invest 20% on our on-prem product. But a lot of our investment goes into the cloud.

And I think a lot of people ask me, Raimo, is are you being out invested? Being -- whether it's the CSPs or some of the other companies. And I think the way to think about it is, the part of our business that we are spending the majority of our money on, is much smaller. If you look at our R&D investments, our go-to-market sales and marketing investments as a percentage of our cloud business, it's significantly higher. Because the majority of our underlying business is on-prem which we need to spend less on sort of thing.

When you look at it as a total company, it's kind of well, your investments look lower as a percentage of revenue. But actually, if you break it out and say, well you've got the cloud business and you've got the on-prem business, and then look at how much we're spending just on that cloud business and the growth in the cloud business, it's a much, much higher number. I think that's how I would encourage people to look at it.

And that investment has been driving technology changes. We first brought out our VantageCloud Enterprise product and that was kind of leveraging our performance at scale, leveraging our total cost of ownership, leveraging our analytical capabilities that were all built in to on-prem. We were able to launch a cloud version of that in enterprise. And then since then, we've released Lake products, our Lake product which is cloud native. It has that real-time scale up-scale out functionality.

All of these investments that we have been having in the last 3.5 years, you've seen come through in terms of the new products that we've released, the new technology and the innovation. And I think we just ran actually this last year around possible events with customers, with partners. And the feedback that we're getting is this is the most innovation that we've seen from Teradata for tens of years. 10, 20, 30 years. It's the most innovation and technology. And I think that kind of is representative of the new Teradata moving forward.

Raimo Lenschow: How does that translate into numbers for you as a CFO? Because if I'm moving from -- you used to sell boxes. Sorry -- that was before your time I think. And now it's cloud. But it does have an impact on numbers. The accounting is different, etc., as well. Can you

speak to that and how you had to change on the CFO side?

Claire Bramley: We had already done the transition from perpetual to subscription, so that helped. That was done before we made this strategic change. Which is a big transformation for all companies. Many companies have been there. We'd already moved for that subscription. There wasn't, once I came onboard, there wasn't a significant additional change in terms of serving cloud.

What we are doing though is obviously really focusing our investments to make sure we're getting the ROI. Really making sure that we manage our profitability. At Teradata, we always talk about profitable growth. We have this business, as I've talked about in the cloud business, it's growing really strongly. I mentioned the Q3 results being 63%. Really strong growth business. But right now, the margins are dilutive to the overall Teradata business.

We have a big margin expansion opportunity as we scale that business. As a CFO, what I'm trying to do is make sure that we've got the right balance in terms of we're investing in the areas that are going to drive future growth. But at the same time, being true to our nature in the fact that we are going to see profitable growth, strong free cash flow generation. It's very much a returns-based approach of really making sure that we're getting the volume and the scale benefits from cloud so that we can expand these margins. And that's what is going to be able to take us to our -- we have a goal set for 2025. I mentioned the $1 billion for cloud. But for operating margin as well, we are anticipating to be in the low 20% range. If you take it where we are today, that clearly is a margin expansion.

We're able to accelerate our growth over the next couple of years as we increase the mix of cloud, and we're able to expand our margin as we scale that business. Which is a great position to in, and all of that obviously drives strong free cash flow.

Raimo Lenschow: Where are the customers in terms of appreciation of your cloud journey? I mean I have to say, at some of the industry events you kind of meet them and there does seem to be a bigger appreciation, kind of a willingness to reengage with Teradata. It should help you in renewals, etc. What are you seeing in the conversations in the field?

Claire Bramley: Yeah. I think it's definitely changed and it's continuing to change. We've still got more work to do, absolutely. But if I look at when I joined Teradata 2.5 years ago, they were, you're talking about your cloud product, you're talking about the strategy, everybody kind of seemed surprised and hadn't heard the true story or wasn't aware of it sort of thing. Now 2.5 years later, everyone is aware of the story, everybody is familiar with the new strategy, and actually, much more knowledgeable on the products. What the different products are, whether it's VantageCloud Enterprise, VantageCloud Lake. Even now we've just launched last quarter like I mentioned, ask.ai and AI Unlimited. And customers have heard about it. They're hearing about it.

I think our coverage out in the market is much stronger and much bigger than it was before. And we'll continue to work on that. And that's one of the reasons Steve brought in a new Chief Marketing Officer while we're doing a lot more customer/partner type events throughout the year. But yes, even this year versus last year, I think that knowledge and appreciation of what we offer has increased. That's an area that we continue to focus on.

