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CORPORATE PARTICIPANTS

Adaire Rita Fox-Martin *SAP SE - Global Customer Operations & Member of Executive Board*

Christian Klein *SAP SE - Co-CEO & Member of Executive Board*

Jennifer B. Morgan *SAP SE - Co-CEO & Member of Executive Board*

Luka Mucic *SAP SE - CFO & Member of Executive Board*

Stefan Gruber *SAP SE - Head of IR*

CONFERENCE CALL PARTICIPANTS

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

Charles Brennan *Crédit Suisse AG, Research Division - Research Analyst*

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

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

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

Philip Alan Winslow *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

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

Stewart Kirk Materne *Evercore ISI Institutional Equities, Research Division - Senior MD*

Walter H Pritchard *Citigroup Inc, Research Division - MD and U.S. Software Analyst*

Ryan Smith *Qualtrics LLC - Co-Founder & CEO*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the SAP Quarter 3 2019 Earnings Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Stefan Gruber, Head of Investor Relations. Please go ahead, sir.

Stefan Gruber - *SAP SE - Head of IR*

Thank you. Good morning or good afternoon. This is Stefan Gruber, Head of Investor Relations. Thank you for joining us to discuss our results for the third quarter 2019. I'm joined by our new Co-CEO, Jennifer Morgan and Christian Klein as well as Luka Mucic, our CFO, who will make opening remarks on the call today. Also joining us for Q&A is Executive Board member, Adaire Fox-Martin, President of our Global Customer Operations; and Ryan Smith, CEO of Qualtrics.

Before we get started, I would like to say a few words about forward-looking statements and our use of non-IFRS financial measures. Any statements made during this call that are not historical facts are forward-looking statements, as defined in the U.S. Private Securities Litigation Reform Act of 1995. Words such as anticipate, believe, estimate, expect, forecast, intend, may, plan, project, predict, should, outlook and will and similar expressions as they relate to SAP are intended to identify such forward-looking statements.

SAP undertakes no obligation to publicly update or revise any forward-looking statements. All forward-looking statements are subject to various risks and uncertainties that could cause actual results to differ materially from expectations. The factors that could affect SAP's future financial results are discussed more fully in our recent filings with the U.S. Securities and Exchange Commission, including SAP's Annual Report on Form

20-F for 2018, filed with the SEC on February 28, 2019. Participants of this call are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates.

On our Investor Relations website, you can find our quarterly statement and a financial summary slide deck. Both documents are intended to supplement our prepared remarks today and include a reconciliation from all our non-IFRS numbers to IFRS numbers. Unless otherwise noted, all financial numbers referred to on this conference call are non-IFRS and growth rates and percentage point changes are non-IFRS as reported year-over-year. The non-IFRS financial measures we provide should not be considered as a substitute for or superior to the measures of financial performance prepared in accordance with IFRS. And finally, just a reminder, today's call is focused on our Q3 earnings results. In 3 weeks on November 12, we will hold our special Capital Markets Day in New York City, where we'll provide more color on our growth strategy and midterm revenue and margin ambitions.

And with that, I'd like to turn things over to our Co-CEO, Jennifer Morgan.

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

Thank you, Stefan. Good morning, and thanks to everyone for joining today's call. First, I'd like to thank Hasso Plattner and the Supervisory Board for their trust and honor of leading this company forward together with Christian Klein, CEO. It's an honor to help write SAP's next chapter and follow Bill.

Before I begin, I want to start with the news we learned about on Friday regarding the passing of Mark Hurd. Mark has had a profound impact on our industry. And on behalf of all of SAP, I want to extend our deepest sympathies to the entire Oracle community and most specially to Mark's family and friends. You are in our thoughts and prayers during this difficult time.

Now let me dive into our Q3 performance. Today, we reported strong Q3 and year-to-date results, which Luka will detail shortly. Clearly, our experienced management vision, powered by Qualtrics, is resonating with customers and is a key differentiator across all aspects of the Intelligent Enterprise. With top line accelerating and operational excellence initiatives in full swing, we're on track to reach our full year and midterm ambition.

Let me spend a minute on the macro. Our strong Q3 performance we've achieved despite headlines about a slowing global economy, trade wars and political uncertainty. We had some impact due to macro challenges, for example, in Asia and the German auto and manufacturing sector, but even in times of uncertainty, technology investment remains a focus for every company, and our business is resilient due to the breadth of our global coverage.

Companies continue to turn to SAP to transform, to accelerate their growth organically and through faster M&A to drive efficiencies, competitiveness and successfully navigate a changing macro and regulatory environment. Our global pipeline is robust, as we head into our seasonally strong Q4. SAP's resilience is further underpinned by more predictable revenue approaching 70% of the mix.

Let me now highlight our strategic growth drivers in the cloud. We made a bold move with the acquisition of Qualtrics and customers are excited about the holistic Experience Management Platform Qualtrics provides, in addition to what the combination of X- and O-Data can do. We're very pleased with Qualtrics' growth, and we are starting to see the scale of SAP helping drive and close pipelines, especially in the Enterprise segment.

Qualtrics had some impressive wins in Q3: Dish Networks, Slack Technologies, SMI, U-Haul, Sharper Image, Stanley Black & Decker, Garmin International and many others selected Qualtrics in Q3 to move beyond systems of record to new systems of action and achieve breakthrough results.

We continue to beat our competition in both the enterprise and volume parts of our business. Qualtrics' volume engine is helping SAP to expand its footprint into new accounts and is helping us open doors for other SAP cloud solutions. We're also seeing an acceleration of our win rates against Medallia, as customers are choosing Qualtrics for its technology and analytics capability and the breadth of XM solutions across customer experience, employee experience, product experience and brand experience.

With the addition of Qualtrics and SuccessFactors, we've redefined a traditional human capital category to Human Experience Management, or HXM. Every company needs to understand the factors that impact employee experience to attract and retain their talent. And since integrating Qualtrics with SuccessFactors suite, we've seen a tremendous demand in SuccessFactors' customer base for Qualtrics. Since May, we've acquired over 300 customers for the Qualtrics platform.

And SAP's evolution towards Human Experience Management is proving to be an accelerant for Employees Central, which added more than 150 customers in the quarter and has now more than 3,500 customers globally. Competitive wins included British Telecom and Hugo Boss. And our joint sales motions are paying dividends. Qualtrics had its largest employee experience beyond history this quarter, as a direct result of our joint go-to-market motion.

