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OTEX - Q3 2017 Open Text Corp Earnings Call

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OVERVIEW:

Co. reported YTD total revenue of $1,628m and GAAP net income of $980m or $3.88 per diluted share. 3Q17 total revenue of $593m and GAAP diluted net income of $22m or $0.08 per share.

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PRESENTATION

Operator

This is the conference operator. Welcome to the OpenText Third Quarter 2017 Conference Call. (Operator Instructions) And the conference is being recorded. (Operator Instructions)

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

Greg Secord - *Open Text Corporation - Vice-President of IR*

Thank you, operator, and good afternoon, everyone. On the call today is Open Text Chief Executive Officer and Chief Technology Officer, Mark J. Barrenechea; and our Chief Financial Officer, John Doolittle. We'll read prepared remarks, followed by a question-and-answer session. The call will last approximately 60 minutes, with a replay available shortly thereafter. I would like to take a moment to direct investors to the front page of the Investor Relations section of our website, where we have posted presentations that will be referred to during this call. And now I'll proceed 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 conclusion, forecast or projection in the forward-looking statements made today. Certain material factors or assumptions were applied in drawing any such conclusion while making a 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 a conclusion, forecast or projection in the forward-looking information and the material factors or assumptions that were applied in drawing the conclusion while making a forecast or projection as reflected in the forward-looking information, as well as risk factors that may project future performance results of OpenText are contained in OpenText's Form 10-K and 10-Q, as well as in our press release which was distributed earlier this afternoon, all 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 may include discussions of certain non-GAAP financial measures. Reconciliations of any non-GAAP financial measures to their most directly comparable GAAP measures may be found within our public filings and other materials, which are available on our website.

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

John Doolittle - *Open Text Corporation - EVP and CFO*

Greg, thank you very much. Welcome to the call, everybody. Let's go through the numbers, and my references will all be rounded in millions of U.S. dollars and compared to the same period of the prior fiscal year, unless I indicate otherwise. Total revenue for the quarter of $593 million, up 35% from last year and $600 million, up 36% on a constant-currency basis. Revenue was negatively impacted by $21 million, $14 million due to acquisition-related accounting rules and $7 million due to foreign exchange. Year-to-date total revenue was $1,628 million, up 21% from last year and $1,642 million, up 23% on a constant-currency basis. Recurring revenue of $506 million, up 34% from last year and $512 million, up 36% on a constant-currency basis. Year-to-date recurring revenue was $1,382 million, up 21% from last year and $1,395 million, up 22% on a constant-currency basis.

License revenue for the quarter of $87 million, up 35% from last year and $88 million, up 37% on a constant-currency basis. Year-to-date license revenue of $246 million was up 24% from last year and $247 million, up 25% on a constant-currency basis.

Cloud services and subscriptions revenue for the quarter of $177 million, up 20% from last year and $179 million, up 21% in constant currency. New MCV bookings this quarter were approximately $52 million, up compared to $46 million in the same period last year. Year-to-date cloud services and subscription revenue of $522 million, up 17% from last year and $526 million, up 18% on a constant-currency basis.

Customer support revenue for the quarter of $263 million, up 43% from last year and $267 million, up 45% in constant currency. Year-to-date customer support revenue of $693 million was up 25% from last year and $701 million, up 27% on a constant-currency basis.

Professional services and other revenue for the quarter of $65 million, up 45% from last year and $66 million, up 47% in constant currency. Year-to-date professional services and other revenue of $167 million, up 15% from last year and $169 million, up 17% on a constant-currency basis.

The impact of foreign exchange for the quarter negatively impacted revenue by $7 million and it had a negative impact of $0.01 per share on adjusted EPS. The negative effect of $7 million by revenue type is broken down as follows: customer support, $3 million; cloud, $2 million; PS, $1 million; and license, $1 million.

Year-to-date foreign exchange has negatively impacted revenue by $15 million and negatively impacted adjusted EPS by $0.02. Negative impact on revenue of $15 million; CS of $7 million; cloud of $4 million; PS of $2 million; and license of $2 million.

Gross margins for the quarter: license was 95%, down slightly from 96% last year; cloud was 56% compared to 58% last year, down primarily due to increased headcount, which includes a mix of employees from different geographies and position levels acquired from recent acquisitions; customer support of 87%, down slightly from 88% last year; and PS margins were 15%, down slightly from 16% last year. PS service margins of the acquired ECD business affected our quarterly performance.

Adjusted operating income, $173 million this quarter, up 25%. However, adjusted operating margin was down slightly at 29% compared to 31%. Our adjusted operating margin was negatively impacted by ECD, which had an adjusted operating margin in the low teens this quarter, and I'll talk more about the ECD results in a minute. On a constant-currency basis, adjusted operating income was $176 million, up 27%. Year-to-date adjusted operating income was $509 million, up 11%, and adjusted operating margin was 31% compared to 34% last fiscal year.

