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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Kinaxis Incorporated Fiscal 2018 Second Quarter Conference Call. At this time, all participants are in a listen-only mode.

Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for questions. I'd like to remind everyone that this call is being recorded today, Friday, August 3, 2018.

I would now like to turn the call over to Rick Wadsworth, Vice President of Investor Relations at Kinaxis Incorporated. Please go ahead, Mr. Wadsworth.

Rick Wadsworth — Vice President of Investor Relations, Kinaxis Inc.

Thanks, Operator. Good morning, and welcome to the Kinaxis Earnings Call. Today we'll be discussing our second quarter results that we issued after the market closed last night. With me on the call are John Sicard, our President and Chief Executive Officer, and Richard Monkman, our Chief Financial Officer.

Before we get started, I want to emphasize that some of the information discussed on this call is based on information as of today, August 3, 2018, and contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those set forth in such statements. For a discussion of these risks and uncertainties, you should review the forward-looking statements disclosure in the earnings press release as well as in Kinaxis' SEDAR filings.

During this call, we will discuss IFRS and non-IFRS financial measures. A reconciliation between the two is available in our earnings press release and in our MD&A, both of which can be found in the Investor Relations section of our website, kinaxis.com, and on SEDAR.

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To begin our call, John will discuss the highlights of our second quarter and recent developments, followed by Richard, who will review our financials for the quarter. Finally, John will make some closing statements before opening up the line for questions. I'll now turn the call over to John.

John Sicard — Chief Executive Officer, Kinaxis Inc.

Thank you, Rick. Good morning, and thank you for joining us today. Q2 represented another strong quarter for Kinaxis; both the top line and the bottom line. We grew subscription services revenue by 24 percent and delivered EBITDA 27 percent of revenue prior to adoption of the new accounting standards that we walked through in detail on our last call. Giving effect to these new standards, our total subscription revenue was 29.1 million and adjusted EBITDA was 11.2 million, or 29 percent of revenue.

We reported record revenue from Europe in Q2, which reaffirms our decision to invest significant sales and operations resources in the region. We see even greater opportunity ahead of us as we expanded the European team and continue to engage with prospective accounts across all market verticals but particularly Consumer Packaged Goods, Automotive, and Life Sciences.

Part of our strength in Europe is attributed to some very recent wins, including Volvo cars. Kinaxis will assist Volvo in the transformation of its global supply chain to better enable volume forecasting, production planning, and other processes within its automotive solution footprint.

Thanks to our success at Volvo, Toyota, Nissan, Ford, and others, Automotive is shaping up to be one of our fastest growing markets.

Another key recent win in Europe was Ipsen, a global biopharmaceutical company, which has selected Kinaxis to manage the company's global supply chain in support of its corporate growth initiatives. Thanks to leading companies like Ipsen, Life Sciences has been our largest market so far this year.

During Q2, we announced our relationship with Extreme Networks, adding another marquis name to our established base in high tech and electronics.

We also revealed that BASF, another key European brand, has been successfully using Kinaxis since 2016 to unify their supply chain processes. BASF is an important customer of ours for many reasons, not least of which is that they demonstrate RapidResponse's effectiveness for process manufacturing businesses.

There is no greater testament to the proven transformative value of our unique concurrent planning technique than its ability to serve leaders like these across such different industries, all from the same cloud-based platform. Naturally, we are continuing to invest in that platform.

During the second quarter, we launched our Self-Healing Supply Chain application, which applies advanced machine learning algorithms to detect key supply chain design flaws and automatically take corrective action before they impact performance.

We will be adding more machine learning use cases as time goes on as well as other new enhancements to ensure that RapidResponse continues to lead the market.

With that, I'll turn the call over to Richard for an overview of the financials.

Richard Monkman — Chief Financial Officer and Vice President, Corporate Services, Kinaxis Inc.

Thank you, John, and good morning. As a reminder, all figures reported on today's call are in US dollars under IFRS.

Kinaxis adopted IFRS 15 and 16, or what I'll refer to as the new Standards, effective January 1, 2018. We have not restated our prior-year financial results. To enable comparison with Q2 2017 results, the information for Q2 2018 has been presented on a basis both before and after the adoption of the new Standards.