Some proof points for SuccessFactors. We just eclipsed 1,000 SuccessFactors customers in APJ. And when you add China, that's another 400 customers. In Latin America, we're approaching 800. Even in mature markets like Europe, we see significant growth to over 2,800 customers. U.K. and Ireland saw triple-digit new bookings growth in Q3.

We're also making great progress aligning Qualtrics empire and our partner ecosystem. We announced the partnership with Ernst & Young, with EY delivering excellent practices and solutions to its clients through its people advisory services and its workforce of the future solution. EY will also become the first Qualtrics' partner network member to adopt Qualtrics experience -- employee experience across their organization of 2,600,000 -- 260,000 employees, and this will combine X-Data and O-Data from SuccessFactors.

In addition to accelerating SuccessFactors business in HCM, our CX business continues to benefit with the infusion of Qualtrics across our C/4HANA portfolio. We introduced a connector between Qualtrics to C/4HANA, the developers and partners to use to build new integration scenarios. We're starting to see organizations combining customer feedback and operational data to listen, understand and act.

E.ON and Brazilian retailer, Swift, also chose SAP C/4HANA solutions in Q3 over our competition, based on SAP's unique and compelling vision, while Tetra Pak and Perfumery Douglas went live on C/4. We're continuing to invest in our customer experience portfolio. We've announced that Bob Stutz, a leader who continued to redefine the CX arena at both Microsoft and most recently Salesforce, has rejoined SAP as President of Engineering in our CX business. Bob's experience and foresight will take us to new places in the future.

Our Intelligent Spend Solution provides collaborative commerce with SAP Ariba, effortless travel and expense processing with SAP Concur and flexible workforce management with SAP Fieldglass. Together, they represent the largest commerce platform in the world with more than 3.4 trillion in global commerce annually transacted in more than 180 countries. This is nearly 8 times the size of Coupa. We are making strong progress on delivering integrated spend scenario starting with services procurement across Fieldglass and Ariba. BT, Sony Music product and many other turned to SAP's Intelligent Spend Solutions in Q3. Specifically, Concur is starting to gain traction, especially in China, with Xiaomi as one of its marquee customer.

Another incredibly exciting announcement and key strategic driver of future growth is our expanded relationship with Microsoft, which we call Embrace. We listen to our customers who ask to help them define and accelerate their journey to SAP S/4HANA in the public cloud. Many of our enterprise customers have chosen Azure. In response, SAP and Microsoft have established a partnership to move on-premise SAP ERP and S/4HANA customers to the cloud through industry-specific best practices, our joint reference architecture and SAP cloud delivered services on Azure. This partnership will both accelerate and simplify customer migration to S/4HANA on Azure.

Microsoft will bundle SAP Cloud Platform services into a bundle we call Embrace and those sell these directly through their field organizations to their customers who will run SAP in the Azure cloud. By putting the customer first, we've combined SAP innovation with Azure to create the optimized environment for SAP S/4HANA to enable the integration, orchestration and extension of SAP systems in the Azure cloud. As always, choice will prevail as we recognize that many of our customers also run SAP on AWS and GCP, for example. In this case, our customers will still have the benefit of the best run SAP and their public cloud of choice. So to summarize, SAP is delivering on its winning strategy and its promises as validated by our strong Q3 and year-to-date results. The fundamentals and future of SAP could not be stronger.

Now I'd like to hand over to my partner and Co-CEO, Christian Klein. We share similar vision. And with highly complementary skill sets and experiences, we will write the next chapter of SAP's success together. Thank you, again. Christian, over to you.

Christian Klein - *SAP SE - Co-CEO & Member of Executive Board*

Thanks, Jen, and thanks to everyone for joining us today. Let me begin with a personal remark. On Friday, we were saddened by the news about the passing of Mark Hurd. Words are never adequate in moments like these. The whole IT industry lost a visionary leader and a brilliant mind. And my thoughts are with his family, his friends and everyone at Oracle.

Being a CEO is a role marked with responsibility and an honor to all. I want to express my heartfelt thanks to Hasso Plattner and the SAP Supervisory Board for the trust they put into China and myself. Starting off with a quarter like this certainly helps. This is where I also want to thank Bill, not only for his amazing quarter, but also for the unique journey during the past decade. This is an outstanding quarter across all key parameters, cloud and on-premise, order entry, revenue, cloud cost margins, operating margins and cash flow. Luka will walk us through those in a minute.

Let me add some color from the co-application's perspective. SAP's ERP flagship solution, S/4HANA, continues its success story. It's the broadest suite in the market, serving over 25 industries and 160 country version. We are continuing to ramp into artificial intelligence to further increase the business value and help our customers to grow and drive automation in the digital age. Until the end of this year, we will have 200 use cases and more than 1,800 features, representing a 60% increase in scope.

S/4 is further gaining market share, and we see positive software license growth and high double-digit cloud revenue growth. 80% of the DAX companies and 65% of the Forbes' Global 2,000 companies already rely on SAP S/4HANA. We are now at more than 12,000 license customers, representing a 25% year-over-year growth. We're also very happy with regard to adoption, especially S/4 with more than just a technical migration. It has allowed our customer a complete redesign of their business model and business processes. We see 60% of customers live or implementing and the other preparing their approaches. To name just a few, this quarter, Dow Jones and Callaway Golf in the U.S. and Breitling in Switzerland went live on S/4HANA as did Daewoong Pharma in South Korea.

In context of that, we are making rapid progress in cloud ERP. S/4HANA cloud, including supply chain management, we are now at cloud revenue run rate of more than EUR 0.5 billion and close to 2,000 customers. We have a coverage of 17 industries already in the cloud, and we are investing heavily in the user experience. This quarter, we saw subsidiaries of McDonald and Xinjiang Daming Mining in China go live on S/4HANA cloud. I also like to provide you with an update on our platform business, including our in-memory database, SAP HANA, with more than 31,000 customers as of today.