On a constant-currency basis, adjusted operating income was $513 million, up 12%. Adjusted net income increased by 22% to $120 million this quarter. And on a constant-currency basis, adjusted net income was $123 million, up by approximately 26%. Year-to-date adjusted net income was $359 million, up 11%. On a constant-currency basis, it was $363 million, up 12%.

Interest expense was $32 million in the quarter, which is in line with the estimated run rate we've provided on our last earnings call. An important achievement this quarter, we renegotiated our interest rate on our term loan B outstanding loan, and the reduction of the rates will lead to savings of approximately $4 million per year. And absent changes in LIBOR, we expect to see our quarterly interest reduced to $31 million.

Adjusted earnings per share for the quarter was $0.45 per share on a diluted basis compared to $0.40 for the same period last year, up 13% and up 15% on a constant-currency basis at $0.46.

Adjusted earnings per share year-to-date of $1.42 on a diluted basis compared to $1.32 for the same period last year, up 8% and up 9% on a constant-currency basis at $1.44. GAAP net income for the quarter was $22 million or $0.08 per share on a diluted basis, down compared to $69 million or $0.28 per share on a diluted basis. The decrease in GAAP net income, mainly due to a few things. First, an increase in amortization expense of approximately $35 million, primarily due to the impact of newly acquired intangible assets from recent acquisitions. Second, an increase in operating expenses primarily due to an increase in special charges of approximately $22 million, just largely associated with our fiscal 2017 restructuring plan and acquisition-related costs. And the remainder of the increase is in accordance with the growth of our business.

As a percentage of revenue, each of our respective operating expense line items is largely in line with our fiscal 2017 target model expectations. GAAP net income was also down due to an increase of $16 million relating to interest expense, primarily associated with the additional senior notes issued in fiscal 2017 and an increase of $6 million relating to higher tax expense relating to the IP reorganization to consolidate ownership management and development of our intellectual property to Canada in July 2016. The increase in these expenses discussed above is partially offset by higher revenues of $153 million.

GAAP net income year-to-date was $980 million or $3.88 compared to $198 million or $0.81. We recorded a significant tax benefit to our -- applied to our first quarter only of $876 million, specifically tied to the IP reorganization that occurred. Consolidating our intellectual property in Canada ensures appropriate legal protections for our consolidated IP, simplifies legal accounting and tax compliance and improves our global cash management. Consistent with this planning, the recent acquisition of the ECD business was purchased by OT Canada and now resides as part of our Canadian-based IP portfolio.

Operating cash flow for the quarter was $156 million, up from $107 million last quarter and $73 million in Q1 '17, yet down 18% from last fiscal year, primarily due to an increase in taxes paid of $16 million, of which $6 million is paid on accountable onetime gain arising from the IP reorganization, an increase in payments related to the special charges of approximately $15 million, primarily associated with our new fiscal 2017 restructuring plan and commitment fees paid to Barclays Bank relating to the acquisition of the ECD business.

Our cash collections were solid this quarter, and our DSO at 54 days is now in line with where it was last year. In fact, we had record collections and made significant progress in reducing DSOs of our acquired companies.

On the balance sheet, at March 31, deferred revenues were $632 million compared to $411 million at June 30, primarily as a result of recent acquisitions.

Tax update. There's nothing new to report on our ongoing discussions with the IRS, but we will continue to keep you updated on any material new developments. While there's no new update on this front, we have revised the disclosure of our estimated aggregate liability in our 10-Q to $575 million, which is up from the previously disclosed $550 million, solely relating to estimated interest that has accrued. To reiterate, our adjusted tax rate for the quarter is 15%, and is expected to be the same for the remainder of this fiscal year. We see no impact on the rate as a result of the ECD acquisition.

Accounts receivable is $360 million at March compared to $286 million at June 30. Days sales outstanding, as I mentioned earlier, was 54, flat compared to last year and up 1 day compared to 53 at June 2016. I will highlight, as an example, the progress we made here. We've reduced the DSOs for our Recommind acquisition by approximately 30 days from where it was when we acquired it.

Also, our Board of Directors declared a 15% increase on our cash dividend to $0.132 per share for shareholders of record on May 26 payable on June 16, 2017.

Now moving on to ECD. We are progressing well with our integration. A few items to note. We recorded a onetime total adjustment of $52 million on ECD deferred revenue, consistent with what we were expecting and discussed during our last earnings call. We brought over net $164 million of deferred revenue to our balance sheet as of the acquisition date. We have provided a deferred revenue waterfall table in our Q3 IR Supplemental deck, which is posted our website. ECD contributed total revenues for the quarter of $80 million. This is consistent with our expectation, considering ECD's historical revenues, timing of the closing, the impact of purchase price adjustments, as well as factoring in an annual disruption of 5% to 10% decline to the ECD business, which is typically higher in the initial periods. ECD's adjusted operating margin came in lower this quarter, in the low teens, as compared to their historical run rate, which was in the mid- to high 20s. However, I want to remind everyone that this was an asset deal and the very nature of the current acquisition makes it inherently more difficult to assume operations day 1 upon closing and integrate activities. We want to reiterate that we expect the ECD business to be on our operating model within 12 months from closing.

