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OTC.TO - Q1 2015 OpenText Corp Earnings Call

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OVERVIEW:

Co. reported 1Q15 revenue of $453.8m, GAAP net income of $64.6m, adjusted net income of $118.6m and adjusted diluted EPS of $0.97.

CORPORATE PARTICIPANTS

Greg Secord *OpenText Corporation - VP of IR*
John Doolittle *OpenText Corporation - CFO*
Mark Barrenechea *OpenText Corporation - President & CEO*

CONFERENCE CALL PARTICIPANTS

Kris Thompson *National Bank Financial - Analyst*
Thanos Moschopoulos *BMO Capital Markets - Analyst*
Scott Penner *TD Securities - Analyst*
Richard Tse *Cormark Securities - Analyst*
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Paul Steep *Scotiabank - Analyst*
Eyal Ofir *Clarus Securities - Analyst*
Rakesh Kumar *Susquehanna Financial Group - Analyst*

PRESENTATION

Operator

Thank you for standing by. This is the conference operator. Welcome to the OpenText Corporation first-quarter 2015 financial results conference call.

(Operator Instructions)

The conference is being recorded.

(Operator Instructions)

At this time, I would like to turn the conference over to Greg Secord, Vice President, Investor Relations. Please go ahead.

Greg Secord - ***OpenText Corporation - VP of IR***

Thank you, and good afternoon everybody. I'd like to start the call with the reading of our Safe Harbor statement.

Please note that during the course of this conference call, we may make statements relating to the future performance of OpenText that contain forward-looking information. While these forward-looking statements represent our current judgment, actual results could differ materially from a conclusions forecast or projection in the forward-looking statements made today. Certain material factors or assumptions that were applied in drawing any such conclusion while making any such forecast or projection as reflected in the forward-looking information.

Additional information about the material factors that could cause actual results to differ materially from the conclusion, forecast, or projection in the forward-looking information and the material factors or assumptions that were applied in drawing the conclusion while making the forecast or projection as reflected in the forward-looking information, as well as the risk factors that may project in the future performance and the results of OpenText are contained in OpenText's forms 10-K and 10-Q, as well is in the press release that was issued earlier this afternoon, each of which may be found on our website. We undertake no obligation to update these forward-looking statements unless required to do so by law.

In addition, our conference call will include a discussion of certain non-GAAP financial measures. Reconciliations of all non-GAAP financial measures to their most directly comparable GAAP measures have been included in today's press release, which may be found on our website.

And with that, I'd like to welcome everybody to the call. With me today is OpenText President and CEO, Mark J. Barrenechea, as well as our Chief Financial Officer, John Doolittle. As with our previous calls, we'll read prepared remarks followed by a question-and-answer session. The call will last approximately one hour, with a replay available shortly thereafter.

I'd also like to direct investors to the investors relations section of our website where we posted an updated PowerPoint that will be referred to during this call, as well as a summary table highlighting OpenText's historical trends and financial metrics.

In the coming months OpenText will be presenting at several investor conferences, notably the TD Bank Investor Conference in Toronto on November 19 and the CSFB Technology Conference in Phoenix on December 2. We'd also like to invite investors and financial analyst to the OpenText Investor Day held on Wednesday November 12 during our annual Enterprise World users conference in Orlando, Florida. Please contact the Investor Relations team for further details and to register to attend this event.

And with that, I will hand the call over to John.

John Doolittle *- OpenText Corporation - CFO*

Greg, thank you very much. Very impressed, you did that all from memory. That was excellent. Good afternoon, everyone. Welcome to our call. I'm looking forward to meeting many of you at our Investor Day next month in Orlando. As you know, I started here about six weeks ago, and I'm extremely impressed with the level of expertise and dedication to excellence that I see here at OpenText.

Turning to the first quarter FY15 results, I am pleased with our overall financial performance, including our focus on costs and cash generation. Moving to the highlights, revenue for the quarter was $453.8 million, up 40% compared to $324.5 million for the same period last year. Regionally, the Americas contributed 54%, EMEA 36% and APAC 10%.

License revenue for the quarter was $58.6 million, up 6% compared to $55.3 million reported for the same period last year. License revenue broken down by industry sector was as follows. 25% from services, 16% from technology, 15% from public sector, 14% from basic materials (sic - see Slide 9 "12%"), 12% from financial services, 6% from industrial goods, 5% each from consumer goods and healthcare, and 2% from utilities.

Cloud services revenue for the quarter was $150 million, up 260%, primarily due to GXS, compared to $41.6 million in the same period last year. Cloud services gross margins were 61.3% in the current quarter compared to 65.7% for the same period last year. The decrease in cloud services margins year over year was in part due to one-time credits that were recorded in the first quarter of FY14.

Customer support revenue for the quarter was $183.9 million, up 9% compared to $168.4 million in the same period last year. Customer support gross margins relatively stable at 87.4% this quarter compared to 86.8% in the same period last year.

Professional services and other revenue for the quarter was $61.3 million, up slightly from $59.1 million in the same period last year. And professional services gross margin was 26% in the quarter versus 23.1% for the same period last year. And the increase in margins here was a result of certain proactive steps taken by the new leader of the services organizations to improve efficiency and the delay in timing of certain expenses.

Gross margin for the quarter before amortization of acquired technology and the stock compensation was 71.6% compared to 73.9% for last year's first quarter, and the decrease was primarily due to a change in the overall product mix, notably the significant addition of cloud revenue from GXS. Pretax adjusted operating income before interest expense and stock compensation was $155.7 million this quarter, up 57% compared to $99.2 million in Q1 of last fiscal year.

