Bentley
Advancing Infrastructure

Bentley Q1 2023 Earnings Call Transcript

Eric Boyer: Good morning, and thank you for joining Bentley Systems' Q1 2023 operating results. I'm Eric Boyer, Bentley's investor relations officer. On the webcast today, we have Bentley Systems' Chief Executive Officer Greg Bentley, Chief Operating Officer Nicholas Cumins, and Chief Financial Officer Werner Andre.

This webcast includes forward-looking statements—made as of May 9th, 2023—regarding the future results of operations and financial position, business strategy and plans, and objectives for future operations of Bentley Systems, Incorporated. All such statements made in or containing during this webcast, other than statements of historical fact, are forward-looking statements. This webcast will be available for replay on Bentley Systems' Investor Relations website at investors.bentley.com. After our presentation, we will conclude with Q&A.

Just a quick administrative matter before we begin. You can now find our 2022 annual report, along with the CEO letter and our inaugural ESG report, on our investor relations website.

And with that, let me introduce the CEO of Bentley Systems, Greg Bentley.

Greg Bentley: Good morning, and thanks to each of you for your interest and attention.

With the retirement of our Chief Investment Officer David Hollister, and the division of his responsibilities among the rest of us, our presentation sequence starting this quarter is meant to be simpler and more concise. I will offer observations about directions in our business, will report on corporate developments, and provide updates on our capital allocation. Then, Chief Operating Officer Nicholas Cumins will provide expanded operating perspectives, now including—in my stead—tone of business by sector and commercial model, as well as by region and by brand. CFO Werner Andre will conclude with our financial performance, as usual.

Robust operating results for 23Q1 echo what I think has come to be expected of Bentley Systems' end-market resilience, predictably accretive business model, and the consistency of our execution—and, thankfully, absent last year's unfavorable drama in Russia and China. We met or surpassed expectations for our financial performance metrics, most significantly including operating margins measured now by adjusted operating income with stock-based compensation.

Our operating cash flows were even higher than expected, but, as Werner will explain, we expect consistency here on a trailing twelve-months basis. As Nicholas will elaborate, all operating trends remain directionally strong.

And as he will explain, even though this year has started appreciably better in China than in other recent years, that probably will serve to accelerate our intentional localization pivot there, at some increasing cost to existing ARR. All considered, our across-the-board strength in 23Q1 duly increases our confidence in our annual financial outlook for 2023; and as to what I consider our key metric, ARR growth—indeed, this expanded sequentially to a first-quarter high of 13% year-over-year, constant currency, business performance, with net revenue retention—over trailing twelve months—remaining consistently high at 110%.

This new business strength is consistent with external benchmarks, as the Dodge survey of U.S. civil engineering firms continues to show that their current backlogs have kept increasing continuously.

Broadening to ACEC's survey of U.S. engineering firms generally, not limited to civil, such firms are confident about backlogs continuing to increase over the coming twelve months.

And as to that twelve-month horizon for their expectations about macro-conditions at large—versus their own environment—U.S. engineering firms' sentiment has generally improved over the last quarter, but again more so for overall engineering and design services, and especially for their own firms' favorable prospects.

And this latest ACEC survey of U.S. engineering firms' current sentiment by industry—here mapped to BSY's infrastructure sectors—correlates with our own new-business resilience, with quite favorable sentiment for water/wastewater within our resources sector, broadly leading sentiment for industries within the public works/utilities sector, satisfactory sentiment for industrial, and industries within the commercial/facilities sector—that is, vertical infrastructure—generally lagging.

For U.S. AEC firms, the most significant annual survey was just published by *Engineering News-Record* (ENR) earlier this month, ranking the U.S.-headquartered Top 500 by design billings.

They report their design billings to ENR in accordance with this breakdown, so their aggregate design billings here can likewise be generally grouped within BSY's infrastructure sectors in these proportions. For resources, including at least water networks, the mainstay for us and for these top design firms overall, public works/utilities, for industrial, and for the commercial/facilities sector, which leaves some reported design billings not allocable to infrastructure sectors.

Of course, each year, the Top 500 are a somewhat different set of firms, so the year-to-year growth in the total of their design billings does not per se correspond to an organic growth rate, but note the conspicuous inflection now underway in the Top 500 firms' design billings, as—along with somewhat greater inflation—design-intensive infrastructure projects for resilience, adaptation, and energy security are being increasingly prioritized.

ENR does not annually report the top design rankings for those largest headquartered outside the U.S. until early summer, so the latest analytics for the global top design firms are still using the combined 2022 rankings, when the consolidated top 637 firms reported aggregate design billings of $216 billion.

I have been reasonably asked why, when China represents only a few percent of BSY revenues, we are allocating so much attention and emphasis on our determinedly new China-specific go-to-market strategy, particularly as everywhere else in the world we relatively uniformly apply our proven direct-sales formula. The ENR top firm rankings show the answer in terms of magnitude: just the top 29 firms in China perform 27% of the design billings of all the world's top firms. This proportion is not an abstract future projection, nor is it derived from murky economic statistics; rather, this reflects the here-and-now proportion that China already represents among our top accounts and prospects. If and when we can earn the same share of design billings in China as elsewhere, our overall scale of usage and revenues could grow, at comparatively little incremental cost, by almost 25%.