Revenues in Q4 are expected to increase by approximately 30% on an absolute basis from the $80 million delivered in Q3.

A quick update on our bank revolver. On May 5, 2017, we were very pleased to amend the revolver to, among other things, extend the maturity from December 22, 2019, to May 5, 2022, and to reduce the interest rate margin by 50 basis points. We're also affirming our 2020 aspirations of non-GAAP operating margins of 34% to 38%, a 90% recurring revenue. Details on these and other metrics mentioned today are contained in the investor presentation posted on our website. There is no change to our fiscal 2017 target model of 30% to 34%, as previously disclosed in our investment materials, and we expect to perform close to the midpoint of that range.

As I think about Q4, there are a few things to note. Keep in mind my comments on ECD revenues and margins. Keep in mind that we expect the foreign exchange headwind to continue and impact revenues by approximately $10 million versus our planned rates. And lastly, keep in mind that we expect purchase price adjustments to impact revenues by $13 million in the quarter.

With that, I will turn it over to Mark.

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Thank you, John, for your remarks, and thanks for your leadership. We achieved 35% year-over-year revenue growth or 36% in constant currency. That is $600 million in total revenue and $512 million in recurring revenues and a tremendous 46% quarter-over-quarter operating cash flow growth. Our recurring revenues are now on an annualized run rate of greater than $2 billion, and year-to-date total revenue was up 21% or 23% in constant currency. These are solid metrics. Let me also note that Q3 results do not include $21 million of lost revenue, $7 million due to foreign exchange and $14 million due to acquisition accounting, $11 million from ECD, $3 million from others. It was also a partial quarter of ECD operations, which means we carried higher cost on lower revenues. Timing is always a factor in acquisitions. And a couple of weeks earlier or a couple of weeks later affects millions in revenues.

OpenText first principle is long-term growth of intrinsic value. I use the word intrinsic because it means essential. I use the word long term because over the last 10 years, we have grown on a compounded rate operating cash flows by 24%, revenues by 16% and adjusted operating margins have expanded from 18% to 34% last fiscal year. The company's historical performance provides us with the experience, expertise and understanding of what is possible within our business and culture. And it gives us the confidence to achieve it going forward.

This fiscal year, we continue to attain double-digit revenue growth and we're on the same path for next fiscal year. We take long-term views and make long-term strategic decisions to grow the intrinsic value of OpenText. This long-term view gives us greater insight into the annual cycles of our business with the benefit of lessons learned from yearly trends. Over the last 4 years, we have returned over $400 million to shareholders through dividends and cash used for share buybacks. And today, we announced a 15% raise on our quarterly dividend to $0.132 per share, as John noted.

I'd like to comment on a topic from our May 2016 Investor Day in New York City, where I reinforced that M&A is our leading growth driver, and I provided an outline of M&A-centric companies. There are many lessons to be learned from these high-performing conglomerates and from our own experiences over the last 2 decades. For example, Danaher focuses on acquiring and integrating around business units, that is, organizing around a strategic thesis versus series of stand-alone acquisitions. They also established the Danaher Business System, a system and approach to create superior value. Roper deploys capital into verticals, and Blackstone systematizes M&A and completes multiple deals per quarter.

OpenText's contribution to these high-performance lessons is threefold. First, our ability to integrate: integrate operations, integrate sales, integrate engineering. Integration is key.

Second, a focus on recurring revenues, which, today, as I said earlier, are on an annualized $2 billion run rate. Integration allows us to scale the organization with no foreseeable boundaries and recurring revenues provide a long-term sustainable business to optimize for cash flows. We're also different from private equity or asset optimization conglomerates because their models require them to buy assets and sell. We buy, integrate and hold.

Third, the OpenText business system. We invest at logical levels to grow our acquisitions and optimize operations to grow cash flows. This is what we call intelligent growth. And if we can't grow as expected, we reduce costs. But in all scenarios, we deliver to our return on investment hurdle rate. At the same time, we believe our current levels of R&D and sales and marketing investments are appropriate to achieve our levels of organic growth. OpenText is a leading provider of enterprise software for digital transformation. This is a $35 billion market, and our strategic thesis, as defined by us. We will continue to organize and execute around this opportunity. We call it Enterprise Information Management, or EIM for short. We are also investing for the next decade and see an opportunity to win in Artificial Intelligence or AI, not only with machine learning analytical, text mining and semantic analysis capabilities already in our portfolio today, but coupled with investments in pure AI and cognitive business solutions like OpenText Magellan. Unstructured content and commercial data is already being managed in OpenText solutions worldwide. The extraction of business insight with AI solutions for our customers is the next logical progression in our customers' journeys. Over the last 5 years, we've invested approximately $7 billion in acquisitions, R&D and sales and marketing. Over the last 12 months, we've invested $250 million in R&D and $411 million in sales and marketing. We are investing to win. Customers need to pick a digital platform, and we want them to choose OpenText. We can win in AI because our software manages some of the world's largest content archives, and we can turn these archives into active data lakes. We are building the pipeline system to feed these data lakes via integrations to SAP, Oracle, Microsoft, Salesforce. Release 16 EP2 was just released to the market and expands these integrations.