Adjusted net income increased by 45% to $118.6 million this quarter, up from $81.5 million in Q1 of last fiscal year. Adjusted earnings per share at $0.97 on a diluted basis, and that compares to $0.69 for the same period last year, up 41%. The sequential effect of foreign currency movement on adjusted earnings per share for the first quarter was negative $0.02, primarily due to the weakening euro.

Our adjusted tax rate for the quarter was 18%. That's in line with the forecasted rate that we announced in the fourth quarter of 2014, and for FY15 we anticipate the rate to continue to be 18%. This is based on our current forecast of earnings expected to be realized in our various tax jurisdictions within our existing business model and structure.

On a GAAP basis, income from operations before interest and taxes for the quarter was $103 million, up 98% from $52 million in the first quarter of last year. Net income in accordance with GAAP, $64.6 million, $0.53 a share on a diluted basis for the current quarter, compared to $30.6 million, or $0.26 per share on a diluted basis same period a year ago.

Operating cash flow, $138.5 million. That's an increase of 73% compared to $79.9 million in the same period last year. 122.9 million shares outstanding on a fully diluted basis for the first quarter of FY15.

Takes us to the balance sheet. On the balance sheet at September 30, 2014 deferred revenues were $320 million compared to $349.9 million as of June 30, 2014, $281.8 million at September 30, 2013. Accounts receivable was $239.8 million at the end of September compared to $292.9 million at June and $153.4 million at September 2013. Our day sales were 48 at the end of the period compared to 53 at the end of June and 43 at the end of September last year.

We had approximately 8,000 employees on September 30 comprised of 1,900 in R&D, 2,000 in cloud services, 700 in customer support, 1,000 in professional services, 1,400 in sales and marketing and 1,000 in G&A. This is relatively flat to where we were last quarter.

Our adjusted operating margin was 34.3%, which is above the high end of our target operating model range for FY15. However, we are not adjusting our target operating model range at this stage as it's early in FY15. Mark is going to spend more time on this, but there is significant global economic uncertainty, as everyone is aware of, and we will review the model again at the end of the second quarter.

Can come from that's on October 22, the Board declared a cash dividend, $0.1725 per share for shareholders of record on November 21, 2014. Once again to conclude and in summary, overall I'm pleased with our performance in the quarter, including our cost management, cash flow from operations, and earnings for the quarter. Now I'll turn the call over to Mark for his remarks.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thank you, John. Welcome everyone to our FY5 Q1 earnings call. Before I begin, let me express that our thoughts and our prayers are with those affected by the tragic events in Ottawa today. We're also very grateful to the first responders who put themselves in harm's way to secure the safety of others. All OpenText staff are safe and accounted for. Our thoughts and prayers for all those affected today in Ottawa.

Onto Q1. I'm going to spend time today on our overall financial achievements, corporate strategy, growth initiatives, the economy, our leadership team, and Enterprise World. It was a record Q1, and there is much to be pleased with. Year over year we have added $129 million in revenues, delivered strong adjusted operating margins of 34.3%, and adjusted EPS of $0.97 through improving our efficiency and cost savings programs.

Further, revenue was up 40%, adjusted net income was up 46%, adjusted cash flows were up 73%, adjusted earnings per share were up 41%. And we announced our quarterly dividend program of $0.1725 per share, and since the inception of our dividend program we have returned to shareholders 18% of operating cash flows.

Overall, the team delivered to our revenue plan while exceeding adjusted earnings. Our business model of intelligent growth delivered strong value against the backdrop of an increasingly difficult economic environment. While I'm pleased with the overall quarter, I am not satisfied with 6% license growth.

The primary factor that held back a double-digit growth rate was the economy. Let me also note that we have delivered positive year-over-year license growth for four consecutive quarters now, with a trailing 12-month growth rate of 11.9%. Our investments in intelligent growth are working.

Let me take a few moments to review our corporate strategy. OpenText is focused on enabling a Digital First World, enabling our customers to simplify their information platforms with automation, transforming their operations with new technologies and modern deployment options, and accelerating the flow of information through the use of our business network.

Information management, compliance, and B2B are the three key end markets we want to win and lead in. Our end markets are built on five key EIM pillars of ECM, CEM, IX, BPM, and discovery. Collectively we call this enterprise information management.

Our customers are asking for hybrid deployments on-premises and in the cloud, and we are having deeper conversations about workload placement and well-defined data zones for data sovereignty requirements. Workload placement helps customers decide what information is right for the cloud, and data zones defined what countries data is in. Not all work loads are right for the cloud. Data zones are a requirement for a global cloud.

We operate our business within a framework that we call the OpenText Intelligent Growth System where we believe in five core principles of financial performance, operational excellence, innovation, customer engagement, and customer/partner loyalty. We lead with value and invest in markets we can win.

Let me talk about a few key Q1 achievements. Our revenues are highly recurring, where customer support was 41% of our business, cloud was one-third at 33%, and PS and license each at approximately 13%. We are focused on technologies, assets, and business practices that increase recurring revenues and the lifetime value of a customer relationship.

For total revenue Americas was 54%, EMEA 36%, and APJ 10%. Our license business delivered $58.6 million. Some key license wins include Mercedes-Benz, L'Oreal, BHP, and PBS. PBS will be joining me on the main stage at Enterprise World. We had three transactions over $1 million, nine transactions were between $500,000 and $1 million. Our average deal size was $324,000, up 21% from $268,000 from last year. Partners influenced 46% of license sales, while new account sales were 23%. Our EIM suite upgrades, information security, and compliance remain key revenue drivers, and we completed over 100 10.5 upgrades in Q1.

