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OTC.TO - Q1 2017 Open Text Corp Earnings Call

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OVERVIEW:

Co. reported 1Q17 total revenue of $492m and GAPP net income of $913m or $7.46 per share on diluted basis.

CORPORATE PARTICIPANTS

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John Doolittle *Open Text Corporation - CFO*

Steve Murphy *Open Text Corporation - President*

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PRESENTATION

Operator

Welcome to the Open Text Corporation first-quarter 2017 conference call. As a reminder, all participants are in listen only mode 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 - VP of IR*

Thank you, operator. Good afternoon, everyone. On the call today is OpenText Chief Executive Officer and Chief Technology Officer, Mark J. Barrenechea, our Chief Financial Offer, John Doolittle, and our President, Steve Murphy. We will 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 and direct investors to the front page of the Investor Relations section of our website where we posted power points that we will be referred to during this call. And now I will proceed with a reading with 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 and 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 Form 10K and 10-Q, as well as in our press release that was distributed 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 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 Mark.

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

Thanks, Greg. I think we're going to have John go first.

John Doolittle - *Open Text Corporation - CFO*

Yes, thanks. Thanks, Greg. Welcome to the call, everyone. Let's go through the numbers.

My references will all be in millions of US dollars and compared to the same period of the prior fiscal year unless I indicate otherwise. Total revenue for the quarter was $492 million, up 13% from last year and up 14% on a constant currency basis. Revenue was negatively impacted by $5 million due to acquisition accounting rules.

In addition the foreign exchange impact versus last year was $5 million negative. Recurring revenue was $431 million, up 12% last year and up 14% on a constant currency basis. License revenue for the quarter was $61 million, up 18% and up 19% on a constant currency basis.

Cloud Services and Subscriptions revenue for the quarter was $170 million, up 15%, both compared to last year and in constant currency. New MCV bookings this quarter were $52 million compared to $41 million for the same period last year, up 27%. Customer Support revenue for the quarter was $210 million, up 13% and up 15% and constant currency basis. Professional Services and Other revenue for the quarter was $51 million, up 3% and up 4% in constant currency.

Next, the full impact of foreign exchange. Foreign exchange negatively impacted revenue by $5 million and negatively impacted adjusted EPS by $0.01. The negative effect of the $5 million by revenue type. Cloud, $1 million, Customer Support $3 million, Professional Services and Other $1 million and License revenue no impact. Gross margins for the quarter were comparable to prior years as follows, License margin was 94% compared to 95% last year.

Cloud Services and Subscriptions margin was 59% compared to 60% last year. Customer Support was 88% compared to 89% last year. Professional Services was 19% compared to 23% last year but up from 14% last quarter and 17% in Q3 2016. Good progress and Steve will comment on that specifically.

All those margins are in line with our FY17 target model. Adjusted operating income was $151 million this quarter, up 2% on a constant currency basis. Adjusted operating incomes was $152 million, up 3%. Adjusted net income increased by 2% to $106 million this quarter.

Interest expense was $27 million in the quarter, which is in line with our estimated quarterly run rate of approximately $28 million, which we discussed on last quarter's call. Adjusted earnings per share for the quarter was $0.86 per share on a diluted basis compared to $0.84 for the same period last year up, 2% and up 4% on a constant currency basis at $0.87. Now to GAAP net income for the quarter was $913 million or $7.46 per share on a diluted basis compared to $41 million or $0.34 per share on a diluted basis.

We recorded a significant tax benefit this quarter of $876 million, specifically tied to the internal reorganization that I talked about last quarter. This internal reorganization was implemented to consolidate ownership, management, and development [of] intellectual property in Canada. We believe the reorganization also reduces our exposure to global political and tax uncertainties, particularly in Europe.

Consolidating our intellectual property in Canada will ensure appropriate legal protections for our consolidated IP, simplify legal, accounting and tax compliance and improve our global cash management. The asset recorded is representative of tax benefits that are anticipated to be realized in future periods. There were approximately 122.4 million shares outstanding on a fully diluted basis.

The operating cash flow for the quarter was $73 million, down from $92 million and DSOs were 52 days, up from 48, largely due to the on boarding of receivables from recent acquisitions. Let me give an example. This quarter we on boarded approximately $30 million of receivables via the Recommind acquisition may have a longer collection of cycle.

This is a temporary issue that will be resolved as we collect these receivables and shorten the cycle. As I've noted on every call, our operating cash flow is a top priority. We ended the quarter with the strong liquidity position, including a cash balance of $835 million.

Tax update, there's nothing to report on our ongoing discussions with the IRS. Our adjusted tax rate for the quarter was 15%, and is expected to be the same for the remainder of this fiscal year and the details of our approach are outlined in the reconciliations. Also, today our Board of Directors declared a cash dividend of $0.23 per share for shareholders of record on December 2, 2016, payable on December 22, 2016.

Turning to the Dell-EMC transaction, Mark will update you in a few minutes, but we're still deciding on our financing plan. In the meantime, we are affirming our external target model pre-EMC for FY17 non-GAAP operating margin's to be in the range of 30% to 34%. We are also affirming our FY20 aspirations of non-GAAP operating margin's of 34% to 38% and a revenue mix that would reflect 50% of our revenues from the Cloud as part of 90% recurring revenue portfolio in 2020. Details on these and other metrics mentioned today are contained in the investor presentation posted on our website.