Prior to the new Standards, total revenue in the second quarter increased 22 percent to 40 million. This total is driven predominantly by our strong base of subscription revenue, which increased

24 percent to 30.1 million due to contracts secured with new customers as well as the expansion of existing customer subscriptions.

After giving effect to the new Standards, total revenue in Q2 2018 was 39 million and total subscription revenue for the period, including both subscription services and subscription term licences, was 29.1 million.

Second quarter professional services revenue, which is not affected by the new Standards, grew by 15 percent to 9.6 million. Professional services revenue will vary quarter to quarter due to a number of factors including the size, timing, and scheduling of customer engagements as well as the level of partner engagements.

Prior to the effect of the new Standards, gross profit grew 20 percent to 27.5 million. This represents 69 percent of revenue compared to 70 percent in Q2 2017.

The slight change in gross profit margin reflects investments in additional headcount and higher depreciation costs associated with the significant expansion of our global data centre capacity. This expansion includes new data centres in Europe and Japan supporting new and ongoing customer engagements.

Under the new Standards, gross profit for the second quarter was 26.5 million or 68 percent of revenue. Prior to the effect of the new Standards, profit for the quarter was 4.4 million or $0.17 per diluted share compared to 5.6 million or $0.21 per diluted share in Q2 2017.

The slightly lower profit reflects the increase in operating expenses made to invest and support our global expansion and ongoing product innovation at a level above the increases in revenue and gross profit. Under new Standards, profit in the second quarter was 4.3 million or $0.16 per diluted share.

Prior to the effect of new Standards, adjusted EBITDA for the second quarter grew 12 percent to 10.7 million, or 27 percent of revenue, which reflects the growth in revenue and gross profit in the period. Under the new Standards, adjusted EBITDA for the second quarter was 11.2 million, or 29 percent of revenue.

Demonstrating the ongoing strength of our business model, cash generated by activities was 9.3 million for the second quarter, up 23 percent. Our cash balances grew to 174.6 million at June 30, 2018 compared to 158.4 million at December 31, 2017.

The nature of our long-term contracts provides us with a high level of visibility to the future contracted subscription revenue. We are now disclosing the minimum committed subscription post-Standards.

As of June 30, 2018, the total backlog of subscription services commitments was 198.7 million, up from 192.6 million in the first quarter. Of the current period amount, 50.3 million will be recognized in the remaining two quarters of 2018, 79.7 million will be recognized in fiscal 2019, and the remaining 68.8 million fiscal 2020 and thereafter.

Our subscription bookings will vary each quarter based on a number of factors, including the timing of the closing of new business, customer expansions and renewals, as well as the length of the minimum subscription term of these commitments.

I am pleased to report that this quarter we closed an additional 32.7 million of subscription bookings. Our backlog, together with a strong pipeline of new and customer expansion opportunities, supports our ability to provide full year guidance.

On a pre-Standards basis, we are reaffirming our guidance for continued strong fiscal 2018 subscription revenue growth and slightly increasing our guidance regarding adjusted EBITDA performance.

For the full year, we expect that total revenue will be in the range of 158 million and 163 million. Subscription services revenue will grow between 23 and 26 percent over fiscal 2017 levels. Sales and marketing expense will be between 24 and 27 percent of revenue. Net research and development expense will be in the range of 17 to 19 percent of revenue. And adjusted EBITDA for 2018 will be between 24 and 27 percent of revenue.

Giving effect to the new Standards, we have increased our expectations for certain key metrics while reaffirming other metrics. We now expect that total revenue will be in the range of 152 million and 156 million. Subscription revenue will be in the range of 109 million to 111 million. Subscription term licences will be between 8 million and 9 million. Sales and marketing expense will be between 22 and 25 percent of revenue. Net research and development expense will be in the range of 19 to 21 percent of revenue. And adjusted EBITDA will be between 25 and 28 percent of revenue.

With that, I will turn the call back over to John.