One important use case is S/4HANA and other LOP applications, such as SuccessFactors running on top of SAP HANA. But over the last 2 years, HANA has rapidly expanded beyond SAP application to third-party application. This is reflected in the share of full used licenses. We have more than 60% already and it continues to expand. We are evolving SAP Cloud Platform as a business technology platform with focus on business services and integrating our LOP application. SAP Cloud Platform is also key when we talk about integration, including our master data integration content and cokernel services like security and identity.

There is no doubt that cloud is becoming mainstream in the enterprise software market, and so we are happy to record increasing cloud cost margins across all business models. We are looking hard on further increasing the efficiency of our internal cloud delivery. You can see that in the margin trend and I will provide additional color at the Capital Markets Day.

At the same time, we understand some industries with high quality complexity, like manufacturing and automotive, where ERP customization is needed, we'll keep major part of their core on-premise for the foreseeable future. The same is true for companies in countries with high -- with political instability, limited infrastructure or increased data security concern. Hence, a lot of landscapes will remain hybrid for many years. SAP allows companies to combine cloud and on-premise in the landscape tailored to their needs, taking into consideration their business requirements and strategic vendor relationship. It's all about customer choice. This is also reflected in our multi-cloud strategy, allowing both our customers and us to leverage the hyperscale of highly elastic and globally available infrastructure to deliver SAP cloud solutions.

Jen discussed earlier the Microsoft partnership and how excited we are about that. Still rest assured, the customer choice in this context remains unchanged. Before I hand it over to Luka, I'd like to point out 3 focus areas that I believe will be critical for our success in the next chapter of SAP. One, customer success. SAP has always been best when we listen to our customers. Customers have been vocal about their feedback, which we greatly appreciate and proactively seek. We are listening and taking action, integration, solution adoption and use and upselling is a key directly related to customer success.

Two, innovation. SAP is not a software distributor. SAP is a software engineering powerhouse. Our continued growth through innovation is based on our ability to leverage on the results as effectively and efficiently. We are refueling processes, removing overlaps, focusing resources and accelerating innovation cycle, so we get the most out of our R&D investment, which are critical to our future success. Also, we will further strengthen co-innovation with our customers to realize true business value with the help of new technology.

Three, our employees. It is our colleagues that drive innovation, provide value to our customers and consistently promote our growth and profitability. We are proud that SAP has been recognized by numerous employee awards worldwide. We are the only company to rank on all 5 classes of Best Places to Work country lists. Our Employee Engagement Index is near record high, but we don't stop here. In addition to further simplifying our internal processes, we are currently conducting our annual employee survey. This year with our own SAP Qualtrics technology, which gives us detailed insights into the good, the best and the ugly. Happy employees are productive and innovative and, therefore, critical to our success.

With that, I would like to hand it over to Luka. Luka, are you happy with the numbers?

Luka Mucic - *SAP SE - CFO & Member of Executive Board*

Yes. Thanks, Christian. As you know, usually, it's hard to get me satisfied, but this time I'm indeed absolutely happy with the results this quarter. And I would also like to take the opportunity to congratulate both you and Jen on being named co-CEOs.

Look, in April, we promised a stronger focus on profits and we are clearly delivering. I'm very pleased to say that our operational excellence measures allowed us to achieve double-digit operating profit growth and a substantial operating margin expansion. And just as important, we achieved this result with continued strong top line momentum.

Let me now provide you with some background on the key drivers of the third quarter. Both cloud and software revenue as well as total revenue grew 13% this quarter. Cloud revenue was, again, a big driver of this growing 37%. New cloud bookings were up 39% and up 51%, excluding our Infrastructure-as-a-Service business. This is a good trend for SAP and net positive for the margin profile of our cloud business.

As mentioned by Jen, we also signed a large partner contract with Microsoft. This contributed 18 percentage points to new cloud bookings growth this quarter. In addition, as Christian said, we saw significant growth in our S/4HANA cloud offering.

Software license and support revenue grew at a solid 4% in the quarter. Software licenses revenue declined by 1%. And with this, our software license revenue was actually slightly better than expected despite macro uncertainties. This was primarily driven by continued growth in our S/4HANA flagship solution and our Digital Supply Chain offering. In Q3, the share of more predictable revenue increased to 69%, up 2 percentage points year-over-year.

Now quickly to the regions where we had a very solid performance in the EMEA region, with cloud and software revenue increasing 10%. Cloud revenue increased 48%, with Germany and the U.K. being highlights. France and the U.K. had exceptional quarters in software license revenue.

We had a strong performance in the Americas region. Cloud and software revenue increased 16%. Cloud revenue increased 32%, with Canada, Brazil and Mexico being highlights. In addition, the United States and Brazil both had strong quarters in software license revenue.

In the APJ region, we had a solid quarter, amidst a challenging market environment. Cloud and software revenue was up 9%. Cloud revenue increased 40%, with Japan and Australia being highlights. Japan had an exceptional quarter in software license revenue as well.

Let's now look at profitability and gross margin in the third quarter. Our cloud gross margin rose sharply year-over-year and increased by 5 percentage points to 69%. As Christian already mentioned, we continue to make progress on efficiency gains in our cloud delivery. This marks the third straight quarter in a row that we have increased our cloud gross margin sequentially. In our most profitable cloud segment, the Intelligent Spend Group, gross margin remained steady year-over-year at 78%. The gross margin of our other SaaS parts businesses expanded massively by 10 percentage points year-over-year and reached 70%, which is an acceleration compared to last quarter. Similarly, as in Q2, we benefited from primarily 4 effects: first, SuccessFactors now running solely on our converged cloud platform based on the HANA database; the extended lifetime of hardware; continued high gross margin from Qualtrics; and also benefits from restructuring.

For our Infrastructure-as-a-Service offerings, the cloud gross margin improved by 9 percentage points year-over-year to 25%. We see Infrastructure-as-a-Service becoming a smaller share of the cloud mix going forward as hyperscalers continued to expand their capabilities to operate SAP workloads in their data centers.

Our cloud and software gross margin increased by 1 percentage point to 82% year-over-year, with a very positive contribution from the cloud margin. Our services gross margin was up 5 percentage points to 27%. The increase of the services margin mainly results from a strong revenue performance paired with the successful execution of operational excellence measures and restructuring benefits.

Overall, operating profit was up 20% year-over-year, driven by a combination of strong top line and further acceleration of our operational excellence and restructuring benefits. This led to a stellar operating margin, which expanded 170 basis points. Year-to-date, we expanded our operating margin by 70 basis points.