And now I will turn the call over to Steve.

Steve Murphy - *Open Text Corporation - President*

Thanks, John. We're reaching critical mass as we onboard our recent acquisitions and expand our vertical geographies and customer base. With Release 16, and most recently EP1, which is Enhancement Pack 1, we have world class offerings that strengthen our leadership position in the EIM market. We are gaining strategic consideration with our customers, and we remain passionate about making them successful.

I continue to focus on driving sustainable organic growth initiatives while improving efficient operations and cost discipline to improve margin and cash flow. Our business model is scaling and I'm pleased with our progress. Let me make some comments on Q1, on what I see as a great first quarter. We had a strong Q1 for License, Customer Support and Cloud businesses.

Total MCV bookings is higher year-over-year and the average size of MCV grew significantly over the same time period. Let me share some quick stats. We had seven on-premise license deals greater than $1 million.

The geographic split of total revenue was Americas 60%, EMEA 30%, Asia Pacific Japan 10%. On-premises customer successes in the quarter included BMW, Paychex and the Qatar Foundation just to name a few. In terms of industry breakdown, financial, services and technology saw the most demand. Now let me give you some quick Cloud stats. Cloud revenue was up 15% year-over-year.

We had 13 new MCV cloud deals greater than $1 million. Cloud customer successes in the quarter include BGL Group, Davide Campari-Milano Group, House Foods Group, IntelliTek Systems, Knorr Bremse, Self Regional Healthcare and Transport for London. We added 31 new Managed Service customers in Q1, which brings our total Managed Services customers to 1,133.

We had 27% MCV growth from $41 million to $52 million, compared to the same quarter last year and average MCV deal by increased 41% from $509,000 to -- pardon me. From $360,000 to $509,000. Financial, services, technology and consumer goods saw the most demand. Let's talk a little bit in specific about some customer wins.

I'll start with license deals. BMW. BMW needed to address the increased number of regulatory requests. Axcelerate 5 and OpenText Discovery eDiscovery solution allows the BMW Group to be more efficient with regulatory requests while still maintaining high standards of response.

Paychex, Incorporated, a leading provider of integrated human capital management solutions for payroll, HR retirement and insurance services has extended its investment at OpenText Exstream for data center disaster recovery. The Qatar Foundation bought OpenText Process Suite platform to drive process control and standardization across support services, shared services, equine management and legal management. The content produced is archived in OpenText Content Suite for compliance and records management purposes in the cloud.

Now on the cloud -- pardon me. IntelliTek Systems purchased OpenText Media Management On Demand and Video services to enable the company to maintain their media files from a secure central repository for improved collaboration, protection and file storage. House Foods Groups is one of Japan's largest food manufacturers.

The company purchased OpenText Optimost to build an engaging corporate website and enhance its online presence. The SaaS platform enables House Foods to quickly create and run tests through an intuitive interface, segment, target and personalize online customer experiences and improve its web operation with the ability to analyze results anytime and anywhere.

Transport for London is overseeing the Crossrail project, which is the largest construction project in Europe. Transport for London has invested in a fully managed cloud service from OpenText to manage technical documents and drawings for the new assets using OpenText Content Suite platform. BGL Group UK, an insurance company, discovered OpenText Optimost when looking to streamline its website performance and personalize customer journeys.

OpenText Optimost allows BGL to be more efficient by going to market quicker with fully tested implementations while saving time and money. The Davide Campari-Milano Group bought OpenText Business-To-Business Managed Services to manage its order to cash process and cover its fiscal compliance needs in South America and Southern Europe. Previous to OpenText, Campari had a fragmented EDI strategy with no visibility at the corporate level and sub-optimal decision-support.

Knorr-Bremse Group is the world's leading manufacturer of braking systems for rail and commercial vehicles. With OpenText Analytics Information Hub, what we call the iHub platform, Knorr-Bremse IT has access to a highly scalable, embedded BI and data visualization platform that enables IT teams to design, deploy and manage secure interactive reports and dashboards. Let me touch on customers. As I've always said, customers do not buy from companies but rather they buy from people.

Customer care and satisfaction are an integral part of our culture at OpenText and it is the reason why we have such a loyal customer base. It is this unrelenting commitment to achieving customer success that positions us to win new business and repeat business again and again. Talk a little bit about sales. Our sales organization is scaling well. Stronger leaders in every region have brought us the process, rigor and discipline to know our pipeline inside and out.

We are fully staffed up with world-class sales professionals. Enhancement pack 1, EP1, establishes a new entry point with the customer with the extended ECM platform for Salesforce and deeper integration with SuccessFactors.

The addition of added discovery functionality from Recommind makes the value proposition for EP1 even more compelling. Our strategic position just got stronger. The hybrid model's also a competitive advantage. Our Managed Services offerings bring strategic customer value and we provided consultative environment where a customer can actually weigh the costs and benefits of either model and then work best to do what is best for them.

We are competing and winning. We have energy and enthusiasm and a renewed discipline around account planning and sales execution in the fields. Let's touch on partners or how the ecosystem of strategic partners continues to grow, fueled by a broader set of product offering and new relationships we inherit my previous acquisitions

Global SIs in large love working with OpenText because of our dedication to building and investing in long-term relationships. If partners invest in us, we will invest in them. A quick update on professional services, our initiatives to address professional services performance over the last three quarters has resulted in improved margins.