John Sicard

Thanks, Richard. I am very pleased with our results this quarter. We grew subscription revenue by 24 percent, delivered very strong profits, and continue to generate significant cash. We are also on track to hit annual guidance numbers that reflect very rapid ongoing growth.

What drives my unwavering confidence, however, is that I see directly ahead of us with global leaders such as BASF, Volvo, Qualcomm, Toyota, Nikon, Flextronics, and so many other marquis customers enjoying the benefits of our unique planning technique, I believe the market shift towards concurrent planning is well underway. And this is well reflected in the growing strength of our pipeline across all verticals.

I have never been happier with our place in the market and the health of our funnel and our ability to capitalize on it.

As you would've seen from our announcement yesterday, I'm pleased to welcome Kelly Thomas and Pamela Passman to our Board of Directors. Kelly joins the Kinaxis board as a 30-year veteran in supply chain management. He has served as the Chief Product Officer of JDA Software and the Senior Vice President of Product Strategy at i2 Technologies prior to its acquisition by JDA. He is currently CEO of Worldlocity, a research and advisory firm specializing in supply chain management software.

Pamela culminated a 15-year career at Microsoft as Corporate Vice President and Deputy General Counsel. She advised the board and led the company's regulatory compliance in over 100 countries, addressing a range of privacy, security, and other issues related to cloud computing and its corporate, philanthropic, and citizenship work. Pamela is currently the Vice Chair of the Ethisphere Institute and President of the Centre for Responsible Enterprise and Trade, organizations that work with global companies to advance risk management internally and with their supply chains.

Kelly and Pamela will both be critical in guiding Kinaxis as we continue to expand our geographic focus, vertical market focus, and product functionality, and as we scale the organization to the next level.

And finally, I'd like to thank Ron Matricaria and Douglas Colbeth, who have recently retired from the Kinaxis board after many years of excellent service to Kinaxis and its shareholders. We wish them both the very best in their endeavours.

On behalf of Kinaxis, I would like to thank you for your support, as always, for taking the time to join us on the call.

With that, I'll turn the line over to the Operator for Q&A.

Q&A

Operator

At this time, I would like to remind everyone, in order to ask a question, please press *, then the number 1 on your telephone keypad.

Our first question comes from the line of Richard Tse from National Bank Financial. Please go ahead.

Richard Tse — National Bank Financial

Yes. Thank you. Just wondering if you could give us a bit of colour in terms of how the partner channel is developing? And I guess I'm also curious to know, how do you engage those partners when some of them actually also partner with your competitors?

John Sicard

Yeah. It's a great question. So as with previous quarters, the vast majority of our new name business activity is being influenced by our existing customer base. We have. I want to say doubled, if you will, the number of partner support team, if you will, since the beginning of this calendar year. And we're now seeing a pretty healthy pipeline of new partners that we expect to announce in the second half of this year. So it continues to be extremely healthy for us.

Our largest, as you would know, all have both Kinaxis practices along with SAP practices and others. However, when it comes to supply chain and concurrent planning, our customers only have one spot to go to, they have one source to be looking at for concurrent planning. So they still come to Kinaxis.

Richard Tse

Okay. And then as you look forward, is there some optimal mix of revenue that you think you want to be at, or is it sort of just free flowing depending on how the business evolves?

John Sicard

Well, Richard, our focus continues to be the long-term predictable subscription revenue. And so our goal would be, even on post-IFRS adoption, is to have upwards of 80 percent of that revenue, a long-term target, from a subscription base.

Now it is important and our customers do—they appreciate the growing knowledge and capabilities of the partners, but some customers also want to work directly with us. And so it's important to continue to have a strong professional services organization. So we will continue to work directly with customers as well as in tandem with partners. But I think we're comfortable in that 80 percent mark.

Richard Tse

Okay. And just one last one from me, in terms of the sales and marketing organization, no doubt there have been some changes over the past year. And it's obviously led to some great success here. Could you maybe share some examples of where changes were made and what's sort of really driving let's say the accelerated pace of activity at Kinaxis?

John Sicard

Yeah. So I'd say overwhelmingly the focus has been on Europe and Asia. And I mean, the team that was formed in the first half of the year is in full swing right now. And I would tell you the size and shape of the pipeline as it relates to Europe has followed suit exactly as we would've expected with the growth of the sales team there.