Turning quickly to IFRS operating profit. This was up 36%, benefiting from lower share-based compensation expenses. For the first 9 months, though, IFRS operating profit was down 28%.

Let me just give you a brief recap and update on the effects that led to this result. Compared to the first 9 months of 2018, we had close to EUR 100 million higher acquisition-related charges and revenue adjustments, mainly from the acquisition of Qualtrics, close to EUR 500 million higher share-based compensation expenses and approximately EUR 1.1 billion higher restructuring expenses.

As mentioned last quarter, these effects are, obviously, much higher than usual this year. We still expect IFRS operating profit to be up significantly next year since we don't expect any meaningful restructuring expenses and acquisition-related charges to likewise decline. Therefore, our IFRS operating profit growth rate in 2020 will be much higher than on a non-IFRS basis.

Moving onto EPS and taxes, where for IFRS EPS, we saw a strong increase of 28% year-over-year, while non-IFRS EPS was up 14%. In the third quarter, our IFRS and non-IFRS effective tax rate each increased close to 2 percentage points year-over-year. However, our tax rate guidance for 2019 remains unchanged.

In Q3, our operating cash flow was up 28%. Free cash flow rose sharply and was up 116%, due to strong operating cash flow and a reduction of our CapEx spend by 50%. For the first 9 months, our operating cash flow was EUR 3.3 billion, down 5% year-over-year.

Compared to the prior year, operating cash flow was impacted by the following effects: first, the benefit of roughly EUR 290 million from the application of IFRS 16, but then higher restructuring payouts of around EUR 240 million, higher share-based compensation payouts of close to EUR 210 million and higher tax payouts of EUR 490 million. For the full year 2019, we, therefore, still expect operating cash flow to be slightly lower than in 2018. Similar to IFRS operating profit, we expect a steep increase in operating cash flow in 2020 as restructuring and tax payouts will decrease sharply.

Free cash flow stabilized for the first 9 months and was flat at EUR 2.3 billion. This reflects our disciplined CapEx spend, which was EUR 703 million, EUR 443 million lower than the previous year. For the full year 2019, we now expect our CapEx to stay below the EUR 1-billion mark.

Before I conclude, I would like to give you an update on our nonfinancial performance and sustainability highlights. We are proud to be recognized as the #1 software company in the Dow Jones Sustainability Index for the 13th year in a row. Developments in the world are leading to increased demand for SAP to enable customers to implement sustainable business models connecting economic, social and environmental objectives.

We want to help ensure that smart integration of impact measurement and valuation will ultimately become standard practice. To this end, SAP is a founding member of the value balancing alliance, a nonprofit organization that has businesses measure their overall societal impact and dependencies.

We aim to lead by example, continuing to steer sustainable holistically in our own operations. Employee retention was down slightly to 93.3% in Q3 year-over-year. We have made great progress in women in management, which is now at 26.3%, up from 25.9% year-over-year. And obviously, with Jen, SAP has named the first female Co-CEO of the DAX company.

In Q3, our carbon emissions were 65 kilo tons, just slightly higher than we anticipated. Despite this, we expected our emissions in 2019 will stay stable at a minimum. We remain committed to our goal of becoming carbon neutral by 2025.

So to summarize, we delivered an exceptional quarter across revenue, profit and cash flow. We achieved double-digit growth in cloud revenue, double-digit growth in cloud and software revenue, double-digit growth in total revenue, double-digit growth in operating profit, substantial operating margin expansion, double-digit growth in earnings per share and triple-digit growth in free cash flow. We reiterate our 2019 outlook with great confidence, and we are on track to reach our midterm ambitions.

With that, thank you very much. And we will now be happy to take your questions.

Stefan Gruber - *SAP SE - Head of IR*

Thank you. Operator, we can now start the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from John King from Bank of America.

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

Couple of questions from me. Firstly, just on the mechanics of the Microsoft deal. I think you're implying it's about EUR 74 million or EUR 75 million run rate of revenue. Can you just explain to us how quickly we will see that kind of revenue run rate in the numbers, please, perhaps, for Luka, I guess?

And then just coming back to the cloud bookings, second question. I guess you could look at this in a number of ways, but depending on the mechanics of that Microsoft deal, I guess the implied clouds -- organic cloud bookings growth was still, I would say, maybe a little bit below what you're expecting in terms of cloud revenue growth over the next few years. And I guess, the question is, would you agree with that? And if so, what are the steps that you're looking to take in order to try and improve the run rate on the cloud bookings side?

Luka Mucic - *SAP SE - CFO & Member of Executive Board*

Yes. Perhaps, I'll take both of those and then please, Jen and Christian add your color, if you want. So on the Microsoft side, it's very simple. Revenue recognition will begin in Q4. And then basically, we will have roughly the figures that you are citing on an annualized basis over the course of the next 3 years basically.

On the new cloud bookings side, look, I mean, first of all, I think nobody should argue with a 39% new cloud bookings growth and 51% without Infrastructure-as-a-Service being a good result. Of course, it was influenced by the Microsoft transaction, but this is representative with the strategic choices that we are making. We are doubling down on the partnerships with our hyperscalers. We'll drive healthy and highly profitable cloud platform and S/4HANA business as a result of those partnerships. And we focus our HANA enterprise cloud Infrastructure-as-a-Service business on high-value opportunities. This is exactly the direction that we want our business to take.

When it comes to the growth rates in new cloud bookings that we need in order to hit our midterm objectives, I think I've been talking about this already on a number of calls previously. It's important to note that first of all, the new cloud bookings are not the only source of our revenues and of our growth. Of course, the renewal performance plays a role. The rent in TCV contracts plays a role, and we have quite a few of them that actually have a higher number of users or other capacity metrics that are kicking in, in later years of a multi-year contract. And on the other hand, obviously, the pay-as-you-go revenues that we have primarily in our Intelligent Spend Group are also not captured in new cloud bookings.

When you take a look at our performance across the different cloud segments, you will actually find that we run basically only healthy businesses that are growing exactly the way they should. In the Intelligent Spend Group, we have been very consistent around the 20% constant currency growth mark now for a number of quarters. And with the stability of our transactional revenues, we expect that this were continuing.