To quantify BSY's current penetration rate outside China, consider that our ProjectWise enterprise collaboration system is particularly well established in these top firms to distribute their engineering workflows across their globally virtualized talent resources. Such work sharing has become increasingly essential for these firms—throughout the pandemic and since then, in light of their staffing challenges—to meet the backlogs we were just looking at. We know from our consumption log analytics the number of users of ProjectWise within these firms, as we charge them each calendar quarter per unique user.

Based on the middle-of-the-road assumption that these top firms' design billings are performed by full-time employees (FTEs)—each estimated to generate an average of $200K of design billings annually—it turns out that about 14% of these FTEs, in a calendar quarter, are ProjectWise users. While I am sure this makes us, by far, the leader in enterprise collaboration for these top firms, the remaining opportunity for firms and projects to further standardize on ProjectWise is a compelling priority for our product, sales, and success organizations.

Collectively, these global ENR top design firms alone account for about one-fourth of BSY's ARR. And, of course, within this, we log each hour of each firm's users' BSY application consumption (and most of these firms are E365 accounts that we charge per day of such use). So, how does our revenue compare to the design firms' revenue, for each such design hour, as to which an educated assumption is that these ex-China firms bill at about $150 on average? For each such hour using BSY applications, the average expenditure by these top design firms is $1.41, or less than 1% of that hour's rate of billing.

And apportioning these firms' ProjectWise expenditures over their BSY application usage hours adds on average about $0.39 in cost per such design hour. While there are other additional costs of going digital—among others, hardware, Microsoft, communications, internal support—I think there would be general agreement that BSY's application software—and ProjectWise, if used—most largely determine the actual value of that design hour—yet presently account for only a few percent of the total cost to the design firm.

At this juncture, when such firms face record backlogs but are constrained from adding hours by the limitations of skills shortages, I think this makes the case that there is a *long* upside runway ahead for us to provide—and be paid commensurately for—more valuable, more specialized applications, enabling a continuously increasing rate of application mix accretion.

Now, by way of reporting corporate portfolio developments in the last two months, we announced during 23Q1 our investment in Worldsensing, up-and-coming global independent leader in integrated infrastructure IoT hardware connectivity solutions. In exchange for the Thread connectivity hardware, which we acquired with sensemetrics in 2021, and a financial investment in Worldsensing's Series D capital round, we have acquired a low-double-digit equity stake. But even more importantly, our sensemetrics software (within iTwin IoT) will be closely (though non-exclusively) integrated with Worldsensing sensors and network connectivity hardware, and our "freemium/trial license" subscription will be included in all new Worldsensing installations.

For this quarter's observations about capital allocation, I will next show how I think about measuring and optimizing debt leverage within our capital structure that's dominated by convertible securities. I think this is significant because you can look at a Bloomberg screen that shows BSY as a highly leveraged outlier, as a result of not distinguishing between convertibles and straight debt.

Now, I recognize that accounting rules do treat convertible securities 100% as debt. But for leverage assessment, I believe it's appropriate to look more through a finance lens, as would the holders of the convertibles—as they are intrinsically and intentionally a dynamic mix between debt on the one hand and equity on the other.

Obviously, our bank debt, which was incurred early last year to finance our highly accretive platform acquisition of Power Line Systems, and which net of cash was down to $340 million at the end of 23Q1, anchors our debt leverage. But how should we think about our unquestionably attractive convertible debt, with coupon rates of 1/8 and 3/8 percent, covenant-free, which financed our highly accretive platform acquisition of Seequent in 2020? It consists of an issue maturing in 2026, which one can view on this Bloomberg page, including here a computed "delta" statistic, that's for the embedded equity option. The delta changes constantly based on the

BSY stock price, volatility, interest rates, and the remaining time to maturity, in this snapshot reflected the market on a recent day. The other issue, maturing in 2027, has a different delta statistic corresponding to its different parameters.

In any prevailing market condition, these delta statistics—look, here I admit to being a recovering financial engineer, as the first company I founded 35 years ago was in the business of software for derivatives modeling—the delta can help us to conceptually apportion each convertible issue between debt and equity. The delta is the "hedge ratio," the degree to which the value of the convertible issue moves in relation to the value of the underlying shares as the stock price changes. The delta would range from 0—at the maturity date, if the stock price would be lower than the strike price, such that the security then behaves as if all debt—to 1 if, at maturity, the stock price would be higher than the strike price, such that conversion to equity would be certain.

Accordingly, at the delta of 0.43 at the first issue, we can ascribe 43% of its face value to the acting as if approximately 4.5 million shares of equity, and the remainder to be acting approximately as if $400 million of debt. And at its delta of 0.39, doing the same for the 2027 issue results as if $350 million of debt.

Now, we reckon our leverage ratio on the basis of our Adjusted EBITDA, as that's what our bank syndicate does for pricing and covenants. And for the last twelve months through 23Q1, our Adjusted EBITDA was $383 million—which implies a net bank debt leverage ratio of 0.9 times, and for the delta-adjusted debt portion of both convertible issues, additional leverage of 1.9 times, for a total current effective-debt leverage ratio of 2.8 times Adjusted EBITDA, tolerably approaching the range which I think we would consider optimal.