And so that's where I would tell you that largest shift has been. It's not to say at all that other parts of the world are slowing. It literally is the growth of the market in those market segments that we're seeing the biggest change.

Richard Tse

That's great. Thank you for the insight.

Operator

Your next question comes from the line of Thanos Moschopoulos from BMO Capital Markets. Please go ahead.

Thanos Moschopoulos — BMO Capital Markets

Good morning. John, can you speak to the maturity of the partner relationships and level of partner involvement in Europe? Is there a lot more work you need to do to educate partners in the region with respect to how to best work with your solution? Or have many of them already gotten up the curve in that regard?

John Sicard

It's a great question, Thanos. In fact, you may have noted that professional services delivered quite strong revenues in this quarter and the vast majority of that revenue came from outside of North America with a heavy amount out of Europe. And part of that is us ramping up the partner ecosystem in that region. We have certainly assigned partners in the region. We announced mSE not long ago and continue to work with Barkawi and others in that region.

However, I would say it is not as mature as North America. And so obviously, we continue our certification practice. We're seeing a pretty sharp increase in number of certified practitioners outside of Kinaxis, consultants outside of Kinaxis. We're just seeing a bit of a lagging, if you will, in Europe. And that is to be expected.

Thanos Moschopoulos

And in terms of the pipeline in Europe, you said that CPG, Automotive, and Life Sciences are leading the way. Do those deals look very much like the types of deals you would see in North America, or are there any regional nuances that you'd call out with respect to the size and scope of contract or the type of customer need that needs to be addressed or anything else?

John Sicard

No. Not at all. In fact, I would say they're quite typical of the engagements that we see both in Asia and in North America; very, very typical. The only stark difference, if you will, is the speed and size of the funnel, of the pipeline in Europe over the last six months, has been tremendous.

Richard Monkman

Well, and the team in the—

John Sicard

Yeah. Well along with the team. As I said, it has followed suit with our investment with the sales engine in Europe. The pipeline has followed suit.

Thanos Moschopoulos

Great. And then finally on the back of the BASF announcement and their success in using RapidResponse, can you update us on how the pipeline's looking with respect to process industries? Is it still relatively early days in that front or is that becoming a meaningful part of the pipeline?

John Sicard

Yeah. So as you know about Kinaxis, we're obviously very cautious about formally announcing new verticals, and our approach has always been the same for as long as I've been here anyway. We find a bellwether account. We prove ourselves successful in that engagement before formally targeting it with our sales engine and formally announcing it.

RapidResponse today, as you know, we're in six verticals, all with a single platform, no custom code, everyone leverages the same object code. So do I believe that RapidResponse will fit process industries like BASF? Absolutely. Can I tell you that this is a broad area of focus for our sales engine and strong element of our funnel? I would tell you it's emerging. I wouldn't be ready necessarily to declare it.

Thanos Moschopoulos

Fair enough. Thanks, John. I'll pass the line.

Operator

Your next question comes from the line of Paul Streep from Scotia Capital. Please go ahead.

Paul Steep — Scotia Capital

Great. Good morning. John, I mean, we talked already and touched on Europe. Could you talk a little bit the thought as we start thinking already maybe about 2019, how Paul and you and the sales team are thinking about maybe going back and maybe increasing overall module adoption in existing accounts in addition to a lot of the new name work you've already talked about that seems to be bearing fruit?

John Sicard

Yeah. Absolutely. Paul has established a—as the sales team has grown, he's established a team focused on new named accounts as well as a team focused on expanding, if you will, our current accounts worldwide. Whereas in previous years, a sales rep would focus on both.

So absolutely, as we scale the sales organization and as our customer base scales, Paul has seen it as an obvious move to have two teams focus on either side of the business. And we continue to see our land and expand model for sales as being extremely successful. Our approach isn't to sell everything on day one. As you know, we currently monitor this measure very rigorously. The speed at which a brand-new customer will double its subscription.