And in the high-growth customer in Experience Management segment, we have been growing close to 100%. In ATS, actually many of the cloud assets that are now reaching scale like S/4HANA, analytics cloud have actually had a very, very strong performance. And as they become a bigger piece of the pie, they will, of course, also influence the revenue performance in a much bigger way. Cloud ERP is an almost untapped opportunity still for us. Christian has mentioned, the run rate that we have achieved by now, the opportunity in the market is huge. So you shouldn't be concerned at all about our momentum in the cloud. Please?

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

Yes. I'll just punctuate a couple of different areas of focus for cloud growth. The Microsoft deal is important because it goes beyond a traditional partnership. They've put pretty big skin in the game and their sales teams across the world are now selling SAP solutions. That's going to help us do 2 things: accelerate the movement of S/4HANA to the cloud and accelerate the sales of SAP's cloud platform services in cloud revenue. So the stickiness of that partnership, we believe, will continue to pay broader dividends.

I'd say 2 other points. Qualtrics is another area where we see huge potential from a platform perspective as well as just giving us an opportunity to have new conversations, especially in places like Asia. This is where we can hit the ground running and really drive growth faster.

And then finally, we heard you. We know that you want to see more organic innovation in the cloud from SAP. It will be something we talk a little bit more on at our Capital Markets Day. But as Luka mentioned, whether it be analytics or the customer-facing solutions or supply chain, this is an engine that we need to get humming even more.

Operator

Our next question comes from Walter Pritchard from Citi.

Walter H Pritchard - *Citigroup Inc, Research Division - MD and U.S. Software Analyst*

I'm wondering between some of the things you talked about on the call with S/4 public ERP ramping up, which -- it looks like the percentage of your S/4 customers that were new actually came down, implying that the installed base might be moving faster. As well as what you talked about with Microsoft and the Azure relationship, do you expect that you start to see a little bit more of a pickup here in the installed base migration around S/4? And I'm just curious, I know investors get a little nervous around cloud versus on-prem, but how do you expect that will influence those 2 revenue streams? If there's any change that you're highlighting here?

Christian Klein - *SAP SE - Co-CEO & Member of Executive Board*

Thank you, Walter, for the question. So I'll start and then handing over to Adaire. So in Q3, so we have seen actually a really strong quarter for S/4. I mean as I mentioned, we have seen positive growth in software on-premise S/4. And we also have seen high double-digit growth for S/4HANA cloud. And actually, we see both. I mean we see many industries like automotive or in the public industry, we see a lot of movement, also now customers migrating to S/4 on-premise. We see also now that we are increasing the business value of S/4. We are serving new business models, putting more and more AI into the product, driving more automation, drive a higher intelligence in the processes. We see now that also the move is really picking up.

And then on the cloud side, especially in the finance area, we are seeing major wins now in Q3. And as I said, being now close to 2,000 customers, this is now a major business for SAP. Even more important that in the cloud, we see that the adoption is even kicking in faster. So we see go lives within 20 days, which is really strong. And this also shows that not only in the cloud we are growing fast, but also customers adopting really fast.

Adaire Rita Fox-Martin - *SAP SE - Global Customer Operations & Member of Executive Board*

Yes. Maybe I'll just add a little bit to that, Walter. Like -- thanks to our colleagues in development who are increasing exponentially the functionality that is in S/4. It means that as our customers look at the value case for the move, there is a very strong value proposition now around the S/4 environment. We are putting a whole range of different components around facilitating an easy and cost-effective move for our customer base. We can see very significant focus from the SI community on the S/4 installed base. We have a strong value assurance program, and the implementation partners are doubling down on this.

In the general business space, we now have 27 conversion factories from various different partners supporting our customers in that segment. With our colleagues in DBS, our model company approach, it means that we are simplifying with preconfigured solutions and content, the implementation of S/4 in a customer's environment. And so we're working to automate as much as we can of that process to ensure that we can facilitate a cost-effective and high-value transformation for our customers.

Operator

We will now take our question from Michael Briest from UBS.

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

Congratulations, Jen and Christian, on your promotions. Just following up on the topic of the private cloud, I mean, you're obviously repeating the ambition for 2023 cloud revenues of EUR 15 billion. But looking at this Microsoft relationship in part, that could be cannibalistic to the growth in HEC. Do you see any change in the mix in 2023? You're expecting the SaaS pass business perhaps to be bigger than previously as a result of this?

And then related to that, Luke, on the CapEx side, I think you said you're expecting less than EUR 1 billion this year. 6 months ago, it was going to be EUR 1.5 billion. I'm wondering how much that relates to this change in hyperscaler relationships? And how much maybe to your -- you have some quite large capital projects like building offices in Munich and suchlike. Is that contributing to the reduction in CapEx?

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

So maybe I can take the first part of the question. We don't see this cannibalizing our revenue because we see that customers want choice, right? And so many of our customers absolutely want SAP to manage S/4 in the cloud, whether it be the public cloud or whether it be HANA Enterprise Cloud. So we see many of our customers are making broader public cloud enterprise decisions. And for us, we wanted to make sure that we didn't limit our conversations to customers only specific to 1 cloud offering.

And so what we found is that the customer has so many voices around their table right now, whether it be movement to public cloud or S/4 or other innovation. And we just found that by coming together and giving them prescriptive options depending on what's important to them, what their industry is, et cetera, then we can make sure regardless we're getting a piece of the pie and we can influence that decision. So we'll continue to see both of those revenue streams grow, but now we're going to be in far more conversations in impacting the direction. Luka?

Luka Mucic - *SAP SE - CFO & Member of Executive Board*

Yes. And first, just the last sentence on this one. I think we have been talking for a while now about the fact that we expect indeed Infrastructure-as-a-Service due to our focus on high-value engagements will not further increase as a percentage of cloud revenues. Actually, we believe that there is now an acceleration in SaaS part, but that is very positive for the overall margin and, of course, also for the gross margins in the cloud.

When it comes to CapEx, it's correct. I mean we have made great progress this year in our CapEx efficiency. Main contributing factors are first of all the progress that we have been making with the hyperscalers and our partnerships in this respect. They are now really powering a lot of the infrastructure support that we need for our applications and that is, of course, helping us a lot. But it's also due to the fact that Gary Slater and Christian's organization and the Cloud Infrastructure team have done a terrific job to rationalize the demand for our own data center hardware and consolidating the procurement centrally. They have also successfully renegotiated the maintenance contracts for our hardware and our data centers in a way that makes it now highly economic to extend the lifetime of the hardware from 4 to 5 years and that helps, of course, also in the CapEx intensity.