Our cloud services business delivered $150 million in revenues on adjusted gross margins of 61.3%. Our cloud is highly profitable. Americas contributed 64%, EMEA 24%, and APAC 12%. We added $108 million of revenues year over year and had slight growth quarter over quarter. We had key wins at Toyota Digital, Michelin, PNC, Unilever, Abago, and others. Enabling a fully-automated procure-to-pay flow with a complex supply chains as a key revenue driver, as well as EMEA expansion opportunities with new partnerships and new EMEA-based telesales team focused on building these market opportunities.

Our customer support business delivered $184 million of revenue on adjusted gross margins of 87.4%. Americas contributed 53%, EMEA contributed 39%, and APAC contributed 8%. For our existing customers we are focused on driving more adoption of our premium programs and more customer self-service through the Internet, which ultimately drives more retention.

Our professional services business delivered $61.3 million of revenue on adjusted gross margins of 26%. Americas contributed 48%, EMEA 44%, and APAC 8% of revenue. Our professional services are well valued by our customers, as reflected by our margin profile which is best in industry.

On last earnings call I highlighted our key FY15 growth programs. Let me provide an update today. First was our product innovation and adoption of our EIM suites and B2B services, which topped the list. We had notable wins such as UXIL, L'Oreal, Petronas, BHP Billiton, and Talisman Energy. The Canadian Mortgage and Housing Corporation purchased our complete range of EIM suites in order to digitize 100% of their business processes for increased efficiencies and cost effectiveness.

Two, B2B expansion programs through EMEA and other services. We are expanding our EDI footprint in the EMEA SMB market with new cloud offerings and out-of-the-box mappings. We have recently launched a European on-demand messaging node and disaster recovery, and are working with our carriers to extend our relationships further into Europe.

The third growth driver I highlighted last call was our compliance solutions. This quarter we won Salt River Project, a water and power utility-based organization in Phoenix, Arizona. The Salt River Project is using OpenText solutions to reduce their amount of unmanaged content and meet regulatory and compliance regulations without -- while reducing risk. TelCom Malaysia purchased a solution based on extended ECM and profusion and capture technologies to help them capture and manage financial records in preparation for the Malaysian government rollout of the GSC this year.

Transitioning customers to manage services in accelerating their journey to the cloud is also a priority for us. We added 15 new quarters -- customers within the quarter, including Michelin, PNC Bank, and Mitsubishi Trust and Banking, Keysight Technologies, BLE Fuse, and IFF.

Michelin signed a multi-year contract to help them manage increasing B2B exchange volumes as well as prepare a competitive advantage in business partner management. PNC contracted OpenText to migrate and onboard over 5,000 of their commercial clients to their new file transmission platform.

Mitsubishi Trust and Banking Corporation will be using OpenText managed services to replace their legacy web services with a state-of-the-art custody portal, allowing them to effectively compete with much larger financial services organization. Toyota Digital has contracted our multi-year premium support for managed services in order to expand their B2B connections, tutorial group OEMs, and tier one suppliers.

The next area of growth programs which we highlighted that I want to provide an update on is partners and alliances, which is a key initiative here in FY15. We added 35 partners in the first quarter, 15 in EMEA, including the Saudi Business Machines intelligence and uni-system; 9 in the Americas, including Indira Brazil, IP Securities Canada, Clair-Info, and Centex Corporation in California; and 11 signed up in APAC, including Infosys, Japan Computer Services, and [Symbis] Technologies.

Partner-driven wins in the quarter included Johnson Controls, who purchased our SAP solution in order to unify its SAP template and business processes across three divisions of the enterprise.

Our last growth initiatives are in our established markets where our first priority is to improve our sales yield per account executive, becoming more productive through training and education and certification. In our fast-growth markets, our first priority is more account coverage. And for inside sales, we are operational in EMEA now. Our global account team is now established with their first 20 accounts on a global basis. The team is focused on intelligent growth. Leading with value, and investing in markets we can win.

Let me spend a moment on the economy. During Q1, the geopolitical and economic issues began to grow and accumulate, and ultimately had an effect on customer buying behavior. Issues range from Ebola in Africa, ISIS in Middle East, the Russian/Ukraine conflict, UK/Scotland vote, Brazilian elections, German production, the unbalance of currencies, followed then by protests in Hong Kong and then an IMF global growth downgrade.

At some accumulation point, customer buying behaviors changed. And we saw this in September. We believe it is prudent to assume these issues will continue over the short term, and thus we will prioritize more on value while this uncertainty is present.

Our intelligent growth approach puts value first while investing in markets we can win. You have seen us operate this way in the past, including Q1. Value is principal one always in the OpenText DNA. We will also be emphasizing to our customers the value we can offer in key areas, including reducing the cost of their information needs by standardizing on OpenText, a transition to managed services to lower operating and capital cost, and the ability to reduce people costs by fully automating their EIM platforms and cost of ownership, which is topical and offers our customers immediate and measurable benefits.

Also within the quarter, we've strengthened and completed our leadership team. As you know, John Doolittle joined us as CFO, and I'd like to take this opportunity to say how much I appreciate John's contribution since his arrival.

Adam Howatson was promoted to Chief Marketing Officer. Many of you have come to know Adam through various IR meetings and presentations. Adam is off to an amazing start. He is a 15-year veteran of OpenText, and among the best natural-born marketers I've ever met. I was about to call him a 15-year-old. He's a 15 -year-old veteran, and he truly is one of the best natural-born marketers I have ever met.