Magellan, our new AI platform, is a new approach to AI via open source, incorporating Apache Spark. Magellan will be showcased in July at Enterprise World and will be available early in the next fiscal year for customers. EP3 is also scheduled for later in this fiscal year.

Our approach to acquisition and integration is evidence to our track record of continuous innovation, from Release 10 to Release 11 to Release 16 and then EP1 and EP2. We are not slowing our investment strategy. There is ample acquisition opportunity in the small, medium and large categories. Their assets could advance our strategy in horizontal, vertical and geographic coverage. The M&A landscape oscillates through time and its dynamics change year-to-year. We have 20 years of experience observing behaviors, building deep experience and developing relationships. It is like building a structure brick by brick. The top growth driver of OpenText is acquisition. So over the last year, we've seen private equity firms view themselves as growth investors and manufacturers turning themselves into software companies via acquisitions. Time will tell how that works out. I'm a bit skeptical that these buyers can add value to assets by lowering traditional hurdle rates. If these acquisitions prove to be unsuccessful, they'll create an additional future pipeline for us.

Our current pipeline is active. And we remain consistent and disciplined in our views on investment hurdle rates. In years rich with M&A, we optimize for revenue growth. In years not as rich with M&A, we optimize towards margin performance. Fiscal '17 is rich in M&A, and we remain active. We are not capital constraint. Each investment at our hurdle rates drives a return on invested capital as each deal has its own investment case. When we close the transaction, it generates operating cash flow. That cash flow, in turn, replenishes our available capital and capacity for future acquisition. Two years ago, we had 5 people on our M&A team. Today, we have approximately 20. We plan on growing and investing in that M&A team, further scaling up our expertise and our capital deployment potential. We are not slowing our investment strategy. It's like managing any active pipeline with more people, capacity and process automation, the more work you can pursue.

Let me transition to some Q3 highlights. License revenue was up 35% year-over-year to $87 million. Cloud revenue was up 20% year-over-year to $177 million. And we have nearly 1,500 managed service customers in the OpenText cloud, which has increased more than 50% year-over-year. 19 deals greater than $1 million, 7 on premise and 12 in the cloud. Average license and cloud MCV size was nearly identical at 364k and 370k, respectfully. Booked $52 million of new MCV, up 11% year-over-year. Customer support delivered $263 million, up 43% year-over-year. Our annual maintenance business has crossed $1 billion annualized run rate. Gross margins were 87%, renewal rates were in the 90% range and I expect the business to continue to improve with scale. PS delivered $65 million of revenues. Revenues were up 45% year-over-year and margins dragged down a bit by lower-margin ECD business, which we intend to fix. Expect PS revenues to decline a bit as we eliminate lower-margin contracts from acquisitions. It's a value over volume strategy.

Financial services, industrial services, consumer goods and technology verticals all contributed greater than 10%. Total revenue geographic split was Americas, 58%; EMEA, 33%; and APJ, 9%.

On premise and cloud customer highlights included Astellas Pharma, Shield Healthcare, ENGIE E&P, Exelon, North Bristol NHS Trust, Iron Mountain, LSC Communications, Froneri International and Tora Trading Systems.

Also, within the quarter, we held our annual Innovation Tour, ITour, and it was an honor to personally host these events in Asia, Japan and Europe. Attendance was up over 25%. It was standing room only, as customers and partners joined us to learn more about digital transformation with Release 16, and our future plans with HP Recommind and Documentum ECD. The ITour was a massive success, connecting with over 5,000 customers and 600 partners in 8 countries.

Let me talk a little bit about what I like to call our second sales force. I want to highlight our partner business. It extends our distribution reach and is very cost-effective. OpenText is committed culturally, programmatically and strategically to being a partner-embracing company. It is quality over quantity. We now have over 1,100 active and productive partners with OpenText. Over the past 18 months into our recent acquisitions, we've implemented a new standard program for our partners, focusing on those who add value for customers and who are actively engaged in our ecosystem. Whereas the total number of our partners may be down, the quality and value delivered by our partners is up. Our partner business is best described by 3 distinct categories: value-added resellers, ecosystem partners and system integrators. With the addition of HP CCM, HP CEM and ECD, we now manage 500 value-added resellers, or VARs, for short. Three examples of our top VARs in the last 6 months include Canon, Fujitsu and Hewlett Packard. We're also building groundwork for our ecosystem partners, and the SAP business continues with new momentum. For example, last week, we signed an overarching cloud reseller agreement with SAP, extending our relationship many years into the future. We are now a strategic SAP partner in the SAP cloud. Major SAP wins in the quarter included KUKA robots and EDF Luminus. We are also integrated into SAP success factors and recently won SRP and ABB in Q3 for this new solution, adding to success this year at British American Tobacco, Barclays and PepsiCo. Our new sales force product added the Region of Peel in Ontario and Tesoro. We also won Ciox Health, Humana and Senior Care customers with AT&T. Lastly, we have a new relationship with Cerner through Documentum, further strengthening our solutions in life sciences and health care.