Now, I would welcome feedback on this apparently novel delta-adjusted approach to monitoring leverage that includes convertibles. But now, over to Nicholas for his informed operational perspectives on 23Q1.

Nicholas?

Nicholas Cumins: Thank you, Greg.

We had a strong start to 2023, and we see momentum continuing into Q2, with healthy pipelines and many upgrade and expansion opportunities.

The demand environment continues to be very positive, and the pace of business is brisk. Incrementally, we see more evidence of funds from infrastructure investment programs flowing through to our accounts around the world, and this will continue to be a tailwind for the foreseeable future.

Let me now provide some color commentary, starting with infrastructure sectors.

The trends in Q1 were consistent quarter-over-quarter. We saw very strong growth in resources, strong growth in public works and utilities, solid growth in the industrial sector, with commercial and facilities somewhat flat. We continued to hear from some accounts concerns about interest rates and inflation. But in Q1, there were no surprises. Horizontal infrastructure remains very resilient.

Turning to commercial models, our E365 and Virtuosity growth initiatives continued their upward inflection.

In Q1, we upgraded to E365 almost twice the number of accounts than we did in Q1 of 2022. Bear in mind, however, that the accounts remaining to be upgraded tend to be those with lower ARR to start with.

Over the last three years, we have grown E365 primarily with global enterprise accounts, and we increasingly view the regional mid-market as a significant opportunity for E365. We were excited to upgrade to E365 a number of regional mid-market accounts in Q1 and we are on pace to hit our target for the year.

As you know, E365 is a consumption-based commercial model, and post-upgrade, our User Success teams pay particular attention to the adoption of our software through success blueprints that are designed to achieve business outcomes through more efficient and effective use of digital delivery workflows.

Q1 was a very strong quarter in terms of consumption growth by E365 accounts.

In SMB, the tone of business was very positive, and we saw a continuation of our growth trajectory across the board. In fact, Virtuosity achieved its highest number of new logos in a single quarter. We see our SMB pipelines growing day in day out, and the good news is that a lot of Virtuosity business is closing within 30 days.

Next, looking across regions.

India was a bright spot. The National Infrastructure Pipeline is funding large transportation and water projects. These projects are ecosystems of their own, and we have been very effective in driving adoption of our software by owner-operators and their value chain of project delivery firms—large and small. Global project delivery firms also continue to tap into India's engineering talent to support projects around the world, and to help close their capacity gap.

We also saw continued solid growth in Europe, with more evidence of EU funding flowing through, for example, in transportation and water projects in Italy.

Growth was solid in the Americas too, with abundant project backlogs across multiple business lines, including projects from owner-operators extending to project delivery firms, primarily for design. And we saw more IIJA funding flowing through to DoTs, which is very positive news for us.

As we have mentioned on previous calls, infrastructure engineering in North America is characterized by a very tight labor market with an aging workforce, and project delivery firms simply cannot attract talent fast enough. Interest rates and inflation are also making infrastructure projects more expensive and, as a result, owners are very focused on managing costs. Both of these factors—productivity and efficiency—align very well with our value propositions.

Middle East and North Africa showed some softness, but this was due to very specific account situations and one-time effects, and we do not believe these constitute a trend.

In China, the impact of COVID is now in the rear-view mirror, and the Chinese government is very focused on bringing the economy back. We had a better start to the year, as revenue retention stabilized in the quarter—although we continue to be cautious for the remainder of the year due to the geopolitical and business environment.

Last week, we officially formed East Wise, our joint venture with POWERCHINA HDEC. The focus is on engineering applications for the hydropower and water conservancy industries that leverage our platform but are developed and distributed domestically. As with our other joint venture TGGX and their product iLink, our net revenue proportion will decline for the accounts that transition to the new localized offerings. However, we expect that the depth of the market for autonomous Chinese solutions will eventually more than make up for this. In the meantime, especially because the joint ventures will cater to the preference of Chinese state-owned enterprises for perpetual licenses, the faster the JVs take off, the greater the erosion of our existing ARR in China.

With respect to products, the performance of OpenRoads, OpenBridge, MicroStation, and AssetWise was notable in Q1.

Of particular interest, in transportation in North America, we saw strong growth in Bentley Open applications, especially OpenRoads and OpenBridge, as well as MicroStation—a reflection of our strength in the DoT ecosystems. DoTs are resource constrained, but the usage of our software accelerated with the engineering services firms that are part of their ecosystem. This was a result of the training and over-the-shoulder mentoring our User Success teams have been giving to engineering services firms to put them in a better position to deliver in the DoT market.

The instances of DoTs requiring models in deliverables showed extensive growth in Q1, and we do not see that slowing down in Q2. DoTs are looking to do more with less through going digital. Digital delivery tools and techniques can streamline processes across the infrastructure engineering lifecycle and enable seamless collaboration across DoT ecosystems. Digital delivery advances design intent to construction using digital twins for collaboration among project stakeholders. Digital twins created and updated throughout the digital delivery process can then be leveraged in asset operations and maintenance to take advantage of engineering data.