Raimo Lenschow: And then if you look into your installed base, it's obviously like you guys had to change.

You needed to change your awareness of your clients which is what you're working on. And then the clients have to move. Where are we on terms of that, the client base kind of moving towards the new cloud world? Like an English person and a German person talking about innings is kind of the wrong analogy, but where are we on that journey?

Claire Bramley: I would say that we -- I'm not sure I'm going to put in innings terms, but I would definitely say that we are past halftime. Let's put it that way. I'm going to go back to football or soccer for the Americans. We're definitely past halftime, but we're not obviously towards the end of the game. We have more work to do. I think we've come a very long way. It was really important for us as a leadership team and for the company to lead with technology. Lead with technology, lead with innovation. I think that's what we've seen a lot over the last 12 months and we'll continue to see over the next 12 months. And then we've been setting up our sales team to be successful. We've really invested in customer support, customer success, to really make sure that existing customers see the value that we bring.

And then obviously then, having a voice, being out there in the market, making sure people have heard of what we're doing and understand what we're doing. We've come a long way. We've come an extremely long way from where we were a couple of years ago. But I would say that we're through the halftime phase, but we've still probably got at least another quarter of the game to go.

Raimo Lenschow: When you say that, is that on customers that have moved already? Or more customers have appreciation? Because like --

Claire Bramley: Yeah, I'd say customer appreciation. If you look at the customer --

Raimo Lenschow: The moving must have been much earlier in terms of them moving over?

Claire Bramley: Yeah, so the moving -- I think what we see from the moving is, more than 50% of our installed base are in the cloud. More than 50% of our customers are in the cloud, but they still have that hybrid approach. Not more than -- we're not more than 50% of our ARR is not in the cloud, as you can see from our numbers. I mean it's in the 30% range, but more than 50% of our customers. I think that's a good indication. And it's around 60% actually. 60% of our customers are in the cloud with us, but less than 50% of our ARR is in the cloud. That's the sign that people are going through this journey to continue to migrate.

Some customers will keep some on-prem business. Some customers are not ready to be 100% in the cloud. Which is why when we talk about 2025 goals, we talk about we expect to be around 50% or more than 50% of our ARR being in the cloud. But we're not talking about 80% or 90%, because we still anticipate some of our customers staying on-prem.

If they're staying with us on-prem, that's great too. We have customers that are expanding with us on-prem. We have new logos on-prem. I think it's interesting that not all of our customers are ready or are planning to move everything to the cloud. We definitely have a range of customers. Some want everything in the cloud. Some just want to focus on certain workloads or certain areas.

Raimo Lenschow: What are you seeing in terms of the competitive field? A few years ago, you were in that camp of like, oh, it's Teradata and they don't get the cloud. But now it's changed a lot. How did that change the competitive dynamic for you?

Claire Bramley: I think to your point, we were considered to -- if you take 3, 4 years ago, no one even anticipated us being in the cloud. I think now we are seen as a strong competitor. I think it's much easier to migrate with Teradata to the cloud than it is to go to a new architecture, into a new company. And we have a very strong installed based to be able to work with to be able to do that.

I think where we are today is we are definitely seen as strong competition. We get talked about in other people's earnings calls, etc. I feel that is a good sign because they see us a competitor. Whereas previously, I think 3 or 4 years ago, no one, absolutely no one expected us to be where we are today. It definitely is a transformation. And I'm expecting that journey to continue as I mentioned.

We've come a long way, but we've still got more work to do. And I think all of the innovation and technology, and I keep coming back to that I guess because we lead with that. It's really important, that Teradata focus. That's why we were strong on-prem and that's why we think it's important for us to be strong in the cloud is that we have the best products, the best total cost of ownership, the best performance at scale, the lowest cost per query and the beast analytical capabilities with our ClearScape Analytics. That's the bit that we're really pushing ourselves and ensuring. And with all of the AI, the development of AI and the expansion of people moving to AI, for us that means more users, more data, more queries. That's a big opportunity for us as well. And we believe that we can enable that in the best cost perspective, but also the best performance as well.

Raimo Lenschow: Now that you're further through and a lot of your customers are in the cloud already, how do you think about that carrot versus stick approach? Because at some point, as you mentioned it, it does help you in R&D because you can be more focused if you just do cloud R&D, etc. Where are you on that decision making in terms of like, okay, I'm -- most of my customers need to be in the cloud, I'm only selling you cloud-only versus like I have a big installed base that is on-prem as I kind of move, so I need to be more accommodating. How do you think about that dynamic?