Our system integrator investments continue to see traction across Deloitte, Accenture, CGI and others, and together we won business in the State of Tennessee at Merck and with the government of Alberta. I'll keep you posted on our progress in the partner business. This is an investment area where we can grow revenue, drive high performance and build long-term intrinsic value.

Let me add to John's comments on ECD. First and foremost, we are on plan. We delivered to our Q3 internal goals and are on track for our overall integration plan. We're also on track to have the business operating on our model in 12 months from closing, as John noted. Customer employees are engaged. Let me highlight a few key additional points. OpenText is now #1 in content services. Content services is at the core of digitalization in AI. We have opportunity in key verticals such as life sciences, financial services, energy and engineering, manufacturing and government. ABB is a great example of a joint customer win. We have an opportunity in cross-selling such as extended ECM for SAP and Salesforce, managed services and InfoArchive. As previously noted, Q3 was a partial quarter or a stub quarter, which means we had lower revenue and higher costs. Within the quarter, we tracked ahead of our internal business plan, exceeding the revenue and margin targets, and on a non-GAAP basis, business was accretive despite the partial quarter of ownership. We also onboarded a low-margin PS business that we're working on correcting because it doesn't fit our business model. We should expect lower ECD PS revenues and increased margins in the medium term. And finally, integrating asset purchases is more difficult in the first few quarters than purchasing entire companies but can drive higher returns. With asset purchases, we spend more time upfront on organizational structure, compensation plans, benefit assessment, customer agreement novation and assignment, employee transitions, facilities and systems and other topics. We've done many asset deals in our careers. These are all nonrevenue-producing activities but are typical of an asset purchase, and with time, the business normalizes. With ECD integration, we have streamlined our organization and further empowered our executive leadership team. It also caused us to step back and consider our optimal organization structure and whether we require the President role or a single head of revenue to maximize performance. Ultimately, we decided to collapse a layer and streamline the management structure.

As a result, we have eliminated the President position and Steve Murphy has left the company. I'd like to thank Steve for his contribution to the company and wish him the best in the future. Effective immediately, his direct reports now report to me.

As we complete fiscal '17, some of our top priorities include: continue to scale our capital deployment strategies and invest in the M&A team; scale ECD revenues and reduce costs; deliver to our fiscal '17 objectives with double-digit revenue growth; expect adjusted operating margin to be closer to the midpoint of our 30% to 40% target range and increase momentum as we come into fiscal '18; continue to drive customer adoption of Release 16 EP2; educate and invest in our cross-selling opportunities, extended ECM, CEM, managed services and InfoArchive; enhance performance of our partners. They have an expanded portfolio of solutions to go to market with. And of course, have a successful Enterprise World and Magellan launch and increase that momentum as we enter fiscal '18. We can win in AI with open source and content analytics.

Let me summarize my remarks. We're executing to plan. 35% year-over-year revenue growth and 46% quarter-over-quarter operating cash flow growth are solid metrics, and we still haven't realized the full benefit of ECD and other recent acquisitions. Our first principle is the long-term growth of OpenText intrinsic value, and we are building a steady, predictable business with strong recurring revenues now on an annualized $2 billion run rate. We are continuously learning from high-performance conglomerates and from our own experiences as we improve our business model, financial results and execution. M&A remains our leading growth driver and we will continue to grow and invest in our M&A team, further scaling up our capital deployment. We returned over $400 million to shareholders and raised our quarterly dividend by 15% today. This fiscal year, we'll continue to attain double-digit revenue growth on the same path for next fiscal year. Customers need to pick a digital platform and that right choice is OpenText. And the EIM market thesis gets stronger with Artificial Intelligence.

John and I will be participating at the CIBC, MUFG and Barclays conferences this quarter, and we're also hosting an Investor Day at Enterprise World on July 11 with the OpenText leadership team. Please join us there for these in-person discussions.

With those remarks, operator, I'd like to open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Richard Tse, National Bank Financial.

Richard Tse - *National Bank Financial, Inc., Research Division - MD and Technology Analyst*

Yes. More color on the ECD acquisition in terms of what needs to be done. Is that sort of headcounts, products, facilities? I'm really trying to get an understanding here of how that opportunity is going to scale over the next 12 months.

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Richard, Mark here, and thanks for the question. We closed the acquisition in late January. So it's, simply, a partial quarter of results. And as we said on the call, we are ahead of our internal plan. So this will be the first full quarter that we have. And in the coming 2 to 4 quarters, we'll complete kind of facility moves. We couldn't move all employees day 1, asset purchase. We will continue to integrate all our systems in the coming quarters. And we'll unveil our first integrated products in the coming quarters as well. Specifically, like on the PS business, we inherited a set of contracts. We honor those customer commitments. Some of those contracts have been at low margin, which we simply need to work through and replace that with an OpenText-style business. So this quarter will be a full quarter of operations. And then in the next 1 to 2 quarters, we complete facilities, first product releases and more and more systems integration.