And we believe that this will continue to be the case. Yes, of course, we also have general CapEx needs through facilities and other CapEx areas, but they are largely planned for and they have not been subject to major changes. So it's really mainly the infrastructure efficiency in IT and in our data centers, and we believe that this will continue so also for the next couple of years, we expect no significant increases from the level that we have reached right now.

Christian Klein - *SAP SE - Co-CEO & Member of Executive Board*

And maybe Michael, just to give you 1 concrete example also how our HANA Enterprise Cloud offering plays together with our hyperscaler strategy. I mean one of our main competitors talked about some SAP ERP replacement and I had actually have no evidence. I didn't find any SAP customer moving over to the competition.

But what we are subsequently doing, there's 1 large ERP customer from the competition, they are now saying, we want to move to S/4HANA. They have not the skills to get to 1 HANA and to 1 S/4HANA, so they said, put S/4HANA on Azure and we go to the HANA Enterprise Cloud. So you help us to first replace the database; second, the ERP; and then, SAP helps with the migration and this is done with the HANA Enterprise Cloud offering class Azure infrastructure. So you also can see that both offerings also play really well together and helps us also to win market share going forward.

Operator

Our next question is from Stewart Materne from Evercore ISI.

Stewart Kirk Materne - *Evercore ISI Institutional Equities, Research Division - Senior MD*

I'll add my congrats to Jennifer and Christian on your new appointments. I guess the question is probably for Jennifer just on Qualtrics. At Sapphire, you all mentioned that the business had been accelerating versus the pre-IPO growth rates. And I was just kind of curious where are you in terms of being able to leverage the global distribution capabilities of SAP with Qualtrics?

And then, I guess, secondly, what kind of halo effect is maybe Qualtrics having on some of the other SaaS properties? I think you mentioned sort of the change in terminology around SuccessFactors. So I just wondered if you can give us a sort of a broader update there on sort of the ability to leverage the Qualtrics brand across all of SAP.

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

Sure. Thanks for the question, Kirk. I'll start and Ryan Smith is actually on the call, and I'll hand it to him to give a little bit more color. So I can look at it from a couple of angles, one is that when you look at SuccessFactors or HR, right, and you look at the traditional category of HR, it's very much an event-driven kind of after the fact solution track -- track driven events it happens in an employee's life cycle. When you look at what's happening in the workforce today, the war for talent, employee experience, Qualtrics has really allowed us to really redefine how we're having these conversations, right?

So it's not just about understanding why things are happening or why I do have attrition? It's understanding how to go further upstream and understanding who is going to attrit, what are my issues going to be? And so being able to have those kind of conversations and take action much further upstream in the business is key. So that's given us a huge kick in SuccessFactors because it really changes the nature of the conversation and it makes it a c-suite discussion because now we're talking to people about how experience actually shows up in the income statement, how it can actually lower your SG&A or it's going to allow you to be more productive in getting employees in retail on the floor and more productive and selling more is one example. So SuccessFactors is one.

The other one, clearly, is around customer experience. When you look at our commerce solution, we see a really strong correlation between bringing together commerce and Qualtrics. But Qualtrics is also allowing us to start conversations in places maybe we wouldn't traditionally go. So it's allowing us to be, whether you're in customer service or other parts of the enterprise, it's getting us broader conversations and broader audiences, which has been fantastic.

From a geographic perspective, you look at a region like APJ, the companies and the brands that are in APJ are foundationally based on this concept of experience. You look at the airlines in Asia and compare them to any other airlines in the world, these companies already understand experience. Now they very quickly can understand how technology can help them scale that in new and different ways. Ryan and I were in Korea and Japan launching this over the summer, and we had incredible growth in our APJ regions around Qualtrics. So we're able to hit the ground much quicker. Our employees are super excited about this solution because they're able to have these conversations and we're really starting to have this enterprise conversation.

Ryan, I'll hand it to you to add any additional color?

Ryan Smith - *Qualtrics LLC - Co-Founder & CEO*

Yes. I think you said it great, Jen. I think the only thing I would add would be if you look back a year ago, we were on the road at this time kind of starting our IPO roadshow, getting ready to go public. And if you would have told me that here we are almost a year later, we've seen a massive increase in our growth rate from what was already out there. We're also seeing anytime we go in with SAP, our deal size increases 30%-plus. We've already seen massive adoption on the EX product with combination of SuccessFactors. We've always been known as a company with the best technology in the space by far. I think the question was always out there as, hey, can we go from 7-figure deals to -- high 7-figure deals to 8-figure deals? And with the combination of SAP, with the partnership network we just launched, massive partnership with Ernst & Young, we launched our Qualtrics development platform where last week we had 300 partners in Utah. We're starting to answer all of those questions.

So like I said, if you would have told me last year at this time that this is where we'd be after the announcement with SAP, with the accelerating growth rate on an already fast-growing company, I would have said, hey, that looks like success to us. So with this combination, we've done everything we said we were going to do plus some, so I couldn't be happier.

Operator

The next question is from Adam Wood from Morgan Stanley.

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

Also, congratulations from my side both to Jen and to Christian on the new roles. I've got 2 questions, if I could. I just wanted to come back to Microsoft and the partnership there to start off with and just to understand a little bit better technically exactly what's happening. Has Microsoft bought a volume of software from you, then they can resell on to their customers bundled on Azure. So that in effect, they're acting as a reseller for that and there's a volume of business that you get directly upfront from Microsoft that otherwise you may or may not got, but would have come through over time with customers directly? And could you maybe help us understand whether there's upside or downside to those numbers?

And then also, whether you would envisage doing similar deals with other hyperscalers in future? Or whether there's other products you could also see that type of deal happening for? So just a little bit more detail around the actual technical details of that Microsoft partnership will be really helpful?

And then secondly, probably for Luka on the margins. You had a big benefit on -- particularly on the cloud gross margin side from the changes you've made around SuccessFactors and integration of the landscapes there. Could you maybe just help us around that and the restructuring? Should we expect a slightly slower pace of margin expansion over the next few quarters because we've got that kind of 1 big benefit? Or are there still benefits from restructuring, particularly to come through?