With the foundation of a stronger, more efficient PS organization, we will look to grow these revenues, while continuing margin discipline on a deal-by-deal basis. Acquisitions. Turning to acquisitions, we've brought together a great set of products that fit together both organizationally and from a one-stop shop perspective. On boarding acquired revenue and integrating teams and products sets are core competencies at OpenText.

We have the experience and the infrastructure to scale our businesses through acquisitions and we are executing to plan. Cross-selling and lead sharing is already occurring between our enterprise sales teams and our newly acquired CEM and Discovery sales teams. We now have five sales pillars aligned at each case under a strong and experienced sales leader. Each of these sales leader reports directly to me.

In many cases we have much improved account coverage due to the natural concentration from acquired sales resources. Lastly on the EMC Documentum, I look forward to learning from the industry vertical expertise of EMC Documentum and I do know that they will gain from is with respect to our ERP expertise and our holistic EIM vision. So before wrap up let me summarize a few key points, we delivered strong quarterly revenue performance showing double-digit growth in both our License of Recurring revenue lines are PS business is back on track and on target to our margin model and I can expect it to continue to grow in the coming quarters.

OpenText remains committed to customer care and satisfaction with deep customer loyalty, we are positioned in the right market at the right time with the best product suite in EIM. We value this culture and we will fiercely protect it, as it is a key driver of our success.

With our recent acquisitions, Release 16 and most recently EP1, we are gaining strategic consideration with our customers. Release 16 is a rallying point for the entire OpenText sales force, and we are leveraging our leadership position in EIM to achieve market share gains. We are winning. Our business model is scaling.

I very much continue to believe in our overall business plan and our ability to achieve it. Thanks a lot. Over to you, Mark.

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

Thank you, Steve, and thank you, John. Q1 was the fastest start to a fiscal year in the history of OpenText. We delivered nearly half a $1 billion in revenues, closed two of our four recent acquisitions, announced an additional acquisition of the Enterprise Content Division of Dell-EMC, all while delivering 13% revenue growth and 27% MCV bookings growth.

This is a monumental time in our corporate history. Cloud revenues came in at a record high of $170 million, or 15% year-over-year growth conjunctive with a solid license quarter of $61 million, or 18% year-over-year growth. Enterprise customers run their businesses on hybrid workloads.

Our Maintenance group delivered $210 million, or 13% year-over-year growth. Total recurring revenues were $431 million, or 88% of our total business. Q2 is a seasonally strong quarter for us and our pipeline currently supports these historical views. As John noted, we also completed our intellectual property reorganization into Canada, which resulted in a single --in a significant tax benefit of $876 million, which we intend to utilize over the coming years. This is solid progress.

And let me highlight the full benefit of our recent acquisitions are not yet reflect in our operating results yet we carry the majority of the cost. Realizing the full benefit will occur as we complete these integrations in the coming quarters.

Consider, we have not yet had a full quarter of revenue benefit from the HP, CCM or Recommind product lines. We have cost reduction opportunities across our operating lines as we right-size the new businesses and to the OpenText operating model. We have cash flow generation opportunities, not just from expense reduction, but also from approved efficiency gains in working capital management like DPO and DSO, that John mentioned.

We on boarded hundreds of new partners and new account executives and this new capacity will have increasing contribution in the coming quarters, as we further integrate our acquisitions, but it will take time and execution over a series of quarters. With that said, customers are responding favorably to our focus on digitalization, our approach to automating hybrid workloads, as well as our recent acquisitions.

Let me also highlight something that I can see inside the Company. The incredible commitment to OpenText and to our customers from OpenText employees. I'm so proud of the team for their incredible contributions over the last few months.

We have asked a lot from our employees and they are delivering. As Steve noted, we will fiercely protect our culture at OpenText. Our OpenText business system is, in many ways, the quantitative algorithm that guides our approach. In FY16, we focused on operating margin and delivered a 290 basis point expansion.

in FY17 we expect to see strong double-digit revenue growth. That growth driven by acquisitions, by organic growth initiatives, each supported by the passion and commitment of our employees. Consistent with our previous approaches, once we on board acquired revenues, we then turn our attention to optimizing and improving operating income performance.

Also within the quarter, we held Enterprise World 2016 in Nashville and spent a week connecting our customers to our new offerings. We announced Magellan, our next generation analytics platform leveraging Apache Spark, and we remain on track to begin shipping in the second half of this fiscal year. Let me walk through each acquisition in a little more detail.

ANX is an information trading grid for automotive, healthcare and transformation/statistic businesses. The ANX integration is nearly complete. The business is already on our operating model and it's contribution can see in our cloud services revenue line this quarter. We are excited about our two HP, Inc. acquisitions. The EIM process flow of engagement insight starts with customer engagement.

I attended Dialogue 2016 in September, to former HP, Inc. customer experience conference and customers are enthusiastic about being part of OpenText, about being part of a software culture and company, for focused investments in the CEM and CCM opportunity and for being part of a larger digitalization opportunity enabled by EIM. These two HP, Inc. acquisitions were asset transactions with staggered closings in certain countries.