Lisa Zangari joined us as our Global Leader for HR, and Lisa represents an incredible advocate for our workforce. Lisa joins us from IAMGOLD. John, Lisa and Adam are all based in Ontario, with the broader leadership team and myself. Also, Gary Weiss was promoted to lead a newly formed Corporate Cloud Group to drive corporate-wide acceleration programs on all things cloud.

January well mark my third anniversary at OpenText. As I look to the next three years and the opportunities in front of us, this is the experienced leadership team I want to turn the market opportunity into a reality. I couldn't be more pleased with the team that we have assembled.

Onto Enterprise World 2014. Enterprise World, our annual innovation event, is just three weeks away. Our customers are going to be very interested in our announcements. It's going to be an important event, as well as a fun event, with comedian Martin Short joining me on stage during our keynotes. As Gregg mentioned earlier, our Financial Analyst Day will be on Wednesday, November 12. I hope you will be able to join us on site in Orlando, Florida.

Let me preview some of the key Enterprise World announcements. First, we have decided to provide a comprehensive service pack that we are calling SP1, Service Pack 1, and accelerate key new capabilities for all our EIM suites. We expect SP1 to be available next quarter. SP1 will provide new capabilities across our suites from analytics, systems management applications such as contract management, and much more as well is a more automated upgrade program making it easier for customers to adopt our new suites. We're taking our learnings from over the last six months and incorporating it into SP1. The details of SP1 will be discussed at Enterprise World.

Second, we will be unveiling the next generation of the OpenText Cloud that will provide new capabilities, programs and services in order to help customers accelerate their transition to our cloud. These new cloud capabilities will be available conjunctive with SP1 over the next 90 days, and provide customers immediate value to reduce their operating cost. Expect some very important announcements here at Enterprise World.

Third and longer-term, Project Blue Carbon. We will be providing an overview of Project Blue Carbon, our next major release beyond SP1. Blue Carbon will focus on the frictionless flow of information within the digital enterprise, which will be a major EIM milestone, not just for OpenText but for our customers and the industry at large.

We will help customers transition from suites to complete information flows from on-premise to the cloud, from the grid to business networks, and from data centers to data zones. We expect that Blue Carbon will be a seminal event in the EIM marketplace, as well as deliver more applications, analytics, and cloud enablement.

These will be the key messages at Enterprise World: more capabilities and faster time to suites via SP1, acceleration to the cloud, and a stronger EIM future with Blue Carbon. We hope to see you there.

Let me wrap up my prepared remarks. Our EIM vision, our products and our services are resonating with customers. We can see this in the marquee customer wins we have achieved and the value we are delivering for companies such as Michelin, L'Oreal, Petronas, and Toyota. We are competing against HP, IBM, Microsoft, companies 50 times our size. And we are beating them and we are winning. We need to compete more.

While I'm pleased with the overall quarter, I was not satisfied was 6% license growth. Again, we've delivered positive year-over-year license growth for four consecutive quarters now, with a trailing 12-month growth rate of 11.9% in license, but we could have done more in the quarter. And we would have done more, except for the economy.

We are assuming this cautious environment remains for the short term, and we are emphasizing value messaging and programs both inside and outside the Company. Value's in our DNA, and as I said in my first earnings call nearly three years ago, above all things we will be focused on adjusted net income, which was up 45% year over year in Q1.

We have kicked off our FY15 growth programs, which remain fully funded. And we are full steam ahead on these programs. The team is focused on intelligent growth. We continue to strengthen our leadership team, and this is the team to capture the EIM market opportunity. I couldn't be more pleased with this leadership team.

Acquisitions are core to our business model, and we will continue to acquire. We look to put $3 billion of capital to work over the next few years. And I'm excited about Enterprise World where we will discuss SP1, new cloud programs, and the future with project Blue Carbon. I expect SP1 and our new cloud programs to be available next quarter and add immediate value for customers.

With that, I'd like to open the call up to your questions.

QUESTION AND ANSWER

Operator

Thank you.

(Operator Instructions)

Kris Thompson of National Bank Financial.

Kris Thompson - ***National Bank Financial - Analyst***

Great, thanks. Mark, last quarter you said that over 50% of your customer base were upgrading to Version 10. Do have any updates for us there?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thanks Kris, thanks for the question. We saw a little over 100 customers added to that last quarter. So we've added about a little over 100 customers upgrading. And we also think SP1 is going to help continue the momentum on Red Oxygen. We are taking a lot of our learning, attempting to accelerate upgrade programs, also filling in some capabilities that folks are looking for. So I'd say we added about 100 customers last quarter, and looking forward to SP1 to help customers accelerate their path to the suite even faster.

Kris Thompson - ***National Bank Financial - Analyst***

Okay, that's helpful. And of the base that's upgraded to 10, what's the percentage that have gone through to 10.5?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

I don't have the precise number in front of me that have gone from 10 to 10.5. We will go look at that and get back to you.

Kris Thompson - ***National Bank Financial - Analyst***

Okay, appreciate it. And one for John. Welcome, and did you mention how much revenue or license revenue GXS contributed in the quarter?

John Doolittle - ***OpenText Corporation - CFO***

Hi, Kris. Thanks for the welcome. I didn't, but I will, and it wasn't material to the overall license number.

Kris Thompson - ***National Bank Financial - Analyst***

Just one more thing that we used to get is the FX impact on EPS. I don't know if you have that handy.

John Doolittle - ***OpenText Corporation - CFO***

I think I mentioned that in my remarks. It was $0.02 negative in the quarter, Kris.

Kris Thompson - ***National Bank Financial - Analyst***

Got it. Missed that. Thanks, guys. Appreciate it.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thanks, Kris.

Operator

Thanos Moschopoulos of BMO Capital Markets.