And again, we're not seeing a huge difference there. As a cohort, it still is in that three-year time frame where a new customer would end up seeing a—we would end up penetrating through and seeing a doubling effect on average of those accounts.

So I'd say it's still very healthy. I would tell you that the sales team now is bifurcated across both of those elements of the business.

Paul Steep

Okay. Great. And you sort of led toward where I was hoping we'd go and you've talked about it, I guess, since late last fall when we touched on it a bit. Do we think the Self-Healing product, when it launches, is one of those potential products that could maybe accelerate that time frame? Or what's been the feedback already, clearly with the beta customers and your advisory panel?

John Sicard

I am absolutely thrilled with the machine learning technology that we've put together. The beta customers that we have tested this on in a production environment, the results have been nothing short of staggering. I can't stress that enough.

The techniques are very potent. They've never been used in this way on top of a concurrent engine. You'll hear a lot about machine learning as it affects demand or supply or capacity. In our world, machine learning sits on top of a concurrent engine. And so it has that end-to-end insight and all of the data in between the chain links, if you will, to analyze.

So we're extremely happy with the early results of beta tests. We'll be sharing more of that at our user conference coming up here at the end of the year. And certainly, I think as it relates to penetrating deeper into our existing accounts, absolutely. It's a new sellable module for us.

Paul Steep

Great. Thanks, guys.

Operator

Your next question comes from the line of Robert Young from Canaccord Genuity. Please go ahead.

Robert Young — Canaccord Genuity

Hi, good morning. First question from me, I thought I'd extend Thanos' question towards process industries. I know you've had a bit of a start in food and beverage. You've got the win in Korea, and so I was wondering if the shift towards process industries—I think CPG has been focused on web manufacturing, and so does that open up a larger opportunity inside of CPG?

Richard Monkman

Most definitely. Most definitely, it does. And, of course, Pulmuone, the largest tofu manufacturer in the world, I want to say they own well the vast majority of the entire demand of the planet's demand for tofu, is quite exciting for us, as is BASF. And it's testing our engine in new ways and proving out, if you will, the validity of RapidResponse outside of the traditional discrete manufacturing processes that you know about us already.

So we're quite happy with our performance in those sectors, and absolutely, I believe this just augments our potential in the CPG space.

Robert Young

Okay. Second question from me would be around the EBITDA guidance. You've had strong EBITDA for the first half of the year. And the guidance seems, at first blush, a little bit conservative. And so I was trying to pull apart the pieces there. Is that because you're expecting a higher contribution from pro services in the second half? Or is it because of gross margins? Just like what would be the margin headwind in the second half that you'd call out there?

Richard Monkman

So, Rob, I wouldn't call it a margin headwind. There are, just at a higher very level, there's a couple key factors. So on a post-Standards basis, so we have to take a look at the timing of the subscription term licence. And as you know, that will vary quarter to quarter. And so from our guidance perspective, you'll see that the majority of the full year subscription term licence component has already been reflected. And so that's why it's a timing issue there on a post-Standards basis.

And then on a pre-Standard basis, we're going to continue with our model of fully expensing customer acquisition cost upon the commencement of the deal. So for instance, a deal that would start in December, we would actually fully expense that, on a pre-Standard basis, those deal costs. Whereas post-Standards now, we're going to be amortizing that over the customer life.

So those are sort of two of the key various changes. I think what we're trying to stress is that we are continuing to deliver very, very strong top-line growth and consistent EBITDA performance. And that trend, together with the cash generation, is going to continue.

Robert Young

Okay. Maybe I'll just pick on gross margins a bit because it's a little bit lower than I expected this quarter. How should we model that going forward? Do you expect it to bounce back, or is this investment data centre and headcount going to sort of be holding gross margins below 70 percent for the rest of the year?

Richard Monkman

Yeah. So we're comfortable being in that range of 70 percent; 68 to 70 percent is a strong margin and, as you highlighted, very much driven by the expansion of the data centres. We feel strongly that we want to get ahead and be fully prepared to execute on this sustained expansion. And again, on a conservative basis, we're going to start fully amortizing or expensing those costs.