We completed the closing process in Q1. Our CEM teams are formed and we expect performance to increase in the coming quarters. The assets will be on our operating model and integration will be complete by the end of this fiscal year.

Recommind is off to a strong start. It is an impressive technology, team and install base. It is market leading in enterprise discovery and strengthens OpenText EIM. A well-managed organization has their content centrally managed but to be expertly managed you need enterprise discovery.

In addition, to organized content management, the episodic needs of legal events also arise requiring the organization to expeditiously find information centrally or federated. The other aspect of Recommind is building applications. And we are building analytic applications, the first of which is our Contract Analytics platform that could be used for support contracts, derivative contracts, swaps, lease contracts and more.

And, please expect more applications to come. Recommind will be in our operating model and integration complete by the end of the fiscal year as well. Let me spend some time on our product strategy.

We remain 100% focused on Enterprise Information Management. It is a large multi-billion dollar market which we walk through many times with fragmented competitors, our key customers who seek the technology to differentiate this strategy, ample acquisition opportunities and a market segment that generates high profits.

ERP came of age when campaign to cash, the killer enterprise process flow, matured. EIM will come of age when Engagement to Insight matures. OpenText took a major step in maturing that digital flow with TeamSite, Exstream and LiquidOffice, Optimost from HP, Inc. and with our new Axcelerate Discovery and Investigations and perceptive contract analytical offerings from Recommind.

Further EP1, Enhancement Pack One, builds deeper capabilities, such as engineering and construction solutions, extended ECM for government, and EP1 brings more data sources into the EIM landscape, such as leveraging transactional data from Salesforce and SuccessFactors. Magellan will enable customers to leverage that EIM information by providing predictive analytics and deep learning technologies in easy, open and cost-effective manner.

As Steve highlighted, a key strategic drive for the Company is Managed Services. Managed Services are new revenue sources for the Company by providing additive cloud-based solution subscription services. We are approaching 1,200 Managed Service customers and we have reached that critical mass for a global secure and enterprise-quality cloud service. We are leading the EIM market here.

This all supports what we see as our top demand drivers. CEM, Discovery, Analytics, Managed Services and Vertical Content applications. Let me spend a moment and provide an update on our announced acquisition of the Enterprise Content Division of Dell-EMC.

First and foremost, our strategic rationale remains consistent and reaffirmed. A marquee install base of nearly 5,600 customers seeking digital transformation, a vertical application opportunity, upsell opportunity into EIM, expanded geographic and account coverage, ability to upgrade into the OpenText Managed Services and nearly 2,000 EIM professionals and experts that will join OpenText.

We are on schedule and expect to close within the estimated next 75 days, pending regulatory approvals and standard closing conditions. Our approach will be a deep functional integration. That is to say we will not run the business standalone but rather we plan to integrate each ECD functional group into their corresponding OpenText group, while leveraging the best talent from either organization.

As it relates to financing, we continue to consider our permanent financing for the transaction, which may include elements of cash on hand, new borrowings under credit facilities, and newly issued equity. We have a $1 billion commitment in support of the transaction. As a reminder in FY16, we generated $526 million in operating cash flows and our continuing objective is to maintain a long-term conservative capital structure including preserving our current credit ratings.

As referred to the financial details, we will not be providing any additional information until after we close, though let me note, at present, there's nothing I see that changes our historical views on how to model or integrate an acquisition. ECD looks very consistent and right in the power alley for OpenText to manage and optimize. I will refer back to investor deck of September 12, 2016, for the ECD transactional details.

Let me summarize my remarks before I open the call to your questions. We're focused on revenue growth and market scaling and expect double-digit revenue growth this fiscal year. We're off to a fast start and nearly $0.5 billion in Q1 revenues, up 13% year-over-year.

We're on track with our recent acquisitions to add approximately $300 million in revenues on an annualized basis. I refer to our quarterly supplement investor presentation on our investor website. The benefits of our new acquisitions are not fully yet reflected in our financial results, and as we complete the integrations additional benefit will be reflected.

We're on track close ECD over the next estimated 75 days. EP1 offers new partner opportunities with Salesforce and SuccessFactors. We see demand drivers with CEM, Discovery, Vertical Content Apps, Analytics and Managed Services in the second half of FY17 with EP2 and Magellan. Expect us to continue to be opportunistic in the market for additional acquisitions that fit our model and Q2 is a seasonally strong quarter for us and our pipeline currently supports these historical views. At the end of the day, all companies are software and analytic companies attempting to maximize the value of their information.

OpenText engagement insight will help companies unlock the value of that information. OpenText is in a great position to benefit from this market dynamic. With that, I would like the operator to open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

First question, Richard Tse, National Bank Financial, please go ahead.

Richard Tse - *National Bank Financial - Analyst*

Great, thanks. Mark, this might be too early to ask this question, but when you close this EMC deal, how long do you think it will keep you out of the market for -- from making other meaningful transactions?

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

Richard, thanks. It's probably a little early to ask the question. As I said in my summary remarks, we are going to continue -- were continuing to be opportunistic in the market for additional acquisitions. I mean we operate in certain functional pillars, as Steve walked us through, in CEM, Discovery, Business Network.

And we continue to seek opportunity across those areas. And as we scale the Company, we have to bandwidth in multiple parts of the Company. So we can continue to be opportunistic in the market.