John Doolittle - *Open Text Corporation - EVP and CFO*

Richard, the only other thing I would highlight there is just to note that we announced a restructuring plan last quarter and we're partway through that restructuring plan. So there will be some people-related cost reductions as we move into this quarter.

Richard Tse - *National Bank Financial, Inc., Research Division - MD and Technology Analyst*

Okay, and then a broader question. You guys have added a lot of products or acquisitions over the past few years, and I think I've asked this question before, but I'm just trying to get an update here. In terms of the ability to sort of upsell and cross-sell, I'm not sure what metrics you guys track internally, but maybe give us a bit of color in terms of the success there and whether that's dollar spend by customer basis and where you may be at. I think Release 16 certainly had a lot to do with that, but perhaps can you give us an update on that, please?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

So Richard, we have bright line opportunity in cross-sell. And I highlighted the main areas where we're focusing on education and investment, and those include managed services, extended ECM, CEM and InfoArchive. So those are the areas that we've picked to be able to educate our sales force, educate our customers and go hard into the installed base to go cross-sell. The more and more we integrate our products, the ability to upsell increases. EP2 is a more integrated release than EP1. EP3 will be more integrated and that will be further consolidation of technology components. So on the cross-sell opportunity, I think we've done a really nice job identifying those core solutions go into the joint installed base's with. And there are 4 or 5 things we're going to take to our entire installed base. And upsell remains an upside opportunity for us and it's directly related to deeper and deeper integration. And release after release, our products get more and more integrated.

Richard Tse - *National Bank Financial, Inc., Research Division - MD and Technology Analyst*

Okay. And just the last one for me. Magellan, is that going to be commercially available this year, because I understand that IBM has been installing Watson through FileNet over the past 6 to 12 months. I'm just kind of curious what the time line is on that.

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Yes. We're on target to release Magellan into GA early next fiscal year. And we'll unveil it at Enterprise World.

Operator

The next question is from Paul Steep, Scotia Capital.

Paul Steep - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Great. Mark, just want to clarify and make sure. When you made the change and sort of delayered, have there been any other changes that are noteworthy within the sales force? Or was that sort of mainly a management change at the upper level?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

No. The only change is the elimination of the President role, and Steve's directs will now report to me. So it's, at the end of the day, a change in 1 person and 1 role.

Paul Steep - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Okay. And then in terms of PS, can you just go back in terms of the magnitude of how much revenue we're talking about in terms of the lower-margin contracts? And then sort of what you're thinking about in terms of the time to sort of call that out of the portfolio.

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Yes. When we've gotten deeper into the ECD PS business, there's just simply contracts of lower margin that doesn't meet our kind of standard and we're interested in value over volume. I don't think we've put a specific number on it. I mean, it's less than 10% of the business, if you will, maybe around or less than 10% of the business. It will take us 1 up 2 quarters to work through.

Paul Steep - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Okay. And then the final one, I guess, I was curious. You went over a little bit in the partner section, which was great. Could you talk about maybe some of the new partners you brought on? I know with EP1, and I guess I'm thinking specifically of sales force, where that is, because that looks like a good sizable opportunity for you down the road.

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Yes. So I think of our partner business, our second sales force, and clearly I decided to highlight it in my prepared remarks. As we get into fiscal '18, it's a driver for our business. So we think of it in 3 areas. The first is value-added resellers, and Canon and Fujitsu are great examples of new VARs that are performing for us. Ecosystem partners. We signed last week a new agreement with SAP, bringing our relationship into the next generation. I mean, we're now a major and strategic partner in the SAP cloud. Our new sales force solution extends our ecosystem partners. Cerner, a relationship that comes over from Documentum, very key reseller engagement for us. System implementers, getting stronger with Accenture, Deloitte, CGI, TCS, as well. So this is our second sales force, as I like to call it. Our momentum is clearly up after 4 important acquisitions this year. And those are some examples in those 3 categories of VARs' ecosystems and implementers.

Operator

The next question is from Paul Treiber, RBC Capital Markets.

Paul Treiber - *RBC Capital Markets, LLC, Research Division - Associate*

Just wanted to continue a little bit on the partner theme. What's the strategy for EMC as a channel partner going forward? And then with the separation of Documentum from EMC, was there any disruption in the quarter- license sales in the quarter because of that process?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Paul, thanks for the question. Like I said in my prepared remarks, you close a deal a week or 2 earlier in the quarter or a week or 2 later and that revenue adds up. So it's clearly timing. We have not entered into a reseller agreement with Dell, and though we're continuing to work with Dell and EMC customers on an opportunistic basis. So no, I wouldn't say there was disruption from a reseller perspective. Where we had activities, sales activities, we continued on them. But we don't have a formal reseller agreement in place, though we continue to engage opportunistically.