We have been—you have seen the strong professional services revenue and one of the key things is we are pulling people in ahead of the curve and also training them. So it's really one of dealing with building forward that continued execution as opposed to any softening in the performance metrics.

Robert Young

And then data centre, you've got one in Canada, one in Europe, two I think are being built in Japan, one in Korea. Is that a good summary? And where would the next place you'd expand? And then I'll pass the line.

John Sicard

Well, that's a pretty good global footprint to begin. We actually have—we actually have two in Canada. One in Europe, one in the US, and then as you noted, a total of actually four in the Asia theatre.

Robert Young

Okay. Thanks. Pass the line.

Operator

Your next question comes from the line of Nick Agostino from Laurentian Bank Securities. Please go ahead.

Nick Agostino — Laurentian Bank Securities

Yes. Good morning. I guess just to change the gears a little bit on some of the Q&A. Obviously, there's a lot of news around tariff wars on a global scale. And I'm just wondering, what's been the reaction, the feedback you're getting from your clients as they maybe have to look at adjusting their supply chains? Are you seeing that driving adoption of RapidResponse amongst your existing users? At the same time, are you maybe seeing some more inbound activity or enquiries from potential new customers just given the potential disruptions that the tariff wars could cause to their supply chains?

John Sicard

It's a very wise question, actually. In fact, the adoption of a technology like RapidResponse is all about absorbing volatility. And these types of trade wars and trade barriers, et cetera, they just augment that volatility and give cause for the need for this type of concurrent planning and agility in supply chain.

I wouldn't say that there has been any specific account pointing to tariff wars as the number one reason that they're leveraging RapidResponse, but I would tell you that having RapidResponse in a world where this type of volatility exists is why Kinaxis has been so relevant at these global players, where manufacturing is global. Subassembly parts come from all over the world and taxation can change from one quarter to the next, which can affect margin and the like. So it has simply made us even more relevant.

Nick Agostino

Okay. Great. And then just second question, just on the competitive side of things, you talk in your MD&A about increasing competitive landscape and maybe pricing pressures or pricing wars from your own customers. Has that changed? And if so, how, now that you're going into the European market and certainly trying to get more and more into the CPG market?

Richard Monkman

Yes. So I wouldn't necessarily call it pricing wars. What's happening is we continue to win on function. I think what we're doing is we're also demonstrating the markets. And when you do that, you actually increase your competition as other players come in because they may not have the same functionality, there is fewer levers for them to impact.

But so yes. We are seeing other entrants. We are very comfortable because we're not aware of anyone else that has this capability of concurrent planning, the Self-Healing Supply Chain, and so on. And again, we're going to go into a relationship with a long-term view.

So we'll go in, and we know that as we continue to drive value, we'll expand. So Nick, we note it as a factor, but it's not, at a management level, one of concern.

Nick Agostino

Okay. Perfect. Thank you.

Operator

Your next question comes from the line of Gus Papageorgiou from Macquarie. Please go ahead.

Gus Papageorgiou — Macquarie

Hi. Thanks for taking my question. Just continuing on the competitive theme. I know historically, one of your biggest competitors has been SAP's marketing and sales organization rather than actual products, but it looks like they're pushing BPI pretty aggressively, and they are claiming some wins. Can you discuss maybe has that competitive threat increased in the last, call it, year? Or do you still see it as basically sales and marketing efforts?

And then just a second follow-up question. Given that the success of hiring more people in Europe is becoming quite evident, have you thought of increasing your sales and marketing sales teams in Asia? Thanks.

John Sicard

Yeah. So thanks, Gus. On your first question, naturally, the vast majority of our accounts already run SAP as a backbone. And I've said this before. We actually don't exist without SAP in many ways. We link to them and to the extent that they have Supply Chain solutions, I can tell you, as Richard just said, they do not, as far as we understand today, offer a concurrent planning type of a technique.

And so we often start our conversations with new named accounts, not by talking about technology whatsoever but talking about the technique of concurrent planning. And when you win that, when you win that philosophy discussion, it leads to the technology that supports it. And we do fundamentally believe there is no other technology on the planet that provides the necessary technology to support concurrent planning.