In this context, we announced in Q1 a new collaboration with design and consulting firm WSB, aimed at leading civil infrastructure owners and contractors to adopt digital delivery and model-based digital workflows. WSB launched a new digital construction management solution and advisory service, based on Bentley's SYNCHRO, leveraging the power of construction digital twins. WSB joined the Bentley Digital Integrator Program, which provides programmatic go-to-market support and knowledge transfer to eligible project delivery firms that are creating and curating digital twins for their clients' infrastructure assets.

Before I hand over, I want to thank all Bentley colleagues for a great start to the year, and for your commitment to consistent execution. More infrastructure is in the works now than at any previous time in history. And the infrastructure sector is relying on Bentley software to help it deliver a more sustainable and resilient future.

And with those operational perspectives, I will now hand the call to Werner to go over our financials in more detail.

Werner Andre: Thank you, Nicholas.

We are pleased that we started the year off strong, which puts us in a good position to achieve our established full-year outlook.

I'm starting with a reminder of our full-year 2023 revenue outlook, as was provided during our year-end 2022 operating results call, with a range of $1.205 billion to $1.235 billion, representing GAAP revenue growth of 9.5% to 12.5%, or 10.5% to 13.5% on a constant currency basis.

Total revenues for the first quarter were $314 million, up 14% year-over-year, or 17% on a constant currency basis.

For the quarter, subscription revenues grew 15% year-over-year, or 18% in constant currency, and represented 88% of our total revenues. The onboarding of Power Line Systems at the end of January 2022 accounts for about 2 percentage points of this improvement, and the continued upgrades of our enterprise accounts to our consumption-based E365 program is moving us towards a more ratable allocation of GAAP revenues between calendar quarters, which benefited the first quarter, on a year-over-year comparative basis.

Regarding our perpetual licenses, recent trends continue, which are reflective of our focus on recurring subscription revenues.

Our professional services revenues benefitted from the acquisition of Vetasi, which we acquired within our Cohesive digital integrator group in 22Q4.

With regards to foreign exchange rates, the U.S. dollar has weakened relative to the exchange rates assumed in our 2023 annual financial outlook. While the impact during 23Q1 was not significant, if end of April exchange rates would prevail throughout the remainder of the year, our full-year GAAP revenues would be positively impacted by approximately $10 million, relative to the revenues based on the exchange rates assumed in our full-year 2023 outlook.

Moving on to our recurring revenue performance.

Our last twelve-months recurring revenues increased by 14% year-over-year, or by 20% on a constant currency basis. On a constant currency basis, the onboarding of our platform acquisitions Seequent and Power Line Systems contributed about 6 percentage points to this improvement.

Our constant currency account retention rate was at 98%, and our constant currency recurring revenues net retention rate remained at 110%, led by continued accretion within our E365 consumption-based commercial model.

We ended Q1 with annualized recurring revenue of $1.071 billion at quarter-end spot rates.

Our constant currency ARR growth rate was 13% year-over-year, and 3.1% on a sequential quarterly basis.

You can see here on the dotted line the ARR growth, which is attributable to the initial onboarding of our platform acquisitions. As the PLS acquisition occurred at the end of January 2022, its ARR onboarding is no longer a factor in the year-over-year comparison.

Our strong and sustained Q1 revenue and ARR growth performance was supported by consistently strong market growth trends, led by our resources and public works/utilities infrastructure sectors; our balanced business performance across regions, other than China; and our E365 and Virtuosity growth initiatives.

With regards to China, our first quarter was slightly better than in recent years, but we are still taking a cautious stance for 2023 due to the continued geopolitical uncertainties; and, as

Nicholas mentioned, our intentional pivot to license sales within that market, which will be a headwind to ARR growth as our joint ventures gain traction.

Our GAAP operating income was $66 million for the first quarter, up $9 million or 16% over 22Q1.

We have previously explained the impact on our GAAP operating results from amortization of purchased intangibles, deferred compensation plan liability revaluations, and acquisition expenses.

Moving on to adjusted operating income inclusive of stock-based-compensation expense, which, as discussed in our 22Q4 earnings call, is now our primary profitability and margin performance measure.

While adjusted operating income with stock-based compensation normalizes for the GAAP charges I just mentioned, this measure intentionally includes stock-based compensation expense, which we believe appropriately captures the economic cost of our business.

Adjusted operating income with stock-based compensation expense was $90 million for the first quarter, up $12 million, or 15%, over 22Q1, with a margin of 28.8%, up 40 basis points year-over-year.

In 2023 and prospectively, we will now measure our long-term annual margin improvement commitment of 100 basis points expressed in terms of adjusted operating income with stock-based compensation, with our margin target for 2023 of approximately 26%.

In that regard, our Q1 margin of 28.8% was fully in line with our expectations for the first quarter, which is typically a higher margin quarter for us due to OpEx seasonality. And I do want to remind you of our seasonal pattern of expenses. We concentrate our annual raises for colleagues to occur as of April 1 of each year. And since approximately 80% of our cost structure is headcount and related support cost, annual raises have a significant impact on our operating expenses in Q2, Q3, and Q4, relative to Q1. This is further compounded by our larger promotional- and event-related costs, which are historically highest in the second half of the year.