Paul Treiber - *RBC Capital Markets, LLC, Research Division - Associate*

Okay. And on the comment about the EMC, ECD structured as an asset purchase and the amount of work that, that required out of the gate, in terms of the impact on costs, are you primarily referring to professional services working through those costs or there's other costs? And could you just elaborate is there any?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Yes. I'll maybe talk a little structurally and ask John to comment. You can see in our filings on the asset purchase, we entered into a transition services agreement with Dell EMC, a TSA. And TSAs are very typical of when you're doing an asset purchase. And our TSA costs are higher upfront, as we rely on their systems, we rely on their network and we rely on their people to conduct business. So our TSA costs are higher in the first few quarters and then trail down over time. So John, I don't know if there's anything...

John Doolittle - *Open Text Corporation - EVP and CFO*

No, that's completely fair. And as we onboard some of these things and take these people into our facilities and put them on our systems, Paul, we'll see those third-party costs from Dell coming down.

Operator

The next question is from Thanos Moschopoulos, BMO Capital Markets.

Thanos Moschopoulos - *BMO Capital Markets Equity Research - VP and Analyst*

Looking at ECD's quarterly revenue trajectory in calendar 2016, it seems like the seasonality of that business is somewhat different from yours. Would you expect that seasonal cadence to persist or to become more similar to yours as you retain the assets?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Thanos, I haven't kind of precisely studied their seasonality or what kind of made that 10-year rhythm sort of click, if you will. We look at our business in Q1, $80 million. John talked about the PPA, purchase price accounting, within the quarter. We're looking at 30% growth quarter-over-quarter as we onboard the business. So let's maybe come back to that in a quarter or 2 and I think we can comment on the seasonality or the kind of the rhythm of the business that we see.

Thanos Moschopoulos - *BMO Capital Markets Equity Research - VP and Analyst*

Fair enough. And then towards margins, I appreciate the disclosure you provided on the ECD margins. If we look at the HP assets, Recommind and ANX, can you provide some color there? Are they on your target? Or is there more work to be done as far as getting them to where you wanted them to be?

John Doolittle - *Open Text Corporation - EVP and CFO*

Yes. I think they're on plan, Thanos, in terms of the guidance that we've provided and getting them on to our operating model. If I look across those acquisitions, they're tracking to that outlook.

Thanos Moschopoulos - *BMO Capital Markets Equity Research - VP and Analyst*

Great. And then just one last one. Mark, could you just elaborate what prompted your decision to make the change to the management structure at this juncture? When you created the role of President, the business was smaller than it is now, so at this juncture, what prompted the decision to delayer?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Yes. I mean, if I look at our maintenance business on an annualized $1 billion run rate, our recurring revenue on a $2 billion run rate, and I'm looking out over the next 3 to 5 years in our continued growth as a business, we fundamentally believe that our business unit structure is the right structure for the business. Now when you take that view, the role is just no longer required to be able to continue with our deployment of capital, our growth rates and aspirations for the business. So we made that call at here, recently, and I'm very comfortable with our, kind of going forward, business unit structure and having Steve's previous directs just reporting directly to me and removing that layer.

Operator

The line is live for Eyal Ofir of Eight Capital.

Eyal Ofir - *Eight Capital, Research Division - VP and Senior Equity Research Analyst*

Just a quick question for you on obviously the integration with the ECD business. It seems like just on the base OpenText business, the quarter was fairly well and there's been no hiccups whatsoever. Can you just talk about, from an ECD standpoint, obviously, the first 2 months post integration how it was and how it looks like as it stands today in terms of pipeline and employee and everything else in terms of what's going on there?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Eyal, thank you for the question. And I can't say it anymore simply except to say we're on track. So I mean, customers are engaged, employees are engaged. We owned the business for 60 days in our Q3. It's a large asset purchase, so there's a lot of time, a lot of precise time spent to carve out a multi-hundred million dollar maintenance business, to carve out 2,000 employees across a couple dozen facilities, to be able to integrate networks and be able to run our systems and conduct business. And the team performed miraculously in Q3, and we tracked ahead of our internal plan and quarter-over-quarter we expect to grow that business around 30%. So I'm very pleased with where we are. We close a week earlier or 2 or a week later or 2, and it affects revenues. So there's certainly some timing things and precision of a week or 2, but I couldn't be more pleased with the acquisition, the strategic nature of it and its trajectory.

Eyal Ofir - *Eight Capital, Research Division - VP and Senior Equity Research Analyst*

Okay, great. And then maybe a question for John. Thanks for the bridge on the cash flow. But one question for me is, because it was an asset purchase and I imagine you had to fund a piece of the business in the first 60 days here. So is there a metric you can give us in terms of how much you actually had to deploy into working capital for the ECD acquisition, otherwise it would have actually probably been greater than that?

John Doolittle - *Open Text Corporation - EVP and CFO*

Yes, Eyal. I can't give you an actual number. I think that question was asked last quarter and I did in fact say that there would be some working capital drain as a result of ECD. We did in fact see that. You'll appreciate that we weren't able to bill and collect, certainly on the license side much by way of revenues in the quarter. And that's going to turn as we move along quarter by quarter. So I don't have an exact number for you, other than to say that there was some working capital used on the acquisition.