And to that end, we do not see SAP's products as a competitive threat. Certainly, they still provide friction to our sales campaigns, but I would tell you that we would not necessarily see them as a competitive threat from a product at this time.

And your second question around hiring and strengthening our sales and marketing engine in both Asia and Europe, in fact, we have in both of those regions, a significant higher rate than we have in North America. So obviously Europe more so. We're harvesting and selling into Europe very aggressively at the moment, and it's going exceptionally well. We've been in Asia for quite some time. However, with the announcement of Toyota and Nissan and others, in Japan, we're seeing a terrific amount of activity there as well. So we've been hiring in both regions pretty aggressively.

Gus Papageorgiou

Great. Thanks for the response.

Operator

Your next question comes from the line of Paul Treiber from RBC Capital Markets. Please go ahead.

Paul Treiber — RBC Capital Markets

Thanks very much, and good morning. Just in regards to backlog and since now that you're providing it, how should we think about the variability in quarterly backlog going forward? Is this quarter fairly typical, or could we see greater fluctuation up and down?

John Sicard

Well, thank you, Paul. Yes. There will be some fluctuation. And there really are three elements to the change in backlog under the subscription model. The first is new customer wins, and those terms typically are a two to a five-year contract, often around the three-year mark. And so what we'll do there is, with regards to the minimum contract commitment, that will be taken as backlog.

Then there is also the expansion of customers. So again, the expansion of any existing contract, and it's typically done on a coterminous basis, so it would be expanded through to the end of their term. And then we also have the renewals coming in. So what will happen is, depending upon the renewal cycle, some quarters may be higher than others. And then similarly, new-name customers. It is an extended sales process we go through. It's very critical for customers to be very comfortable with their supply chain. That typically involves proof of concepts and other activity.

So the cadence, if you will, of new-name wins will vary, and so you will see that lumpiness persist. However, the main objective, really, of the backlog disclosure and the way we're doing it, providing it at this point in time, is for you and others to see that the strength of that subscription model and the forward visibility and why we have confidence in our guidance.

Paul Treiber

Second question from me is based on the M&A, it does look like you opened an office in London. Just wondering what's the nature of that? Is that primarily sales and marketing or is it support or maybe even R&D? And then what's the reason why you felt like you needed a presence in London as opposed to other parts of Europe?

John Sicard

Yeah. Part of our push into Europe led us to hiring some pretty significant talent in the UK, and that's been part of the rationale for establishing a bit of a base there. Quite honestly, it's simple as a single flight from Ottawa, definitely helps quite a bit. And some of you may note that Paul Carreiro himself, in a previous life, led a very, very large organization in Europe; home base for him was also London. So to some extent, he is leveraging his experience and connections in the region to find the appropriate talent to help us scale.

Paul Treiber

Great. Thank you. I'll pass the line.

Operator

Your next question comes from the line of Blair Abernethy from Industrial Alliance Securities. Please go ahead.

Blair Abernethy — Industrial Alliance Securities

Thanks very much. John, just wondering if you can reflect a bit on the automotive vertical, as to sort of what stage of adoption you're at there now? I mean, if you sort of look at the electronics vertical where, a number of years ago, you guys sort of reached critical mass there. Are we approaching that adoption inflexion point at this stage now? What sort of evidence do you have that you're getting there?

John Sicard

Well, for sure, as I noted in my opening remarks, having names like Volvo, Toyota, Nissan, and Ford, and others, they give me great confidence that this technique of concurrency and end-to-end planning is resonating in the automotive space.

We can guess, if you will, as to what is causing that. I have my own opinions. I think the automotive industry, which has manufactured cars very much in the same way for tens and tens of years, are now seeing a dramatic shift. There's a lot more electronics in a car than there are mechanical devices. And so you're starting to see a shift in manufacturing process and a shift in planning. And certainly, 2008 had its effect on that industry and how it is able to drive its supplier base. It's certainly much more collaborative now than perhaps it had been prior to 2008.

So we're certainly pleased with our progress in that space. It is a space where the data volumes for planning are extremely heavy, which is where we shine. We do exceptionally well in highly complex environments. We sort of cut our teeth, if you will, on the aerospace and defence industry, which has very common elements.