Richard Tse - *National Bank Financial - Analyst*

Okay and then I going through the presentation deck here and it looks like you are sort of dedicating a little bit more effort towards R&D. I was wondering if you would maybe share with us what areas you will be focusing on with respect to R&D here?

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

Yes, so maybe I'll take one part of that and maybe hand another part to John if he wants to jump in. Let me just also note first part of your question, we also have plenty to do right now, as we noted. As we onboard HP, Inc., CEM, CCM, Recommind and ANX is pretty much fully integrated into the business.

And certainly the ECD Group will keep us quite occupied over a series of quarters as we integrate and get the business to our operating model. I think the R&D expense came in a little high and it is just that some of the acquisitions we made were not quite in the OpenText model. And as part of some my prepared remarks, part of our execution in the coming quarters, is to simply do what we do when we integrate, is to get those businesses in line to our operating target models. And R&D is one of those areas where we have opportunity to do that. John, anything you want to add?

John Doolittle - *Open Text Corporation - CFO*

I totally agree, Mark.

Richard Tse - *National Bank Financial - Analyst*

And just one last one. Maybe for Steve, since you've come in, it sounds like you've made a lot of changes here. From my vantage point, the Company historically has not been terribly great in terms of up-selling and cross-selling, given the organic numbers. Have done anything since you joined to maybe capitalize on that opportunity, given that you've got all these great products here in front of you?

Steve Murphy - *Open Text Corporation - President*

Yes, we have done several things. So I think the first one is the alignment by product so that we got specialization within each of the five pillars. And it is no exaggeration to say we have got really strong VP, SVPs running each group, has dramatically improved the skill level and the focus of that, that team has on that product when they go out and sell. And if you think about our peer group and some of the big software companies out there, it is a proven model and it does work.

Now it may mean that somebody used to do two or three different things and only does one, so satisfaction-wise that may or may not be good for somebody but we have sharpened our focus. And I have set an expectation of product knowledge, that it should be extremely high and we do it inspect for that and I think that is a key part of getting the value out of the sales force. And I will continue to have that product-specific, vertical-specific focus, which ECD from Documentum is a great fit for our enterprising sales force.

Richard Tse - *National Bank Financial - Analyst*

Great, thank you very much, guys.

Operator

Paul Treiber, RBC Capital Markets.

Paul Treiber - *RBC Capital Markets - Analyst*

Thanks very much. I was hoping, if you could clarify that the $5 million purchase price accounting impact that you called out, was that already reflected in the estimated revenue from those acquisitions that were in the press releases or is that incremental or in addition to that? Or I guess it would be a reduction to the revenue in those press releases?

John Doolittle - *Open Text Corporation - CFO*

Yes, most of it is incremental, Paul.

Paul Treiber - *RBC Capital Markets - Analyst*

Okay. Should we -- is there a rule of thumb that we should model for that type of purchase price accounting impact? I think in the past, many years ago, you guys have mentioned 20% to 25% impact from the deferred revenue write-downs is that a fair rule of thumb?

John Doolittle - *Open Text Corporation - CFO*

Yes, I can't give you a rule of thumb because every deal stands on its own two feet. You've got to look at the balance sheet and the metrics for each and every deal. So it would be tough to give you a percentage as a rule of thumb.

Paul Treiber - *RBC Capital Markets - Analyst*

Okay, moving on to the receivables, you mentioned -- or I think that the HP acquisitions are structured as carve-outs, that would involve some working capital buildup or some [build up of those receivables, did that have an impact on the cash flows in Q1?

John Doolittle - *Open Text Corporation - CFO*

Yes, the acquisitions in general had an impact on our cash flow performance in Q1. And I called out Recommind, as one example, where we inherited about $30 million of receivables and the days of the collection cycle on those are quite long. And you're absolutely right on the HP deals, we did not inherit any receivables, so receivables built during the quarter.

Paul Treiber - *RBC Capital Markets - Analyst*

Okay. And then just for Mark, when you think about the competitive landscape now that you have Documentum, really it is a three horse race among the big guys. How do you see, over the long-term, differentiating against IBM and Microsoft longer term?

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

Sure thing. Good question, Paul. And I would like to maybe just add my voice to your previous question as well, which is, as you think of revenue in Q1, as John talked about, we had the $5 million effect of purchase price accounting. $5 million of FX and I'd just emphasized a note in my script that we did not have a full quarter of revenue benefit from CCM and Recommind.

Those are very simple and very clear things to just take in consideration when we look at our, what we think, is a very solid quarter at 14% revenue growth and constant currency. In terms of the competitive landscape, customers are responding to engagement to insight. And we can see opportunities where customers are looking to extend well beyond traditional document management and to customer experience management. And we strengthened that with CEM.

We can see opportunities where our customers are looking to bring in new data sources. We are looking to combine content with process management, with BPM. And also I'm looking to bring in eDiscovery capabilities into their content world. So we are going to differentiate first and foremost through expanding the process flow, from ECM to Enterprise Information Management.

Second, is we're going to differentiate with Managed Services. We have the ability now on a global basis, enterprise quality, secure, to be able to, in a lot of ways, have a company outsource to us, complete process flows into our cloud. And we're doing that with very large brand names, I mean Transportation for London, huge successes for us, in engineering and construction. BMW, I mean these are more key customers.