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

So I'll start. So as it relates to Microsoft, really what this was about is making sure we were being very prescriptive with our customers around what are the cloud services from SAP and what are the different services from Microsoft the customers should be thinking about when they are combining our solutions, right? Today, they're kind of, I'll use this from Microsoft, this from SAP. We've come together and have been very, very clear on. So the business platform around SAP, as it relates to the integration of SAP system, as it relates to extensions of SAP or orchestration of SAP system. We have a set of SAP Cloud Platform services that do this. We've bundled those together in Embrace. Microsoft made a commitment to those and can resell those to customers. So no downside to those numbers, only upside.

The way that we really went about estimating kind of our initial start of this market was really in a few key areas of the world. And we put a very -- a lot of scrutiny around the pipeline, the business, where we saw the customers moving, those who had told us where they plan to move. So we see this as a start.

We also want to make sure we're very clear here that we provide our customers choice. So let's say, for example, we have lots of customers who maybe run on AWS. They've already chosen to run SAP on AWS. Those cloud platform services that I just mentioned around the integration, orchestration and extension, those customers can buy those directly from SAP, right? So they can still get SAP's reference architecture on AWS or on GCP from SAP. The difference here is Microsoft puts the skin in the game. They are really teaming with us. They're doubling down on the innovation and engineering with us and they're going to have their sales people out selling this as well.

Luka Mucic - *SAP SE - CFO & Member of Executive Board*

Yes. And perhaps just quickly on the margins front. No, we have not yet lost our firepower. We have additional benefits to gain from the platform convergence. I think I have been talking a lot in the past years about this being an opportunity alone in the low triple-digit million euro figure. Year-to-date, we have had a benefit of just above EUR 50 million from the replatforming. That means that at least the same amount is still to come. I believe, actually, we will do slightly more than this because the benefits are really significant and now we have paved the way for further efficiency increases for automation in other areas.

And secondly, this is only SuccessFactors. We are still to fully complete the job on the Ariba business network. The application side at Ariba is already done. The business network side will be finished as well come Q1 next year. And with that, you will see also the additional benefits in our Intelligent Spend Group business network cloud margins, which certainly will then help us to further increase the cloud margin also strongly in 2020.

By the way, in the SaaS parts business, we are now at 70.4% margin. This is what we had predicted only for next year. So we are clearly ahead of our plans, and you can continue to expect us to do very well on the cloud margin.

Operator

The next question is from Phil Winslow from Wells Fargo.

Philip Alan Winslow - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Congrats, again, on great Q3, and congrats to you, Jennifer and Christian. I'm looking forward to working with you closely going forward.

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

Thank you.

Philip Alan Winslow - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Just wanted to focus on the manufacturing vertical because I think everybody on this call knows that the manufacturing industry really runs on SAP. On the Q2 call, obviously, you flagged some issues with China and then you called out Germany. But you actually continued to put up good results overall. What you're hearing from these manufacturing customers in terms of just their spending intentions because, as you mentioned last call, changes in supply chain might need to drive more spending with you all, but there's obviously some macro issues. Just if you could just double-click on that vertical, that would be great?

Christian Klein - *SAP SE - Co-CEO & Member of Executive Board*

Yes. So I'll start and then handing over to Adaire for some specifics about China. I mean on the manufacturing side, we are doing extremely well. I mean we have folks now who are very competitive offering from the on-prem as well as on the cloud. We won the solution on different hyperscalers, so we offer choice. And also, in China now S/4 will also go live now on AliCloud in Q4. So also there, we will also have S/4HANA running on Chinese infrastructure starting in Q4 now actually this quarter.

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

Yes. Maybe just on the German side, a little bit of color on that. We had a very strong performance from SAP in Germany in Q2. And we did enter Q3 with an exceptionally strong pipeline for Germany despite what we saw is an overperformance on their numbers in Q2. But we definitely saw, during the course of Q3, some slowdown in execution, particularly for the customers in the discrete manufacturing session -- section -- segment.

I would say it was really around business caution from fear of a recession. And we enter now Q4 with a very strong pipeline, not just from a seasonal perspective, but also because of an element of some backlog while some of those deals cash flow down a little bit. And we're using and have used the opening weeks of this quarter to really build out those value cases and the validation of those cases and the validation of those funds with our customers in this end segment. So I remain quite optimistic about our business in MEE, particularly because as I look forward to the Q4 pipeline, it is much broader than the discrete segment.

And in China, we have -- I had the privilege of starting businesses in China for over 27 years now and I have a very strong footprint in China with about 70% of the Fortune 2000 are being SAP customers in China. Nevertheless, I will tell you that we are seeing a slowdown. We are seeing customers who are adopting a wait-and-see strategy, specifically focused not so much on the software itself, but on the challenges of business continuity in the event of increasing tension as it relates to some of the macro political and economic scenarios we have seen.

And there's also a very strong focus from the Chinese governmental website on what they term, indigenous innovation. This the ability of companies in China in order to have Chinese components, et cetera, in their supply chain. Nevertheless, I would say to you that as a result of some of the work that we have been doing around, work with AliCloud and the ability to land our products environment in China for China, I'm confident that we will be able to address those business continuity issues that were raised and move forward and continuing to grow our business in China at the rate that we've been growing it over the last decade.

Luka Mucic - *SAP SE - CFO & Member of Executive Board*

And perhaps just one sentence. On a global level, believe it or not, our 2 best-performing verticals were actually services and discrete manufacturing.

Operator

The next question is from Stefan Slowinski from Exane BNP.

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

I was just following up on the previous question. I apologize if you've answered this already, but on the Microsoft deal, I was just wondering if you think you could be able to put similar partnerships in place with some of the other hyperscaler partners you've mentioned. I mean obviously, you've just talked about Alibaba and AliCloud in China. I mean is this something that you could potentially see Alibaba doing in terms of helping you sell direct in China?

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

Yes. So I think that we're open to the future. Obviously, we have a very specific relationship that we define and motion that we define with Microsoft that will be very specific and preferred by the 2 of us. So in looking at other partnerships, first of all, we already have pretty strong partnerships with both GCP and AWS. We're users of their technology and we will continue to be. And so there's always possibilities for the future, but today it's really just about Microsoft.