Eyal Ofir - *Eight Capital, Research Division - VP and Senior Equity Research Analyst*

Okay, perfect. And actually, before I pass the line, just last question for Mark. What inning would you say you're in, in terms of asset transitioning over the employees and the facilities on the TSA front, because I imagine that's where you'll actually start chasing greater cost synergy as well once you bring them on to the OpenText model. And I'll pass the line.

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Yes, fair enough. So look, I think this will be a big quarter for us to kind of complete the employee transition and continue to be in the heavy side of our TSA costs. And as we enter fiscal '18 and by the next time we have our next call, we should be majority -- I mean, 90%-plus of employees, 95% of employee work completed and through the most expensive part of the TSA.

Operator

The next question is from Phillip Huang of Barclays.

Phillip Huang - *Barclays PLC, Research Division - Senior Equity Research Analyst*

Yes. Just on the -- maybe I'll ask about the ECD integration in a more general way. I was wondering if there was anything new that you guys might have learned about the business, aside from, I guess, identifying the low-margin contracts for optimization, which you guys have talked about and how other assets of the business compared to, say, your expectations. Are there any surprises both positive or negative?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Phil, thanks for the question. I'll say, you always have an upside or downside surprise in anything that you do, right? And I'd say, on the upside, the employee and customer engagement is just fantastic. And I just look at our ITour campaign that we finished, where we're able to engage in roughly 8 locations and 5,000 customers attending. The engagement was the best I've seen in my professional career of being able to get on the road and spend time face-to-face with customers. So on the upside, the passion and the engagement from customers and employees has just been fantastic. And at the end of the day, as I like to say, what makes great software, great people. And I'm just really, really thrilled with that. We have work to do on the integration. And this will be an important quarter for us to get through the facility side and the people transition. We bought an asset that was purchased -- we did a carve-pout of a carve-out, right? You know, Documentum was inside of EMC that had just been purchased from Dell, and then we carved that out from Dell. We closed a few weeks earlier and we're carving out from EMC, not carving out from Dell. So that is probably running a little slower and a few lessons learned there of a carve-out from a carve-out, but we're on target for our overall plan, just a few timing issues.

Phillip Huang - *Barclays PLC, Research Division - Senior Equity Research Analyst*

Right, right. That's very helpful. And then I want to touch on the, I guess, the delayering of the management as well. With the President role now streamlined, I was wondering if you can maybe elaborate a bit how you expect things to improve from the change. I believe Mr. Murphy was primarily responsible for customer-facing activity. It sounds like you feel that perhaps a more decentralized approach to what might be a little bit more effective. Is that the right read to that? And do you expect any sort of further changes to the structural changes as the integration progresses?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Yes, fair enough. We have eliminated the President role and we don't intend to un-eliminate it. We also feel we don't need a head of revenue role for the business. We are organized around how customers buy and the activity of renewals and continuing the selling motion in a digital B2B business. We're organized around that with James McGourlay. And when we look at how we are selling our cloud services and business network, we're organized around that with George Schulze. We look at our enterprise business, organized around Ted Harrison, and our professional services with Prentiss Donohue. Our business units are organized around how customers buy. So we're not looking to re-add the role. We're not looking for a head of revenue. We're organizing for the foreseeable future around how customers purchase. And they'll report directly to me.

Operator

The next question is from Richard Tse of National Bank Financial.

Richard Tse - *National Bank Financial, Inc., Research Division - MD and Technology Analyst*

Yes. I had a follow-up question on ECD. When you guys balled this out, would it be safe to say that, given this was an asset purchase, you kind of cherry-picked the assets you wanted? And I guess, on a relative basis, the return of that type of acquisition, has that historically been better? Or did you sort of model it better than your typical transactions?

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

That's a two-pronger...

Richard Tse - *National Bank Financial, Inc., Research Division - MD and Technology Analyst*

Sorry about that.

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

It's okay. Thanks for the question, Richard. In general, you prefer asset purchases because you get to pick what you what and organize how you want. But you tend to get off to a little slower start, as I said on the call, because you're spending your first few months on more time on nonrevenue-generating activities. So I think our historical experience of asset purchases generate more value. You get to organize the way you want, but you tend to get off to a slightly slower start. I think it's going to run very true here in ECD. Similar pattern.

All right. So I think this is officially the summary. Thank you, Greg. Look, I'm going to end where I started. We achieved 36% year-over-year growth in constant currency and delivered $600 million in the quarter and just had a tremendous quarter-over-quarter 46% operating cash flow growth.

John and myself and the leadership team look forward to seeing you at Enterprise World for our Investor Day. And John and I will be at the -- one or both of us will be at CIBC, MUFG and the Barclay conferences this quarter.

Thanks for attending the call and look forward to speaking with you soon.

John Doolittle - *Open Text Corporation - EVP and CFO*

Thanks, everybody.

Mark J. Barrenechea - *Open Text Corporation - CEO and CTO*

Thanks.

Operator

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