And then third, we are going to differentiate with our expertise and it is one of the reasons I highlighted it. We are maniacally focused on Enterprise Information Management and can present thousands of success stories and thousands of professionals to help customers make that transition into digitalization. So those are the areas we are looking to differentiate on, Paul.

Paul Treiber - *RBC Capital Markets - Analyst*

Thank you for taking my questions.

Operator

Stephen Bersey, MUFJ.

Stephen Bersey - *MUFJ - Analyst*

Hi, great. I know it's early days with the EMC acquisition or the Documentum acquisition. But I'm wondering if you are able to get in there early given the friendly nature of that deal, and kind of understand the product a little more as far as their processes and what they were up to with future functionality.

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

Steve, thanks. Thanks for the question. We are guided by kind of the standard regulatory processes that we are under. But as we have gotten closer to ECD over the last month and a half -- month or so, we are reaffirmed on what we liked in coming into the transaction.

First and foremost, their vertical content. Steve mentioned our strength in big data sources, like ERP, highlighted our SAP relationship. We like what Documentum brings in their vertical content.

We also very much like their view of information lifecycle management, through InfoArchive. As a second opportunity, and we remain impressed with the opportunity to upgrade if you will, the Documentum to install base, both into CEM, into our Managed Services, and to the wider EIM opportunity.

So I would say our view is reaffirmed over the last month or so as we have gotten closer to their products and their organizations. Steve, anything you want to add to that?

Steve Murphy - *Open Text Corporation - President*

I would reiterate that within the boundaries that are appropriate with the SEC and otherwise, we have a friendly relationship, the quality of the product, the industry vertical expertise, to Mark's point, and the quality of the people, are all consistent with what I would've expected from a world-class company like EMC. EMC-Dell in this case. It's very exciting.

Stephen Bersey - *MUFJ - Analyst*

Great, and maybe on the Magellan roll out in the second half, just how is that going to be integrated across all of your platform? What is the game plan for getting that into all of your different products?

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

Sure, Steve, thanks for that as well. It will be a series of releases. Our first release will be where we are taking the Apache Spark analytic engine and making that part of Actuate. And we have already done our first level integration of Actuate across Content Suite, Process Suite, Experience Suite.

And we see an opportunity to go from, if you will, a relatively close predictive engine to a completely open productive engine not to get too technical, but it's called MLlib, what's inside of Apache Spark. That also opens up whole new data sources for us. Hadoop, not just SQL databases, but also deep learning databases on graph databases, as well. So step one is to be able to embrace Spark, that will open up all these open algorithms, new data sources, and our first level integration of Actuate back into to all our suites will remain on track.

The next piece is to take some of our existing engines and then integrate them into Magellan, like art Narrative Science engine, our Face and Voice Recognition engines that we have. But the first step is to bring in Apache Spark, open the platform up with open algorithms and the next phase will be deeper integration.

Stephen Bersey - *MUFJ - Analyst*

Sounds fun, looking forward to it, thanks.

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

Yes, same here. Thanks, Steve.

Operator

Paul Steep, Scotia Bank.

Paul Steep - *Scotia Capital - Analyst*

Great, thanks. Mark, maybe you could just give us a perspective here. There's been lots of FUD in the market as normal with one of the large deals closing with Documentum.

With Muhi being in Barcelona on Tuesday can you give us a view of what you committed to Documentum's customers to make them comfortable with the investment you are making here? And then secondly maybe any feedback he brought back from the conference about what those clients are thinking about OpenText.

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

Yes, fair enough, Paul. Actually I'm not familiar with the fodder of the large deal, so I'm pretty dialed in but I have not heard that. I will go learn as to what that FUD is but it hasn't hit my -- it is not a blinking green light on my radar screen. So Muhi joined our conference in Barcelona and, look, we -- both product lines just have a clear place in the OpenText future.

Content Suite, is the foundation for large data sources such as SAP, Oracle, [email]. The Documentum group has a firm position for vertical applications and that is the simple and clear distinction and they are both going to have that position in our future. And we will reaffirm that with their installed base in Barcelona. It's really that simple. We like their information lifecycle management product that we think and work underneath all our pillars, in the technology suite, and our Managed Services just has massive scale.

I get a kick out of reading the FT every day and seeing the lower right-hand corner that Oracle is number one in the ERP cloud with 2,000 customers. They've been at it for a decade. And I have great respect for Oracle.

We've been at it for a few years and we are near 1,200 customers in your EIM cloud. So our Managed Service offerings is leading EMI market and I think will be a great opportunity for all Documentum customers.

Paul Steep - *Scotia Capital - Analyst*

Great, I guess the second one would be for either you or Steve. Maybe feedback on what you seen out of the client base on shifting the traditional light ECM licenses toward the cloud and what you've heard back from the field in terms of clients uptake on that? Thanks, guys.

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

So you may notice that the MCV number went up significantly and we are seeing traction with content customers saying they are interested and willing to write a contract to move business into the cloud. So I think that so long as we are responsive, we can demonstrate that our data centers can perform and be safe, we can protect the data. And we can agree to SLAs that work for both for us and the customers around the things like reliability, we are seeing bigger and bigger deals from larger and larger customers move into the cloud where it makes sense.