Claire Bramley: I think I should -- I think always when we work with our customers, it needs to be a carrot approach. I mean maybe in the past, the stick approach worked, but I think it has to be a carrot approach. But there are so many reasons why it makes sense. Not just from Teradata standpoints but from a customer standpoint. And let me talk through some of those.

If customers can move to the cloud, especially if they want to focus on AI, having that true scale up-scale out capacity, on-prem you have fixed capacity as everybody knows. You have fixed capacity. If you want to then expand your capacity through more users, more data, more queries, you have to then invest in another large on-prem business.

In cloud, it's instant, it can be instantaneous sort of thing. I think there is a lot of reasons for why this makes sense. Not just for us because it's good expansion, and the expansion rate. But for our customers, to give them the flexibility. If we can offer it to them at a competitive cost so that it doesn't have a total cost of ownership increase for them, and give them that flexibility. And I think the difference with Teradata is, we give them the control as well. We have kind of a governance operations dashboard so they can see and manage where they're using computational queries, how much they're using, how much they're spending.

And a lot of our customers actually choose to have fixed pricing. They have fixed pricing, but then they have consumption on top of that because they want that predictability in terms of how much am I going to spend, how much is it going to cost? We work with our customers on that. I think when they see all of these reasons, then it's a carrot approach to sell that value proposition to show them why it brings value to them. But it can also bring value to us because it helps us from an expansion rate. And we definitely see a higher net expansion rate in the cloud than we do on-prem. And that's the advantage for us. Even at a lower margin right now, it's still beneficial for us from a growth standpoint. Because then we see that margin expansion opportunity as well over the next couple of years.

Raimo Lenschow: That was actually my next question. Because you do have a mix effect on revenue and revenue growth because you have the cloud business coming in at a higher growth rate. That's taking -- it's getting a bigger and bigger part of the total which kind of creates then a positive mix effect for overall growth. In a way, like how excited are you as a CFO about that?

Claire Bramley: Yes, absolutely. I mean like I said, we all want to grow. We want to grow faster. And to your point, the cloud mix helps us from that standpoint. Cloud is clearly growing much faster as it becomes a bigger mix. That means that the total company growth will be higher. And as long as we're doing that profitably, and we're generating strong free cash flow through good profitability, then that is a very exciting proposition.

And I think if you look at where Teradata was several years ago and where we are now, from a growth standpoint, from a profitability standpoint, and just from a consistency and innovation standpoint, it's been a huge transformation. Yes, I'm very excited about increasing our total growth as a company at the same time as being committed to bringing value back to shareholders. Whether it's share repurchases and strong free cash flow.

Raimo Lenschow: You mentioned already one part of that is obviously that as the cloud, you guys carry the cost of like running it, the instance in AWS or Azure or wherever you do. That kind of gives you initially a gross margin kind of headwind. Can you talk a little bit about how you see that evolving? Is there with more scale you can negotiate better terms, so that helps you? Like how do you think about that dynamic over time?

Claire Bramley: Yeah, absolutely. One of our biggest costs for providing cloud is the cloud service provider costs. And as we get bigger and as we have more volume going through cloud and going through the different cloud service providers, we're absolutely in a better position to negotiate better costs. That is, as we scale, we can definitely improve our margin rate for cloud.

But there are other things we can do as well. We're looking at ways to automate and be able to bring down our kind of underlying costs as well. But the biggest one is cloud service providers. And we've already seen some benefit from that, so I'm really, as a CFO, very happy with the margin expansion we're seeing on cloud year-over-year. It's grown significantly compared to 12 months ago. And the forecast as we look forward is continued margin expansion. That makes me very excited to be able to get the benefit through scale, but also through automaton and innovation as well.

Raimo Lenschow: Do you benchmark? Obviously, there are guys who started before you on that cloud journey and they report gross margins. Do you benchmark yourself against -- you don't

have to share it, but like do you benchmark yourself against it? And then look at the scale, the year, and --

Claire Bramley: Absolutely, yes. We absolutely benchmark. And we believe over time -- we need a few more years, because to your point, we're several years behind some of our peers. But yes, I do believe that we have a path to be able to over a number of years get to parity. And I look at as where they are today versus where we are today. But I also look at it where they were historically and are we on par with that? So yes, we do a lot benchmarking. We hold ourselves to a highest level of performance. And I do see a good path over the next kind of 2, 3 plus years to be able to significantly increase. And we've already seen that. Even if I just look at the last 2 years, the margin expansion has been significant. That gives me the confidence in future margin expansion as well.