Adaire Rita Fox-Martin - *SAP SE - Global Customer Operations & Member of Executive Board*

Maybe I can comment on the Ali side because...

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

Please, thank you.

Adaire Rita Fox-Martin - *SAP SE - Global Customer Operations & Member of Executive Board*

You're very welcome. In China, as I'm sure, everybody is aware, there's a unique set of licensing laws around Software-as-a-Service and Platform-as-a-Service as well as the unique set of cybersecurity laws. So therefore, with Ali, we have physically landed the cloud platform on to the Ali infrastructure in China. And we will typically land S/4 on to the Ali infrastructure in China. And that means then we have the opportunity with the AliCloud team to take those 2 solutions directly to the market -- a very large-scale market of small, medium enterprises in China.

Jennifer B. Morgan - *SAP SE - Co-CEO & Member of Executive Board*

Thanks, Adaire.

Operator

The next question is from Charles Brennan from Crédit Suisse.

Charles Brennan - *Crédit Suisse AG, Research Division - Research Analyst*

Can I just ask one about the competitive landscape? In your prepared remarks, you made reference to both Medallia and Coupa. Can you talk about your win rates against some of the larger, more conventional competitors in Workday and Salesforce? And I guess, the driving force behind the question is the recent comments from Workday that they're now penetrated in 40% of the Fortune 500. That sounds like they're making some reasonable progress.

Adaire Rita Fox-Martin - *SAP SE - Global Customer Operations & Member of Executive Board*

I can add on to the comments that I made before. I think one of the things that I wanted to stress in my remarks is just the size and scale from an Ariba perspective of the networks that we do have, right, and the work that we've done. And we've had several wins over our competition in the enterprise space last quarter. So we feel very good about our win rates and what's happening there.

As it relates to SuccessFactors, we have our large SuccessFactors customer event in Q3. And again, the conversations that we're having, they're moving beyond just talking about HR, the traditional HR processes. So we've actually seen some really great wins using Qualtrics within North America. But I think more importantly, the advantage that we have is just the ability to scale broadly outside the United States. We're not a German company. We're not an American company. We're a global company. And we've got feet on the street everywhere. So when you look over in Asia, when you look over in Latin America and you look at some of the customers that we're adding, we have a head start. Now when you're bringing Qualtrics and you start to differentiate solutions like SuccessFactors, that allows us to accelerate even further.

So we feel really good about where we are right now with the wins. The thing I like about Qualtrics, if you think about Qualtrics, right, Qualtrics is not about surveys. It's not just about surveys and sentiments. When you think about what SAP did with ERP, back -- decades ago, we saw silo systems, supply chain manufacturing, financial running the operations of a company. We saw an opportunity to bring those interdependent functions together, have better insights into the business and be more efficient. That was back when the data was in the 4 walls of the company and that became the operational data platform.

Qualtrics takes a very similar analogy to that. Most data about your consumers and even your employees is not just inside the company but outside the company. Businesses are gathering sentiment and engaging with customers, employees across multiple functions of a company, outside the company, et cetera. Lots of companies do surveys, lots of functions within companies take employee sentiment or customer sentiment.

The differentiator with Qualtrics is they figured out how all that's interdependent and they created a platform. So this platform approach and technology that Ryan talked about earlier, this is what differentiates SAP. This is what our sales force knows how to talk about and this is where we're really starting to see the uptick in getting those big deals that Ryan mentioned earlier.

It's an enterprise discussion. It's on the agenda of every CEO today. So those are just a couple of things I'm seeing.

Operator

And this question is from Mohammed Moawalla from Goldman Sachs.

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

Jennifer and Christian, my congratulations as well on your new roles. I had a couple. And firstly, Luke, you, obviously, have some pretty strong gross margin tailwinds continuing into next year, but also some of the big OpEx benefits kicking in. You've also talked about sort of reinvestments back in the business. Can you talk about sort of the flexibility you have around delivering the margin and perhaps the shape of the margin expansion over the next couple of years in the event that the top line potentially faces risk, be it a macro or anything else?

Luka Mucic - *SAP SE - CFO & Member of Executive Board*

Yes. Sure. We can do so. So first of all, obviously, the benefits from the restructuring program this year has not been significant because it takes a while for the program to take effect, so the bigger impact will come next year. What you see this year in terms of progress on the gross margin side is really around the replatforming and increased operational efficiency and through consolidation of data center operations and infrastructure operations. And therefore, I'm very, very confident that we can continue to scale this business with increasing gross margin contributions also next year and even beyond next year.

We've always said that in 2019 against our target of -- on an average 1 percentage point of margin increase, the market should not expect a full percentage point already this year because we have the dilutive impact from our acquisitions that we have to digest. And given that this is a 40 basis points dilutive headwind, I think you can see how the underlying is already performing against the average 1% that we have in mind.

That in turn means that we will plan to do slightly more than that 1% next year to catch up because next year, we have the full run rate benefit from the restructuring. But it's clear, the restructuring is not a cost-cutting exercise, and I want to be very, very clear about that. We have done the restructuring in order to tailor our investments and our capacity to those areas where we have the biggest growth opportunities, and we are putting actually our actions to where our plans work. We are seeing tremendous investment in Qualtrics. We are seeing a tremendous investment in our different cloud constituents. We are adding additional capacity only in the productive areas in research and development, in sales and in services, and that will continue to be the case to propel our growth.

In terms of optionality, our business model has become way more resilient. We have now close to 70% of our revenues in highly predictable revenue sources. Contrast that to only 1/3 when we hit the financial crisis in 2008 and that gives you a good perspective on how resilient our business model has become. And therefore, if we have to optimize our level of investments against only 30% variability in the top line, that would be much easier than in the past. So you should take a lot of confidence out of this that we can and will hit our midterm ambitions as we have announced them.

Stefan Gruber - *SAP SE - Head of IR*

And Mo, did you have a follow-up or -- if that's the case, well, this concludes our Q3 earnings call for today. Thank you so much for joining, and we look forward to speaking to you again at our CMD on November 12 in New York City.

Thank you very much, and goodbye.

Operator

Thank you. Ladies and gentlemen, that now concludes today's conference call. Thank you for your participation. You may now disconnect.