I look a lot of the margins of those deals to make sure that as a business comes over is attractive and so long as it is we are interested in taking that business into our cloud and into our data centers. We have more than 30 data centers globally.

Paul Steep - *Scotia Capital - Analyst*

Great, thanks, guys.

Operator

Steven Li, Raymond James.

Steven Li - *Raymond James & Associates, Inc. - Analyst*

Thank you. Mark, your PS group had some challenges a couple quarters ago. Has this been resolved and are you happy with this Q1 PS?

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

Yes, Steve, thanks for the question. I just want to add just a little bit of commentary the last question and leave PS to Steve. Let me just reinforce the comments on customers asking for hybrid workloads. And we have talked a lot about this and demonstrated multiple years of on boarding cloud revenues while holding license, constant through those years and expanding margin. For FY17, we expect to grow double digit.

And Steve and his team delivered a fantastic Q1 with cloud growing at 15% and license growing at 18%, just as a demonstration of our hybrid strategy working. Steve, I will hand over to you the PS question.

Steve Murphy - *Open Text Corporation - President*

Yes, thanks, Mark. So just a few quick questions, one things that you need with -- so we expect that each of our lines of business will stand on its own two feet and earn well on a standalone basis. And one of the things that had probably slipped over the last year or so is that we were not having that level of discipline within professional services on a deal-by-deal level.

So at this point, we have controls in place to make sure that from the ground up any business we take down in professional services, whether it is time and material or fixed fee or otherwise, is a proximal piece of business and when it all adds up we get the kinds of margins that we expect.

So it is a combination of discipline, control and making sure that, that business is measured and expected to perform on an autonomous basis, which at this point it is. And I think that in addition to the improved margins, I certainly expect to see double-digit growth for that professional services business this year.

Steven Li - *Raymond James & Associates, Inc. - Analyst*

Great and maybe one more, Mark, For EMEA, was there any unusual weakness? I thought your licenses was down year-over-year despite the acquisition. Thanks.

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

Steve, thanks for that. It's certainly a data point but we don't think it's a trend. Again, I will highlight, as John expertly outlined, the $5 million PPA impact, $5 million of FX.

And again, I will highlight that we just did not have a full quarter of benefit from CCM and Recommind and, John, maybe do you want to talk a little bit about the mix? A little bit of mix with the new acquisition?

John Doolittle - *Open Text Corporation - CFO*

Yes, I would agree, Mark, with what you said. Stephen, it's as look back over the trending, I would say that it is a data point. It ebbs and flows, one quarter EMEA is a greater percentage and the next quarter it is North America. And the acquisitions that we have on boarded have trended to more of a North American revenue stream then EMEA, so that tilts the mix just a little bit.

Steven Li - *Raymond James & Associates, Inc. - Analyst*

Thank you.

John Doolittle - *Open Text Corporation - CFO*

Thanks Steve.

Operator

Thanos Moschopoulos, BMO Capital Markets.

Thanos Moschopoulos - *BMO Capital Markets - Analyst*

Hi, good afternoon. Are you seeing any impact on the sales pipeline, either positive or negative from the Documentum deal? Are you finding that prospects are incrementally more interested in engaging with you guys or, on the flip side, is there any hesitation you're seeing until the deal closes and until you can provide more color on the product roadmap?

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

Yes, so I would say there's no impact. Based on what I am observing, no impact.

Thanos Moschopoulos - *BMO Capital Markets - Analyst*

Either positive nor negative?

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

Neither positive nor negative.

Thanos Moschopoulos - *BMO Capital Markets - Analyst*

Fair enough. Maybe a different one for John. The license gross margin was slightly below your target operating model this quarter. Was that just some noise related to the acquisitions and should that bounce back to more normal levels going forward?

John Doolittle - *Open Text Corporation - CFO*

Yes, that's right, Thanos. It was a little noise from the acquisitions. And as we look across all the line items from the acquisitions, we'll be getting those onto our target models so it's just a temporary thing.

Thanos Moschopoulos - *BMO Capital Markets - Analyst*

Maybe one last one in terms of the cloud bookings, I was struck by the number of deals over $1 million. I think Steve kind of alluded to it, but just to clarify, is that sort of incrementally being driven by more engagement on the content side rather than the managed service GSX side of the business that is driving that? Or is it a mix of both?

Steve Murphy - *Open Text Corporation - President*

No, you're right, that's what it is. It is a mix of both but certainly large content server deals are moving into the cloud, where it makes sense for the customer, and it makes sense for us.

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

Yes, and Thanos, I would amplify those comments from Steve that over the last year the organization has done a great job of expanding beyond sort of supply chain outsourcing opportunities via TXS into CEM opportunities, enterprise content opportunities, as well. And we're starting to see that success flow into bookings and in cloud revenue.

Steve Murphy - *Open Text Corporation - President*

We are and there is growth as far as the skills of the sale force has, there's growth with respect people understanding what a multi-year contract looks like, what margins need to look like, what the terms and conditions need to be or the SLAs or penalties need to be. So that when we do one of those deals it's going to be a profitable piece of business and the salespeople are confident around being able to sell that and understand the technology that underpins putting something in the cloud. So there has been, for the year I have been here, tremendous growth out in the field of folks that sell, understanding how to do those deals and do them in a way that are profitable. So that is a capability we have developed and are continuing to develop

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Thanos Moschopoulos - *BMO Capital Markets - Analyst*

And in light of this traction does it change at all, your outlook in terms of maintaining the stability of the license base?