And so do I see an absolute inflexion? I hate to declare those, in terms of—yeah. We saw one. It started Monday. I think it's one of those things that it's just this trend, if you will, or momentum. I would call it a momentum in the space.

We're seeing that the use cases and the value proposition of concurrency is resonating very, very well in that space when we talk to practitioners about what we do versus how they've been doing it for 30 years. So we're quite pleased, and I think we'll continue to see momentum.

Blair Abernethy

That's great. Thank you. And then just on the aero and defence vertical. You haven't talked much about it on the call. Anything to update there?

John Sicard

So they continue to be an active vertical for us. Obviously, I wouldn't call it as large a market segment as automotive and its suppliers and certainly not as vibrant as CPG or Life Sciences.

Blair Abernethy

Okay. Great. Thanks very much.

John Sicard

Thank you.

Operator

Your next question comes from the line of Edson Lai from GMP Securities. Please go ahead.

Edson Lai — GMP Securities

Good morning. Thanks for taking my questions. So you talked about Europe being a growing presence. If we're looking three or five years down the road, how should we think about the relative weighting for the different regions, such as Asia, North America, Europe? Thanks.

Richard Monkman

Well, yes. You can see, actually, from our financial statements, not only the message we've been providing, but you can see the significant increase in Europe. The nice thing is, we really do view global expansion. I think what John has touched on is we are also expanding the North American team.

As to weighting, I think it's going to probably, long term, just follow the broader industry trends. So would that be maybe closer to a third of our business from Europe, pushing a third from Asia theatre, and then the rest being North America.

One thing that we're very excited about is a lot of our global customers have significant footprint in Southeast Asia, and we see that and as well as, quite frankly, India, continue to grow and becoming more sophisticated in their supply chains. And so we see that as a meaningful market more for the midterm. So I think that's going to, in a long-term basis, look to impact the balance in a positive way.

Edson Lai

Perfect. Thank you. And then I guess a follow-up question to that. Do you see similarities that you see in Southeast Asia compared to Latin America? Or even South America in that case?

Richard Monkman

Well, we're not active in the Latin American theatre at this point in time. We do have partners that are very active in the Latin America market. And so it would probably be something, just given the unique characteristics of the different countries in Latin America, that we probably work—I would expect we would probably work more closely with partners in that theatre than go direct.

Edson Lai

Perfect. Thanks again. I'll pass the line.

Operator

Your next question comes from the line of Gal Munda from Berenberg. Please go ahead.

Analyst — Berenberg,

Yeah. Hi. This is Josh on for Gal. Just maybe continuing on Europe for a bit. Could we get a little bit more colour on the investment in the region? Is it more for direct sales? Are you guys going to be going with partners there?

Richard Monkman

Yeah. Certainly, we're investing in direct sales and professional services the heaviest. I will tell you that we've also begun to invest in hosting centre operations as well as having a central area for support, customer support and customer care. So we're looking at Europe as a full operations centre, notwithstanding R&D obviously, but full operations centre.

Analyst

Okay. And then maybe just on the hosting centre operation. Is that in direct response to demand you're already seeing? Or is that in anticipation of future demand?

Richard Monkman

Well, sorry. It's a little bit of both in that our message has always been that we are not—Europe in particular, we, as John talked about, established strong operations and will continue including the customer support. We just feel that it shows the commitment. Our customers are really looking to that long-term relationship. And there are some very capable, especially in the Amsterdam area, data centre capacity. And so it's really a combination of our commitment to Europe, as well as having a very diversified operation base, similar to the most recent two data centres in Japan. So it's a commitment as well as a facilitization (phon).

Analyst

All right. Thank you.

Operator

And there are no further questions at this time. I will now turn the call back over to Mr. Wadsworth for closing remarks.

Rick Wadsworth

Thank you, Operator. And thank you, everyone, for participating on today's call. We appreciate your questions and your ongoing interest and support of Kinaxis. We look forward to speaking with you again in November when we report our Q3 results. Bye for now.

Operator

This concludes today's conference call. You may now disconnect.

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