We expect that our annual stock-based compensation expense will be decreasing as a percentage of revenues to a range of 6%, from approximately 7% in 2022. There will continue to be some stock-based compensation expense volatility between quarters, corresponding to the timing of our ongoing annual rounds of broad-based equity grants, which are predominately granted in the first and fourth calendar quarters.

With respect to liquidity, our Q1 operating cash flow of $176 million increased by 73% year-over-year.

I discussed during our 22Q4 operating results call that our 22Q4 cash flows from operations were atypically low, due to a shift in timing of Q4 billings and, therefore, collections of certain E365 renewals and newly converted E365 contracts, all representing healthy new business. These 22Q4 timing shortfalls were fully offset in early 2023, resulting in 23Q1 being a strong cash flow quarter.

As previously discussed, our business model produces reliable and efficient cash flows over a trailing twelve-months period, but with some variability between quarters due to timing. For 2023 and prospectively, we estimate that our conversion rate of Adjusted EBITDA to cash flow from operations will be approximately 80% over a trailing twelve-months period.

Along with providing sufficiently for our growth initiatives, and our 2023 increase to our modest dividend, in 23Q1, we spent about $21 million on de-facto share repurchases, associated mainly with deferred compensation plan distributions, to offset dilution from stock-based compensation.

As of the end of Q1, our net senior debt leverage was 0.9 times, and, when including our 2026 and 2027 convertible notes as debt, our net debt leverage was 4.2 times. This is down from the end of 2022, which was 1.3 times and 4.7 times respectively.

As a reminder, now approximately 85% of our debt is protected from rising interest rates, through either very low fixed coupon interest of our convertible notes, or our $200 million interest rate swap, expiring in 2030.

With regards to our 2023 financial outlook, we started the year with strong operational execution and momentum in our end markets. This allows us to express great confidence in our 2023 outlook, which we believe is appropriately balanced between our business momentum, and a cautious approach towards China and our commercial and facilities sector due to geopolitical and macro uncertainties.

And with that, I think we're ready for Q&A. Over to Eric to moderate. Thank you.

Eric B: We'll now move to the Q&A portion of our call. We ask each analyst to please limit themselves to one question only so we can get to everybody today. Our first question will come from Kristen Owen from Oppenheimer.

Kristen Owen: Thank you. I wanted to ask first about Seequent because that just continues to be a business that outperforms our expectations. And as an outside observer, you might look at that business and think: well, mining, geothermal, these are capital-intensive businesses.

So why are they holding up so well? And if I could ask you to talk a little bit about what's sustaining growth in that segment and maybe where we are in terms of on tapping some of the revenue synergies between the legacy customer bases there? Thank you.

Greg B: I might start. The reasons are secular reasons. The world's priority on energy transition and electrification require the mining activities, and that's got a long runway ahead, I believe.

Much of our purpose in bringing the subsurface digital twin into our realm is the synergies with civil engineering projects and subsurface infrastructure conditions. And that's proceeding as well. It's just not nearly so visible in the numbers as is the momentum in mining.

Nicholas, would you like to add?

Nicholas C: Yes. So, Seequent is indeed maintaining a high level of growth, and it is fair to say that it's a rather diversified business. The majority of their growth is still in mining, and the market conditions remain really favorable in mining.

So, despite some short-term volatility on some prices, the mining companies are looking and using long-term price assumptions to decide whether they're going to open up new mines or expand existing mines. And those assumptions are positive, so they're still investing.

But in this, Seequent is involved in more than mining. One of the main reasons why they were so excited to be part of Bentley was to accelerate their growth in civil. And I will say, for most of 2022, our focus was still more on their back-office integration with Seequent, and our focus has shifted to the front-office synergies, the business synergies, in particular with civil.

So, now, all the relevant Seequent products for civil engineering are available to our E365 accounts. And in Q1, we've seen a nice uptake of those products. It's still early, of course, but it's looking very promising.

Greg B: And finally, just a reminder that the consumption of the Seequent software in mining is more to do with the OpEx throughput of mines than the CapEx, necessarily, of Newmont.

Eric B: Thanks, Kristen. Our next question will come from Matt Hedberg from RBC.

Matt Hedberg: Hey, guys. Good morning. Thanks for taking my question. And I appreciate the format this quarter. It was super helpful.

Greg, you spent some time talking about the importance of China, which I think we all appreciate. Maybe I missed it, but could you talk maybe about some of the expected ARR headwinds this year? I don't know if you can quantify that. And then, perhaps, even more so, once the JVs are in place, what sort of tailwind do you think that could provide at some point in the future?

Greg B: Well, it's toughest to know, so I say the unpredictability in China—the rest of our business is so predictable, and the trends are so prevailing that China is, by far, the contrast. As far as ARR in China, the rest of our business is an ARR-intensive business, but China increasingly is not an ARR-intensive country. They prefer perpetual licenses. There is not the ability to have SaaS software there. And we're going increasingly indirect. All of those are factors that will literally reduce our ARR.

And so as to the significance of China for our overall financial outlook for this year, recall that over each of the past two years, in each of those years, we have lost more than a full percent of our overall ARR in China. Partially, that's the rest of the world growing. Partially, that's currency weakness in China. But it's mainly state-owned enterprises and geopolitical headwinds.