Thanos Moschopoulos *- BMO Capital Markets - Analyst*

Hi. Welcome to John as well. And maybe it's not a fair question since you're the new guy, but I'll ask it. I realize you're not updating the operating model at this point, but if we were to go by the model that would assume a significant ramping in OpEx. Just to clarify, do you have plans to ramp up your hiring at this point, or is that not something we should expect to see near term?

Mark Barrenechea *- OpenText Corporation - President & CEO*

Thanos, I'm taking all unfair questions (laughter).

John Doolittle *- OpenText Corporation - CFO*

He made that clear from the beginning. Thank you for the welcome, again. So on the operating model, I mentioned in the remarks, as you pointed out, that we are leaving the target model in place. We did come in, as you know, on top -- on the top end, over the top end on operating margin. So a number of reasons for leaving it the way it is. One is we are three months in, so it's still early days in the year. Mark did a great job of laying out some of the challenges in the economic environment that surround us.

There are some issues on timing of expenses, you're right. So we have looked at each of the expense lines this quarter, and we've looked at where those are going to be in the balance of the year. We do expect some uptick on things like commissions and other compensation, some marketing increases, we talked about Enterprise World, vacation accruals as we progress through the year.

And last item which Kris asked about is foreign exchange and the impact of the euro. It was negative in Q1. The trend has continued. And we will evaluate, though, each quarter. So we will be taking a look at this at the end of the second quarter again. But that's the rationale for leaving it where it is.

Thanos Moschopoulos *- BMO Capital Markets - Analyst*

Okay. Now OpEx fell of quite a bit sequentially, even though I think you said headcount was relatively flat. Other than commissions and year-end bonuses, what were the other dynamics? Was there a lot of costs you took out in terms of overhead at GXS?

John Doolittle *- OpenText Corporation - CFO*

There was some of that, some costs in GSX that came out. There was some -- it was the summer months, so vacation was taken in the summer months, and so vacation accrual wasn't where it normally is. We really did ratchet back on travel and held the line just generally on expenses. That's why quarter over quarter it's where it landed.

Mark Barrenechea *- OpenText Corporation - President & CEO*

Thanos, I would add to the comments from John that we talked about on last call, we still have some GXS efficiencies that we expect to weave in here in the coming quarters. So we saw a little bit of that as well.

Thanos Moschopoulos - ***BMO Capital Markets - Analyst***

Great. Just one last one for you, Mark. It seems like the sequential drop-off was more pronounced in the Americas than in other regions. Anything especially going on there, or was that just more reflective of the fact that Q4 was exceptionally strong?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thanks for that. On the license side, our trailing 12-month average growth rate is 11.9%. And that's a good growth rate. In quarter 6%, although we are not satisfied with 6%. And when we look at the Americas, it's as you said, we are coming off a strong Q4. There's nothing pronounced here. I am happy with the team we've put them place, with the changes a couple quarters ago. The only factor I might add is I think the economic impact, we struggled bit in Latin America, primarily dominated by the elections in Brazil. It's, as you know, there is nothing structural, there's nothing I am looking to change in the Americas. I am pleased with what we've done. We came off a strong Q4 in the Americas, and Latin America wasn't helpful. Brazil is the dominant force for us and they held elections and re-elections last quarter.

Thanos Moschopoulos - ***BMO Capital Markets - Analyst***

Great. Thanks, guys. I'll pass the line.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thanks, Thanos.

Operator

Scott Penner of TD Securities.

Scott Penner - ***TD Securities - Analyst***

Thanks. Mark, just two topics, if I could. First of all the GXS business, if you could give an update on whether the OpenText and GXS sales force are fully now up to speed for cross-selling, and what has been the initial reaction in the field about any additional application areas that you would like to get into, or feedback from customers on that?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Scott, thank you for that. When we -- historically when we've purchased assets, we tend to -- we have historically described that we believe those assets will, in the short term, have reduced revenues. We did not do that with GXS. I'll note that we had at our cloud -- our cloud services business did over $150 million of revenues in the quarter, slightly up quarter over quarter. But not down historically like we -- like on other acquisitions. The bringing together of the two organizations, I think that is a -- that's reflective in our third quarter together that our revenues on an uptick in the cloud.

I'd also note that one of the big areas of opportunity was bringing the teams together in EMEA, our on-demand messaging services, our managed hosted services, and managed services from GXS now collectively known as managed cloud services. And we delivered some strong winds in EMEA and are now going after, which is a new market for us, which is the mid-market. The IX, B2B, EDI mid-market in EMEA. I'm very pleased with how the sales force is for GXS, EasyLink, and our professional services have come together as one team. Our revenue's up quarter over quarter in our third quarter together, and we are now going after [some] marked new opportunities, specifically in EMEA, and we've announced some nice wins.

Scott Penner *- TD Securities - Analyst*

Thanks. The second question really is more just, Mark, as you well see, you guys see, we are seeing some enterprise vendors now that being hit really in the capital markets as the license, perpetual licenses shift towards SaaS and term, to some extent. Just hoping you could address head-on the notion that this transition dynamic is still yet to come for OpenText.

Mark Barrenechea *- OpenText Corporation - President & CEO*

Scott, thanks for the question. It's obviously a very direct question, so I appreciate it. I take a different view. Our customers are asking for a hybrid world. And cloud is a big term. I will spend a little time on this one. We have -- we are primarily -- we are an enterprise organization. We service highly regulated industries. And it's a workflow discussion.

Where do banks, where do financial institutions, where do construction companies, pharmaceuticals, CPG companies want to place their workloads at the enterprise level? And our customers continue to ask for workloads on premise, and in our cloud. But not SaaS, but in the cloud.