Raimo Lenschow: Last couple of minutes I wanted to talk a little bit about cash. Because that was one of the -- I don't know if you take all the credit, but the last few years, the cash situation at Teradata and the cash flow generation has improved a lot. Can you talk a little bit about what drove that? What action did you take? Maybe it was from the mix effects that are playing out. And then I have a follow-on on Q4.

Claire Bramley: Yeah, I think historically, the way that Teradata's cash flow generation was kind of more of a reactive approach. It was going to be what it was going to be. I think the difference that I've brought in, and I came from HP, so they managed cash really well. They have a strong focus on cash flow forecasting, cash flow management, so I kind of brought that experience to Teradata. And we have spent a lot of time in terms of ensuring that we're proactively managing our cash flow, that we're focused on the cash conversion cycle, specifically DSO because that's the biggest one for us.

Yes, we're much more proactively managing. We've gotten much better at forecasting and influencing the cash flows. But I think at the end of the day, it obviously comes from the -- profitability comes from the revenue. But yeah, we have taken a much more proactive approach when it comes to managing cash flow and free cash flow generation.

And we're much more predictable now. We are a little bit backend loaded this year, but we have good confidence in that just due to to if you look at last year, what we did in the last quarter of last year compared to what we need to do this year, it's slightly more this year. But actually, last year we had a DSO of 74 days and this year I'm anticipating it to be lower. Just that difference in the DSO days give me that confidence in our cash flow generation for '23 as well. And then continued acceleration of cash flow generation as we get out to the 450 to 500 for 2025.

Raimo Lenschow: You mentioned that large deal earlier. Will that have an impact on cash, or no?

Claire Bramley: No.

Raimo Lenschow: That's not coming, so the cash flow number is different there.

Claire Bramley: Yes, there's no impact from revenue, profitability or cash flow.

Raimo Lenschow: Okay, that's really good to hear. And then last question for me is on profitability. That's the other thing. Obviously as part of the transition, profitability suffers a little bit. How do you think about this coming out again? More cloud -- we'll not coming out, but it's like having more cloud in the mix, etc. How will that impact over time the profitability?

Claire Bramley: Yeah, so as I mentioned, we -- the cloud is dilutive to our margins. But as we accelerate our growth, that gives us other scale opportunities in terms of our costs. And we're seeing cloud margin expand over time. I have good confidence. We finished 2022 at 16% operating margin. We have the goal in 2025 to be in the low 20s and we're still on track for that. I'm confident about the combination of growing and scaling and margin expansion in cloud to be able to help us expand our operating margins over time.

Raimo Lenschow: Is that kind of the classic you need to think of gross margin dollars rather than gross margins? That in more gross margin dollars kind of cover like the OpEx which is kind of more fixed as a cost, and so that's how the operating margin should go higher over time?

Claire Bramley: Yes, exactly.

Raimo Lenschow: Same dynamic as everyone else.

Claire Bramley: Exactly. And that's the advantage of growing. To your point, you were saying, as a CFO, are you excited about total growth? Absolutely. Because it gives you opportunities to be able to drive up your margins. You can still invest the same or slightly more in dollars, but if you're not including your overall costs -- there's fixed costs in our cost of sales and gross margin, there's fixed costs within our overall operating expenses. The fixed costs are not growing and your topline is growing, you're going to get that scale benefit, which is great. That's the big advantage to being able to grow.

Raimo Lenschow: Yeah, okay. And then last question, and then I'll let you go, is how do you think about usage of cash? Now cash generation is really coming up nicely. How do you think about that going forward?

Claire Bramley: Yeah, so our capital allocation strategy is very much about reinvesting back in the business, about share repurchases, and small tuck-in M&A. We did one, as I mentioned previously, this year and we'll continue to kind of look at the landscape to see if there's any out there that we want to continue to focus on. Small tuck-in M&A. Our biggest commitment from a capital allocation standpoint is 75% of share repurchase, 75% of free cash flow that we will do through share repurchases. And I think that right now, I believe because of our valuation and because of where we are, is the best return to shareholders. But we continue to look at what is the best return to shareholders? What is the best use of our cash? And they are the 3 that we look at. It's reinvesting, share repurchases and M&A, but more from a kind of tuck-in technology M&A standpoint.

Raimo Lenschow: Okay, perfect. That's a good summary. Claire, thanks for joining us again.

Claire Bramley: Thank you so much, Raimo.

Raimo Lenschow: Good to have you here.

Claire Bramley: It was my pleasure. Thank you so much.

Raimo Lenschow: Thank you.