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

No, not at all. Not at all.

Thanos Moschopoulos - *BMO Capital Markets - Analyst*

Okay, thanks for clarifying. I'll pass the line, thanks guys.

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

Thanks, Thanos.

Operator

Eyal Ofir, Dundee Capital Markets.

Eyal Ofir - *Dundee Capital Markets - Analyst*

Thanks, thanks for taking my question. Just a first housekeeping question for you guys. Can you just provide the aggregate dollar figure, how much in the acquisitions contributed this quarter?

John Doolittle - *Open Text Corporation - CFO*

We haven't broken that out, Eyal.

Eyal Ofir - *Dundee Capital Markets - Analyst*

Okay that's fine. And I just wanted to clarify, I guess, a question for both Mark and Steve, just from the pipeline your comment about pretty strong seasonal trends into the December quarter, can you just talk to where you are seeing strength coming out of? Is it a region-specific, product-specific category? And how do the dynamics playing out? Thanks.

Steve Murphy - *Open Text Corporation - President*

Yes, you bet, Steve here. We have, as you would suspect, a relatively detailed look at the pipeline on a daily basis, and seeing large seven-figure deals in some places like Europe that, from a linearity standpoint are above where I would -- ahead of where I would expect and that underpins our belief that it will be a seasonally strong Q2. To Mark's comment, I will be -- support consistent with what he said, which is we have reason to believe, based on the data, it will be a strong Q2.

Eyal Ofir - *Dundee Capital Markets - Analyst*

And could there be also some pent-up demand based on contract abilities in either in the quarter post-Brexit or some other areas in Europe? Is that also happening as a trend?

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

Yes, Eyal, it's just a tag team, this one. I think the headlines seem worse than reality. And it is sort of an inverse what usually is the mood.

The Brexit headlines, oh heck, we had news this morning that Parliament has to approve Brexit. There are multiple elections coming up in Europe as well. And as Steve noted, we're -- could [choose] seasonally stream strong quarter and we're expecting our European teams to deliver in that vein.

So as we look across all of the countries we operate and geographies, it feels like there is -- the headlines seem a little worse, if you will, than the reality on the ground. And of course, we have the US election coming up that we are all paying attention to. But independent of that, we are expecting a seasonally strong Q2.

Eyal Ofir - *Dundee Capital Markets - Analyst*

Okay, great. It seems like from -- based on what [others said], he said they also kind of seeing the same thing in Europe. So thanks, I appreciate the comments and I will pass the line.

Operator

Stephanie Price, CIBC.

Stephanie Price - *CIBC World Markets - Analyst*

Good evening.

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

Hi Stephanie.

Stephanie Price - *CIBC World Markets - Analyst*

Steve, you mentioned partners in your prepared remarks, talking about inheriting a number of partnerships with recent acquisitions. Can you talk a bit more about this and where you expect to see some growth out of these new partners?

Steve Murphy - *Open Text Corporation - President*

Yes, a couple of things. One specifically would be that Documentum had done a very good job developing the channel in Japan and they have done considerable business over there through what is almost entirely a channel-driven business to an impressive extent. So I look forward to understanding what that channel looks like in Japan and how we can make the most of that.

Also when it comes to the global system integrators, whether it be Accenture and Deloitte, Documentum has had a considerable amount of success there with LiquidOffice. So very impressed with their ability, with the big GSIs to be effective and to have brand recognition in some cases we just don't have. The Documentum name is -- it's a fantastic [granite]. It's one that we will really be able to take advantage of with the GSIs.

Stephanie Price - *CIBC World Markets - Analyst*

Great. And then I know it's early days but can you talk about demand for EP1 as well?

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

Yes, so Stephanie, I'll maybe take a piece of that. So it is early days, we announced EP1 just a few days ago. It's a very seamless enhancement pack. Our strategy is go through a series of rapid enhancement packs, EP1, EP2 then EP3 to really accelerate that cadence of more capability, right?

These are capability packs thus we call them enhancement packs. And it is early days but I will highlight some of the big drivers behind EP1. One is expanding data sources. Salesforce.com, we now have an extended ECM into Salesforce. We are using it across our 10,000 person organization.

SuccessFactors, another big data source which is now available to our customers with EP1. Engineering and Construction is a new advanced module for us. And wins like Transportation from London is an example of the strength of an EP1.

New vertical apps as well, we're now in high functional mode for Healthcare Direct in the US and document exchanges for that within EP1. So it is early days. But EP1 is a very strong enhancement pack. It's not a maintenance release by any means.

Stephanie Price - *CIBC World Markets - Analyst*

Great, thank you very much.

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

Very good. Well I think that brings us, Greg, to the end of our prepared conference call and I would like to just end on a couple of points. We are on track for double-digit growth in FY17. Our EIM position continues to gain strength in the market through CEM, Discovery, Managed Services, and soon ECD.

And as I look beyond -- even beyond these activities in the second half FY17, new demand drivers with Magellan and continuing to differentiate with our Managed Service. So thanks for joining the call today and we will all speak soon. Thank you very much.

Operator

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