And this is part of our managed cloud services where we want to be able to provide hosting, an economic benefit to be able to move their workloads, their computers into our cloud. So SaaS, we don't see SaaS competing with us in the enterprise. We don't see SaaS.

In terms of a term license versus perpetual licenses, regardless of where you are putting those licenses, whether it's on prem, in our cloud, or in a public cloud, we offer term today. We have for many, many years. So, no. I don't feel -- I can't speak to what the other companies are -- Oracle or IBM or others looking to achieve or not talking about, but we don't see SaaS as a competitive threat to OpenText. We do see the cloud as an advantage. And then there is an economic model behind that cloud, which is either on prem or perpetual or term, but we have offered term for a while. It grew 6% in license last quarter and trailing 12 months, 11.9%.

Scott Penner *- TD Securities - Analyst*

Thank you. Appreciate the answer.

Operator

Richard Tse of Cormac Securities.

Richard Tse *- Cormark Securities - Analyst*

Mark, you were really bullish after last quarter on the license side, and rightly saw you guys had a great quarter, and certainly can appreciate the economic backdrop. But what were you tracking on the licenses before the economy softened there? Can you give us a sense, were you [given] -- looking at a $65 million, $75 million license number? Just trying to get a sense of what that would have been.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Richard, that's probably hard for us to do. We are clearly mindful of what the consensus number was, of $64 million. We delivered, if you round up, to $59 million. So we are mindful certainly of the consensus number, but we are primarily on our total revenue plan for the quarter. Look, as we came into September there was a lot of accumulation of global and economic issues.

Our thesis on our growth programs remain intact as well as fully funded. Our EIM suites are resonating. We have blue chip wins from customers, these are marquee customers. Our pipeline remains up coming into Q2. I'll note, though, on the change in customer buying behaviors, we haven't seen deals canceled. We haven't seen them shrinking. We did see deals deferred into the quarter. We've ready closed some of them. We're monitoring that closely. So what was the net effect within the quarter? It is hard to quantify. It's hard to quantify.

Richard Tse - ***Cormark Securities - Analyst***

Okay. I guess related to the economy, does it improve the market for acquisitions now in terms of the opportunities out there? And maybe you can talk a little bit about what you are doing there right now, how active it is, and some of the valuations in the market.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

I would say that pipeline is up too, Richard. Certainly when -- in tough economies with free capital and evaluations on -- near infinite valuations on no earnings, you need to be very patient as a value buyer. And maybe in down economies where maybe capital is a little tighter, and valuations become more reasonable, though I still think they have room to go to become even more reasonable, it certainly advantages you as a value buyer.

So we still look to put our $3 billion of capital to work in the next few years. A down economy, I wish it were an up economy of course, a down economy, though, does advantage a value buyer such as us. Our pipeline is up.

Richard Tse - ***Cormark Securities - Analyst***

Just one last question on cloud. Who do you guys see as the prominent players on the cloud side in your market, or the market that you designate as EIM here? Is it Alfresco, or is there any other players out there?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

I would look at it as maybe a bit bifurcated here. On the functional side, we are very focused on IBM Sterling Commerce. And going after -- and having competitive wins on their platform as a service for EDI and B2B integrations. And then you have some other competitors around there, E2open, SPS and some others, but Sterling Commerce has sort of competitor number one in that.

Second is managed cloud services. We want to be able to bring in the core EIM platforms for our ECM, CEM, BPM. So that would be IBM Services or Oracle Services. Microsoft Azure if you're hosting Microsoft Technologies there.

Richard Tse - ***Cormark Securities - Analyst***

That's great. Thanks, Mark.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thanks, Richard.

Operator

Michael Nemeroff of Credit Suisse.

Michael Nemeroff - ***Credit Suisse - Analyst***

Hey, guys. Thanks for taking my questions. Welcome aboard, John. First question for John, and then one for Mark, if I may. You mentioned there was a $0.02 FX impact to EPS. By my calculations that's about $10 million in revenues. Is it fair to assume that the distribution of that FX effect on revenue follows the target model, so about $1.5 million or $2 million of license on that FX effect?

John Doolittle - ***OpenText Corporation - CFO***

That'd be fair to say, although I'm not sure that you've got the revenue number quite right. I'd call it closer to $5-ish million. But that's mainly due to the euro. And we have some costs, natural cost hedge there as well. But it should follow. There's no reason why it shouldn't follow the target model in terms of the breakdown of revenue by category.

Michael Nemeroff - ***Credit Suisse - Analyst***

That's helpful. And then Mark, last quarter you had a very strong showing on the ELA sales, took up the ASPs quite meaningfully. Could you tell us, describe for us what the environment is for those ELA sales? Are people waiting for SP1 before they buy in on the ELA? Give us a sense for what happened. I know the macro was an impact, but were there any other things that customers were saying that they were pausing for?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

No. Primarily driven by the economy, Michael. Our average deal size was up about 20% Q1 over Q1. I think last Q1 it was $268,000, this quarter it was $324,000. So up 20%, and that's meaningful up year-over-year. Our primary effect here was the economy.

SP1 will help. We are taking -- we are proactively taking the learnings that we had, accelerating a service pack, adding key capabilities to that service pack, things like we're going to accelerate a new release of Media Manager that's all in HML5. We've had some new usability enhancements in Content Server. We have a new business object browser we are putting in for SAP. We have some very compelling analytics going across our suites in a new CIO dashboard.