To do the right thing for the long term—which is always our focus, not the short term—we are pivoting to this localization strategy. But it's only going to mean that everything else benefits, not ARR, and we literally will lose existing ARR the better that goes, as Nicholas said.

Now, how fast will it turn around to where we have higher unit volume to make up for that? And by the way, we make up for it on other line items than ARR. Well, that is really hard to say. But we are really hopeful about it. And the reason I wanted to show that China is 27% of the engineering activity by even just the largest identifiable firms, is to reinforce the magnitude of—their engineers are great users of our software here and now if we can get that to them, overcoming the geopolitical obstacles.

Eric B: Thanks, Matt. Our next question will come from Joe Vruwink from Robert W. Baird.

Joe Vruwink: Great. Hi, everyone. Yeah, I think this might be the first quarter where you've explicitly commented on the connection between IIJA, DoTs being funded, and now your related product seeing a consumption benefit.

So, I guess my question is, what is your expectation here in North America as just more projects are undertaken through 2023 and even, it should be the case, into 2024? And then, maybe not to lead you in any direction, but it seems like water and the electric utilities could maybe be the next big areas to see a step up, if road and bridge are seeing it right now.

Greg B: Yes, I think especially the uptick we remain to not have seen yet in IIJA is in this other half of the money, besides the transportation money, and that really is making progress but is not equivalently flowing, as is the case with the road, and bridge, and transit funding already. Nicholas, do you want to add to that?

Nicholas C: We are indeed seeing the budget of the DoTs are growing quite a bit, and this is obviously related to IIJA. And this allows them to fully fund projects where software is being used. A good example is the Brent Spence Bridge between Kentucky and Ohio.

So, this is where we're seeing now the first impact of IIJA. But we're just starting, right? It's a growing tailwind, and it's going to get stronger. We are seeing a more direct link when it comes to transportation, indeed, but—exactly as you were saying, Joe—we just have to look at IIJA and where they're planning the funding. And we know that it will come, as well, when it comes to the water infrastructure and when it comes to the electric grid.

Joe V: Thank you.

Greg B: Just to add that they are permitting legislation in Congress now in the U.S., which would help to catalyze faster spending, especially for electric transmission and distribution—among many energy projects. But the ones that are really teed up that would we make a big difference for us are in the transmission and distribution of electricity.

Eric B: Thanks, Joe.

Joe V: Thank you.

Eric B: Next question will come from Jason Celino from KeyBanc.

Jason Celino: Great. Good morning, gentlemen. Thanks for fitting me in. I think my one question, I think I'll just focus on commercial facilities. I guess, in the quarter, did you see any headwind there?

And then, I guess, for the second half, do you embed maybe some extra conservatism to the ARR guide? Thanks.

Greg B: Well, I think our word was "flat," which, of course, could be worse. And we hope it won't get worse. But, Nicholas, do you want to add on that?

Nicholas C: We remain very cautious because we attribute the flat growth to the market conditions. And we assume it is related to the, let's say, general underutilization of vertical infrastructure and the high interest rate environment, which is not favorable for new projects.

Now, remember that it's a very small percentage of our ARR. It's a one, single-digit, now, percentage of our ARR. But it was flat last quarter. We saw it flat again this quarter. We remain cautious.

Jason C: OK, great. Appreciate the color. Thank you.

Eric B: Thanks, Jason. Our next question will come from Joshua Tilton from Wolfe.

Joshua Tilton: Hey, guys. Can you hear me?

Greg B: Yes.

Joshua T: Great. Thanks for taking my question. I wanted to go back to the IIJA dollars and the DoTs, maybe just how has the competitive landscape within the DoTs changed since the last time we had an infrastructure bill or some type of funding to this level? And do you feel like there are more hands maybe trying to grab at the pie this time around?

And how do you ensure that maybe you can take a similar share of the funding, as you have done previously?

Greg B: Well, I think our share of work done by DoTs, and in every five- or six-year bill, more and more relatively of their work is done in their supply chain and the engineering firms as they source more and more of it. We think that's been to our general benefit, as we focus more on this.

Something to be said is, however, is that, in the current environment of constraints on engineering capacity, and with the IIJA money in each state, there's pressure on the DoTs, to be sure, to spread that money around to include the smaller firms and disadvantaged firms. And in many cases, they have only done site civil engineering work with other competitive software.

So, there's pressure on the DoTs to be sure to include those new smaller firms to get some of this IIJA work. We think that's ultimately good for us because those firms will want to take a look at Bentley software and how they can increase their DoT work with specialization on Bentley software as well. And we have programs to help them contractually be introduced to our software. But it's all hands on deck to meet this capacity constraint for the DoTs competitively.

Joshua T: Thanks.

Eric B: Our next question will come from Matthew Broome from Mizuho Group.

Matthew Broome: Hi, everyone. Thanks for taking my question. Could you maybe just talk about your current M&A priorities and how you view the current landscape there?

Greg B: Well, we still have white space to fill. And I think our acquisition of EasyPower earlier this year is a great example for some specialized electrical analysis that, if you like, is on the facility side of the meter, and plants, and major infrastructure installations.

It had been something where the electrical modeling was often done in other software. It wasn't integrated, and now, it can all be done increasingly in Bentley software without semantic translations and so forth. It will improve the quality and speed. Its electrical modeling is never done in a plant or installation because the controls are constantly changing, even when the rest of the capital remains the same. So, that's just an example of an appropriate programmatic acquisition.

The thing is, you can't—even though we say programmatic, it can't quite be expected and scheduled out. And as you know, we've had fewer and smaller programmatic acquisitions over the last year and a half now, for no particular reason. To start with, some of it, I think, had to do with valuation or business owners waiting for better valuation. But we have a reasonable pipeline and are approaching it no differently than ever. The results turn out to be a little episodic, but that's the nature of the beast in M&A, I think.

Matthew B: Got it. Thanks very much.

Eric B: Thanks, Matthew. Next question comes from Andrew DeGasperi from Berenberg Capital Markets.

Andrew DeGasperi: Thanks for taking my question. I guess if I were to look at the growth for the rest of the year, in terms of the consumption-based accounts versus Virtuosity, do you think we still will see the same typical pattern that we've seen? In other words, we see a seasonal slower Q2 with the ramp-up for the rest of the year. And then, do you think the balance between the two will change in any way?

Greg B: Well, Virtuosity—the experience we have is only over the last couple of years, and it only gets bigger every quarter. There's a bit of a higher seasonality in Q4. But otherwise, I think it's stand back and watch that continue to flourish.

In consumption, of course, we can measure consumption historically as the—but historically, our revenues in ARR haven't depended as much on consumption as they do now, given E365 has become our largest commercial program. So, we're learning more about that as we study it more.

And as I mentioned, after 22Q4, a Q4 has more holidays in it. There are fewer days of work. There are fewer days of consumption, therefore. Q1 doesn't have that problem. And then the other quarters, you can make a science of where do the holidays fall and so forth. We haven't applied ourselves to that yet.

But subject to the holiday calendar effect, which can be a couple of percent—if you think of a day within a quarter that has 60 workdays or so, it can matter. But subject to that, we certainly think everyone's as busy as they can be. And our success teams, especially, are there helping to introduce new, more specialized applications and digital workflows, especially.

So, I hope we look back at this year and see a continued increase in application-mix accretion. And my reason to show that, even in the top firms, only $1.41 per hour is what's spent on our applications now is to show how much more potential there is to help them be more productive, for the reasons Nicholas talked about, by using more specialized software. We have that specialized software. We just need to be introducing those to the success teams.

Eric B: Thanks, Andrew. The next question comes from Jay Vleeschhouwer from Griffin Securities.

Jay Vleeschhouwer: Thank you. Good morning. Nicholas, in your prepared remarks regarding pipeline, could you talk about how that's being manifested in terms of demand for multi-solution sales across the portfolio, and as well for the demand for your services and consulting support via Cohesive, for example, are you having to invest incrementally in your services and implementation capacity? Thank you.

Nicholas C: We are strengthening the solution dimension in our go-to market. And by solution, we mean how different products and the combination of products and services helped solve specific issues of user's accounts in specific industries. So, as we do this, especially for our key growth industries, then, yes, all conversations are multi-product, are cutting across product and services.

Now the beauty of something like Enterprise 365 is once you're on that program, it goes very quickly from a conversation about solution that cuts across products to adopting and using those products because we removed all the friction in order to purchase the software, in order to access the services that are needed, in order to implement, configure, integrate the software that you need.

Greg B: And I guess what I would add is in our applications, they can be added one at a time, one day at a time, one user at a time, and end up being multi-product on a project that way. But our enterprise solutions, ProjectWise and AssetWise, are typically procurement cycles involving RFPs, often involving Cohesive to help with integration and so forth.

Both sales motions at once are important, the incremental evolutionary increase in depth of applications and adding new users of ProjectWise and AssetWise. And I sort of showed how ProjectWise is used extensively by the top firms, but not by all the top firms, and we have many more opportunities there, and implementation and digital integrator services are needed.

And we want to be leading the way in helping ultimately to recruit new digital integrators among the engineering firms themselves to help the owner-operators. And we're learning to do it better through Cohesive, which is now part of Nicholas' remit this year as well.

Eric B: Thanks, Jay.

Jay V: Thank you.

Eric B: Our next question will come from Blair Abernethy from Rosenblatt Securities.

Blair Abernethy: Thanks. Good morning. I just wanted to see if we could get a little more color on the Virtuosity side of things. It sounds like you had record logos, new logos out of this quarter. Where are you seeing these? What sort of verticals or geographic areas are you seeing strength? Are you seeing any weaknesses in any areas? Just a little more color on that would be helpful.

Greg B: Nicholas?

Nicholas C: Yes, we have more than 700 new logos through Virtuosity this quarter. It is our record quarter, and the momentum is very strong. It correlates with where we're growing as a company overall. It correlates nicely actually with, for example, the commentary I gave on the regions. You will see, let's say, a rate of similar growth when it comes to Virtuosity.