And then we are taking our first six to nine months of learning on upgrades from customers in professional services. We saw a path to automate a few things and get it into SP1, and bring that back to customers. So SP1 will be a very positive adder for us. But primarily it was driven by the economy last quarter.

Michael Nemeroff - ***Credit Suisse - Analyst***

Do think that the economy is -- has it affected the way that you are thinking about the results for the fiscal year? Or is it still too early, given that it's only Q1?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

When I look at the issues that accumulated, there are issues that are structural and then issues that are just temporal. The issues that we all read about feel a bit more temporal, short term, than long-term structural. So that feels a bit positive to me. Our pipeline is up, which is another positive for us. But we are going to be prudent and going to assume that these uncertainties last for at least the short term, which means a quarter or two. We're going to be a bit more judicious about expenses and continue to emphasize cash flows and earnings and value.

Michael Nemeroff - ***Credit Suisse - Analyst***

Great. Thanks for taking my questions.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thank you, Michael.

Operator

Stephanie Price of CIBC World Markets.

Stephanie Price - ***CIBC World Markets - Analyst***

Hi, Mark.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Hi, Stephanie.

Stephanie Price - ***CIBC World Markets - Analyst***

In terms of SAP, I was wondering if you could spend a few minutes on them. They've talked about a couple of bad quarters here and license revenue moving to the cloud. Can you talk a bit about the partnership and how that is going, and the percentage of license revenue you are seeing from them these days?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Sure thing. So first, the partnership remains strategic and in a great position. We've added new products. We are soon to add a new business object browser with SP1. Their business contributed roughly 10%, approximately 10% of license revenues within the quarter. And this relationship will endure. Products come and go, but the relationship endures. And as SAP moves to the cloud, we will move to the cloud with them.

But right now the majority of what we do is on premise. But as SAP business model shifts, we will shift with them. We'll introduce products to fill the spaces that we need to fill. We already offer our solutions in HANA, and HANA operates in the cloud. Our time -- our travel and expense product is a service that runs behind some of their cloud services.

So the relationship is strategic. We are -- keep investing in products. We have a strong plan for the year. They contribute about 10% in the quarter. And we will transition with them as they transition to the cloud.

Stephanie Price - ***CIBC World Markets - Analyst***

Great. John, welcome.

John Doolittle - ***OpenText Corporation - CFO***

Thank you, Stephanie.

Stephanie Price - ***CIBC World Markets - Analyst***

Wondering if you could elaborate a bit on CapEx. It was a bit higher than we were expecting this quarter. Can you talk about that, and also maybe a full-year run rate expectation?

John Doolittle - ***OpenText Corporation - CFO***

Yes, Stephanie. Thanks a lot. I think we had given you guidance of around $75 million to $80 million for the year, and you are right, we were high. We were about $30 million in the quarter on CapEx. Still sticking to the call on the $75 million to $80 million for the year. So we had some purchases of servers to support our cloud offerings in the quarter, and they were fairly significant. And we wouldn't expect that to repeat. $75 million to $80 million is I think where we will land for the year.

Stephanie Price - ***CIBC World Markets - Analyst***

Okay. And then just in terms of the services margin, it was lower than we expected as well. I think you mentioned some costs being deferred. How should we think about that going forward?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Stephanie, just to clarify, the services, the professional services margin?

Stephanie Price - ***CIBC World Markets - Analyst***

Yes.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Higher than expected?

Stephanie Price - ***CIBC World Markets - Analyst***

Sorry, lower than expected. Did I say -- yes, lower than expected.

John Doolittle - ***OpenText Corporation - CFO***

We were actually -- Stephanie, we were higher than we were last quarter. So we were in at 26% on professional services in the current quarter, and it was 23% last year for the same quarter. I mentioned a couple things. One is we appointed a new services leader and he took some proactive measures before the beginning of the quarter; eliminated some positions. So some of that is -- will be ongoing savings, but a portion of that was timing. So we wouldn't expect to see the 26% continue. We'd see it come back more towards our normal run rate.

Stephanie Price - ***CIBC World Markets - Analyst***

Perfect. Thanks so much.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thanks, Stephanie.

Operator

Paul Treiber of RBC Capital Markets.

Paul Treiber - ***RBC Capital Markets - Analyst***

Thanks very much for taking my question. Just in regards on, since we're in the margin topic, on gross margins for cloud services. It looks like it's been slightly above the target model for the last several quarters. What has been driving that over the last several quarters, and should we expect it to continue to be sustained above the targets?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Paul, I will actually take that one. Part of what is driving our very strong margin performance in cloud, we are profitable in the cloud, highly profitable in the cloud actually, compared to others. Is really consolidation of cost across OpenText

Commercial, EasyLink networks, and GSX networks. So the consolidation of data centers, networks, and operations have contributed nicely.

Paul Treiber - ***RBC Capital Markets - Analyst***

And I think when the GSX acquisition originally closed, I think the goal was for it to be onboarded within 18 months or so. In light of the cost coming down, does it seem like it's running, or the integration is going at a faster pace than what you originally thought?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Yes, I think we talked about maybe last call where we were originally at two years than 18 months. Then I think last call we were primarily -- we felt we had completed the majority of the integration, but there were still some areas of value to unlock in the coming quarters. This is certainly one of those areas. So the ability to consolidate data centers and it's corresponding infrastructure is an area that is contributing to the margin.

Paul Treiber - ***RBC Capital Markets - Analyst***

Great. I will pass on. Thanks very much.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thanks, Paul.

Operator

Paul Steep of Scotia Capital.