One thing that is interesting is we're growing not only with accounts in isolation, we are also growing and winning accounts in the context of those very large projects. So, a good example is in India, for example, where our software is being used by large engineering firms, owners, operators, in charge of massive water projects that are funded by the National Infrastructure Pipeline.

This is actually pulling a lot of smaller engineering firms in their ecosystem to use our software. So, we're getting smarter and smarter about how we play the dynamics of the full ecosystem in order to win not just the large organizations, but the smaller ones that are part of that. And when we do that, we do it through Virtuosity.

Greg B: And I'll add that in China, where we mentioned things having stabilized in the past quarter, Virtuosity practitioner subscriptions are doing well in China. Now these, I think, are being acquired obviously not by the big state-owned enterprises, but by the ecosystem in China. So, we go where we can go in a very large market.

And even though, overall, China is characterized by preferring perpetual licenses, by preferring large enterprise commercial programs, it's such a large market that we even can grow in Virtuosity there.

Eric B: Thanks.

Blair A: Thank you.

Eric B: Our next question will come from Matt Martino from Goldman Sachs.

Matt Martino: Hey, guys. Matt on for Kash here. Greg, India continues to perform very well. Can you just further characterize the strength you're seeing in the region from an end market and application perspective? Thanks.

Greg B: Well, it tends to vary from quarter to quarter between Northern and Central and Southern Europe, but I'm going to ask Nicholas to comment on that, sitting in Europe, as he is doing. However, one thing I will remark upon is if you look in our 10Q, you'll see very high year-over-year revenue growth in Europe, which doesn't correspond to our commentary on ARR. And that has to do with 606 GAAP vagaries that come and go.

So, it's doing well, but there was an outsized revenue growth there that isn't nearly so fundamental. But can you break it down for us, Nicholas, in Europe?

Nicholas C: I will say, if we look at Q1, the main growth drivers where we saw the strongest growth were in transportation and with rail projects, in particular, and then in industrial with EPCs and automotive. That's for Q1, but in general, what we're seeing is a really positive impact of the EU infrastructure plans. The first one that came to force is the NextGenerationEU. And we estimate that about 20% of the funding has been released, and that goes straight to projects where our software is being used. In the preparatory remarks, I mentioned, for example, the water projects in Italy. There are rail projects as well in Italy where our software is being used, and they're funded by the EU.

And then, there's a new plan that got fully adopted now called the Repower EU plan. It is about ensuring energy security, which is top of mind, as you can imagine, in Europe. It's also about accelerating energy transition. It was discussed a while back, but it was fully adopted in February. And we expect that to become a tailwind as well because it plays to our strengths.

Eric B: Thanks, Matt. Our last question today will come from Michael Funk from Bank of America.

Michael Funk: Hey, all. How are you doing?

Greg B: Cheers, Mike.

Michael F: Yeah. Thank you for the question. What if I could—so, on the leverage, Greg, you highlighted earlier your own calculation for a net debt to EBITDA adjusting for the convert. How does it affect your view on funding acquisitions and debt capacity?

Greg B: Well, our compass is set so that we'll continue to de-lever. Werner quantified that, about a 0.5 times de-levering in the first quarter alone. Now, the first quarter is our strong cash flow quarter, so we're—in the gear we're in, we'll continue to de-lever.

And I regard that that's not imperative as if we're, in fact, over-levered, but it will help us to be opportunistic, as you suggest, for M&A opportunities, if the programmatic opportunities come closer together or would get somewhat larger. And, of course, we can't anticipate a platform acquisition, but they have come along, so they could come along again. And we would like to be well positioned to that, with less leverage than we have at the moment.

So, it's not an urgent matter to de-lever, but it's a sensible thing to do, to be better prepared for M&A opportunities. And in the meantime, we continue with our increased dividend this year and with our commitment to, more or less, repurchase equity and/or convertibles to offset our stock-based compensation, which we're on track with so far this year. But I just generally feel comfortable with our leverage situation, among things, because our interest rates are either low or offset by our swap to the extent of 85% of the debt we have now.

And I did want to bring attention to the way we think about it so that a balanced view—the thing about convertibles is they're either going to get converted or they're not, and we have to be ready for either situation. But such is the magnitude that they bear in relation to our cash flow, that I think we can be comfortable with that.

Michael F: And, Greg, previously, I think you mentioned private market valuations are relatively elevated. Are you seeing those come down at all as you evaluate targets?

Greg B: I think somewhat. Yes. But, Nicholas, the portfolio development, the programmatic acquisitions now are within your remit. Do you have a sounding on the market for that?

Nicholas C: No, I don't have anything special to say here.

Greg B: Do you know, Michael, our iTwin Ventures? That's a startup market. Of course, we're all on the investment committee for that. And my goodness, the private valuations have certainly been affected in that early stage.

In the mature firms that we're acquiring in our programmatic program, yes, I think there is some improvement in the balance of power to the purchaser. And I don't think valuations are quite an issue now. It's availability and fitness that is determining our programmatic acquisition pace.

Michael F: Great. Thank you all for the time.

Eric B: Thanks, Michael. That concludes our call today. We thank each of you for your interest and time in Bentley Systems and look forward to updating you on our progress in coming quarters.

Greg B: Cheers.

Werner A: Thank you.

Nicholas C: Thank you.