Paul Steep - ***Scotiabank - Analyst***

Great, thanks. Mark, maybe you can clarify or provide some context around this. I'm trying to get a sense of -- I think we've all seen the headlines and the economic comments out there. You've got a fairly broad-based network with EasyLink and GXS. Are some of your comments driven by what you're seeing transactionally there, or is this driven more off of sentiment out of the license side? Has there been a marked change over the networks in terms of you deliver a broad-based set of transactions?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Interesting question, Paul. I think it's a fairly well studied set of commentary, both from what we hear from our customers and we can see and anticipate in our infrastructure. And we do see a lot. So I think it's a well reasoned set of observations on a change in customer buying behaviors last quarter and in anticipating over the next couple of quarters.

Paul Steep - ***Scotiabank - Analyst***

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Okay. The second one from me. In terms of how we want to think about GXS in terms of the managed service penetration and the opportunity there over the coming quarters? Thanks.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Yes. Paul, thanks for that. It's a significant opportunity for us. It's many things I'm very excited about, this is one of them. We've added a couple dozen customers last quarter into our managed cloud services. And that's going to put us up in the high 800s, approaching 900 customers that are operating in the OpenText Cloud. Near 900 large enterprises who have moved either their information management, supply chain, or B2B integration services to run in the OpenText Cloud. We will be speaking to this very directly at Enterprise World about new programs, new infrastructure that will continue to help customers accelerate into our managed cloud services. And this is an area where we can add hundreds and hundreds of customers to our infrastructure in the coming years.

Paul Steep - ***Scotiabank - Analyst***

Perfect. Thanks, guys.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thanks, Paul.

Operator

Eyal Ofir of Clarus Securities.

Eyal Ofir - ***Clarus Securities - Analyst***

Thanks for taking my question. Hi, guys. First off, just Mark, on the obviously you talked about the macro, but it seems like you are also having the SP1 as potentially helping demand here. Is there also function in the license number, [though as potential headwind] by clients delaying deploying -- deployment until they see SP1 come out, and obviously go with the latest product?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Eyal, it's not an unreasonable conclusion, but I didn't see that. I primarily saw the economy last quarter. We came off a very strong Q4, and I primarily saw the economy last quarter. I'm sure there is a deal here and there waiting for something. But in terms of trends, I am not hearing customer say I'm waiting for SP1. SP1 is a bit more anticipatory where we know we can help, and we are seeing things where we can help, us so we are going to go help and accelerate that service pack. I'd say primarily it's the economy.

Eyal Ofir - ***Clarus Securities - Analyst***

Would you be willing to size up -- one of your other questions was about potential deals getting slipping through, and you mentioned that there were a few. Would you be able to size that up for us from a license standpoint?

Mark Barrenechea - ***OpenText Corporation - President & CEO***

No, we are not putting out a quantum on it. We are mindful of the license consensus around $64 million. We delivered $59 million. Overall, that's close to 1% of revenues. But no, we're watching the deals that slip. We are monitoring it. Deals haven't gone away. Deal sizes haven't shrunk. We've already closed a few. We are monitoring them closely.

Eyal Ofir - ***Clarus Securities - Analyst***

Perfect, thanks. And just for John, last question from me. In terms of the actual OpEx, obviously seasonality plays in here, but is there anything we should be normalizing for in one of the OpEx lines? Thanks. I'll pass the line from there.

John Doolittle - ***OpenText Corporation - CFO***

Thanks for the question. I did mention that on an earlier question, but yes, you should look at the timing of some of the expenses. I do expect to see an uptick in commissions and other compensation, some marketing increase costs as we do Enterprise World. So there will be some uptick. I'm not going to give you an exact number, but that's again why we are leaving the target model where it is.

Eyal Ofir - ***Clarus Securities - Analyst***

Okay, thanks. I'll pass the line.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Thanks, Paul.

Operator

Rakesh Kumar of Susquehanna Financial Group.

Rakesh Kumar - ***Susquehanna Financial Group - Analyst***

Great. Thanks for taking my question. This is a question for John. Over the past couple of weeks there have been some talk about EU looking into Luxembourg tax arrangements. I was hoping you could elaborate your thoughts on the development.

John Doolittle - ***OpenText Corporation - CFO***

Thanks a lot for the question. I know this has come up before. Just by way of background for those folks that aren't familiar with the issue, we did reorganize our IP several years ago. I've had a look at that since I've come in. A lot of preparation went into that, including obtaining advice from (inaudible) side experts. So I've reviewed the background, comfortable that the Company took all the right steps.

But the years in question are under audit. The US has been looking at that. And more recently, as you point out, the EU has announced that they're taking a look at Ireland and Luxembourg. We are obviously watching that, monitoring developments carefully. We have not heard anything from the EU, at this point; no reason to expect we will. But we are keeping our eye on those developments, as you are as well.

Operator

There are no further questions at this time. I'll now hand the call back over to Mr. Barrenechea for closing remarks.

Mark Barrenechea - ***OpenText Corporation - President & CEO***

Very good. Thank you, operator. There's a lot to be pleased with within Q1. Revenue up 40%, adjusted net income up 46%, operating cash flow's up 73%, adjusted earnings up 41%, and our quarterly dividend program. True to our DNA we delivered a strong earnings quarter against the backdrop of a difficult global environment. Intelligent growth and a focus on value lead our business decisions. We lead with value and we invest in markets we know we can win in.

Information management, compliance and B2B are the three key end markets we are going after. Total cost of ownership, product innovation, cloud development options are the go-to-market initiatives to take us there. Thank you everyone for your questions, and I look forward to seeing you at Enterprise World in November. That concludes today's call.

Operator

This concludes today's conference call. You may now disconnect your lines. Thank you for participating, and have a pleasant day.

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